(*Emphasis added.*) Congress approved of the flexible nature of partnerships, and the broad business purpose requirement when, in 1951, it enacted the predecessor of Section 704(e)(1), which provides that a person will be recognized as a partner if he owns a capital interest in a partnership in which capital is a material income producing factor, whether or not such interest was derived by purchase or gift from any other person. See also S. Rep. No. 781, 82nd Cong. 1st Sess., 38 (1951). These provisions are not limited to family partnerships but apply for all purposes of the Code.

The first implied intent of the Rules more likely than not would be interpreted in a manner consistent with the existing case law, such as *Culbertson*, *ACM*, and *ASA Investerings*. These cases require that the partnership conduct a business for the joint benefit of the partners, that there be a nontax reason for each transaction, and that the expected nontax benefits exceed the transaction costs. As discussed, MRF conducted asset management activities for the benefit of the partners, each transaction was entered into for nontax reasons, and it was reasonably expected that the nontax benefits would exceed the transaction costs.

The Regulations provide that the second deemed intent of Subchapter K is that the form of each transaction must be respected under the "substance over form principles." This appears to be a regulatory codification of the substance over form doctrine. As discussed previously, each transaction more likely than not would be respected under the substance over form doctrine.

The Regulations provide that the third implied intent of Subchapter K is that the tax consequences of each transaction must "clearly reflect income." The Rules, however, acknowledge that various provisions of Subchapter K were adopted for policy reasons and administrative convenience, and that these provisions may produce results that do not clearly reflect income. In this situation, the third intent is satisfied if the first two intents are satisfied and if Congress clearly contemplated that the provision would be applied so as to produce the results. A taxpayer is not required to prove that Congress intended a particular result. Rather the normal rule of statutory construction that Congress is presumed to have meant what it said unless there is clear evidence to the contrary.

The legislative history of Subchapter K indicates that Congress intended to provide simplicity, clarity and certainty with respect to the tax treatment of partnerships. S. Rep. No. 1622, 83rd Cong., 2d Sess., 89 (1954). In 1951, Congress stated that the presence of tax avoidance motives was by itself not important. S. Rep. No. 781, supra. The Rules also acknowledge that Subchapter K was intended to permit taxpayers to conduct joint business through flexible arrangements. This proper reflection of income standard set forth in the Regulations must be applied in light of this Congressional mandate.

The Rules contain several examples, where the Code provision produces a distortion of income, but the result is upheld. See Treas. Reg. 1.701-2, Ex. 6, 9, 10 and 11. Proper application of Subchapter K results in certain "distortions" of income by not requiring a uniformity of inside and outside basis. This lack of uniformity, which is the general rule of Subchapter K (basis adjustments are optional, Section 734) requires the result described in this opinion letter. Therefore, it is more likely than not that the transactions described herein would not be considered to violate the proper reflection of income standard because the result clearly reflects Congressional intent.

b. **Reduction of Tax Liability as Principal Purpose.**

The Regulations also provide that determining whether a partnership was formed or availed of with a principal purpose to substantially reduce the present value of a partners' aggregate federal income tax liability in a manner inconsistent with the above described intent of Subchapter K will be based on an examination of all of the facts and circumstances, including a comparison of the purported business purpose for a transaction and the claimed tax benefits resulting from the transaction. Treas. Reg. § 1.701-2(c).

The Rules describe certain illustrative factors, which may indicate (without being determinative) that a partnership was used with a principal purpose to substantially reduce a partners' federal tax liability in a manner inconsistent with the intent of Subchapter K. Treas. Reg. § 1.701-2(c). Under the Regulations, the weight to be given to any one factor will depend on the facts and circumstances of a particular situation.[44] For instance:

(1) The present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's business directly.

(2) The present value of the partners' aggregate federal tax liability is substantially less than if purportedly separate transactions that are designed to achieve a particular end result are treated as steps in a single transaction. For example, the analysis may show that that it was contemplated that a partner who was necessary to achieve the intended tax results and whose interest was liquidated or disposed of would be a partner only temporarily in order to provide the tax benefits to the remaining partners.

(3) One or more partners who are necessary to achieve the claimed tax results either have a nominal interest in the partnership, are substantially protected from any risk of loss from the partnership's activities, or have little or no participation in the profits from the partnership's activities other than a preferred return in the nature of a payment for the use of capital.

(4) Substantially all of the partners are related.

(5) Partnership items are allocated in accordance with the literal language of Treas. Reg. § 1.704-1 and §1.704-2 but the results are inconsistent with the purpose of Code Section 704(b).

(6) The benefits and burdens of ownership of property nominally contributed to the partnership are in substantial part retained by the contributing partner.

(7) The benefits and burdens of ownership of partnership property are in substantial part shifted to the distributee partner before or after the property is actually distributed to the distributee partner.

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[44] *Id.*

These factors are difficult to apply, even with the aid of the examples.

The first factor appears to be a restatement of the substantiality test of Treas. Reg. § 1.704-1(b)(2)(iii), although there the test is limited to allocations of partnership income and deductions and does not create an artificial comparison to hypothetical events occurring outside of the partnership. In the instant case, there is no assurance that the present value of the partners' aggregate federal tax liability would necessarily be substantially less than had the partners owned the partnership's assets and conducted the partnership's business directly. An initial question is: what should the point of comparison be? If one of the goals of the transactions is to create a limited liability pooled investment vehicle for Barka and others, it would be impossible for Barka to do so "directly;" a limited liability vehicle with two or more members would be necessary. If a corporation were used, the similar basis rules would achieve a similar outside basis result, and if the corporation were willing to register as an investment company, regulated investment company status could be elected to pass through character. Thus, there is no certainty that the test could be applied in the instant case, or if the test were applied to one or more alternative structures, there is no certainty that this factor would apply to the Transactions.

The second factor appears to be a restatement of the "end-result" formulation of the step transaction doctrine. The extent to which the step transaction doctrine or this factor is applicable depends upon the facts of a particular transaction. As discussed above, it is more likely than not that each transaction would be treated as undertaken for independent reasons, no transaction would be dependent on another transaction, and the parties would be at risk with respect to each transaction. Consequently, it is more likely than not that this factor would not be present in the Transactions.

It is more likely than not that the third factor would not be present in this case, as no member had a nominal interest in MRF. Treas. Reg. § 1.701-2(d)(1), Ex. 1 states that a 1% interest in a partnership is not nominal. Further, each member shared proportionately in all items of MRF's income, gain or loss, and no member, including Barka, was substantially protected from risk of loss from MRF's activities.

It is more likely than not that the fourth factor would not be present in this case as none of the partners are directly or indirectly related.

It is more likely than not that the fifth factor, which relates to the allocation of partnership income, would not be present. Each item of MRF's income, gain, loss or deduction was allocated in accordance with the interests in MRF, and each member's capital account was appropriately charged. Given the pro-rata nature of the members' interests in MRF, there would be no special allocations of any item of income, gain, loss, credit, or deduction that would give a non-equity-like return to any of the partners.

It is more likely than not that the sixth factor would not be present in this case. There is no property that has been "nominally" contributed to MRF by any partner. Further, all property contributed to MRF is owned by MRF, and no partner has in substantial part retained the benefits and burdens of ownership of the contributed property. Any assets that a partner receives from MRF will not be the same assets that such partner contributed.

Finally, it is more likely than not that the seventh factor would not be present. The benefits and burdens of ownership of MRF's property were not shifted to any distributee member before or after the property were actually distributed.

There are two examples contained in Treas. Reg. in § 1.701-2, Treas. Reg. § 1.701-2(d)(1) Ex. 7 and Ex. 8, that could be viewed as similar to the instant case. In Treas. Reg. § 1.701-2(d)(1) Ex. 7, a foreign corporation, X, a domestic corporation, Y, and the promoter, Z, form a partnership and hold interests in the ratio of, respectively, 90%, 9.9% and .1%. The partnership enters into a transaction that, according to the example, was undertaken principally for the purpose of generating artificial losses. As described in the example, income is accelerated and allocated 90% to X, which then redeemed from the partnership for an amount equal to its initial contribution. Losses subsequently generated by the partnership are allocated to Y and Z. Thus, X is only temporarily in the partnership and receives only a return of its initial investment and Z has a de minimis interest.

Example 7 is distinguishable from the instant case. This is because in the instant case there is no de minimis partner, because every member has at least a 1% interest and more importantly there is no transitory partner as in the Example because none of the members' interests in MRF is being liquidated. Any bad debt deduction attributable to the Japanese Debt Portfolio would not be artificial, because any such deduction reflects the difference between the actual acquisition cost of the Japanese Debt Portfolio to United Finance and the fair market value of such asset at the time of the deduction.

In Treas. Reg. § 1.701-2(d)(1) Ex. 8, A wants to sell land to B. A and B devise a plan the principal purpose of which is to duplicate loss built-in losses with respect to the land for a substantial period of time. To do so A, his brother, C, and C's wife, W, form a partnership to which A contributes the land with a value of $60 and a basis of $100, and C and W each contribute $30 cash that is used to purchase investment assets. The land is leased to B for 3 years and B has a purchase option on the land. At the end of three years, when the value of the partnership's assets have not changed, the partnership redeems A's interest for the $60 of investment assets acquired with C and W's contributions. This generates a $40 loss for A. No Code Section 754 election is made, which would have stepped down the partnership's tax basis in the land. B then exercises its purchase option and acquires the land for $60, generating a $40 partnership loss that is allocated to C and W. Although the allocated loss reduces C and W's tax basis in their partnership interests, they leave the partnership in existence, deferring any gain that they would realize on the liquidation of the partnership. The example stated that any purported business purpose for the transaction is insignificant in comparison to the anticipated tax benefits. Example 8 is distinguishable from the instant case. In the instant case, no losses are duplicated because of the fact that United Finance is not a U.S. taxpayer.

The facts of FSA 200134002 are somewhat analogous to Example 8. A partner contributed a built-in loss asset to a partnership and then sold the interest, recognizing a loss. No Section 754 election was in effect. The underlying asset was then sold, resulting in a second loss allocated to the purchaser. The IRS said it could challenge such a transaction based on facts showing that it was part of a plan to "duplicate losses" and that the transaction lacked economic substance. Among other things, the IRS was concerned that the contributing partner had entered into a put agreement with respect to its interest in the partnership, minimizing the risk of loss with respect to the asset. Significantly, the put right facilitated the sale of the partnership interest and thereby provided necessary funds for the repayment of a loan made at the time of the original contribution from a lender related to the purchaser. These facts are distinguishable from the facts of the Transactions in that United Finance was neither contractually bound to sell its interest in MRF nor economically compelled to do so. Absent factors suggesting that a partnership is a sham or lacking in economic substance, the failure to make a Section 754 election should not be grounds for a challenge under the Treas. Reg. § 1.701-2(d) anti-abuse rules. See Treas. Reg. § 1.701-2(d)(1), Example 9 (failure to make Section 754 election in connection with property distribution is respected despite planning to reduce tax liability of the partners, where partnership is bona fide).

5. **Abuse of Entity Rule.**

The other part of the anti-abuse Regulations, the abuse of entity rule, is found in Treas. Reg. § 1.701-2(e). This Regulation provides that the IRS may treat a partnership as an aggregate of its partners "as appropriate to carry out the purpose of any provision" of the Code or Regulations. However, this rule will not apply to the extent that (a) a provision of the Code or Regulations prescribes the treatment of a partnership as an entity, and (b) entity treatment and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision. Thus, under Treas. Reg. § 1.701-2(e)(2), a partnership may not be so disregarded when a provision of the Code prescribes entity treatment for such a partnership and that treatment and the ultimate tax results, taking into account all relevant facts and circumstances, are clearly contemplated by that provision.

Although there is no authority on point, as discussed above, the partnership provisions themselves (including the Treas. Reg. § 1.701-2(a) intent of Subchapter K anti-abuse rules) contemplate the use of a partnership as a vehicle to permit taxpayers to conduct joint activities. Section 722 by its terms contemplates that a partner's tax basis in the partner's partnership interest is determined with reference to the tax basis of property contributed by the partner, and the partnership provisions contemplate that there can be disparities between a partner's tax basis in its partnership interest and the partnership's tax basis in its assets (See e.g., Section 754). Furthermore, the examples contained in Treas. Reg. § 1.702-1(f) relate to the use of the partnership to gain advantage of its entity status outside of Subchapter K. Finally, the entity classification Regulation, § 301.7701-3, permits MRF to elect to be treated as a partnership for all federal tax purposes. As discussed above, MRF satisfies the requirements to be respected as a partnership. See e.g., *Culbertson* and *ACM P'ship*. Consequently, although the matter cannot be free from doubt because of the absence of direct authority, it is more likely than not that the IRS would not be successful were it to attempt to disregard MRF as an entity and treat MRF as an aggregate of its members in whole or in part pursuant to Treas. Reg. § 1.701-2(e).

6. **Step Transaction Doctrine.**

In determining the tax consequences of a series of events, the courts use a step transaction analysis to determine the scope of the transaction to which the tax law should be applied. The step transaction doctrine combines and treats a series of separate steps "as a single transaction if they are in substance integrated, interdependent, and focused toward a particular end result." Bittker & Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS (2d ed.), ¶ 4.3.5. The courts have articulated three different formulations of the step transaction doctrine: the "binding commitment" test, the "interdependence" test, and the "end result" test. *Penrod v. Comr.*, 88 T.C. 1415, 1429 (1987). For example, in the instant case, the IRS might attempt to apply the step transaction doctrine to treat United Finance as selling an interest in the Japanese Debt Portfolio to Barka followed by Barka contributing the Japanese Debt Portfolio to MRF. Were the IRS successful, the tax basis of the Japanese Debt Portfolio in the hands of MRF would be reduced. As discussed below, IRS more likely than not would not be successful were it to attempt to apply the step transaction doctrine to the Transactions.

Under the "binding commitment" test, a series of transactions is amalgamated only if there is a binding legal commitment to undertake each of the steps. *Comr. v. Gordon*, 391 U.S. 83, 96 (1968). This formulation should not apply to the Transactions, because, based upon the representations in II, above, none of the parties to the Transactions were bound to participate in any element of the Transactions.

Under the "interdependence" test, a series of transactions are integrated only if the steps are "so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series." *Manhattan Bldg. Co. v. Comr.*, 27 T.C. 1032, 1042 (1957). Thus, the issue is whether the first step would have occurred without the second. For example, in *Associated Wholesale Grocers, Inc. v. U.S.*, 927 F.2d 1517 (10th Cir. 1991), the court applied the interdependence test to integrate two purportedly independent transactions and deny the claimed loss because the two agreements were, by their terms, dependent on each other. Unlike the factual situation in *Associated Wholesale Grocers*, each Transaction set out above was independently undertaken by the party involved, and each Transaction presented such party with the potential for economic gain or loss. <u>See also</u> *McDonalds Rest. of Illinois, Inc. v. Comr.*, 688 F.2d 520, 524 (7th Cir. 1982); *Security Industrial Ins. Co. v. U.S.*, 702 F.2d 1234 (5th Cir. 1983). Where each step has independent economic significance, the courts will not integrate the steps. *Redding v. Comr.*, 630 F.2d 1169 (7th Cir. 1980), cert. denied, 450 U.S. 913 (1981). In Rev. Rul. 79-250, 1979-2 CB 256, the IRS agreed, but also inserted a requirement that each step must be "undertaken for valid business purposes and not mere avoidance of taxes."

Based upon the foregoing, each step undertaken by each of the parties should be viewed as independent from the others and, consequently, the "interdependence" formulation of the step transaction doctrine should not be applicable to the Transactions. Furthermore, even adopting the position of the IRS in Rev. Rul. 79-250, <u>supra</u>, each of the Transactions undertaken by the parties was supported by a reasonable expectation of profit.

The "end-result" formulation integrates a series of transactions into a single transaction "when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." *King Enterprises, Inc. v U.S.*, 418 F.2d 511,516 (Ct. Cl. 1969). The courts, however, have limited the expansive scope of the end-result test.

In *Esmark, Inc. v. Comr.*, 90 T.C. 171 (1988), aff'd without published opinion, 886 F.2d 1318 (7th Cir. 1989), the taxpayer wanted to dispose of certain businesses owned by one of its subsidiaries. Mobil, an unrelated company, acquired a portion of Esmark's outstanding shares from the public in a tender offer, and then tendered these shares to Esmark in exchange for stock of a wholly-owned subsidiary of Esmark. Under the law at the time, the exchange of the subsidiary's stock for the Esmark shares was tax-free at the corporate level. By contrast, a sale of the subsidiary's stock for cash, which could then have been used to buy back the Esmark shares, was taxable at the corporate level.

Although it recognized that the reduction of taxes was a significant factor in structuring the transaction, that Mobil's tender offer was part of an overall plan, and that Mobil, not Esmark, had borne the economic cost of the tender offer, the Tax Court held that Mobil's ownership of the Esmark shares, "however transitory," must be respected, and the transaction treated as a redemption of the Esmark shares. In rejecting the IRS's attempt to apply the step transaction doctrine to recast the transactions, the court stated:

> That Mobil's tender offer was but part of an overall plan is not in dispute. The existence of an overall plan does not alone, however, justify application of the step-transaction doctrine. Whether invoked as a result of the "binding commitment," "interdependence, " or "end result" tests, the doctrine combines a series of individually meaningless steps into a single transaction. In this case, respondent has pointed to no meaningless or unnecessary steps that should be ignored.
>
> Respondent proposes to recharacterize the tender offer/redemption as a sale of the Vickers shares to Mobil followed by a self-tender. This recharacterization does not simply combine steps; it invents new ones. Courts have refused to apply the step-transaction doctrine in this manner.

Esmark, 90 T.C. at 195-197. The court further noted that each of the steps "had permanent economic consequences," and could not be combined. 90 T.C. at 198. See also *Grove v. Comr.*, 490 F.2d 241 (2d Cir. 1973) and *Carrington v. Comr.*, 476 F.2d 704 (5th Cir. 1973). The Tax Court subsequently reaffirmed the *Esmark* step transaction analysis. *Turner Broad. System v. Comr.*, 111 T.C. 315 (December 23, 1998).[45]

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[45] The IRS agrees that the step transaction doctrine does not permit the creation of new steps or the reordering of existing steps. See Rev. Rul. 78-197, 1978-1 CB 83. In each of Priv. Ltr. Rul. 88-15-003 (Dec. 11, 1987); Priv. Ltr. Rul. 87-38-003 (May 22, 1987); Priv. Ltr. Rul. 87-35-007 (May 18, 1987); and Priv. Ltr. Rul. 87-35-006 (May 18, 1987), an unrelated underwriter acquired a corporation's outstanding debt, exchanged that debt for other securities of

To be compared to the Tax Court's decision in *Esmark*, is its decision in *Idol v. Comr.*, 63 T.C. 444 (1962), aff'd, 319 F.2d 647 (8th Cir. 1963), which was distinguished by the Tax Court in *Esmark*. In *Idol*, the taxpayer wished to withdraw cash from his controlled corporation as a capital gain, rather than as a dividend. To achieve this result, the taxpayer sold shares of stock to a third party who had an interest in acquiring certain of the corporation's assets. On the same day, Idol caused the corporation to exchange such assets for the recently purchased shares of stock. Furthermore, the stock purchase agreement contained a provision pursuant to which the taxpayer agreed to cause a redemption of the shares for the desired assets and a provision pursuant to which the share purchaser agreed not to be represented on the corporation's board of directors or to take a role in management. (Although not specifically addressed by the Tax Court, these provisions in the sales agreement would arguably have fallen within the "binding commitment" formulation of the step transaction doctrine.) Furthermore, the record disclosed that the stock purchaser had previously expressed no interest in acquiring the corporate stock and only wished to acquire assets. Based on these facts, the Tax Court concluded that the form of the transactions should not be respected and that they should be recharacterized as a sale of the assets by the corporation to the stock purchaser followed by a dividend to the taxpayer. In distinguishing *Idol*, the Tax Court in *Esmark* focused on the fact that the stock seller never effectively divested himself of the ownership of the shares that he nominally sold and that the stock purchaser effectively merely purchased the corporation's assets, whereas in *Esmark*, the parties changed their economic position through their participation in the transactions consistent with the transactions' form.

More recently, in *True v. U.S.*, 190 F.3d 1165 (10th Cir. 1999), the Court of Appeals affirmed the District Court's summary judgment in favor of the IRS regarding the integration of one series of transactions under the "end result" formulation of the step transaction, where the evidence clearly showed that the end result was the sole outcome intended to be achieved by entering into the transactions from the outset. With respect to such series of transactions, the Court of Appeals also concluded that such integration would be appropriate under the "interdependence" formulation as well, because the facts showed that each of the steps would have been fruitless without the others. The Court of Appeals, however, reversed the District Court's summary judgment integrating another series of transactions. The Court of Appeals concluded that there was a factual issue under the "end result" formulation, because the evidence created a genuine factual issue as to whether the end result achieved was the sole intended result from the outset. The Court of Appeals concluded that there similarly was a factual issue under the "interdependence" formulation, because it appeared that each step might have economic significance on its own. The conclusion that can be drawn from the *True* decision appears to be that if the facts demonstrate that at the time of entering into a series of transactions an investor has in mind a sole outcome and no other outcome can be discerned, a court can apply the "end-result" formulation of the step transaction doctrine to disregard intermediate steps, particularly if those intermediate steps had so little economic significance on their own to fall within the "interdependence" formulation.

Again, in both *Salomon, Inc v. U.S.*, 976 F.2d 837 (2d Cir. 1992) and *Walt Disney, Inc. v. U.S.*, 4 F.3d 735 (9th Cir. 1993), the issue was whether a transfer of assets to a subsidiary as part of a

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the corporation, and then sold each other securities to the public. In each ruling, the IRS held that the step transaction doctrine could not be applied to reverse the order of the transactions.

divisive "D" reorganization resulted in the recapture of investment credit. While both courts seemed to apply the "end result" formulation to integrate the transfer of assets and subsequent spin-off, each court cited facts that would indicate a "binding commitment" or "interdependence" test. In *Walt Disney*, the court cited an overall intention for the steps to occur, and the fact that the company had a legal obligation to transfer the assets and distribute the stock. In *Salomon*, the court based its conclusion in part on the fact that at the time of the asset transfer the taxpayer intended to spin-off the stock, establishing the interdependent nature of the steps. The District Court concluded that such an interdependent relationship also existed in the series of transaction integrated under the step transaction doctrine in *True*.

United Finance and Barka were at risk with respect to each of their respective interests in MRF. First, the parties bore the risk that the Japanese Debt Portfolio might decline in value before they were contributed to MRF. Additionally, upon contribution of the Japanese Debt Portfolio to MRF, United Finance also bore the economic risk with regard to a change in the value of its interest in MRF. Moreover, Barka has the same risk after having purchased United Finance's interests in MRF. Thus, the transactions had the type of economic significance lacking in the integrated Transactions in *True* and *Salomon*. Consequently, based on *Esmark*, it is more likely than not that the "end result" test of the step-transaction doctrine would not apply to the Transactions.

Based on the foregoing analysis, it is more likely than not that the step transaction doctrine would not apply to the transactions described above. Each Transaction undertaken by United Finance, MRF and Barka had independent economic significance and placed them at risk. There was no obligation or agreement between United Finance, MRF and Barka obligating them to undertake any of the transactions described herein.

7. **Sham Transaction, Economic Substance, Business Purpose Doctrines.**

There are innumerable cases addressing the judicially developed doctrines of "sham transaction," "business purpose," and "economic substance." One of the most recent attempts to synthesize these cases appears in "Appendix II To JCX-82-99: Description and Analysis of Present-Law Rules and Recent Proposals Relating to Corporate Tax Shelters," Prepared by the Staff of the Joint Committee On Taxation, JCX-84-99, Nov. 10, 1999 ("JCT Appendix").

a. **"Sham Transaction Doctrine".**

With respect to the "sham transaction doctrine," the JCT Appendix describes two types of "shams," "shams in fact" and "shams in substance." The first involves transactions that in fact never occur. As an example, the JCT Appendix cites *Goodstein v. Comr.*, 267 F.2d 127 (1st Cir. 1959), in which assets were never purchased and a loan never incurred by the taxpayer. It is more likely than not that the Transactions would not constitute one or more "shams in fact," because every Transaction did in fact occur as described in Part I hereof.

With respect to the "sham in substance" aspect of the doctrine, the JCT Appendix cites *Yosha v. Comr.*, 861 F.2d 494 (7th Cir. 1988) as an example. In *Yosha*, the taxpayers entered into a series of transactions on the London Metals Exchange ("LME") that were not "shams in fact" because they actually occurred. The taxpayers, however, were fully protected against loss through arrangements by the promoter with the LME brokers, and the transactions were structured so that the taxpayers could not earn a profit from them, i.e., as an economic matter the trades were voided although as a legal and factual matter they occurred.[46] Thus, the taxpayers were in the position of economically, or "in substance," never having entered into the transactions. A similar analysis is applied in determining whether a taxpayer is the owner for U.S. federal income tax purposes of a particular asset. Thus, if the taxpayer has none of the economic risk of an owner and none of the economic benefits of an owner, the taxpayer would ordinarily not be treated as the owner, i.e., the taxpayer's economic ownership is voided, and such situations could be viewed as "shams in substance."

In the instant case, we understand that none of the parties entered into arrangements that voided the economic effects of any of the Transactions. Consequently, it is more likely than not that the Transactions would not constitute one or more "shams in substance." Much confusion about the sham transaction doctrine has arisen because the courts often treat transaction that fail the "economic substance" or "business purpose" doctrines as "shams." In this regard, the JCT Appendix notes:

> [T]he delineation between [the sham transaction] doctrine (particularly as applied to "shams in substance") and the "economic substance" and the "business purpose" doctrines . . . is not always clear. Some courts find that if transactions lack economic substance and business purpose, they are "shams" notwithstanding that the purported activity actually did occur.

b. **Economic Substance and Business Purpose Doctrines.**

As with the relationship of the sham transaction doctrine to the business purpose and economic substance doctrines, there is some confusion about the relation of the latter two to each other. Again, the JCT Appendix is helpful in trying to clarify the confusion:

> In its common application, the courts use business purpose (in combination with economic substance . . .) as part of a two-prong test for determining whether a transaction should be disregarded for tax purposes: (1) the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering into the transaction, and (2) the transaction lacks economic substance. [citation omitted]

JCT Appendix at n.63. This language mirrors the language of the Fourth Circuit Court of Appeals in *Rice's Toyota World, Inc. v. Comr.*, 752 F.2d 89 (4th Cir. 1985) where the court said "[t]o treat a transaction as a sham the court must find that the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering the transaction, and that the

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[46] Because the arrangements to protect against loss were arranged by the promoter, the court was not faced with addressing the effect of bona fide hedging transactions with unrelated parties. Hedges provided by a party involved i the transactions was also viewed as a negative factor in *ACM P'ship v. Comr*, T.C.M. (CCH) 1998-203, aff'd in part ad rev'd in part, 157 F.3d 231 (3rd Cir. 1998), cert. denied, 526 U.S. 1017 (1999).

transaction has no economic substance because no reasonable possibility of profit exists." *Id.* At 91.[47] Consequently, to determine whether the Transactions will be respected in the instant case one needs to test the Transactions under each prong. This is because the Transactions will not be respected for U.S. federal income tax purposes only if they fail both prongs, i.e., the Transactions lack both business purpose and economic substance.

(i) **Business Purpose.**

For a transaction to have a business purpose, there must be a business or commercial reason for the taxpayer to engage in the transaction without regard to tax benefits. Thus, a transaction will fail the business purpose test where "the only purpose for entering into the transaction was the tax consequences." *Friedman v. Comr.*, 869 F.2d 785,792 (4th Cir. 1989); *Rice's Toyota World, Inc. v. Comr.*, supra. The existence of such a purpose was recently addressed in *IES Indus. Inc. et al., v. U.S.*, 2001-2 USTC 50, 471 (CA-8), 253 F.3d 350 (8th Cir. 2001), and *United Parcel Serv. of America, Inc. v. Comr.*, T.C. Memo. 1999-268, rev'd and rem'd 254 F.3d 1014, (11th Cir. 2001).

Recently in *IES*, the Eighth Circuit held that certain deductions that IES took were valid.[48] IES purchased American Depository Receipts ("ADRs") with dividend rights and then sold the ADRs without dividend rights, through a series of pre-arranged transactions. All of the ADR dividends involved here were paid by foreign corporations in jurisdictions with a 15% withholding rate on dividends paid to U.S. citizens based on the applicable treaties. Therefore, the record owner of the ADR is entitled to 85% of the dividend in cash but will be taxed in the U.S. on 100% of the dividend. The record owner will also be entitled to a dollar-for-dollar foreign tax credit. Here, the sellers of the ADRs were all tax-exempt entities, still required to pay the 15% foreign tax, but not entitled to the foreign tax credit (as they owed no tax in the U.S.). The purchase price of the ADRs was based upon the market price plus 85% of the value of the dividend, while the sale price was simply the market price. In summary, IES purchased ADRs with dividend rights attached, or cum-dividend, for more than it sold them ex-dividend, thus incurring capital losses. IES sought to carry back the losses to offset capital gains received when it sold stock in tax years 1989 and 1990, and thus to receive a refund of capital gains taxes paid in those years.[49]

In its examination of the business purpose issue, the court stated that "a taxpayer's subjective intent to avoid taxes thus will not by itself determine whether there was a business purpose to a transaction." The court also added that the fact that there was only a minimal risk of loss involved in the transactions did not undermine the business purpose but demonstrates that the taxpayer "did its homework before engaging in the transactions." The court also noted that the other parties in the transactions were "separate entities" from IES and that they were all engaged in

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[47] "To treat a transaction as a sham the court must find that the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering the transaction, and that the transaction has no economic substance because no reasonable possibility of profit exists." *Rice's Toyota World, Inc. v. Comr*, 752 F.2d 89, 91.

[48] The court did reverse and remand the case on the issue of another tax refund related to the transactions at issue.

[49] According to the court, despite these capital losses, IES actually generated a profit on the transaction, as the full amount of the dividend exceeded the capital losses incurred.

"legitimate business" before entering into these transactions. All of these factors led the court to conclude that there was a business purpose in this case.

In the *United Parcel Service* case, the taxpayer tried to avoid taxation with respect to certain fees by restructuring them as insurance. Economically, the taxpayer was in substantially the same position as before the restructuring, but through the arrangements was able to exclude the payments from income. The taxpayer put forth a number of purported commercial reasons for the restructuring of the fees. The taxpayer argued that (i) it was required to restructure the arrangements because such payments would fall afoul of restrictions under some state insurance laws; (ii) it intended to leverage the profits into the creation of a new reinsurer that could become a full-line insurer; (iii) by removing the fees from its operating ratios it could obtain larger rate increases than had it received the fees directly; and (iv) by restructuring the fees it protected its transportation business from the risk of increased liabilities. However, the taxpayer offered no credible evidence that the restructuring would in fact achieve such goals. The court also found that goal (ii) could have been accomplished by merely making an investment in such a reinsurer.

On appeal, a split court in the Eleventh Circuit reversed this decision. The Court of Appeals stated that the Tax Court's interpretation of "business purpose" was too narrow and that business purpose does not mean a transaction that is free of tax considerations but (at least in the context of a going concern) that "figures in a bona fide, profit-seeking business." This case was ultimately settled on an undisclosed basis.

Nonetheless, it is more likely than not that even the narrower understanding of "business purpose" formulated by the Tax Court is met in this situation, given that the parties had a reasonable opportunity to earn a reasonable profit, in excess of all fees and transaction costs, from the contributions to MRF and the later disposition of the Japanese Debt Portfolio without regard to tax benefits.

Similarly, in *Winn-Dixie Stores Inc. v. Comr.*, 113 T.C. 254 (1999), aff'd, 254 F.3d 1313 (11th Cir. 2001), the court disallowed interest deductions on policy loans in a corporate-owned life insurance ("COLI") program that insured the lives of approximately 30,000 workers. The program resulted in a pre-tax loss for the taxpayer. The taxpayer argued that (i) the program enabled it to fund costs of one of it benefit programs, and (ii) increased the benefits it could offer to its employees under such program. As to (i), the court found that there was no contemporary evidence that it had purchased the COLI policies to provide such funding; that the COLI policies were not designed to fund such benefits; that the taxpayer's CFO never told the entity that was planning the COLI transactions that the purpose was to fund the benefit program; and that projections showed that the cash flow from the program was needed to pay future interest and premiums as opposed to being available to fund the benefits plan. As to (ii), the court found that the described additional benefits were not related to the COLI program. See also *IRS v. CM Holdings*, No. 97-695 (D. Del. 2000); and *American Electric Power v. U.S.*, 2001 U.S. Dist. LEXIS 1705 (SD Ohio 2001).

In *Compaq Computer Corp. v. Comr.*, 113 T.C. 214 (1999), rev'd, 2002-1 USTC 50, 144 (5th Cir 2001), the Tax Court disallowed foreign tax credits associated with dividends on certain ADRs. Among the factors taken into account was that the officer of the taxpayer in charge of the investments made no inquiry into the commercial aspects of the transactions. In reversing the Tax Court, the Fifth Circuit noted the transaction was not motivated solely by tax consequences of the transaction. The record indicated the taxpayer had a business purpose in trading ADRs and the transactions did in fact occur. *IES Indus.*, supra, was cited with approval.

In *ACM P'ship v. Comr., T.C. Memo.* 1998-203, aff'd in part and rev'd in part, 157 F.3d 231 (3rd Cir. 1998), cert. denied, 526 U.S. 1017 (1999), and *Saba P'ship v. Comr.*, 78 T.C.M. 684, TC memo 1999-359, vacated and reworded, 273 F.3d 1135 (CA-DC 2001), involving similar transactions, the Tax Court found that the purported business purposes of the transactions were unsupported by the evidence and, similar to the foregoing cases, the individuals involved with execution of the transaction did not exhibit behavior consistent with trying to achieve the purported commercial purposes. In *Saba*, however, the Circuit Court refused to hold that the partnerships were shams.

The common thread in these cases is that to have the requisite business purpose to support the tax benefits achieved, there must be a purported commercial reason for engaging in the various transactions, the transaction must be consistent with such reason, and such reason must be supportable by contemporary evidence, including a showing that the transaction was handled in a business-like manner. This analysis is supported by a number of cases.

For example, in *Levy v. Comr.*, 91 T.C. 838 (1988), the taxpayers entered into a sale-leaseback of computer equipment for the purported reason of diversifying their business and investments. In upholding the tax benefits the court stated:

> Based upon our careful examination of the relevant facts and evidence in this case, we conclude that petitioners entered into the transaction in issue for sound business reasons (namely to diversify their investments by entering into a legitimate long-term investment involving the purchase and leaseback of computer equipment). Petitioners approached the decision to enter into this transaction in a businesslike manner. Petitioner's financial advisor thoroughly and in good faith investigated the proposed purchase-leaseback transaction. He prepared cash flow analyses, which included the components of the transaction that were critical to earning a profit on the investment. Those components included the current fair market value and projected residual value of the equipment, the fair rental value of the lease, and the rent participation agreement. He explained to petitioners the significance of and risks associated with the projected residual value of the equipment and the rent participation agreement. In addition, he explained to petitioners the tax consequences of the transaction. Petitioners also retained a law firm with expertise in leasing transactions to investigate the financial status and creditworthiness of each participant involved in the transaction, to investigate each participant's business reputation, and to handle the legal aspects of this complex transaction.
>
> We are satisfied that petitioners had a good faith and substantial business purpose for entering into the transaction. Petitioners participated in the purchase

leaseback transaction only after they were convinced that the investment had a reasonable possibility of producing a profit.

Levy, 91 T.C. 838, 855-856. Similarly see *Pearlsten v. Comr.*, T.C. Memo. 1989-621; *Rubin v. Comr.*, T.C.M. (CCH) 1989-484.

In *Caruth Corp. v. Comr.*, 865 F.2d 664 (5th Cir. 1989), aff'g, 688 F. Supp. 1129 (N.D. Tex. 1987), the issue was whether a charitable contribution would be allowed for a contribution of stock of a controlled corporation after the dividend was declared, but before the dividend record date. The court upheld the deduction in part upon finding that lag between the declaration and record dates had a business purpose:

> [Taxpayer] contends that the distinction between the two dates was designed to encourage his nephews . . . to sell their shares to him . . . The lag between the declaration date and record dates was designed to give the nephews an opportunity to sell. The plan failed in this respect; the nephews held their share.
>
> The district court made factual finding the [taxpayer] wished to buy out his nephews' interests in North Park Incorporated, and that he believed declaration of a dividend might facilitate this objective. We review these findings pursuant to the clearly erroneous standard, and find clear support in the record. With these factual findings in place, we believe it obvious that the distinction between declaration and record date did, as [taxpayer] contends, serve a legitimate business purpose.
>
> *Caruth*, 865 F.2d at 650.

Lastly, it should be noted that a transaction can have an appropriate business purpose even if the transaction itself does not generate a profit. See *Caruth v. Comr.*, supra, *Horn v. Comr.*, 968 F.2d 1229 (D.C. Cir. 1992).

In the instant case, as set forth in the Summary, Barka sought to make investments in distressed debt assets with others who had demonstrated a unique and potentially profitable business model. In addition, Barka chose the tiered structure, described above, to be able to invest in such instruments, to make other investments through MRF and to insulate itself and its assets from the claims or any creditors of MRF. Furthermore, United Finance had a compelling reason to become a member of MRF given its stated purpose for creation. Based upon the information provided in the Summary, it is more likely than not that the Transactions should have the requisite business purpose to be respected under the authorities discussed above.

(ii) Economic Substance.

It is well established that a transaction or series of transactions may not be respected for tax purposes unless the transaction or transactions have economic substance separate and distinct from the economic benefit derived from tax reduction. *Gregory v. Helvering*, 293 U.S. 465 (1935). Transactions failing to meet this standard lack the requisite "economic substance" (often interpreted as a having a reasonable possibility of pre-tax profit) and will not be respected for tax purposes. However, the Supreme Court has held that a transaction should be respected if it has "economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." *Frank Lyon Co. v. U.S.*, 435 U.S. 561,583-584 (1978). Thus, transactions have been upheld where the transactions were designed to achieve a tax benefit, but were endowed with positive pretax economics. See e.g., *Northern Indiana Public Service Company v. Comr.*, 105 T.C. 341 (1995), aff'd, 115 F.3d 506 (7th Cir. 1997).

The *Yosha* decision articulated the standard slightly differently, stating:

> A transaction has economic substance when it is the kind of transaction that some people enter into without a tax motive, even though the people fighting to defend the tax advantages of the transaction might not or would not have undertaken it but for the prospect of such advantages—may indeed have had no other interest in the transaction.

Yosha, supra, 861 F.2d at 499.

It should be noted that a taxpayer need not be correct, only reasonable or rational, in its judgment of possible economic benefits. Profit motive depends on the taxpayer's subjective and good faith intent to earn a profit. *Finoli v. Comr.*, 86 T.C. 697, 722 (1986). The fact that a venture fails to produce a profit in the anticipated amount or at all does not indicate that the venture was not profit-motivated. *King v. U.S.*, 545 F.2d 700, 708 (10th Cir. 1976). However, that profit potential cannot be illusory. In *ACM P'ship v. Comr.*, supra, the Tax Court found that at the time it entered into the partnership, the taxpayer's only real opportunity to earn a profit was through an increase in the credit quality of the issuers of certain notes, or a 400-500 basis point increase in 3-month LIBOR interest rates. The court found no impact on credit quality was possible as the lenders were extremely highly rated at the time of the transaction. Moreover, the court did a 6-year review of 3-month LIBOR rates and did not find an increase of even 300 basis points in the necessary time frame. Since the analysis of the historical data showed no reasonable basis for expecting a profit, the court ruled against the taxpayer. "We do not suggest that a taxpayer refrain from using the tax laws to the taxpayer's advantage. In this case, however, the taxpayer desired to take advantage of a loss that was not economically inherent in the object of the sale, but which the taxpayer created artificially through the manipulation and abuse of the tax laws. A taxpayer is not entitled to recognize a phantom loss from a transaction that lacks economic substance." In its analysis, the Third Circuit focused upon the foregoing finding of the Tax Court, stating:

> Tax losses such as these, which are purely an artifact of tax accounting methods and which do not correspond to any actual economic losses, do not constitute the type of 'bona fide' losses that are deductible under the Internal Revenue Code and regulations.

The Third Circuit also noted:

> [O]n November 3, 1989, [the partnership] invested $175 million of its cash in private placement Citicorp notes paying just three basis points more than the cash was earning on deposit, then sold the same notes 24 days later for consideration equal to their purchase price, in a transaction whose terms had been finalized by November 10, 1989, one week after ACM acquired the notes. These transactions . . . offset one another and with no net effect on ACM's financial position.

From these cases it appears that the "substance" necessary to meet the requirements of the "economic substance" doctrine is somewhat different from the "substance" required under the "sham in substance" doctrine. As discussed above, the latter requires that the transaction have the economic consequences consistent with what the transaction purports to be: Does the taxpayer really have the economic incidents of ownership if the taxpayer purports to own the asset? The former requires that, having passed the "sham in substance" test, the transaction make economic sense: Does the taxpayer have a reasonable possibility of economically benefiting from the transaction without regard to tax benefits?

Despite being inconsistent with the economic substance cases, one case has suggested that there must be not only a reasonable possibility of making a profit, but also the possibility must relate to a profit that is greater than de minimis. See *Sheldon v. Comr.*, 94 T.C. 738 (1990).[50] A handful of other decisions have indicated that the court should consider whether the profit motive for a transaction was greater or less than the tax motive. See e.g., *Fox v. Comr.*, 82 T.C. 1001 (1994); *Estate of Baron v. Comr.*, 83 T.C. 542 (1984), aff'd, 798 F.2d 65 (2d Cir. 1986). However, to date, these cases appear to represent a minority view. Thus, the tax benefits achieved in a transaction should not be denied under the economic substance doctrine merely because the transaction's principal purpose was to achieve such tax benefits. See e.g., *Northern Indiana Public Service Co. v. Comr.*, supra. Congress has precluded such a broad test for all disallowance by incorporating such a principal purpose test into specific Code Sections such as Code Section 269. Long-standing judicial authority has also recognized that "any one may so arrange his affairs that his taxes shall be as low as possible." *Helvering v. Gregory*, 69 F. 2d 809 (2d Cir. 1934). See also, *Cottage Savings Association v. Comr.*, supra, upholding the tax benefits generated by a transaction executed solely for tax purposes.

Similarly, in *Salina P'ship LP, FLP Group, Inc. v. Comr.*, supra, a partnership had been previously formed by an investment bank and made a series of investments. Understanding from the investment bank that the purchase of 50% or more of the interests in the partnership would provide certain tax benefits, the taxpayer purchased 98% of the outstanding partnership interests. The IRS conceded that the partnership was profitable and such profitability provided the taxpayer with sufficient profit motive to imbue the post-purchase portion of the transaction with economic substance. However, the IRS contended that the pre-purchase part of the transactions did not have

[50] On December 23, 1997, the IRS issued Notice 98-5, announcing that the IRS will issue regulations effective on and after such date dealing with foreign taxes paid or accrued in connection with certain abusive transactions. Such transactions were described as those in which the anticipated economic benefits are insubstantial in relationship to the anticipated tax benefits. It is currently uncertain as to when or whether such regulations will be issued, the criteria they will establish with respect to the insubstantiality of anticipated economic benefits, or whether such regulations will have application beyond the area of foreign taxes.

sufficient economic substance and, accordingly, the taxpayer's tax benefits achieved through the transaction should be denied. The court stated that although the purchase of the partnership interest provided the taxpayer with a perceived tax benefit, "this factor, standing alone, is insufficient to render the transaction a sham in substance." The court found that the investment in the partnership provided the taxpayer with a reasonable opportunity to earn profits independent of tax benefits, and that such opportunity imbued the entire transaction with a sufficiently valid business purpose to give the transaction the economic substance necessary to be respected.

In contrast, in FSA 20010351 the taxpayer wanted to acquire an interest in a foreign corporation in order to expand its business activities abroad. Rather than purchasing the stock outright, the taxpayer had the foreign parent corporation transfer its interests in the corporation to a partnership, and then sell the interests in the partnership to the taxpayer. However, prior to acquiring the partnership interest, the partnership engaged in a foreign currency transaction. When the taxpayer bought the partnership interest, the taxpayer claimed that the partnership had terminated under Section 708(a), and under Section 732(c) reallocated its basis in the partnership property to increase the amount attributed to the foreign currency. Thus the taxpayer had a higher basis in the foreign currency and acquired both the stock it desired as well as foreign currency, which it could immediately sell and generate a loss. The FSA concluded that the transaction lacked economic substance because the loss claimed on the foreign currency had no realistic tie to the movement of exchange rates, and there was no chance that the transaction would have generated a profit. Thus, the transaction was not respected.

As discussed above in connection with the discussion of business purpose and set forth in the Summary, Barka sought to make investments in distressed debt assets identified by MRF. Based upon the information provided in the Summary, the Transactions should have the requisite economic substance to be respected under the authorities discussed above.

c. **Conclusion.**

Based upon the information provided in the Summary, and the Representations, and recited in the preceding analysis, it is more likely than not that the Transactions should have the requisite economic substance and business purpose to be respected under the authorities discussed above.

8. **The Bad Debt Deductions Claimed Are Bona-Fide And the Bona-Fide Loss Rules of Section 165 Do Not Apply.**

The operating loss is generated under Sections 63, 163, and 166. The operating loss is not generated under Section 165.[51]

Section 165(a) states that:

[51] No opinion is expressed as to whether settlements in part or in its entirety of the Japanese Debt Portfolio with the borrowers could result in an operating loss under Section 165.

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Treas. Reg. § 1.165-1(b) interprets this provision, stating that for a loss to be allowable under Section 165(a), the loss must be evidenced by a closed and completed transaction, fixed by identifiable event, and be actually sustained during the tax year. Further, the loss must be a "bona fide" loss and substance rather than form should govern.

The "bona fide" loss language of Treas. Reg. § 1.165-1(b) refers, not to the loss itself, but to the transaction that led to the asserted recognition of the loss. In *McWilliams v. Commissioner*, 331 U.S. 694 (1947), the Court disallowed a loss on sale of stock where the taxpayer's wife simultaneously purchased the same number of shares of identical stock. The Court observed that sales of property having a value less than basis can be used as a device "for realizing tax losses on investments which, for most practical purposes, are continued uninterrupted." Examples of deductions that have been denied pursuant to this principle include sales of property followed immediately by repurchase of the same or similar property and sales to members of the taxpayer's family. The loss-limiting rules of Section 1091 (the so-called "wash-sale" rules) and Section 267 (suspending losses on the sale of depreciated assets between related parties) are statutory embodiments of the principle that a loss is only "bona fide" when the property is economically disposed of by the taxpayer.

The "bona fide" loss language of Treas. Reg. § 1.165-1(b) applies where the particular "sale" is only a "provisional step" rather than a closed and completed transaction. Alternatively, the language can apply where the taxpayer retains an economic interest in the asset that nominally gives rise to the loss. See *Scully v. United States*, 840 F.2d 478 (7th Cir 1988) for a decision embodying this principle (because the sale did not change the control or flow of economic benefits from the property sold).

In summary, a loss is "bona fide" and allowable if there is a closed and completed transaction in which the financial interests of the taxpayer have been in fact transferred to an independent party. This analysis provides plenty of support for the distinction made by the *ACM* court between the situation there and *Cottage Savings*. The loss in *Cottage Savings* was clearly "bona fide" in the sense that it was evidenced by a closed and completed transaction between the parties in which the taxpayer transferred control and the flow of economic benefits from the property sold. By contrast, in *ACM*, the courts ruled the loss did not result from a closed and completed transaction, because no such transaction had ever taken place. There was no "disposition" in the installment sale because there was no economic substance to the acquisition.

The "bona fide" language of Treas. Reg. § 1.165-1(b) does not mean that the loss must arise from an actual economic outlay which is not recouped. There are, however, several cases that provide possible authority to challenge the losses as not bona fide.

a. **Scully v. Commissioner**

Scully v. Commissioner, 840 F.2d 478 (7th Cir. 1988), Notice 99-59, Notice 2000-44, FSA 200122022, FSA 200015005, FSA 200146025, and FSA 200145010 are possibly relevant. The Service generally quotes *Scully* for the proposition that, "to be deductible, a loss must be a 'genuine economic loss.'"

In *Scully*, the Seventh Circuit held that there was no deductible loss where trustees of the family trust sold assets to other family trusts having the same fiduciaries and the same beneficiaries. The disposition merely resulted in a reshuffling of assets, which resulted in no "genuine economic loss" because the taxpayer retained control over the property -- that is, the sale was effectively a circular transaction with no economic substance. The Court of Appeals relied on J. Mertens' Law of Federal Income Taxation for the following principle in concluding that the loss incurred on the sale of the real estate was not deductible:

> Losses will not be allowed which are claimed in connection with transactions which do not vary control or change the flow of economic benefits . . . [A taxpayer] will not be permitted to transfer assets from one pocket to another and take a loss thereby where he remains at the conclusion of the transfer the real owner of the property, either because of retention of title, command over the property, either directly or through the person who appears as the nominal vendee or transferee.

Scully is therefore a case standing only for the proposition that there must be a disposition of the taxpayer's economic interest in an asset for the losses to be realized for tax purposes. *Scully* does not support the Service's position that tax losses must correspond to economic losses; rather, *Scully* simply means that a tax loss can be recognized only if the loss results from a transaction that changes tax ownership of property.

The court in *Scully* distinguished the facts before it from *Widener*, 80 T.C. 304 (1983), a Tax Court case in which property was also transferred between two trusts. The difference for the *Scully* court was that in *Widener*, there were real differences in the trusts.

b. **Shoenberg v. Commissioner**

Shoenberg v. Commissioner, 77 F.2d (8th Cir. 1935), cert. denied, 296 U.S. 586 (1935), cited by the Service in Notice 99-59, Notice 2000-44, FSA 200145010, FSA 200146025, and Chief Counsel Notice 2002-001, was an Eighth Circuit case in which the Court of Appeals held that there was no deductible loss where an investor sold stock at a loss and on the same day bought the same number of identical shares through his investment company. A little more than 30 days later, the investor purchased the shares from his investment company at a lower price than that for which he had originally sold them. The Court of Appeals denied the investor's loss deduction, stating that "where such sale is made as part of a plan whereby substantially identical property is to be reacquired and that plan is carried out, the realization of loss is not genuine and substantial; it is not real." Moreover, the court noted that "for all practical purposes" the taxpayer used his controlled corporation "as an agency for purchasing, holding, and selling to him, stocks identical with those he sold to establish the claimed loss." Economically, the transaction was again a circular transaction with no economic substance in which the taxpayer in essence retained the economic benefit of what he purported to have sold.

In analyzing the transaction, the court noted: "[t]o secure a deduction, the statute requires that an actual loss be sustained. An actual loss is not sustained unless when the entire transaction [in this case, the sale of the securities] is concluded the taxpayer is poorer to the extent of the loss claimed; in other words, he has that much less than before." *Shoenberg*, n. 35 supra. That statement, in the context of a sale of property, would generally not make sense. A taxpayer, in a sale transaction, is never poorer in the economic sense immediately after the sale than he was immediately before the sale -- in other words, his economic position is the same, from a fair market value perspective, both before and after the sale. In the factual context of *Shoenberg*, however, the statement makes sense because the taxpayer, following the purported sale was not poorer relative to his initial economic position -- he retained the economic interest in the securities and the sale had no economic effect on him. Conversely, to interpret that passage as the Service has -- as support for the Noneconomic Loss Doctrine -- would be nonsensical because the loss realized by the taxpayer in *Shoenberg* was very real from an economic perspective -- the taxpayer had purchased the securities for $502,383.17 and had subsequently "sold" them for $311,752.50. Accordingly, the quoted statement supports the conclusion that *Shoenberg* deals only with whether a sale transaction producing a loss effectuates a transfer of the economic benefits and burdens of the property transferred. Cf. *San Antonio Savings Association v. Commissioner*, 887 F.2d 577 (5th Cir. 1989) ("Realization does not require that a taxpayer must be 'richer or poorer' as a result of the exchange itself. Generally items exchanged will be of equivalent value.").

Accordingly, *Shoenberg*, like *Scully*, is a case in which the court held that a loss was not realized by the taxpayer when the taxpayer held the same beneficial interest in the purportedly sold assets both before and after the sales. Yet the Service has cited *Shoenberg* in the context of the Noneconomic Loss Doctrine for the proposition that "to be deductible, a loss must be 'actual and real.'" *Shoenberg* says that to be deductible, a loss must be actual and real, but that language merely means that the loss must arise from a transaction that relieves the taxpayer of the economic benefits and burdens of the property -- not that the loss must reflect an actual economic loss.

c. Judicial Gloss On The 'Bona Fide' Loss Requirement

George Freitas Dairy v. United States demonstrated clearly that a loss need not be "economic" for it to be recognized as "bona fide." In *George Freitas Dairy*, the taxpayer abandoned its interest in a private milk quota system and attempted to claim an abandonment loss under Section 165. Later the same year, a governmental quota system was imposed, and the Service argued that the taxpayer did not sustain a loss because the private quota system had essentially been replaced by a governmental quota system that left the taxpayer in the same economic position. The court responded by noting that a "deduction cannot be denied simply because the loss may not be wholly disadvantageous to the taxpayer . . . the district court found, this was not a sham transaction acted out for tax purposes." In other words, because the transaction was not a sham acted out for tax purposes, the loss could not be disallowed merely because the taxpayer did not suffer an economic disadvantage.

Similarly, in *Feldman v. Wood*, the taxpayer claimed a loss under Section 165 but suffered no economic detriment; indeed, the taxpayer apparently obtained an economic benefit from the transaction that produced the loss. It was "irrelevant" in the court's view whether there was an economic loss corresponding to the tax loss. The court upheld the allowance of the loss despite the Service's entirely valid claim that the allowance of the loss allowed a "deduction in cases where no economic loss [was] actually sustained."

In *Feldman*, the taxpayer had leased property to a tenant pursuant to a long-term lease. The tenant had the right to raze the building on the leased property and to construct new improvements. The tenant razed the building and built a new building on the premises, which apparently enhanced the value of the property to the taxpayer (there was, after all, a new building on the premises). Under the Treasury Regulations in effect at the time, there was some question concerning whether the taxpayer-lessor could deduct as a loss the remaining basis in the building even though a new building was constructed to replace the existing building in which the taxpayer-lessor had a tax basis.

The Regulation that spawned the litigation in *Feldman* has been interpreted differently by some courts. In one of the cases that interpreted the regulation contrary to *Feldman*, the Seventh Circuit stated that it did not believe that economics were "entirely irrelevant" because the construction of a new building following the demolition of the old building might invoke the provision of Section 165 that precludes a loss if the loss is compensated by "insurance or otherwise." *Landerman v. Commissioner*, 454 F.2d 338 (7th Cir. 1972). The Seventh Circuit in *Landerman* did not, however, opine that a Section 165 loss required a corresponding economic loss; rather the court simply noted that if there were compensation for the loss, the loss would not be allowed.

Significantly, other cases agreed with the analysis in *Feldman* and rejected the argument that the loss was not allowable because the lessor "suffered no economic loss." *Hightower v. United States*, 346 F.Supp. 707 (M.D. Fla. 1971), aff'd 463 F.2d 182 (5th Cir. 1972).

d. **IRS Gloss On Bona Fide Loss FSA 1999-495**

A recent pronouncement by the Service also supports the proposition that a Section 165 loss need not be accompanied by an economic loss. In FSA 1999-495, the Service rejected three alternative arguments for disallowing a short-term capital loss that resulted from an exchange of stock in connection with a merger. In the FSA, a corporation purchased shares of stock in a target corporation in an effort to take control of the company. The corporation's efforts failed, and the target company merged with a "friendly suitor." Like the other target shareholders, the corporation received stock in the combined entity in exchange for its target stock. The corporation then claimed a short-term capital loss.

The Service began its analysis by referring to the requirement in Treas. Reg. § 1.165-1(b) that the claimed loss must be actually sustained, that only a bona fide loss is allowable and that substance and not mere form governs. The Service then discussed *Shoenberg*.

Significantly, the Service concluded that it could not rely on *Shoenberg* because:

> a loss deduction cannot be denied simply because the loss is not wholly disadvantageous to the taxpayer. *Georgia [sic] Freitas Dairy, Inc. v. United States*, 582 F. 2d 500, 502 (9th Cir. 1978); *Forward Communications Corp. v. United States*, 608 F.2d 485, 501 (Ct. Cl. 1979). Sections 1001 and 165 generally provide that a taxpayer will be allowed to deduct a loss where it sells property for less than its cost. This is what the taxpayer did in this case. The Commissioner is bound to treat the transaction in accordance with its form unless he can show that the form chosen by the taxpayer is without economic substance. *Frank Lyon Co. v. United States*, 435 U.S. 561, 583-84.

The Service then clarified how the "substance and not mere form shall govern in determining a deductible loss" language should be applied in Treas. Reg. § 1.165-1(b) context. The Service referred to *Newman v. Commissioner*, an economic substance case that explicitly set forth the Commissioner's logic that "bona fide loss" as used in Treas. Reg. § 1.165-1 (b) is derivative of the base judicial doctrine of economic substance. Simply stated, the resulting premise is that if a transaction or series of transactions have economic substance, any losses that may result should satisfy the Commissioner's requirement that the losses are "bona fide."

e. <u>ILM 200025053</u>

Perhaps the most illuminating glimpse into the Service's thinking with respect to the Noneconomic Loss Doctrine comes from the Service's Internal Legal Memorandum addressing the advice issued in TAM 200023003. In the ILM, the Service noted the recent issuance of Notice 99-59. The Service then quoted the *ACM* language quoted in Notice 99-59, but noted that:

> [o]ther cases suggest a more narrow interpretation of the requirement that a loss be bona fide . . . *Cottage Savings* addressed the deductibility of losses realized on the exchange of home mortgages. The Supreme Court, after holding that the exchanged mortgages were "materially different" and that therefore their exchange was a realization event under Code Section 1001, concluded further that the Section 165 requirement that a loss be bona fide did not prevent deduction of the losses: "Because there is no contention that the transactions in this case were not conducted at arm's length, or that Cottage Savings retained de facto ownership of the participation interest it traded to the four reciprocation S&L's, *Higgins* is inapposite." The case cited by the Supreme Court -- *Higgins v. Smith*, 308 U.S. 473 (1994) -- concerned a sale of securities to a controlled corporation under circumstances indicating that the taxpayer retained beneficial ownership of the securities. One could argue that the Supreme Court opinion suggests a narrow inquiry under Section 165 -- whether a disposition occurs in an arm's length transaction -- rather than a broader economic substance inquiry, the type engaged in by the Court in *ACM Partnership*.

The Service then noted that the *ACM* decision -- or at least its interpretation of the *ACM* decision -- was not inconsistent with the Supreme Court's opinion in *Cottage Savings*, because in *Cottage Savings* actual economic losses had been sustained, thus apparently concluding that

Cottage Savings, despite being contrary to the Noneconomic Loss Doctrine, did not prevent its application. What the Service seems to be forgetting in this ILM is that Judge Greenberg's comments that are quoted by the Service in support of the Noneconomic Loss Doctrine cite *Cottage Savings* as support. Thus, it is not enough for the Service to distinguish *Cottage Savings*.

f. The Code Does Not Abhor Noneconomic Losses

Judges often express a concern about granting a taxpayer a "windfall" or other "unanticipated" tax benefit. As clearly expressed by the Supreme Court in *Gitlitz v. Commissioner*, supra, these concerns are misplaced when the Regulations or the Code mandate a particular tax result. The fact that a transaction results in more favorable tax consequences than other alternatives should not change the tax treatment of a transaction. As the Supreme Court has stated more than once: "[T]he fact that favorable tax consequences were taken into account by [taxpayer] on entering into the transaction is no reason for disallowing those consequences. We cannot ignore the reality that the tax law affects the shape of nearly every business transaction."

Numerous cases have held in a variety of contexts that as long as: (i) the form a taxpayer has selected results in the desired tax consequences under the law then in effect, and (ii) what a taxpayer has purported to do was in fact done (that is, so long as the transactions are not shams), the courts will not recharacterize a transaction so as to maximize tax liabilities merely because a taxpayer has intentionally structured it so as to maximize after-tax returns by minimizing tax. Accordingly, the courts have (1) upheld a taxpayer's sale of a corporation's stock to a tax-exempt organization, followed by the liquidation of the corporation and leaseback of the operating assets, thereby converting substantially all the earnings subject to personal tax at ordinary rates to earnings subject to tax at the much lower individual capital gain rate; (2) respected the sale of oil leases made solely to secure deductions for loss in value; (3) respected the sale of dividends to accelerate income into the year in which it could be offset by an interest deduction; and (4) respected a tender offer followed by prearranged tax-free distribution complying with literal requirements of Section 311 as in effect at the time.

Even if a taxpayer has used statutory or regulatory provisions to obtain what might be described as an unintended tax benefit, the courts generally follow the law as in effect, and leave it to Congress or to the drafters of the regulations to fix the law. See *Gitlitz*, supra. Given the inherent complexity of the tax law, and the need for taxpayers to be able to plan their affairs with the degree of certainty necessary for a free-market economy, the courts have generally accepted the form of a transaction that satisfies the relevant tax rules. Accordingly, the courts have been of the view that "[g]ranting the government's proposition that . . . taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's."

Many sections of the Code in essence permit deductions or losses that could be described as noneconomic in nature. For example, a fair market value basis is granted to an estate on the death of an individual. At a later date, a transferee of the estate may sell the property at a loss in circumstances in which the loss was generated by the basis step up available under the Code. Arguably, the loss in such cases is a noneconomic one, at least in those cases in which the estate is granted a basis step-up that ultimately results in the loss to the beneficiary of the estate. Moreover, a taxpayer is permitted to take a deduction for depreciation or amortization even though a building has nominal or no value. Furthermore, percentage depletion is available even though the taxpayer has no basis in a property and the deduction may be taken even where the property has a nominal or no value (for example, there are environmental problems with the property).

Finally, if tax losses are allowable only if there is an equal economic loss associated with the tax loss taken, then the theory is that the taxpayer has, in essence, fair market value basis for this purpose. Thus, a taxpayer may take a loss only to the extent of the expenditure that the taxpayer seeking the loss has in the transaction. But if that were true, then the Code and the Regulations would not, as they do, contain provisions such as Section 382 and the SRLY rules that deal with purchased losses, and there would be no carryover basis rules such as Section 351 that essentially permit a transferee taxpayer to take a loss that economically accrued before the transferee taxpayer obtained the property.

g. **Gitlitz v. Commissioner**

The Supreme Court's ruling in *Gitlitz*, supra, emphasized that a noneconomic loss may be entirely deductible under the Internal Revenue Code. In *Gitlitz*, the taxpayer was the shareholder of an insolvent S corporation that incurred discharge of indebtedness income in 1991. Due to the S corporation's insolvency even over the discharge of indebtedness, the S corporation excluded the entire discharge of indebtedness amount from gross income pursuant to Sections 108(a) and 108(d)(7)(A). The taxpayer then increased his basis in his S corporation stock in accordance with his pro rata share of the amount of the S corporation's discharge of indebtedness. The taxpayer used this increase in basis to deduct $1,010,648 in losses even though the corporation was in bankruptcy and was therefore worthless.

The Commissioner asserted that the discharge of indebtedness income did not increase the taxpayer's basis in his S corporation stock. Rather, the Commissioner contended that the discharge of indebtedness' exclusion from gross income under Section 108(a)(1) altered the character of the discharge of indebtedness such that it was no longer an "item of income" and thus did not increase the shareholder's basis under Section 1367(a)(1). The Court dismissed the Commissioner's argument in the following manner:

> The Commissioner asserts that discharge of indebtedness is unique among the types of items excluded from gross income because no economic outlay is required of the taxpayer receiving discharge of indebtedness. But the Commissioner is unable to identify language in the statute that makes this distinction relevant and we certainly find none.

Ultimately, the Court determined that, despite the fact that there had been no economic outlay or receipt for the discharge of indebtedness and no corresponding gain realized the taxpayer was entitled to step up his basis in his S corporation stock. Thus, despite the fact that the loss claimed by the taxpayer based on that increased basis was wholly uneconomic, the plain language of the statute entitled the taxpayer to the loss:

> [C]ourts have discussed the policy concern that, if shareholders were permitted to pass through the discharge of indebtedness before reducing any tax attributes, the shareholders would wrongly experience a "double windfall": They would be exempted from paying taxes on the full amount of the discharge of indebtedness, and they would be able to increase basis and deduct their previously suspended losses. See e.g., 182 F.3d. at 1147-1148. Because the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern.

While it is unclear how the suspended losses in *Gitlitz* arose, the language of the Tenth Circuit Court of Appeal's opinion indicates that they were not Section 165 losses. The Tenth Circuit did observe, however, that the principal issue in *Gitlitz* was equally applicable to a Section 165 loss. Thus, *Gitlitz* is inconsistent with the notion expressed by the Service in its interpretation of *ACM* that, to be deductible under Section 165, any tax loss must be accompanied by an equivalent economic loss.

h. Consequences of Alternative Analysis

The Service has, to date, asserted the Noneconomic Loss Doctrine only in situations that suggest palpable tax avoidance. One might argue, as would likely the Service, that "normal" transactions would not be affected by the Service's assertion of a "doctrine" that punishes only "tax shelters" (however the term "tax shelters" is defined).

The impact of the Noneconomic Loss Doctrine, however, is much more far reaching than the transactions attacked by the Service. Consider the following situation: Taxpayer acquires a 5) percent interest in Partnership XY, which has no Section 754 election in place. Partnership XY holds an asset with a fair market value of $100, but an adjusted basis of $0. Subsequently, Partnership XY sells the asset, realizing a gain of $100. The gain passes through to the Taxpayer, who dutifully pays his tax on the gain. He does not object too much to this gain, because it results in a step up of his basis in his partnership interest. The absence of a Section 754 election merely results in a timing problem -- he will obtain an offsetting loss when he sells his partnership interest.

Let us assume that, unfortunately, the Taxpayer, when he sells his partnership interest, faces an Internal Revenue Service that steps in and disallows his loss, citing the Noneconomic Loss Doctrine. Taxpayer acquired his interest for $100 and subsequently sold his interest for $100. There was no economic outlay matched by the $100 loss that would be claimed by the Taxpayer. The Noneconomic Loss Doctrine would result in a disallowed loss for our Taxpayer. This problem would arise in any situation where a taxpayer realizes a phantom gain and obtained basis for the gain.

The Service could correct this issue quite easily -- by instituting a "Noneconomic Gain Doctrine" to match the inopportune applicability of the Noneconomic Loss Doctrine. Our suspicion is, however, that the first time a court reduced a taxpayer's gain on the sale of property that had depreciated for tax but not economic purposes, the Service would quickly rethink the "Noneconomic Gain Doctrine."

The fact is that the Code is littered with noneconomic provisions that tie a taxpayer's basis in property to something other than fair market value. These Code provisions reflect Congress's decisions to either favor simplicity over accuracy or provide incentives for various businesses or activities. Simply overlaying these provisions with a Noneconomic Loss Doctrine would destroy some incentives that Congress wished to create, and punish some innocent taxpayers who are afflicted with noneconomic gain.

It is more likely than not that the claimed bad debt deduction will be respected as a bona-fide deduction without limitation for non-economic considerations.

I. Conclusion

We express no opinion, nor is any opinion implied, regarding any other tax issue or any other aspect of the relationship between and among the parties. This opinion letter speaks only as of the date hereof and we disclaim any obligation to modify or revise this opinion as a result of any change in law of facts on which this opinion is based. This opinion may be relied upon solely by MRF in connection with the specific transactions described above and for no other purpose and by no other person without our prior written consent in each instance.

Very truly yours,

Seyfarth Shaw LLP

SEYFARTH SHAW

GRT:dc

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EXHIBIT C

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DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiffs, v. PRICEWATERHOUSECOOPERS, LLP, COOPERATIVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW, LLP and GRAHAM R. TAYLOR, Defendants.	Case No.: A-16-735910-B Dept. No.: XV **AFFIDAVIT OF LORI L. ROESER IN SUPPORT OF MOTION TO DISMISS FOR LACK OF JURISDICTION ON BEHALF OF DEFENDANT SEYFARTH SHAW LLP**

STATE OF ILLINOIS)
) ss:
COUNTY OF COOK)

Before me, the undersigned authority, personally appeared Lori L. Roeser, who first being duly sworn, deposes and states as follows:

1. My name is Lori L. Roeser, I am an attorney licensed to practice law in the State of Illinois and a partner of Seyfarth Shaw, LLP ("Seyfarth" or the "Firm"). I have been a partner at the Firm since 2010. From 2010 to 2015, I served as Seyfarth's Associate General Counsel. I currently serve as the Firm's Deputy General Counsel, having served in that position since 2015. I make this affidavit on my own personal knowledge and based on my review of records kept in the ordinary course of Seyfarth's practice.

2. By virtue of my positions with the Firm, I am personally familiar with Seyfarth's practices and procedures, records and operations of Seyfarth, as they relate to the facts set forth in this Affidavit.

3. Seyfarth is an international law firm headquartered in Chicago, Illinois. Seyfarth is a limited liability partnership organized under Illinois law. Seyfarth provides legal services to its clients with its primary practice areas including labor and employment, corporate/business services, real estate, litigation and employee benefits matters.

4. Seyfarth has offices in 10 locations in the United States. Seyfarth does not currently have and has never had an office in the State of Nevada.

5. Seyfarth does not employ staff, attorneys or agents who are domiciled in Nevada.

6. Seyfarth does not own, use, or possess, or hold a mortgage or other lien on any real property in the State of Nevada.

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7. Seyfarth is not registered with Nevada's Secretary of State to do business in Nevada.

8. Seyfarth does not pay taxes in Nevada.

9. Seyfarth employs more than 850 attorneys worldwide. None of Seyfarth's partners reside in or are licensed to practice in Nevada. One attorney who is licensed in California and practices out of Seyfarth's Sacramento, California office, Heath A. Havey, was previously employed in Nevada and maintains his law license in Nevada. Mr. Havey has been employed by Seyfarth less than one year. He joined the firm in October 2015. Mr. Havey is not a partner of Seyfarth. According to Seyfarth's records, Mr. Havey resides in Roseville, California.

10. Graham Taylor was a partner at Seyfarth from July 2003 through June 2008. Between 2003 and 2008, Taylor was a resident and citizen of the state of California, and worked out of Seyfarth's San Francisco office.

11. At no time was Plaintiff Michael A. Tricarichi a client of Seyfarth.

12. At no time has Seyfarth had an agent, employee, or partner doing business in the State of Nevada in connection with, or in relation to Plaintiff.

13. At no time has Seyfarth operated, conducted, engaged in, or carried on a business or business venture in the State of Nevada in connection with, or in relation to Plaintiff.

14. Seyfarth did not travel to Nevada to meet with Plaintiff or for any other purpose with respect to the matters alleged in the Complaint.

15. Seyfarth could not have anticipated being sued in Nevada in connection with this matter and any having to defend such lawsuit in Nevada would create an extreme burden upon Seyfarth as an out-of-state

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law firm with no partners who are citizens of Nevada and no contacts whatsoever in Nevada related to this matter.

FURTHER AFFIANT SAYETH NAUGHT.

Lori L. Roeser

Lori L. Roeser

SWORN TO AND SUBSCRIBED before me by Lori L. Roeser, who is personally known to me / or who produced ______________ as identification this 30th day of June, 2016.

Veronica Gavin

(Signature of Notary)

VERONICA GAVIN
OFFICIAL SEAL
Notary Public, State of Illinois
My Commission Expires
July 25, 2019

Veronica Gavin

(Name of Notary
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DISTRICT COURT
CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiff, v. PRICEWATERHOUSE COOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR, Defendants.	)	CASE NO. A-16-735910-B DEPT. NO. XV ACCEPTANCE OF SERVICE

Service of Complaint, Demand for Jury Trial, and Summons herein upon Defendant Coöperatieve Rabobank U.A. is accepted this 26th day of August, 2016, by Dan R. Waite, Esq. and Lewis Roca Rothgerber Christie LLP, who warrants that he is duly authorized to accept service on behalf of the Defendant specified above.

The undersigned also represents Utrecht-American Finance Company.

This acceptance of service is conditioned on Defendants Coöperatieve Rabobank U.A. and Utrecht-American Finance Co. ("Defendants") response to the Complaint being due on October 14, 2016.

By accepting service and/or recognizing service has been completed, Defendants do not waive, and therefore reserve, all defenses available to them, including jurisdictional defenses, other than service of process.

LEWIS ROCA ROTHGERBER CHRISTIE LLP

Dan R. Waite
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Attorney for Defendants
Coöperatieve Rabobank U.A. and
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DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiff, v. PRICEWATERHOUSE COOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR, Defendants.	CASE NO. A-16-735910-B DEPT NO. XV **PLAINTIFF'S OPPOSITION TO DEFENDANT SEYFARTH SHAW'S MOTION TO DISMISS FOR LACK OF JURISDICTION** JURY TRIAL DEMANDED

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I. INTRODUCTION

Defendant Seyfarth Shaw, LLP ("Seyfarth") was an active participant in a conspiracy that targeted, defrauded and injured Plaintiff Michael A. Tricarichi, a Nevada resident. In addition to its role in defrauding Plaintiff, Seyfarth has also undertaken extensive other business in the State of Nevada. Accordingly, this Court has both specific / conspiracy, and general, personal jurisdiction over Seyfarth.

In an effort to slink away from this reality, and from being held accountable for its actions here, Seyfarth ignores both the law, particularly controlling Nevada Supreme Court precedent, and also the facts regarding its own actions. Regarding the law, Seyfarth relegates to a brief footnote discussion of the Nevada Supreme Court's decision in Davis v. Eighth Jud. Dist., 97 Nev. 332, 629 P.2d 1209 (1981), which holds that Nevada courts have personal jurisdiction over out-of-state defendants – like Seyfarth – who participate in a conspiracy that injures a Nevada resident. Seyfarth dismissively claims in one sentence that Davis "does not survive" the rulings in three other cases that have nothing to do with a conspiracy, are readily distinguished, and do not even mention Davis. As discussed further below, Seyfarth is wrong. Davis remains the law in Nevada, and that means that Seyfarth is subject to the jurisdiction of the Nevada courts for its role in the fraudulent conspiracy that caused Mr. Tricarichi tens of millions of dollars in injury.

Regarding the facts, Seyfarth tries to distance itself from the truth by repeating the mantra that "None of [the alleged] activity involved Seyfarth…. None of this alleged activity took place in Nevada…." or words to that effect. (See, e.g., Mot. at 1, 4.) But as the allegations of the Complaint and the exhibits accompanying this Opposition demonstrate, Seyfarth was an integral part of a fraudulent enterprise that targeted Plaintiff, dealt over and over again with

Plaintiff in Nevada, and caused serious harm to Plaintiff – in Nevada – while Seyfarth and the other defendants lined their own pockets as a result.

Seyfarth likewise tries to ignore the true extent of its general business activities in Nevada. Seyfarth's motion focuses on the fact that one of its lawyers is admitted to the Nevada bar, arguing (correctly) that this alone is not enough to establish general personal jurisdiction over the firm. But Seyfarth makes no mention whatsoever of the firm's various other, persistent contacts with this State. These include Seyfarth's representation of clients in significant Nevada matters; regular attendance by Seyfarth lawyers at professional events in Nevada; Seyfarth publications addressing Nevada law; and the admission of numerous Seyfarth lawyers in Nevada courts. These facts all go to show that Seyfarth has repeatedly and purposefully availed itself of the Nevada jurisdiction and should hardly be surprised when it is haled into court here.

Via this Opposition and his Complaint, Plaintiff makes a more than adequate showing that Defendant Seyfarth is subject to personal jurisdiction before this Court. Accordingly, Plaintiff asks that the Court deny Seyfarth's motion to dismiss. Alternatively, Plaintiff requests that – to the extent the Court finds Plaintiff's present showing insufficient to establish personal jurisdiction – Plaintiff be permitted to take jurisdictional discovery regarding Seyfarth and its contacts with the State of Nevada. At a minimum, Plaintiff's present showing indicates that there is yet further evidence establishing personal jurisdiction to be found if discovery proceeds on the subject.

II. FACTUAL BACKGROUND

A. Plaintiff Tricarichi and Defendants Seyfarth and Taylor

Plaintiff, Michael A. Tricarichi, has been a resident of Las Vegas, Nevada since May 2003. (Cmplt. ¶ 9; Tricarichi Aff. ¶ 3) After moving to Nevada, Mr. Tricarichi, the sole shareholder of Westside Cellular, Inc. ("Westside"), sold his Westside shares in what is now known as a "Midco" transaction. (Cmplt. ¶¶ 24-54) Defendants' wrongdoing in connection with this sale caused Mr. Tricarichi to suffer millions of dollars in tax and other liabilities that he otherwise would not have faced. (Id. ¶¶ 9, 75-80)

Defendant Seyfarth Shaw, LLP ("Seyfarth") is a law firm that facilitated such matters by issuing – as it did numerous other times – a bogus tax opinion letter to an affiliate of Fortrend International, LLC ("Fortrend"), which promoted the Midco transaction to Plaintiff and purchased the Westside shares. (Cmplt. ¶¶ 5, 13, 59-72) By doing so, Seyfarth conspired with its co-defendants and others, aided and abetted fraud, and engaged in racketeering. (Id. ¶¶ 97-121) A primary actor in Seyfarth's wrongdoing was Graham R. Taylor, a Seyfarth partner at the time and a co-defendant here. Taylor issued the bogus opinion letter in Plaintiff's case, along with numerous other such letters facilitating tax shelter transactions promoted by Fortrend and others. (Id. ¶¶ 5, 14, 61) After his involvement in Plaintiff's case, Taylor pleaded guilty in Utah federal court to conspiring to commit tax fraud, and was subsequently disbarred. (Id. ¶ 66)[1]

B. Midco Transactions Generally

"Midco" or "intermediary" transactions, a type of abusive tax shelter, were widely promoted during the late 1990s and early 2000s. (Cmplt. ¶ 24) The IRS has listed Midco transactions as "reportable transactions" for federal income tax purposes, meaning that the IRS considers them, and substantially similar transactions, to be improper tax-avoidance mechanisms. (Id.) A leading promoter of Midco-type transactions was Fortrend, which was involved in numerous such transactions that were, years later, rejected by the tax courts. (Id.)

Midco-type transactions were generally promoted to shareholders – like Mr. Tricarichi – of closely held C corporations with potentially large taxable gains. (Cmplt. ¶ 25) Promoters of Midco transactions targeted such shareholders and offered a purported solution to "double taxation," that is, the taxation of gains at both the corporate and

[1] Mr. Taylor was served with the Complaint in this case on May 26, 2016, has not responded, and has thus defaulted.

individual shareholder levels. (Id.) Generally speaking, Midco transactions proceeded as follows: First, an "intermediary company," or "midco," affiliated with the promoter – typically a shell company, often organized offshore – would purchase the shares of the target company, and thus its tax liability. (Id.) After acquiring the shares and this tax liability, the intermediary company would engage in a second step that was supposed to offset the target's realized gains and eliminate the corporate-level tax. (Id.) This second step, also unbeknownst to the selling shareholder(s), would itself constitute an improper tax-avoidance maneuver, frequently a "distressed asset/debt," or "DAD," tax shelter. (Id.) This was the case with the deal that Mr. Tricarichi was drawn into, where Seyfarth made the DAD scheme possible, as further discussed below.

To draw Mr. Tricarichi and others like him into such transactions, Midco promoters like Fortrend (which is now defunct) represented to the target company's shareholders that they would legitimately net more for their shares than would otherwise be the case absent the intermediary transaction. (Cmplt. ¶¶ 15, 25) As happened with Plaintiff's transaction, however, such representations often proved, years later, to be false. (Id. ¶ 26) As set forth in the Complaint, Plaintiff thus found himself "holding the bag" in late 2015 after what was promoted to him by Fortrend and facilitated by Seyfarth and the other Defendants resulted in substantial tax liabilities and penalties for Plaintiff personally. (Id. ¶¶ 75-80)

C. The Remaining Defendants

The co-defendants of Seyfarth and Taylor, and a brief summary of their respective roles in the case, are as follows:

- **<u>PricewaterhouseCoopers LLP ("PwC")</u>** is an accounting firm with expertise in tax matters that Mr. Tricarichi retained to review the proposed transaction. PwC advised Mr. Tricarichi that the proposed Midco transaction was legitimate for tax purposes, and that Mr. Tricarichi had no ongoing exposure related to Westside once the transaction with Fortrend was completed. Unbeknownst to Mr. Tricarichi at the time, PwC's advice in this regard was, at minimum, grossly negligent. (Cmplt. ¶¶ 3, 10, 37-43, 53, 56-58, 81-96)

- **<u>Coöperatieve Rabobank U.A. ("Rabobank")</u>**, along with its affiliate and co-defendant Utrecht-America Finance Co., promoted and facilitated the Midco transaction by loaning Fortrend the lion's share of the purchase price for Plaintiff's company, and by serving as the key conduit for the funds that changed hands at closing, in return for a substantial fee – all along knowing that the transaction was improper for tax purposes. (Cmplt. ¶¶ 4, 11-12, 44-52, 54, 97-123)

- **<u>Utrecht-America Finance Co. ("Utrecht")</u>** is a wholly-owned subsidiary of defendant Rabobank. Utrecht facilitated the Midco transaction by loaning Fortrend the vast majority of the purchase price, knowing that the transaction was improper for tax purposes. (Cmplt. ¶¶ 4, 11-12, 44-52, 54, 97-123)

D. Third Parties

While not named as defendants here, several third parties (in addition to Fortrend) played significant roles in the fraud that ensnared Plaintiff. They include:

- **<u>Timothy H. Vu (f/k/a Timothy H. Conn, a/k/a Timothy Conn Vu) ("Conn Vu")</u>:** Conn Vu worked at Fortend promoting and facilitating various tax-shelter transactions, including the transaction promoted to Plaintiff. He managed various companies acquired by Fortrend, including Westside. Conn Vu is currently the subject of a federal criminal investigation in New York with respect to such conduct, and it is anticipated that he will be indicted. (Cmplt. ¶¶ 16, 41, 55, 72; App. Ex. F at ¶¶ 1, 7-9, 53-57, 193 et seq., 242 etc.; App. Ex. G) [2]

- **<u>John P. McNabola</u>:** McNabola was an agent of Fortrend and the president of the Fortrend affiliates involved in defrauding Plaintiff. The U.S. Department of Justice has identified McNabola a co-promoter, along with Conn Vu, Seyfarth's Taylor and others, of unlawful Midco and "DAD" tax shelter transactions during the period 2003-2010. (Cmplt. ¶¶ 17, 42, 47, 60-62, 69, 72; App. Ex. F at ¶¶ 9, 12-14 et seq., 140 etc.)

- **<u>John E. Rogers</u>:** Rogers was a Seyfarth partner from July 2003 until May 2008. In early 2003, shortly before he joined Seyfarth, Rogers conceived of and created the illegal DAD tax shelter that was used in connection with the Fortrend transaction and numerous other such transactions. In 2010, the U.S. Department of Justice sought to enjoin Rogers from engaging in such fraudulent conduct; Rogers agreed to a permanent injunction in September 2011. (Cmplt. ¶¶ 19, 64-68; App. Ex. H at ¶¶ 6, 12-13, 20-22, 63; App. Ex. I)

- **<u>Midcoast Credit Corp. ("Midcoast")</u>** is a now-defunct Florida corporation that, in 2003, along with Fortrend, was promoting tax-shelter transactions to Plaintiff and

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[2] Citations to "App. Ex. __" are to the Appendix of Exhibits in Support of Plaintiff's Opposition to Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction, which is in turn supported by the accompanying Affidavits of Michael Tricarichi and Thomas Brooks.

others. In October 2013, the principals of Midcoast were indicted and charged with criminal conspiracy to commit fraud and other offenses for designing and implementing fraudulent tax schemes. (Cmplt. ¶¶ 18, 29-35)

E. Plaintiff Becomes Ensnared in the Midco Transaction.

Prior to 2003, Plaintiff was the president and sole shareholder of Westside, which purchased network access from major cellular service providers and resold that access to its cell-phone customers. (Cmplt. ¶ 27) Over time, Plaintiff learned that certain of these providers were price discriminating against Westside. (Id.) Westside sued those providers because of such anticompetitive trade practices; prevailed on liability; and reached a settlement regarding damages, pursuant to which Westside ultimately netted, in April / May 2003, proceeds of about $40 million. (Id. ¶¶ 27-28) In exchange, Westside was required to terminate its business as a retail provider of cell phone service and to end all service to its customers in June 2003 – effectively relinquishing its assets in return for the settlement proceeds. (Id. ¶ 28)

Plaintiff asked the Hahn Loeser law firm to look into tax matters related to the anticipated settlement. (Cmplt. ¶ 29) Because Westside was a C Corporation, there was a concern that the settlement proceeds could be subject to double taxation. (Id.) Plaintiff was introduced to, and received information from, both Fortrend and Midcoast, who represented that they were involved in the distressed debt receivables business and wanted to purchase Plaintiff's Westside stock as part of this business. (Id. ¶¶ 29-32)

Fortrend and Midcoast each made an offer proposing essentially the same transaction: An intermediary company would borrow money to purchase the stock. (Cmplt. ¶ 32) After the sale closed, the intermediary company would merge into Westside, and the purchaser would employ Westside in its distressed-debt collection business. (Id.) The purchaser would fund its operations with Westside's remaining cash (Fortrend represented that financing for its distressed-debt recovery business was otherwise difficult to obtain), and employ Westside's tax liabilities to legitimately offset tax deductions associated with this business. (Id.)

Fortrend and Midcoast represented to Plaintiff that the transactions they were each proposing would result in legitimate tax benefits and thus a greater net return to Plaintiff than he would otherwise realize. (Cmplt. ¶ 33) These representations included the assurance that the acquiring party had successfully undertaken numerous other transactions like the one being proposed to Plaintiff and that such transactions were proper under the tax laws. (Id.) Neither party told Plaintiff that the IRS was scrutinizing and challenging similar transactions as improper tax shelters. (Id.) Absent Defendants' improper actions, Plaintiff would have left the settlement proceeds in Westside, paid the corporate-level tax and invested in other business ventures through Westside, thereby avoiding any shareholder-level tax on a distribution from Westside. (Id. ¶ 34)

Because Plaintiff thought Midcoast and Fortrend were competitors, he began negotiating with both in the hope of stirring up a bidding war. (Cmplt. ¶ 35) Rather than continue to compete, though, Midcoast and Fortrend secretly agreed that Midcoast would step away from the transaction in exchange for a kickback of $1,180,000. (Id.) As a result of this bid-rigging, Midcoast's final offer was intentionally unattractive, and Plaintiff chose to proceed with Fortrend. (Id.)

F. The Fraud Continues, with Seyfarth's Aid.

In the meantime, in early 2003, Rogers was inventing the "DAD" scheme. (Cmplt. ¶ 64) A distressed asset/debt (or "DAD") scheme uses purportedly high-basis, low-value distressed debt acquired from foreign entities that are not subject to United States taxation. (Id. ¶¶ 62-63) The distressed debt is passed through one or more U.S. entities that fail to claim the proper basis for that debt. (Id. ¶ 63) The U.S. taxpayer that finally ends up holding the debt then claims the significant tax loss that has passed through in order to offset other U.S. income or gain. (Id.) The effect is that the U.S. taxpayer is seeking to benefit from the built-in economic losses in the foreign party's distressed asset when the U.S. taxpayer did not incur the economic costs of that asset. (Id.) [3]

At the time, Rogers and Taylor were both partners together at another firm, and would both join Seyfarth in July 2003, after that other firm went bankrupt. (Cmplt. ¶¶ 64-65) Seyfarth, Rogers and Taylor would go on to promote, facilitate and participate in numerous DAD and other illegal tax shelters with Fortrend and others. (Id. ¶ 64) Numerous clients of Seyfarth, Taylor and Rogers were – like Fortrend – themselves tax shelter promoters who used the purported losses from DAD and similar schemes as part of abusive Midco transactions. (Id. ¶¶ 64, 72) As the Tax Court noted in Plaintiff's case, Seyfarth "gained notoriety for issuing bogus tax-shelter opinions," and the opinion it would issue in Plaintiff's case "seems par for the course." (Id. ¶ 64)

Meanwhile, on or about July 22, 2003, Fortrend's Mr. Conn Vu (via another Fortrend affiliate – Nob Hill Holdings, Inc.) sent Plaintiff – in Nevada – a letter of intent regarding the proposed purchase of Plaintiff's Westside stock. (Cmplt. ¶ 41; App. Ex. A) The parties proceeded to discuss and negotiate a proposed stock purchase agreement. (Cmplt. ¶ 41)

On August 13, 2003, Fortrend asked Rabobank for a $29.9 million short-term loan, setting forth how those funds would remain in and be transferred through accounts at Rabobank that the parties would open, before being quickly repaid to the bank. (Cmplt. ¶ 46; App. Ex. B) Rabobank approved the loan, with a Fortrend affiliate, Nob Hill, Inc. ("Nob Hill"), being the nominal borrower. (Cmplt. ¶¶ 46-47) Fortrend and Rabobank had previously

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[3] As part of its business, Millennium (a Fortrend affiliate) had previously obtained a portfolio of distressed Japanese debt for a cost of $137,000. (Cmplt. ¶ 60) Fortrend/Millenium would later claim – based on a Seyfarth opinion letter – that its tax basis in that portfolio was actually more than $314 million. (Id.)

participated in numerous Midco transactions together. (Id. ¶¶ 49-50) Rabobank knew that such transactions were improper for tax purposes, but did not disclose that to Plaintiff. (Id. ¶¶ 51-52, 56-58)

On or about August 20, 2003, Plaintiff received documents to open an account at Rabobank, which he returned to Rabobank in early September. (Cmplt. ¶ 48; App. Ex. C; Tricarichi Aff. ¶ 5) The documents reflect Plaintiff's residence in Nevada, where Fortrend and Rabobank were doing, and continued to do, business with Plaintiff. (Cmplt. ¶¶ 48, 52-54; App. Ex. C; Tricarichi Aff. ¶ 5)

On or about August 21, 2003, Seyfarth sent McNabola at Millennium Recovery Fund, LLC ("Millenium"), a Fortrend affiliate formed in the Cayman Islands, the opinion letter supporting the DAD scheme that Fortrend used to write off the Japanese loans that Fortrend would contribute to Westside, in order to "offset" the taxable gain on Westside's settlement proceeds. (Cmplt. ¶¶ 42, 60-61; Ex. B to Gehringer Aff. in Support of Seyfarth Mot.) Without a good-faith basis, the Seyfarth opinion letter stated that it was appropriate for Millennium to claim this huge basis for distressed debt that it had acquired for a tiny fraction of that amount. (Id.) On information and belief, Seyfarth and Taylor received a substantial fee in return for the Seyfarth Opinion Letter. (Cmplt. ¶ 70) [4]

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[4] The Seyfarth Opinion Letter in this case was not the only time that Seyfarth and Taylor were involved in similar transactions with McNabola, Conn Vu and Fortrend. (Cmplt. ¶ 72) The U.S. Department of Justice, based on its investigation, has stated that McNabola, with the assistance of Seyfarth's Taylor, structured and/or assisted with setting up a DAD transaction by which First Active Capital Inc. ("First Active"), in or about August 2005, acquired distressed Chinese debt with a supposed basis of more than $57 million. (Id.; App. Ex. F at ¶¶ 16, 201-203) First Active, which was incorporated in August 2005, and of which McNabola was the sole officer and director until 2006, then used this distressed debt to offset gains in connection with other transactions in which it participated in 2005, 2006, 2008, 2009 and 2010. (Id.) In each of these transactions, Conn Vu, who replaced McNabola as an officer and director of First Active, used the distressed debt that First Active had obtained to offset gains otherwise incurred. (Id.) First Active had no legitimate business purpose and was used solely to facilitate such illegal tax avoidance schemes. (Id.)

On August 28, 2003, Fortrend sent Plaintiff – in Nevada – an amendment of the letter of intent. (App. Ex. D; Tricarichi Aff. ¶ 6) The amendment extended the exclusivity period for the proposed transaction in order to facilitate the Parties' ongoing negotiations. (Id.) In the transaction's final structure, Fortrend would use its affiliate Nob Hill (of which McNabola was the president) as the intermediary company to purchase the Westside stock. (Cmplt. ¶ 42) Nob Hill's sole shareholder was Fortrend affiliate Millennium. (Id.) Plaintiff and Fortrend / Nob Hill executed the stock purchase agreement, and the transaction closed, on September 9, 2003. (Cmplt. ¶ 54; App. Ex. E)

In the stock purchase agreement, which McNabola signed, Nob Hill represented that Westside would remain in existence for at least five years after the closing and "at all times be engaged in an active trade or business." (Cmplt. ¶ 42; App. Ex. E at § 5.2(b)) Nob Hill also provided purported tax warranties. The agreement represented that Nob Hill would "cause … [Westside] to satisfy fully all United States … taxes, penalties and interest required to be paid by … [Westside] attributable to income earned during the [2003] tax year." (Cmplt. ¶ 42; App. Ex. E at § 5.2(a)) Nob Hill agreed to indemnify Plaintiff in the event of liability arising from breach of its representation to satisfy Westside's 2003 tax liability, and represented that it had sufficient assets to cover this indemnification obligation. (Cmplt. ¶ 42; App. Ex. E) Nob Hill further warranted that it had no intention of causing Westside to engage in an IRS reportable transaction. (Id.) Plaintiff relied on these material representations and warranties in deciding to proceed with the Fortrend transaction. (Cmplt. ¶ 43) Unbeknownst to Plaintiff, however, these representations and warranties were false when made; and they were not subsequently fulfilled. (Id.) Such provisions were without any value because the indemnitor/purchaser had insufficient assets with which to satisfy them when they were made and going forward, and simply intended to misappropriate Westside's funds, offset its tax liabilities with a bogus deduction via a reportable transaction, and conduct no business of substance. (Id.)

As part of the closing on September 9, Nob Hill's Rabobank account was credited with the $29.9 million Rabobank loan proceeds; Nob Hill transferred the purchase price from its Rabobank account into the Rabobank account that Plaintiff had been required to open; Nob Hill acquired Plaintiff's Westside stock; Plaintiff's resignation as an officer and director of Westside became effective (with Plaintiff being replaced by Fortrend personnel); Nob Hill repaid the Rabobank loan; Nob Hill paid Rabobank a $150,000 fee; and Nob Hill merged into Westside with Westside being the surviving corporation. (Cmplt. ¶¶ 54-55) For their part, Rabobank and Utrecht proceeded with the transaction and the loan to Fortrend (Nob Hill) despite knowing that the transaction was a Midco deal that constituted a reportable transaction considered by the IRS to be an improper tax-avoidance mechanism. (Id. ¶¶ 49-51)

Thereafter, Westside's remaining funds, rather than being used to facilitate Fortrend's debt-collection business as represented, were drained by Fortrend's owners. (Cmplt. ¶ 55) Westside – with Fortrend's Conn Vu now at the helm – proceeded over the next seven months to siphon those funds from Westside's bank account. (Id.) Westside did not engage in the debt-collection business as Fortrend represented to Plaintiff it would. (Id.)

G. Notice 2001-16

Notwithstanding multiple representations to Plaintiff that the Fortrend transaction was proper under the tax laws, Defendants and Fortrend actually knew that on January 18, 2001 the IRS had issued Notice 2001-16. (Cmplt. ¶ 56) The Notice describes transactions where a corporation disposes of substantially all of its assets and then the corporation's shareholders sell their stock to another party who seeks favorable tax treatment. (Id.) Notice 2001-16 states that any transactions that are the same as, or substantially similar to, those described in the Notice are "listed transactions." (Id.) Listed transactions are deemed by the IRS to be abusive tax shelters. (Id.) Persons failing to report these tax shelters may be subject to penalties. (Id.) The IRS concluded in Notice 2001-16 that it "may challenge the purported tax results of these transactions on several grounds." (Id.) It further warned that it "may impose penalties on participants in these transactions." (Id.) Defendants and Fortrend failed to properly advise Plaintiffs about the 2001 Tax Notice and its significance for the Fortrend transaction. (Id. ¶¶ 57-58)

H. Fortrend Closes the Loop with the DAD Scheme Made Possible by Seyfarth.

Unbeknownst to Plaintiff, after the closing of the stock purchase, the second-stage DAD transaction proceeded. (Cmplt. ¶ 69) On November 6, 2003, Millennium contributed to Westside a subset of the Japanese debt portfolio, consisting of two defaulted loans (the "Aoyama Loans"). (Id.) The Aoyama Loans had a purported tax basis of $43,323,069. (Id.) Between November 6 and December 31, 2003, Westside wrote off the Aoyama Loans as worthless. (Id.) On its Form 1120, U.S. Corporation Income Tax Return, for 2003, Westside claimed a bad debt deduction of $42,480,622 on account of that write-off. (Id.) Westside did not pay any amount of taxes. (Id.)

I. Plaintiff Is Left Holding the Bag as a Result of the Foregoing Events.

The IRS audited Westside's 2003 tax return. (Cmplt. ¶ 75) At the conclusion of the audit, the IRS disallowed the $42,480,622 bad-debt deduction that Fortrend had claimed based on the Seyfarth opinion letter. (Id.) The IRS sent a notice of deficiency to Westside determining a deficiency of $15,186,570 and penalties totaling $6,012,777 under the tax code, but Westside – which had no assets or resources by that point as a result of Fortrend's actions – did not pay these amounts and did not petition the U.S Tax Court for relief. (Id. ¶¶ 75-76)

The IRS then proceeded with a transferee liability examination concerning Westside's 2003 tax liabilities. (Cmplt. ¶ 77) Transferee liability is a method of imposing tax liability on a person (here, Plaintiff) other than the taxpayer (here, Westside) that is directly liable for the tax. (Id.) As a result of its examination, the IRS determined that Plaintiff had transferee liability for Westside's tax deficiency and penalties. (Id. ¶ 78) (Years before, Plaintiff had timely paid the taxes on the long-term gain incurred in 2003 as a result of the sale of his Westside stock.) (Id.)

Plaintiff petitioned the U.S. Tax Court for review of the IRS notice of liability. (Cmplt. ¶ 79) The matter was litigated and proceeded to trial. (Id.) After trial, the Tax Court found in October 2015 that – contrary to what Defendants and Fortrend had led Plaintiff to believe – the Fortrend transaction was an improper Midco transaction, and Plaintiff was liable under transferee liability principles for Westside's tax deficiency and penalties totaling about $21.2 million, plus interest and interest penalties. (Id.) As a further result of Defendants' actions, Plaintiff has been required to spend millions more in fees and expenses. (Id. ¶ 80) All told, Plaintiff has suffered tens of millions of dollars in damages as a result of Defendants' actions. (Id.)

J. Seyfarth's Other Contacts with Nevada

The foregoing shows that Seyfarth was part of a conspiracy that was aimed at – and that succeeded at – defrauding (among other victims) Plaintiff in Nevada. As discussed below, these actions mean that this Court has personal jurisdiction over Seyfarth.

In addition to Seyfarth's contacts with Nevada via this conspiracy, based only on publicly available information, Seyfarth generally does business with this State. These contacts include Seyfarth's representation of clients in significant Nevada matters; regular attendance by Seyfarth lawyers at professional events in Nevada; and Seyfarth publications addressing Nevada law; not to mention the admission of numerous Seyfarth lawyers in Nevada courts.

While Plaintiff obviously does not have access to all information regarding Seyfarth's activities in Nevada, a search of Seyfarth's website, and of other information available online, gives an indication of the scope of those activities. (Brooks Aff. ¶¶ 9-10) Searches on the firm's website using the terms "Vegas" and "Nevada" produce numerous hits, as do other online searches. (Id.) Among the results are the following items:

- Seyfarth's involvement in a "blockbuster" real estate transaction where it represented TIAA-CREF in the purchase of the Grand Canal/Palazzo in Las Vegas for $725 million. (App. Ex. J)

- Seyfarth's representation of a Fortune 100 financial services company in the acquisition of a 50 percent interest in a $1.5 billion retail center in Las Vegas, as well as negotiation of related property management and leasing agreements. (App. Ex. K)

- Seyfarth attorneys making presentations and/or receiving awards at numerous conferences and trade shows in Las Vegas. (App. Ex. L)

- Seyfarth's ongoing representation, in the United States District Court for the District of Nevada, of defendant/counterclaimant Randstad Professionals US, LP in *Count's Kustoms, LLC et al. v. Frontiera*, Case No. 2:16-cv-00910-JAD-GWF. (App. Ex. M)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of plaintiffs in Allstate Ins. Co. v. Nassiri, Case No. 2:08-cv-00369-JCM-GWF. (App. Ex. N)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the lead defendant in *Pennington v. Int'l House of Pancakes,* LLC, Case No. 2:15-cv-0949-RCJ-CWH. (App. Ex. O)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendants in *Impact Marketing Int'l, LLC v. Big O Tires,* LLC, Case No. 2:10-CV-01809-RLH-VCF. (App. Ex. P)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendant in *UBICOMM, LLC v. Frederick's of Hollywood* Stores, Inc., Case No. 2:13-cv-01299-JAD-VCF. (App. Ex. Q)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the lead defendant in Christiano v. Eagle Materials, Case No. 3:14-cv-00266-LRH-WGC. (App. Ex. R)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendants in Meritage Homes of Nevada, Inc. v. FNBN-RESCON I, LLC, Case No. 2:12-cv-01425 RFB-PAL. (App. Ex. S)

- Seyfarth's representation, in the United States District Court for the District of Nevada, of the plaintiffs in *Trump Ruffin Comm'l LLC v. Local Joint Exec.* Bd. Las Vegas, Case No. 2:15-cv-01984-GMN-GWF. (App. Ex. T)

- Seyfarth partner Jerome F. Buch's representation of a client in a matter involving the Venetian Casino & Hotel in Las Vegas. (App. Ex. U)

- Seyfarth counsel Heath A. Havey's maintaining admission to the Nevada bar. (App. Ex. V)

- Seyfarth partners Mark P. Grajski, Aaron R. Lubeley and John D. Meer's admission to the bar of the United States District Court for the District of Nevada. (App. Ex. W)

- Seyfarth's various publications regarding Nevada law and/or court rulings. (App. Ex. X)

As discussed further below, such contacts support a finding that this Court has personal jurisdiction over Seyfarth in Nevada.

III. ARGUMENT

"Once a defendant challenges personal jurisdiction, the plaintiff may … make a prima facie showing of personal jurisdiction prior to trial and then prove jurisdiction by a preponderance of evidence at trial." Trump v. Eighth. Dist. Ct., 109 Nev. 687, 692, 857 P.2d 740, 743 (1993). "The plaintiff must produce some evidence in support of all facts necessary for a finding of personal jurisdiction…. In determining whether a prima facie showing has been made, the district court is not acting as a fact finder. It accepts properly supported proffers of evidence by a plaintiff as true." Id. at 692-93, 857 P.2d at 744 (citations omitted). "Where possible, a Nevada resident should be able to obtain judicial redress in the most convenient, cost-effective manner, which in this case would be within Nevada." Id. at 703, 857 P.2d at 750.

A. Seyfarth Was Part of a Conspiracy Targeting Plaintiff in Nevada, and Is Thus Subject to Personal Jurisdiction in This State.

As set forth above and in the Complaint, Seyfarth played an important role in a conspiracy aimed at defrauding Mr. Tricarichi, a resident of Nevada. Seyfarth tries to ignore this fact, leaving the point for the very end of its brief. And even then, Seyfarth disregards controlling Nevada Supreme Court authority binding it to this court's jurisdiction.

In Davis v. Eighth Jud. Dist., 97 Nev. 332, 629 P.2d 1209 (1981), the Nevada Supreme Court held that Nevada courts have personal jurisdiction over out-of-state defendants who participate in a conspiracy to injure a Nevada resident. In Davis, the administrators of the estate of Howard Hughes sued a "group of aides, physicians, attorneys, and business executives who had attended the late Hughes during the last years of his life. The complaint alleged essentially that the group conspired to seize control of the Hughes empire for their own financial gain by taking advantage of the trust and confidence Hughes had placed in them." Id. at 334, 629 P.2d at 1211. Certain out-of-state defendants filed motions arguing that there was no personal jurisdiction over them in Nevada. Id. The Nevada Supreme Court rejected this argument:

> A state has power to exercise judicial jurisdiction over an individual who causes effects in the state by an omission or act done elsewhere with respect to causes of action arising from these effects…. We conclude that it is reasonable and constitutionally permissible to require the … defendants to appear and defend their activities in Nevada where the alleged injuries occurred.

Id. at 338-39, 629 P.2d at 1213 (citation and internal quotations omitted). As the Nevada high court held, its decision in Davis abides by the "traditional notions of fair play and substantial justice" articulated by the U.S. Supreme Court's personal jurisdiction jurisprudence. Id. at 338-30, 629 P.2d at 1213-14 (citing World Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 292 (1980); International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945)). As the court further noted, "[T]he burden on the defendant, while always a primary concern, will in an appropriate case be considered in light of other relevant factors, including the forum State's interest in adjudicating the dispute, … the plaintiff's interest in obtaining convenient and effective relief, [and] the interstate judicial system's interest in obtaining the most efficient resolution of controversies…." Id. at 339, 629 P.2d at 1214 (quoting World Wide Volkswagen, supra).

Seyfarth, like the out-of-state defendants in Davis, was an active participant in a conspiracy aimed at defrauding and injuring Plaintiff, a Nevada resident. Over and over again, Seyfarth and its co-conspirators knowingly directed their actions toward Plaintiff in Nevada. As set forth above:

- Plaintiff became a Nevada resident in May 2003. At or about that time, Plaintiff's company Westside netted $40 million in settlement proceeds from litigation with competing cellular providers.

- Plaintiff was introduced to Fortend, which proposed buying Plaintiff's stock in Westside via an intermediary company, to become part of Fortrend's distressed-debt business. Fortrend and other co-conspirators made various misrepresentations and material omissions to Plaintiff in connection with this proposal.

- Shortly before joining Seyfarth in July 2003, Rogers invented the DAD scheme.

- In July 2003, Fortrend sent Plaintiff – in Nevada – a letter of intent regarding the proposed stock purchase. Fortrend and Plaintiff proceeded to negotiate the proposed purchase, continuing to misrepresent matters to Plaintiff.

- On August 13, 2003, Fortrend asked defendant Rabobank for a $29.9 million loan to finance the stock purchase. Fortrend and Rabobank had previously participated in numerous Midco transactions together. Rabobank knew that such transactions were improper for tax purposes, but did not disclose that to Plaintiff.

- On or about August 20, 2003, Plaintiff received documents to open an account at Rabobank, which he returned to Rabobank in early September. The documents reflect Plaintiff's residence in Nevada, where Fortrend and Rabobank were doing, and continued to do, business with Plaintiff.

- On or about August 21, 2003, Seyfarth sent Fortrend affiliate Millenium the opinion letter supporting the DAD scheme that Fortrend planned to employ to write off certain Japanese loans Fortrend would contribute to Westside, in order to "offset" the taxable gain on Westside's settlement proceeds. Seyfarth received a substantial fee for the letter.

- On August 28, 2003, Fortrend sent Plaintiff, again in Nevada, an amended letter of intent to allow for further negotiations and extend the time for completion of the transaction.

- On September 9, 2003, Fortrend and Plaintiff executed a stock purchase agreement; the purchase price changed hands via the parties' Rabobank accounts; and the deal closed.

- After the closing, Fortrend drained Westside of its funds and did not engage in the distressed-debt business in which it had told Plaintiff it would engage.

- In late 2003, with Westside now a stripped-out shell, Fortrend – relying on Seyfarth's opinion letter – contributed the Japanese loans to Westside; wrote off those loans as worthless; claimed a bad debt deduction for the loans on Westside's tax return; and failed to pay any amount of taxes – despite its prior promises to the contrary.

Pursuant to Davis, such activity subjects Seyfarth to the jurisdiction of the Nevada courts.

Seyfarth seeks to avoid this inevitable conclusion by repeatedly uttering the mantras, "None of this activity involved Seyfarth…. None of this alleged activity took place in Nevada…." or words to that effect. (See, e.g., Mot. at 1, 4.) But as the foregoing summary indicates, Seyfarth's actions were an integral part of a scheme whereby Fortrend and the Defendants defrauded Plaintiff – in Nevada – and lined their own pockets in the process. Indeed, numerous courts have dismissed arguments similar to Seyfarth's and found that conspiracy personal jurisdiction exists. See, e.g., Cleft of the Rock Foundation v. Wilson, 992 F.Supp. 574, 583-84 (E.D.N.Y. 1998) (denying motion to dismiss by attorney defendant who was alleged to have "facilitated the conspiracy by laundering the proceeds of the scheme through his attorney trust account;" attorney argued that he "neither knew nor had any contacts with any plaintiff," but court found that "plaintiffs have alleged facts sufficient to establish [defendant's] co-conspirator status for purposes of conferring personal jurisdiction"); Olson v. Jenkens & Gilchrist, 461 F.Supp. 2d 710, 724-26 (N.D.Ill. 2006) (finding personal jurisdiction over law firm that participated in tax shelter conspiracy); Madanes v. Madanes, 981 F.Supp. 241, 261 (S.D.N.Y. 1997) (finding jurisdiction over foreign corporation whose role in conspiracy was to conceal funds). The two opinion-letter cases that Seyfarth cites[5] are entirely inapposite; neither involved a conspiracy, as this case does. Seyfarth's argument appears to be that it is sheltered from personal jurisdiction in Nevada because Fortrend and the other defendants had the direct contact with Plaintiff in Nevada. But the law does not support this argument. See Khan v. Gramercy Advisors, LLC, 2016 IL App (4th) 150435 ¶ 159 (2016) ("Minimum contacts do not have to be direct. A person can purposefully make minimum contacts with the forum state through someone else.") (citing Asahi Metal Ind. Co. v. Super. Ct.

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[5] Rockwood Select Asset Fund XI (6)-1, LLC v. Devine, Millimet & Branch, 750 F.3d 1178 (10th Cir. 2014); Trierweiler v. Croxton and Trench Holding Corp., 90 F.3d 1523 (10th Cir. 1996).

of Calif., 480 U.S. 102, 112 (1987), and finding personal jurisdiction over participants in tax-shelter conspiracy); Trump, 109 Nev. at 695, 857 P.2d at 745 (plaintiff "needed only to make a prima facie case … that Ribis acted as Trump's … agent and therefore that Ribis' contacts with Nevada were attributable to Trump. We conclude that [plaintiff] made the required showing.").

Seyfarth relegates the Nevada Supreme Court's controlling decision in Davis to a brief footnote, claiming that Davis "does not survive" the U.S. Supreme Court's ruling in Walden v. Fiore, 134 S.Ct. 1115 (2014), and similar cases. (Mot. at 11 n.3) But Walden and the other cases cited by Seyfarth[6] do not even mention Davis and are entirely distinguishable – none of these cases involved a conspiracy. Indeed, numerous courts have found conspiracy personal jurisdiction to exist after Walden (and the other cases) were decided. See, e.g., Best Chairs Inc. v. Factory Direct Wholesale, LLC, 121 F.Supp. 3d 828, 837, 839-40 (S.D. Ind. 2015) (citing Walden and finding conspiracy personal jurisdiction); First Community Bank, N.A. v. First Tennessee Bank, N.A., 2015 WL 9025241 at *11, 12, 14, 15, 27 (Tenn. 2015) (same); Khan, supra, at ¶¶ 77 et seq., 155-160 (same).

Seyfarth also argues that some federal courts in Nevada have been unfavorable to the conspiracy theory of personal jurisdiction. These federal courts, of course, are not the Supreme Court of Nevada, which held that conspiracy personal jurisdiction exists in Davis.

Finally, Seyfarth argues that Plaintiff's conspiracy allegations are "bare" and "not enough" to establish jurisdiction. (Mot. at 14) Plaintiff respectfully disagrees. The Complaint and supporting documentation cited above more than adequately allege both a conspiracy and Seyfarth's role in that conspiracy.

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[6] World Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 292 (1980), and Dogra v. Liles, 129 Nev. Adv. Op. 100, 314 P.3d 952 (2013).

B. In the Alternative, Plaintiff Should Be Allowed to Proceed with Jurisdictional Discovery.

Even assuming for the sake of argument that such allegations and documentation are not sufficient, in and of themselves, to support a finding of personal jurisdiction, they certainly make a sufficient showing for the Court to allow jurisdictional discovery. See, e.g., PDL Biopharma, Inc. v. Genentech, Inc., 2011 WL 4433687 (Nev. Dist. Ct. 2011) (allowing jurisdictional discovery when plaintiff "demonstrated … a possibility it can produce facts through jurisdictional discovery" to support finding of personal jurisdiction); Consipio Holding, BV v. Private Media Group, Inc., 2011 WL 6015547 (Nev. Dist. Ct. 2011) (denying motion to dismiss without prejudice pending completion of jurisdictional discovery); Trintec Inds., Inc. v. Pedre Promotional Prods., Inc., 395 F.3d 1275 (Fed. Cir. 2005) (jurisdictional discovery appropriate where party can supplement jurisdictional allegations through said discovery); GTE New Media Svcs. Inc. v. BellSouth Corp., 199 F.3d 1343 (D.C.Cir. 2000) (same).

Here, Plaintiff has demonstrated, via the Complaint's factual allegations and underlying documentation, that Seyfarth was an active participant in the conspiracy that targeted and injured Plaintiff in Nevada. While these facts are sufficient in and of themselves to establish jurisdiction, they also suggest that there is further evidence establishing personal jurisdiction to be found if discovery proceeds on the subject. Should the Court desire further information to support a finding of conspiracy/specific jurisdiction, Plaintiff submits that, while not necessary for such a finding, such discovery would include (1) depositions of Taylor, Rogers, at least one Seyfarth representative, and potentially others, such as Fortrend; (2) document discovery from Seyfarth, Taylor, Rogers and potentially others, such as Fortrend; and (3) interrogatories, and possibly requests to admit, to Seyfarth and possibly the other parties. This discovery would focus on subjects including (a) further detail regarding the conspiracy that harmed Plaintiff, particularly Seyfarth's involvement in it; (b) creation of the DAD scheme and how that Seyfarth scheme became an integral part of the fraud in which Plaintiff was ensnared; (c) Seyfarth's relationship with, and/or retention by, Fortrend, including Seyfarth's knowledge of Fortrend's promotion of tax shelters in, e.g., Nevada; and (d) the genesis of the Seyfarth opinion letter and Seyfarth's knowledge regarding how that opinion fit into the broader scheme. Accordingly, to the extent the Court finds Plaintiff's present showing inadequate to establish personal jurisdiction, Plaintiff requests an opportunity to proceed with such jurisdictional discovery.

C. Seyfarth Has Submitted Itself to General Jurisdiction in Nevada.

In order to argue against general personal jurisdiction in Nevada, Seyfarth ignores the true extent of its contacts with this State and thus, not surprisingly, contends that its contacts with Nevada are too limited for such jurisdiction to exist. Seyfarth focuses on the fact that one of its attorneys, Heath Havey, is a member of the Nevada bar. But Seyfarth makes no mention of its other, more pervasive contacts with this State, which are set forth above in section J of the Factual Background. These include Seyfarth's representation of clients in significant Nevada matters; regular attendance by Seyfarth lawyers at professional events in Nevada; and Seyfarth publications addressing Nevada law; not to mention the admission of various Seyfarth lawyers in Nevada courts. The totality of such contacts establishes that Seyfarth has purposefully availed itself of the Nevada jurisdiction, and that it is thus appropriate for Seyfarth to proceed as a defendant in a Nevada court. See, e.g., Resnick v. Manfredy, 52 F.Supp.2d 462, 469 (E.D.Pa. 1999) (jurisdiction was proper over 100-attorney firm whose records indicated it had serviced a total of 54 clients in state, some of whom were current clients); K/S Shadow Mountain Partners I v. Parsons Behle & Latimer, 2007 WL 987289 (Cal. Ct. App. 2007) (finding both general and specific jurisdiction over Utah law firm); Patent Rights Protection Group, LLC v. Video Gaming Tech., Inc., 603 F.3d 1364, 1370 (Fed. Cir. 2010) (defendants' "admitted presence at numerous trade shows in Nevada indicates that … neither company faces a particularly onerous burden in defending itself in Nevada"); Zuffa, LLC v. Showtime Networks, Inc., 2007 WL 2406812 at *4-6 (D.Nev. 2007) (defendant's participation in conventions in Nevada, among other things, "suggest[s] that [defendant] should have anticipated being haled into the forum").

D. The Court Should At Least Allow Discovery Regarding Seyfarth's General Contacts with Nevada.

The foregoing information regarding Seyfarth's general contacts with Nevada was obtained by searching Seyfarth's website and other information available online. While, again, these facts are sufficient in and of themselves to establish jurisdiction, they also suggest that there is further evidence – currently unavailable to Plaintiff but in the possession of Seyfarth and others – establishing personal jurisdiction to be found if discovery proceeds on the subject. Accordingly, discovery regarding such evidence would be appropriate if the Court is of the view that Plaintiff has not yet come forward with enough to support a finding of personal jurisdiction. See, e.g., PDL Biopharma, 2011 WL 4433687 (allowing jurisdictional discovery); Consipio Holding, 2011 WL 6015547 (denying motion to dismiss without prejudice pending completion of jurisdictional discovery); Trintec, 395 F.3d at 1283 (jurisdictional discovery appropriate where party can supplement jurisdictional allegations through said discovery); GTE New Media, 199 F.3d at 1351-52 (same); Patent Rights, 603 F.3d at 1372 (district court's denial of jurisdictional discovery constituted abuse of discretion); Zuffa, supra (allowing jurisdictional discovery). Should the Court desire further information to support a finding of general jurisdiction, Plaintiff submits that, while not necessary for such a finding, such discovery would include deposing at least one Seyfarth representative; document discovery from Seyfarth; interrogatories, and possibly requests to admit, to Seyfarth; and possible follow-up discovery to other parties. This discovery would focus on the full scope of activity by Seyfarth and its attorneys in Nevada, including representation of clients in Nevada and/or related to Nevada matters or property; representation of clients in litigation pending in the Nevada state or federal courts; representation of clients in matters pending before Nevada administrative agencies; travel to Nevada by Seyfarth personnel in connection with such representations or otherwise; revenue generated from such representations; attendance by Seyfarth lawyers at professional events in Nevada; solicitation of clients in Nevada; Seyfarth advertising in Nevada; and Seyfarth publications and/or opinions addressing Nevada law. If the Court is not inclined to find personal jurisdiction on the current record, Plaintiff asks that he be allowed to take discovery regarding such matters in order to more fully develop the record.

IV. CONCLUSION

WHEREFORE, for all the foregoing reasons, Plaintiff Michael A. Tricarichi respectfully requests that the Court DENY Defendant Seyfarth Shaw's motion to dismiss for lack of jurisdiction, or in the alternative, allow Plaintiff jurisdictional discovery and a further response to Defendant's motion.

SPERLING & SLATER, P.C.

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(*Pro Hac Vice*)
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HUTCHISON & STEFFEN, LLC
Mark A. Hutchison
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Todd W. Prall
10080 West Alta Drive, Suite 200
Las Vegas, NV 89145

Attorneys for Plaintiff Michael A. Tricarichi

CERTIFICATE OF SERVICE

Pursuant to NRCP 5(b), I certify that I am an employee of Hutchison & Steffen, LLC and that on this 26th day of August, 2016, I caused the document entitled **PLAINTIFF'S OPPOSITION TO DEFENDANT SEYFARTH SHAW'S MOTION TO DISMISS FOR LACK OF JURISDICTION** to be served on the following by Electronic Service to:

ALL PARTIES ON THE E-SERVICE LIST

/s/ Madelyn B. Carnate-Peralta
An employee of Hutchison & Steffen, LLC

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CLERK OF THE COURT

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Attorneys for Plaintiff

DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiff, v. PRICEWATERHOUSE COOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR, Defendants.	CASE NO. A-16-735910-B DEPT NO. XV **AFFIDAVIT OF MICHAEL A. TRICARICHI IN SUPPORT OF PLAINTIFF'S OPPOSITION TO DEFENDANT SEYFARTH SHAW'S MOTION TO DISMISS FOR LACK OF JURISDICTION** JURY TRIAL DEMANDED

I, Michael A. Tricarichi, having first been duly sworn upon oath, hereby depose and state as follows:

1. I am over 18 years of age, and otherwise am fully competent to execute this affidavit. I have personal knowledge of all of the facts stated herein.

2. I am the Plaintiff in the above-captioned case.

3. I have been a resident of Las Vegas, Nevada, since May 2003.

4. Exhibit A in the Appendix of Exhibits in Support of Plaintiff's Opposition to Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction (the "Appendix") is a copy of the letter of intent that Fortrend affiliate Nob Hill Holdings, Inc. sent to me in Las Vegas, Nevada on or about July 22, 2003.

5. Exhibit C in the Appendix is a copy of Rabobank account opening documents which I received on or about August 20, 2003, and which I returned to Rabobank in early September 2003. The documents reflect my residence in Nevada.

6. Exhibit D in the Appendix is a copy of an amendment of the letter of intent that Fortrend affiliate Nob Hill Holdings, Inc. sent to me in Las Vegas, Nevada on or about August 28, 2003.

7. Exhibit E in the Appendix is a copy of the Stock Purchase Agreement between Nob Hill Holdings, Inc., as buyer, and myself, as seller, dated as of September 9, 2003.

Further affiant sayeth not.

Michael A. Tricarichi

Subscribed and sworn to before me

this 25th day of August, 2016.

Kevin J. Brennan, Esq. (S/C#0075699)
my commission has no expiration date.
O.R.C. §147.03

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Attorneys for Plaintiff

DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiff, v. PRICEWATERHOUSE COOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR, Defendants.	CASE NO. A-16-735910-B DEPT NO. XV **AFFIDAVIT OF THOMAS D. BROOKS IN SUPPORT OF PLAINTIFF'S OPPOSITION TO DEFENDANT SEYFARTH SHAW'S MOTION TO DISMISS FOR LACK OF JURISDICTION** JURY TRIAL DEMANDED

I, Thomas D. Brooks, having first been duly sworn upon oath, hereby depose and state as follows:

1. I am over 18 years of age, and otherwise am fully competent to execute this affidavit. I have personal knowledge of all of the facts stated herein.

2. I am one of the attorneys for the Plaintiff in the above-captioned case.

3. In connection with drafting both the Complaint in this matter, and Plaintiff's Opposition to Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction, I located and reviewed various documents, as discussed further below. Submitted with this affidavit is the Appendix of Exhibits in Support of Plaintiff's Opposition to Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction (the "Appendix").

4. Exhibit B in the Appendix is a copy of an August 13, 2003, Fortrend request to Rabobank for a $29.9 million short-term loan. The document was a joint exhibit (Exhibit 34-J) in *Michael A. Tricarichi v. Commissioner of Internal Revenue*, U.S. Tax Court Docket No. 23630-12, which was tried before that court in June 2014.

5. Exhibit F in the Appendix is a copy of the Complaint in *U.S. v. Timothy H. Vu*, Case No. 3:15-cv-01807, in the U.S. District Court for the Northern District of California, available on that court's electronic filing site.

6. Exhibit G in the Appendix is a copy of a Joint Status Report in *U.S. v. Timothy H. Vu*, Case No. 3:15-cv-01807, in the U.S. District Court for the Northern District of California, available on that court's electronic filing site.

7. Exhibit H in the Appendix is a copy of the Complaint in *U.S. v. John E. Rogers et al.*, Case No. 1:10-cv-07068, in the U.S. District Court for the Northern District of Illinois, available on that court's electronic filing site.

8. Exhibit I in the Appendix is a copy of the Stipulated Final Judgment of Permanent Injunction and Order against John E. Rogers in *U.S. v. John E. Rogers et al.*, Case

No. 1:10-cv-07068, in the U.S. District Court for the Northern District of Illinois, available on that court's electronic filing site.

9. After receiving Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction, I undertook searches on Seyfarth's website (www.seyfarth.com) using the terms "Nevada" and "Vegas." The results of these searches included links to the following Seyfarth website entries (some of which have been marked to point out the most pertinent information):

a. A March 24, 2014 entry noting Seyfarth's involvement in a "blockbuster" real estate transaction where it represented TIAA-CREF in the purchase of the Grand Canal/Palazzo in Las Vegas for $725 million. (Exhibit J in the Appendix)

b. A January 1, 2014 entry noting Seyfarth's representation of a Fortune 100 financial services company in the acquisition of a 50 percent interest in a $1.5 billion retail center in Las Vegas, as well as negotiation of related property management and leasing agreements. (Exhibit K in the Appendix)

c. Several entries reflecting Seyfarth attorneys making presentations and/or receiving awards at numerous conferences and trade shows in Las Vegas. (Group Exhibit L in the Appendix)

d. Exhibit U in the Appendix is the biography of Seyfarth partner Jerome F. Buch, reflecting his representation of a client in a matter involving the Venetian Casino & Hotel in Las Vegas.

e. Exhibit V in the Appendix is the biography of Seyfarth counsel Heath A. Havey, reflecting his maintaining admission to the Nevada bar.

f. Group Exhibit W in the Appendix includes the biographies of Seyfarth partners Mark P. Grajski, Aaron R. Lubeley and John D. Meer, which reflect their admission to the bar of the United States District Court for the District of Nevada.

g. Group Exhibit X in the Appendix includes various Seyfarth publications regarding Nevada law and/or court rulings.

10. After receiving Defendant Seyfarth Shaw's Motion to Dismiss for Lack of Jurisdiction, I also undertook searches on Westlaw for decisions in Nevada cases where Seyfarth had appeared as counsel. After finding such decisions, I obtained the online court dockets for those cases, which reflect the following:[1]

a. Seyfarth's ongoing representation, in the United States District Court for the District of Nevada, of defendant/counterclaimant Randstad Professionals US, LP in *Count's Kustoms, LLC et al. v. Frontiera*, Case No. 2:16-cv-00910-JAD-GWF. (Exhibit M in the Appendix)

b. Seyfarth's representation, in the United States District Court for the District of Nevada, of plaintiffs in *Allstate Ins. Co. v. Nassiri*, Case No. 2:08-cv-00369-JCM-GWF. (Exhibit N in the Appendix)

c. Seyfarth's representation, in the United States District Court for the District of Nevada, of the lead defendant in *Pennington v. Int'l House of Pancakes, LLC*, Case No. 2:15-cv-0949-RCJ-CWH. (Exhibit O in the Appendix)

d. Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendants in *Impact Marketing Int'l, LLC v. Big O Tires, LLC*, Case No. 2:10-CV-01809-RLH-VCF. (Exhibit P in the Appendix)

e. Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendant in *UBICOMM, LLC v. Frederick's of Hollywood Stores, Inc.*, Case No. 2:13-cv-01299-JAD-VCF. (Exhibit Q in the Appendix)

[1] Again, some of these items have been marked to point out the most pertinent information.

f. Seyfarth's representation, in the United States District Court for the District of Nevada, of the lead defendant in *Christiano v. Eagle Materials*, Case No. 3:14-cv-00266-LRH-WGC. (Exhibit R in the Appendix)

g. Seyfarth's representation, in the United States District Court for the District of Nevada, of the defendants in *Meritage Homes of Nevada, Inc. v. FNBN-RESCON I, LLC*, Case No. 2:12-cv-01425 RFB-PAL. (Exhibit S in the Appendix)

h. Seyfarth's representation, in the United States District Court for the District of Nevada, of the plaintiffs in *Trump Ruffin Comm'l LLC v. Local Joint Exec. Bd. Las Vegas*, Case No. 2:15-cv-01984-GMN-GWF. (Exhibit T in the Appendix)

Further affiant sayeth not.

Thomas D. Brooks

Subscribed and sworn to before me

this 25th day of August, 2016.

Official Seal
Jacqueline Gonzalez
Notary Public State of Illinois
My Commission Expires 04/18/2019

IN THE SUPREME COURT OF THE STATE OF NEVADA

MICHAEL A. TRICARICHI,

Appellant,

v.

COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO. and SEYFARTH SHAW LLP,

Respondents.

Supreme Court Case No. 73175

District Court Case No. A-16-735910-B

APPEAL

From the Eighth Judicial District Court, Department XV
Clark County, Nevada
Hon. Joe Hardy, District Court Judge

JOINT APPENDIX
Volume I

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CHRONOLOGICAL TABLE OF CONTENTS TO JOINT APPENDIX

Volume I

Volume II

Volume III

Volume IV

Volume V

Volume VI

Volume VII

Volume VIII

Volume IX

ALPHABETICAL TABLE OF CONTENTS TO JOINT APPENDIX

CERTIFICATE OF SERVICE

Pursuant to NRCP 5(b), I certify that I am an employee of Hutchison & Steffen, LLC and that on this 19th day of September, 2017, I caused the document entitled JOINT APPENDIX VOLUME I to be served on the following by Electronic Service to:

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Ryan Lower
Steve Morris

Service by regular U.S. Mail as follows:

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Attorneys for Respondents Coöperatieve Rabobank U.A. and Utrecht-America Finance Co.

An employee of HUTCHISON & STEFFEN, LLC

BUSINESS COURT CIVIL COVER SHEET

A-16-735910-B

Clark County, Nevada

XV

Case No. ______________
(Assigned by Clerk's Office)

I. Party Information *(provide both home and mailing addresses if different)*

Plaintiff(s) (name/address/phone):	Defendant(s) (name/address/phone):
MICHAEL A. TRICARICHI	PRICEWATERHOUSE COOPERS, LLP, et al.
Attorney (name/address/phone):	Attorney (name/address/phone):
Mark A. Hutchison, Esq., Todd L. Moody, Todd W. Prall Hutchison & Steffen, LLC, 10080 W. Alta Drive, Suite 200, Las Vegas, NV 89145, Tel: 702-385-2500	

II. Nature of Controversy *(Please check the applicable boxes for both the civil case type and business court case type)*

☐ Arbitration Requested

Civil Case Filing Types

Real Property

Landlord/Tenant
- ☐ Unlawful Detainer
- ☐ Other Landlord/Tenant

Title to Property
- ☐ Judicial Foreclosure
- ☐ Other Title to Property

Other Real Property
- ☐ Condemnation/Eminent Domain
- ☐ Other Real Property

Construction Defect & Contract

Construction Defect
- ☐ Chapter 40
- ☐ Other Construction Defect

Contract Case
- ☐ Uniform Commercial Code
- ☐ Building and Construction
- ☐ Insurance Carrier
- ☐ Commercial Instrument
- ☐ Collection of Accounts
- ☐ Employment Contract
- ☐ Other Contract

Torts

Negligence
- ☐ Auto
- ☐ Premises Liability
- ☐ Other Negligence

Malpractice
- ☐ Medical/Dental
- ☐ Legal
- ☐ Accounting
- ☐ Other Malpractice

Other Torts
- ☐ Product Liability
- ☒ Intentional Misconduct
- ☐ Employment Tort
- ☐ Insurance Tort
- ☐ Other Tort

Civil Writs
- ☐ Writ of Habeas Corpus
- ☐ Writ of Mandamus
- ☐ Writ of Quo Warrant
- ☐ Writ of Prohibition
- ☐ Other Civil Writ

Judicial Review/Appeal/Other Civil Filing

Judicial Review
- ☐ Foreclosure Mediation Case

Appeal Other
- ☐ Appeal from Lower Court

Other Civil Filing
- ☐ Foreign Judgment
- ☐ Other Civil Matters

Business Court Filing Types

CLARK COUNTY BUSINESS COURT
- ☐ NRS Chapters 78-89
- ☐ Commodities (NRS 91)
- ☐ Securities (NRS 90)
- ☐ Mergers (NRS 92A)
- ☐ Uniform Commercial Code (NRS 104)
- ☐ Purchase/Sale of Stock, Assets, or Real Estate
- ☐ Trademark or Trade Name (NRS 600)
- ☐ Enhanced Case Management
- ☒ Other Business Court Matters

WASHOE COUNTY BUSINESS COURT
- ☐ NRS Chapters 78-88
- ☐ Commodities (NRS 91)
- ☐ Securities (NRS 90)
- ☐ Investments (NRS 104 Art.8)
- ☐ Deceptive Trade Practices (NRS 598)
- ☐ Trademark/Trade Name (NRS 600)
- ☐ Trade Secrets (NRS 600A)
- ☐ Enhanced Case Management
- ☐ Other Business Court Matters

29th Apr 2016
Date

Signature of initiating party or representative

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CLERK OF THE COURT

COMP

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Todd L. Moody (5430)
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Attorneys for Plaintiff

DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI,	CASE NO. A-16-735910-B
Plaintiff,	DEPT NO. XV
v.	**COMPLAINT**
PRICEWATERHOUSECOOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR,	BUSINESS COURT MATTER
	JURY TRIAL DEMANDED
Defendants.	EXEMPT FROM ARBITRATION

NATURE OF THE CASE

1. Plaintiff, Michael Tricarichi, built a cellular telephone business from the ground up and preserved that business through years of litigation necessitated by the illegal trade practices of several larger, competing cellular providers. After those competitors were found liable for their anticompetitive actions, Mr. Tricarichi and his company, Westside Cellular, resolved the damages owed for those actions via a substantial settlement. As part of the settlement, Mr. Tricarichi's company exited the cellular phone business.

2. Faced with the question of what to do next, Mr. Tricarichi considered a number of options, including investing in other ventures via Westside, of which he was the sole shareholder. During this process, Mr. Tricarichi met with representatives of another company, Fortrend International, LLC ("Fortrend"), which offered to buy all his shares in Westside and employ Westside in Fortrend's debt-collection business. Fortrend represented, among other things, that Westside's remaining assets would facilitate this business, and that it would employ Westside's tax liabilities to legitimately offset tax deductions associated with the debt-collection business. As a result, Fortrend said, Mr. Tricarichi would realize a greater net return on his investment in Westside than would otherwise be the case if Westside were liquidated. Fortrend assured Mr. Tricarichi that the proposed transaction, including its tax aspect, was legitimate and in accordance with the tax laws. Unbeknownst to Plaintiff, Fortrend's representations and assurances were knowingly false.

3. Mr. Tricarichi retained a nationally recognized accounting firm with expertise in tax matters – Defendant PricewaterhouseCoopers LLP ("PwC") – to review the proposed transaction. PwC, via its senior partner Richard Stovsky and tax experts in its National Tax Office, did so, ultimately advising Mr. Tricarichi that the proposed transaction was legitimate for tax purposes, and that Mr. Tricarichi had no ongoing exposure related to Westside once the

transaction with Fortrend was completed. Unbeknownst to Mr. Tricarichi at the time, PwC's advice in this regard was, at minimum, grossly negligent.

4. Defendant Coöperatieve Rabobank U.A. ("Rabobank") and its affiliate Utrecht-America Finance Co. ("Utrecht") facilitated the transaction by loaning Fortrend the lion's share of the purchase price and by serving as the key conduit for the funds that changed hands at closing, in return for a substantial fee – all along knowing that the transaction was improper for tax purposes.

5. Defendants Seyfarth Shaw LLP ("Seyfarth") and Graham R. Taylor – a law firm and a now-disbarred lawyer who was a Seyfarth partner at the time – unbeknownst to Plaintiff until years later, further facilitated the transaction by providing Fortrend with a legal opinion blessing steps that Fortrend would take but that Seyfarth and Taylor actually knew to be illegitimate for tax purposes – also in return for a substantial fee.

6. Despite their representations and advice to the contrary to Mr. Tricarichi, Fortrend knew and PwC should have known that the Fortrend transaction was illegitimate for tax purposes, and would result in substantial tax and penalty exposure to Mr. Tricarichi personally. Defendants Rabobank, Utrecht, Seyfarth and Taylor knew the same thing, but they failed to disclose this material information to Mr. Tricarichi and otherwise facilitated the transaction that would result in harm to him.

7. As a result of Defendants' actions, Plaintiff was forced to defend himself before the IRS and in the U.S. Tax Court, and was found liable in October 2015 for millions of dollars in back taxes, penalties and interest, which Fortrend did not pay.

8. As further set forth below, Defendants' actions constitute gross negligence, the aiding and abetting of fraud, conspiracy and violations of the Nevada racketeering statute. Defendants should be held to account for these actions and for the tens of millions of dollars in damages that Mr. Tricarichi has suffered as a result.

PARTIES

9. Plaintiff, Michael A. Tricarichi, is an individual who has resided since May 2003 in the City of Las Vegas, Clark County, Nevada. Plaintiff was previously the president and sole shareholder of a company that provided telecommunications services. As a result of Defendants' improper actions in connection with the purchase of Plaintiff's shares in that company, Plaintiff has suffered millions of dollars in liabilities that he otherwise would not have faced.

10. Defendant PricewaterhouseCoopers LLP ("PwC") is a limited liability partnership organized and existing under the law of Delaware, and is registered with the Nevada Secretary of State to do business in the State of Nevada. PwC engages in the business of tax and business consulting and has maintained a Nevada CPA License (PART-0663) since at least 1990. PwC has offices and is doing business in the City of Las Vegas, Clark County, Nevada and PwC has partners who reside in the State of Nevada. At all times material to this Complaint, PwC held itself out to the public, including to the Plaintiff, as having specialized knowledge and skill possessed by a specialist in the field of income taxes, tax savings transactions, and business tax consulting.

11. Defendant Coöperatieve Rabobank U.A. ("Rabobank"), formerly known as Coöperatieve Centrale Raiffeisen-Boerenleenbank, B.A., is a bank with principal branches in New York, New York and Utrecht, Netherlands. Rabobank is organized as a Dutch cooperative and regulated in the U.S. by the Federal Reserve Bank of New York and other agencies. Rabobank did business with Plaintiff in Nevada via its New York branch. Rabobank also has other offices throughout the world and the United States and does business in the U.S. and, on information and belief, Nevada via a number of branches, divisions and affiliates, including Defendant Utrecht-America Finance Co. During the period relevant to this complaint, Rabobank's business included financing and facilitating, via such

units, certain tax savings transactions promoted by third parties including Fortrend International, LLC and Midcoast Credit Corp. Rabobank purposefully did business with Plaintiff in Las Vegas, Clark County, Nevada in connection with such a transaction, including entering a deposit account agreement with Plaintiff in Las Vegas.

12. Defendant Utrecht-America Finance Co. ("Utrecht"), a wholly-owned subsidiary of Rabobank, is a Delaware corporation with its principal place of business in New York. Utrecht was, on information and belief, a subsidiary via which Rabobank financed transactions promoted by Fortrend, Midcoast and related entities, and financed the transaction into which Plaintiff was drawn. Utrecht purposefully directed its activities complained of herein toward and established contacts with Las Vegas, Clark County, Nevada in participating in the transaction described below.

13. Defendant Seyfarth Shaw LLP ("Seyfarth") is a law firm with its principal office in Chicago, Illinois. Seyfarth has offices and is doing business in a number of different cities and states including San Francisco, California, and, on information and belief, Nevada. At least one Seyfarth attorney maintains a Nevada bar license and on information and belief Seyfarth partners reside and/or do business in Nevada. During the period relevant to this complaint, Seyfarth's business included providing opinion letters that facilitated certain tax savings transactions promoted by third parties including Fortrend International, LLC.

14. Defendant Graham R. Taylor ("Taylor") is a disbarred lawyer residing, on information and belief, in Tiburon, California. During the period relevant to this complaint, Taylor was a partner at and agent of Seyfarth whose business included providing opinion letters that facilitated certain tax savings transactions promoted by third parties such as Fortrend International, LLC, including a transaction promoted to Plaintiff. After his involvement in this transaction, Taylor pleaded guilty in Utah federal court to conspiring to commit tax fraud, and was subsequently disbarred.

THIRD PARTIES

15. Fortrend International, LLC ("Fortrend") is, on information and belief, a defunct Delaware limited liability company that had its principal place of business in San Francisco, California. During the period relevant to this complaint, Fortrend and its affiliates were engaged in the promotion of certain tax-shelter transactions, including the transaction promoted to Plaintiff.

16. Timothy H. Vu (f/k/a Timothy H. Conn, a/k/a Timothy Conn Vu) ("Conn Vu") is an individual residing in San Francisco, California, who has held himself out as a tax practitioner. In or about March 2003, Conn Vu began working with Fortrend as its agent to promote and facilitate certain tax-shelter transactions, including the transaction promoted to Plaintiff. On information and belief, Conn Vu managed various companies acquired by Fortrend, which he and other co-promoters used to facilitate tax-avoidance transactions. These companies included Westside Cellular. Conn Vu is currently the subject of a federal criminal investigation in New York with respect to such conduct, and it is anticipated that he will be indicted.

17. John P. McNabola ("McNabola") is, on information and belief, an accountant residing is Dublin, Ireland. The U.S. Department of Justice, based on its investigation, has named McNabola as a co-promoter, along with Conn Vu, Taylor and others, of certain unlawful Midco and "DAD" tax shelter transactions during the period 2003-2010. McNabola was an agent of Fortrend and the president of the Fortrend affiliates involved in defrauding Plaintiff.

18. Midcoast Credit Corp. ("Midcoast") is, on information and belief, a defunct Florida corporation that had its principal place of business in West Palm Beach, Florida. During the period relevant to this complaint, Midcoast and its affiliates were engaged in the promotion of certain tax-shelter transactions, including a transaction promoted to Plaintiff. In October 2013, the principals of Midcoast, along with other individuals, were indicted and charged with

criminal conspiracy to commit fraud and other offenses for allegedly designing and implementing fraudulent tax schemes.

19. John E. Rogers ("Rogers"), an attorney residing, on information and belief, in Kenilworth, Illinois, was a Seyfarth partner and agent from July 2003 until he was forced to resign in May 2008. In early 2003, shortly before he joined Seyfarth, Rogers conceived of and created an illegal tax shelter that was subsequently used to facilitate the Fortrend transaction with Plaintiff and, on information and belief, numerous other such transactions. In 2010, the U.S. Department of Justice sought to enjoin Rogers from engaging in such fraudulent conduct, with Rogers agreeing to a permanent injunction in September 2011.

JURISDICTION AND VENUE

20. This Court has subject matter jurisdiction over this matter pursuant to Art. 6, Sec. 6 of the Nevada Constitution.

21. This Court has personal jurisdiction over Defendants by virtue of their ongoing contacts with the state of Nevada, and/or because they purposefully availed themselves of, or directed their activities toward, the forum state of Nevada by participating in, substantially assisting and/or conspiring with Fortrend and other parties to advance the transaction that was promoted to and targeted Plaintiff, a Nevada resident, with Plaintiff's injuries arising in Nevada as a result, as set forth below.

22. Venue is proper before this Court because the Defendants, or one of them, reside in this District, and because the claims at issue arose in substantial part in this District.

23. This matter is properly brought as a business matter in business court pursuant to EDCR 1.61(a)(ii)-(iii).

FACTUAL BACKGROUND

Midco Transactions Generally

24. "Midco" transactions, a type of abusive tax shelter, were widely promoted during the late 1990s and early 2000s. The IRS has listed Midco transactions as "reportable transactions" for federal income tax purposes, meaning that the IRS considers them, and substantially similar transactions, to be improper tax-avoidance mechanisms. Fortrend and Midcoast were leading promoters of Midco-type transactions, with both companies being involved in numerous such transactions that were, years later, accordingly rejected by the tax courts.

25. Midco-type transactions were generally promoted to shareholders of closely held C corporations that had incurred large taxable gains. Promoters of Midco transactions targeted such shareholders and offered a purported solution to "double taxation," that is, the taxation of gains at both the corporate and individual shareholder levels. Generally speaking, Midco transactions proceeded as follows: First, an "intermediary company," or "midco," affiliated with the promoter – typically a shell company, often organized offshore – would purchase the shares of the target company, and thus its tax liability. After acquiring the shares and this tax liability, the intermediary company would engage in a second step that was supposed to offset the target's realized gains and eliminate the corporate-level tax. This second step, unbeknownst to the selling shareholder(s), would itself constitute an improper tax-avoidance maneuver, frequently a "distressed asset/debt," or "DAD," tax shelter (discussed in more detail below). The promoter received cash via the transaction, and represented to the target company's shareholders that they would legitimately net more for their shares than they otherwise would absent the intermediary transaction.

26. As was the case with Plaintiff's transaction, however, such representations often proved, years later, to be false. As set forth below, Plaintiff (and others like him)

subsequently found himself "holding the bag" after the transaction that was promoted to him by Fortrend and Midcoast; facilitated by Defendants Rabobank, Utrecht, Seyfarth and Taylor; and blessed by Defendant PwC, resulted in substantial tax liabilities and penalties for Plaintiff personally.

The Midco Transaction Into Which Plaintiff Was Drawn

27. Prior to 2003, Plaintiff was the president and sole shareholder of Westside Cellular, Inc. ("Westside"). From 1991 through 2003, Westside undertook various telecommunication activities in Ohio, including the resale of cellular phone service. In particular, beginning in 1991, Westside purchased network access from major cellular service providers in order to serve its customers. Plaintiff, as Westside's president, soon came to believe, however, that certain of these providers were discriminating against Westside. So, in 1993 he engaged the Cleveland law firm of Hahn Loeser & Parks, LLP ("Hahn Loeser"), to file a complaint with the Public Utilities Commission of Ohio ("PUCO") against certain of these providers, alleging anticompetitive trade practices. Westside's survival hung in the balance.

28. The PUCO ruled in Westside's favor on the liability issue, and the Ohio Supreme Court ultimately affirmed that decision. In early 2003 Westside returned to the lower court to commence the damages phase of the litigation. Not long thereafter a settlement was reached, pursuant to which Westside ultimately received, during April and May 2003, total settlement proceeds of $65,050,141. In exchange, Westside was required to terminate its business as a retail provider of cell phone service and to end all service to its customers in June 2003 – effectively relinquishing its assets in return for the settlement proceeds. From the approximately $65 million settlement, Westside would pay $25 million in legal fees and employee compensation and severance, leaving approximately $40 million in settlement proceeds.

29. Anticipating the settlement, Plaintiff asked Hahn Loeser to look into tax matters related to the anticipated settlement. Because Westside was a C Corporation, there was a concern that the settlement proceeds could be subject to double taxation. Hahn Loeser had prior experience with Midcoast and thought Midcoast might assist Plaintiff in this regard. So, a meeting between Plaintiff and Midcoast representatives was arranged for February 19, 2003.

30. At the February 19 meeting, Midcoast's representatives (including Donald Stevenson and Louis Bernstein) explained to Plaintiff that it was in the debt collection business and that, as part of its business model, it purchased companies in postures like Westside's.

31. Thereafter, Plaintiff was also introduced to Fortrend and received an informational letter from Fortrend's Steven Block. Plaintiff and his representatives subsequently had multiple calls and at least one face-to-face meeting with Fortrend representatives, including Block, in or about March/April 2003. Like Midcoast, Fortrend claimed that it was involved in the distressed debt receivables business and that it wanted to purchase Plaintiff's Westside stock as part of this business.

32. Midcoast and Fortrend each expressed interest in acquiring Plaintiff's Westside stock, and each made an offer proposing essentially the same transactional structure: An intermediary company would borrow money to purchase the stock. After the sale closed, the intermediary company would merge into Westside, and Fortrend / Midcoast would employ Westside in its distressed-debt collection business. The purchaser would fund its operations with Westside's remaining cash (Fortrend represented that financing for its distressed-debt recovery business was otherwise difficult to obtain), and employ Westside's tax liabilities to legitimately offset tax deductions associated with this business.

33. Fortrend and Midcoast represented to Plaintiff that the transactions they were each proposing would result in legitimate tax benefits and thus a greater net return to Plaintiff than he would otherwise realize. These representations included the assurance that the acquiring party had successfully undertaken numerous other transactions like the one being proposed to Plaintiff and that such transactions were proper under the tax laws. Neither party told Plaintiff that the IRS was scrutinizing and challenging similar transactions as improper tax shelters.

34. Absent Defendants' improper actions, Plaintiff would have left the settlement proceeds in Westside, paid the corporate-level tax and invested in other business ventures through Westside, thereby avoiding any shareholder-level tax on a distribution from Westside.

35. Because Plaintiff thought Midcoast and Fortrend were competitors, he began negotiating with both in the hope of stirring up a bidding war. Rather than continue to compete, though, Midcoast and Fortrend secretly agreed that Midcoast would step away from the transaction in exchange for a kickback of $1,180,000. As a result of this bid-rigging, Midcoast's final offer was intentionally unattractive, and Plaintiff chose to proceed with Fortrend.

36. Based on the representations made by Fortrend, Plaintiff was inclined to proceed with the Fortrend transaction. But, not wanting to run afoul of the tax laws, Plaintiff engaged a nationally regarded accounting firm, Defendant PwC, to independently evaluate the bids and proposed transactions for his Westside stock, verify that they and the purchasers were legitimate, and evaluate any potential tax issues.

37. On or about April 25, 2003, Plaintiff signed a letter agreement (the "PwC Engagement Letter") whereby PwC agreed to provide such tax research and evaluation services relating to the proposed sale of Westside's stock. The PwC Engagement Letter specifically noted that PwC had an obligation to determine whether Plaintiff would be

participating in a reportable transaction as defined by the IRS. The PwC Engagement Letter further noted that it would work with Plaintiff to avoid the imposition of any tax penalty. Plaintiff is unsophisticated in tax matters and was relying on PwC's expertise in deciding whether to proceed with the transaction.

38. Unbeknownst to Plaintiff, PwC had on at least one prior occasion brought Fortrend to the table to facilitate a Midco transaction that PwC itself had advocated. In particular, in late 1999, PwC advocated that a Midco transaction be used in the purchase of the Bishop Group Ltd. ("Bishop") by PwC's client Midcoast Energy Resources, Inc.; PwC approached Fortrend to serve as an intermediary; and a Fortrend affiliate in fact served as an intermediary, purchasing the Bishop stock in a Midco transaction that PwC helped negotiate. As it did in Mr. Tricarichi's case, Rabobank also facilitated the Bishop transaction by loaning Fortrend the purchase price and serving as the conduit through which funds changed hands at closing, all in return for a substantial fee. PwC disclosed none of this to Plaintiff. The Bishop Midco transaction was audited by the IRS starting in late 2003 (but before Plaintiff had reported the Westside stock sale on any tax returns), found deficient by the IRS in 2004, and confirmed by the courts in 2008 and 2009 to be an illegal tax shelter.

39. Consistent with the Engagement Letter, during the period April-August 2003, a team of PwC tax professionals, including Rich Stovsky, Timothy Lohnes and Don Rocen, set out to examine and advise Plaintiff regarding the transactions proposed by Fortrend and Midcoast. PwC personnel put between 150 and 200 hours into this effort, for which PwC charged approximately $48,000 in fees. PwC participated in various calls with the parties and/or their representatives, reviewed transaction documentation, and undertook research. PwC understood, among other things, that Fortrend would borrow a substantial sum from Rabobank in order to finance the transaction; that Fortrend intended to employ Westside's

tax liability to offset gains and deductions associated with high basis / low value assets; and that Plaintiff was relying on Fortrend to satisfy Westside's tax obligations.

40. PwC further understood but failed to properly advise Plaintiff that IRS Notice 2001-16, which had been issued in January 2001, applied to Midco transactions described therein and to "substantially similar" transactions; that the term "substantially similar" was broadly construed in this context; and that the proposed transaction and its tax implications posed risk for Plaintiff.

41. On or about July 22, 2003, Fortrend (via an affiliate) sent Plaintiff a letter of intent, signed by Conn Vu, regarding the proposed purchase of Plaintiff's Westside stock. The letter of intent proposed, among other things, that Fortrend would pay $34.9 million (later reduced slightly to $34.6 million) for the stock. The parties proceeded to discuss and negotiate a proposed stock purchase agreement, with PwC reviewing the terms thereof as part of its engagement.

42. Fortrend would use its affiliate Nob Hill, Inc. ("Nob Hill"), of which McNabola was the president, as the intermediary company to purchase the Westside stock. Nob Hill's sole shareholder was Millennium Recovery Fund, LLC, a Fortrend affiliate formed in the Cayman Islands. In the stock purchase agreement, which McNabola signed, Nob Hill represented that Westside would remain in existence for at least five years after the closing and "at all times be engaged in an active trade or business." Nob Hill also provided purported tax warranties. The agreement represented that Nob Hill would "cause ... [Westside] to satisfy fully all United States ... taxes, penalties and interest required to be paid by ... [Westside] attributable to income earned during the [2003] tax year." Nob Hill agreed to indemnify Plaintiff in the event of liability arising from breach of its representation to satisfy Westside's 2003 tax liability, and represented that it had sufficient assets to cover this indemnification obligation. Nob Hill

further warranted that it had no intention of causing Westside to engage in an IRS reportable transaction.

43. Plaintiff relied on these material representations and warranties, as well as PwC's evaluation and assessment of them, in deciding to proceed with the Fortrend transaction. Unbeknownst to Plaintiff, however, these representations and warranties were false when made; and they were not subsequently fulfilled, as PwC knew or should have known that they would not be. Although the stock purchase agreement contained covenants by the purchaser to pay Westside's taxes, and despite the fact that the agreement contained an indemnification provision in that regard, such provisions were without any value because, upon information and belief, the indemnitor/purchaser had insufficient assets with which to satisfy them when they were made and going forward, and simply intended to misappropriate Westside's funds, offset its tax liabilities with a bogus deduction via a reportable transaction, and conduct no business of substance.

44. Defendants Rabobank and Utrecht provided Fortrend financing for the vast majority of the purchase price, and Rabobank was the key conduit for the funds that changed hands in order to close the transaction. Without such participation and substantial assistance by Rabobank and Utrecht, Fortrend would not have been able to proceed with the transaction. Rabobank frequently partnered with Fortrend in executing Midco deals, and had done dozens of transactions with Fortrend prior to Plaintiff's transaction.

45. On information and belief, from 1996 to 2003, Fortrend promoted almost one hundred Midco transactions, and worked closely with Rabobank to obtain financing for many of those transactions. In Plaintiff's case, of the $34.6 million agreed purchase price for Westside's stock, $29.9 million would come from Rabobank, via Utrecht. (The remainder was loaned to Nob Hill by another Fortrend affiliate, Moffat.) The loan and the closing were

structured in such a way that Defendants Rabobank and Utrecht considered that they really bore no risk of non-payment.

46. On August 13, 2003, Fortrend asked Chris Kortlandt at Rabobank for a $29.9 million short-term loan, setting forth how those funds would remain in and be transferred through accounts at Rabobank that the parties would open, before being quickly repaid to the bank. Kortlandt at Rabobank subsequently requested and received internal approval of this loan, with Nob Hill as the nominal borrower. Rabobank understood that Westside would be required to have cash in excess of $29.9 million on deposit with Rabobank when the stock purchase closed. Rabobank therefore considered the risk of nonpayment of the loan to be essentially zero. The risk rating shown on Nob Hill's credit application was "N/A, or based on collateral: R-1 (cash)." Rabobank used the R-1 risk rating to denote a loan that is fully cash collateralized.

47. Among the financing documents subsequently executed by Nob Hill (the Fortrend affiliate) were a promissory note for $29.9 million, a security agreement, and a pledge agreement dated as of September 9, 2003. McNabola signed all these documents as Nob Hill's president. Pursuant to the security agreement, the Tax Court subsequently found, Nob Hill granted Rabobank a first priority security interest in a Rabobank account that Plaintiff would open for Westside in connection with the transaction, in order to secure Nob Hill's repayment obligation. Pursuant to the pledge agreement, the Tax Court also found, Nob Hill granted Rabobank a first-priority security interest in the Westside stock and the stock sale proceeds as collateral securing Nob Hill's repayment obligation. Among the financing documents to be executed by Westside were security and guaranty agreements in favor of Rabobank, and a control agreement. McNabola also signed these documents. Via the security and guaranty agreements, the Tax Court further found, Westside unconditionally guaranteed payment of Nob Hill's obligations to Rabobank, and granted Rabobank a first priority security interest in

Westside's Rabobank account. The control agreement further gave Rabobank control over Westside's account – including all cash, instruments, and other financial assets contained therein from time to time, and all security entitlements with respect thereto – in order to ensure that Westside did not default on its commitments, the Tax Court determined, further concluding that these agreements effectively gave Rabobank a "springing lien" on Westside's cash at the moment it funded the loan. For all practical purposes, therefore, the Tax Court found, the Rabobank loan was fully collateralized with the cash in Westside's Rabobank account, consistent with the R-1 risk rating that Rabobank assigned to that loan.

48. As noted above, in order to facilitate the transaction, Plaintiff and Westside were required to open accounts at Rabobank. The account opening documentation reflects Plaintiff's and Westside's residence in Las Vegas, Clark County, Nevada, where Rabobank and Utrecht thus knew Plaintiff resided, and where they proceeded to do business with, and direct their actions toward, Plaintiff and Westside. Plaintiff was relying on Rabobank, a large bank with a worldwide presence, to serve as an independent escrow agent and lender, rather than as a self-interested facilitator and co-conspirator of Fortrend's fraud – which, unbeknownst to Plaintiff, was Rabobank's actual role.

49. Rabobank and Utrecht proceeded with the transaction and the loan to Fortrend (Nob Hill) despite knowing that the Fortrend transaction in this case was a Midco deal that constituted a reportable transaction considered by the IRS to be an improper tax-avoidance mechanism. During the years 1998 – 2002, Rabobank (via, on information and belief, subsidiaries including Utrecht) had financed a total of 88 Midco transactions, at the pace of about 18 transactions per year. Rabobank earned considerable and attractive fees via the loans, which ranged in amount between $6 million and $260 million, and were mostly for terms of only one to three days. At the time, Rabobank was experiencing difficulty in other areas of its

business, and opportunistically looked at the Midco financing transactions as "easy money" – short term loans with high yield and no credit risk.

50. The Midco transactions that Rabobank / its affiliates participated in with Fortrend included the following, among others:

a. Bishop Group: In or about October 1999, Rabobank facilitated the purchase of Bishop stock by loaning another special-purpose Fortrend affiliate (K-Pipe Merger Corp.) approximately $200 million short-term for the purchase price, and by serving as the conduit through which funds changed hands at closing, in return for a substantial fee. Like Nob Hill in this case, K-Pipe was a shell company with no assets and conducted virtually no business after the purchase. A federal court in Texas subsequently found that the Bishop transaction was a sham and constituted an improper Midco tax shelter, and that determination was affirmed by the U.S. Court of Appeals for the Fifth Circuit.

b. Town Taxi and Checker Taxi: In or about October 2000, Rabobank loaned Three Wood LLC, a newly formed Fortrend special-purpose affiliate, $30 million short-term to purchase the stock of Town Taxi Inc. and Checker Taxi Inc. from the Frank Sawyer Trust after those companies had sold all their assets. Rabobank again served as the conduit through which funds changed hands at closing, on information and belief in return for a substantial fee. On information and belief, in order to induce the Trust into the transaction, Fortrend falsely represented to the Trust that Fortrend had a strategy to legitimately offset the taxes due as a result of the taxi companies' asset sales. Within about two months of the closing, Fortrend stripped Town Taxi and Checker Taxi of their remaining funds, totaling millions of dollars, moving that money to other Fortrend affiliates. Late in 2000, Fortrend contributed to Town Taxi and

Checker Taxi the stock of other companies that had ostensibly declined in value, subsequently claiming tax losses that offset nearly all the gains from the Town Taxi and Checker Taxi asset sales. After the IRS examined the transaction, the U.S. Tax Court found in 2014 that it constituted an improper Midco tax shelter.

c. St. Botolph Holding Co.: In or about February 2001, Rabobank loaned $19 million to Monte Mar, Inc., a special-purpose Fortrend affiliate, to purchase from the Frank Sawyer Trust the stock of St. Botolph, which was in the process of selling its assets. Rabobank again served as the conduit through which funds changed hands at closing, on information and belief in return for a substantial fee. On information and belief, in order to induce the Trust into the transaction, Fortrend falsely represented to the Trust that Fortrend had a strategy to legitimately offset the taxes due as a result of St. Botolph's asset sales. Over the next ten months, Fortrend stripped St. Botolph of its remaining cash. In 2001, Fortrend contributed to St. Botolph stock that had ostensibly declined in value, subsequently claiming tax losses that offset nearly all the gains from the St. Botolph asset sale. After the IRS examined the transaction, the U.S. Tax Court found in 2014 that it constituted an improper Midco tax shelter.

d. Slone Broadcasting: In December 2001, after the assets of Slone Broadcasting had been sold, Utrecht loaned another special-purpose Fortrend affiliate, Berlinetta, Inc., $30 million short-term to purchase the stock of Slone. Fortrend represented to the shareholders of Slone that it had a legitimate strategy to reduce the taxes due as a result of the asset sale. On information and belief, Rabobank served as the conduit through which funds changed hands at closing, in return for a substantial fee. Slone Broadcasting and Berlinetta merged, and the company's named was changed to Arizona Media, which then claimed an inflated basis for certain Treasury bills contributed to the company by another Fortrend affiliate. Conn Vu was also Arizona Media's president, secretary and treasurer. The IRS maintains that the Slone-Fortrend transaction was an illegal Midco tax shelter, with the former Slone shareholders having transferee liability, and the matter is currently in litigation.

51. However, on information and belief, in or about October 2002 – that is, approximately ten months before it financed the transaction involving Plaintiff – Rabobank determined that many if not all of the Midco transactions it had previously financed were reportable transactions as defined by the IRS. As a result, the number of Midco transactions executed by Rabobank after October 2002 decreased significantly. Rabobank undertook only five Midco financing transactions in 2003, one of those being the financing in Plaintiff's case. In 2004, Rabobank undertook only one Midco financing transaction, its last. A Rabobank internal audit further found in 2005 that Rabobank's internal controls had been inadequate in numerous respects with respect to the Midco transactions in which it had participated. The audit found, among other things, that it was at least "questionable" whether Midco promoters like Fortrend could be described as "reputable" companies with which Rabobank should be doing business. Rabobank would have stopped financing Midco transactions entirely after October 2002 were it not for the fact that it did not want to harm its existing relationships with Midco promoters like Fortrend.

52. In addition to its own activities directed toward Plaintiff and the Nevada forum, Rabobank/Utrecht knew or should have known – via their participation in this and prior Fortrend transactions – that their co-conspirators Fortrend, McNabola and Conn Vu were directing and undertaking the acts alleged herein at Plaintiff and in the Nevada forum. Rabobank's / Utrecht's actions caused harm to Plaintiff in Nevada.

53. Notwithstanding the problematic nature of the transaction proposed by Fortrend, which should have been apparent to PwC given its expertise in tax matters, PwC, based on its examination and due diligence, came to the conclusion that the transaction did not fit the IRS definition of a Midco (or substantially similar) transaction and that it was not a reportable transaction as defined by the IRS. PwC also came to the conclusion that Plaintiff would not be subject to transferee liability for Westside's taxes as a result of the Fortrend transaction. PwC's examination of the proposed transaction concluded with a determination that there was no reason not to go forward with Fortrend's offer to purchase Plaintiff's Westside stock. PwC advised Plaintiff of its conclusions in or about August 2003. Relying upon PwC's advice, Plaintiff proceeded with the Fortrend transaction. Had PwC advised Plaintiff otherwise, Plaintiff would not have proceeded with the transaction.

54. The parties executed the stock purchase agreement, and the Fortrend transaction closed on September 9, 2003. As part of the closing, Nob Hill's Rabobank account was credited with the $29.9 million Rabobank loan proceeds; Nob Hill transferred the purchase price from its Rabobank account into the Rabobank account that Plaintiff had been required to open; Nob Hill acquired Plaintiff's Westside stock; Plaintiff's resignation as an officer and director of Westside became effective (with Plaintiff being replaced by Fortrend personnel); and Nob Hill paid Rabobank a $150,000 fee. After the Rabobank and Moffat loans were repaid the same day, however, Westside's remaining funds, rather than being used to facilitate Fortrend's debt-collection business as represented, were actually drained by Fortrend, as set forth below.

55. The day after the closing, Nob Hill merged into Westside with Westside being the surviving corporation. By that point, there was approximately $5.2 million left in Westside's bank account. Westside – now under Fortrend's control – proceeded over the next

seven months to transfer about $4.8 million of that amount to various Fortrend affiliates and co-promoters, including MidCoast, which in mid-September received its $1,180,000 payoff for stepping away from the transaction. After Conn Vu transferred the remaining funds to another bank in or about April 2004, Fortrend emptied the account and it was closed. Westside did not engage in the debt-collection business as Fortrend had represented to Plaintiff it would.

56. Notwithstanding the multiple representations of Fortrend and PwC to Plaintiff that the Fortrend transaction was proper under the tax laws, and the silence of Rabobank and Utrecht in this regard, Defendants and Fortrend knew that on January 18, 2001 the IRS had issued Notice 2001-16 ("the 2001 Tax Notice"). The 2001 Tax Notice describes transactions where a corporation disposes of substantially all of its assets and then the corporation's shareholders sell their stock to another party who seeks favorable tax treatment. The 2001 Tax Notice states that any transactions that are the same as, or substantially similar to, those described in the 2001 Tax Notice are "listed transactions." Listed transactions are deemed by the IRS to be abusive tax shelters. Persons failing to report these tax shelters may be subject to penalties. The IRS in the 2001 Tax Notice concluded that it "may challenge the purported tax results of these transactions on several grounds." It further warned that it "may impose penalties on participants in these transactions."

57. The publication of the 2001 Tax Notice put Defendants and Fortrend, who were experienced in tax matters, on notice that there was, at minimum, a significant likelihood that the IRS would consider the Fortrend transaction to be a listed transaction. In addition, as a result of the 2001 Tax Notice, Defendants and Fortrend, who were experienced in tax matters, knew or should have known that there was, at minimum, a significant likelihood that the IRS would hold Plaintiff liable as a transferee

for the unpaid taxes owed by Westside.

58. Defendants and Fortrend failed to properly advise Plaintiffs about the 2001 Tax Notice and its significance for the Fortrend transaction. To the contrary, PwC advised Plaintiff that the Fortrend transaction did not fall within, and was not substantially similar to the transaction listed in, the 2001 Tax Notice, and was not a listed transaction as defined by the IRS; PwC advised Plaintiff that he would not be exposed to transferee liability with respect to the Fortrend transaction; Fortrend also made such representations; and Rabobank and Utrecht remained silent, facilitating the transaction despite knowing that it was a listed transaction per the 2001 Tax Notice.

With Seyfarth and Taylor's Assistance,
Fortrend Closes the Loop on its Fraud Post-Closing

59. After the closing, Fortrend did not conduct business via Westside in the manner Fortrend had told Plaintiff it would. In fact, in order to draw Plaintiff into the Midco transaction, Fortrend had made various misrepresentations to Plaintiff when it described, represented and warranted how Westside's business would proceed after the stock sale. Contrary to what Fortrend represented, Fortrend's plan was never to operate Westside going forward as part of a legitimate debt-collection business, and its plan was never to "cause … [Westside] to satisfy fully all United States … taxes, penalties and interest required to be paid by … [Westside] attributable to income earned during the [2003] tax year." Contrary to its representations via Nob Hill and otherwise, Fortrend always intended to engage in an IRS reportable transaction; avoid paying Westside's taxes; strip Westside of its assets; and leave Plaintiff "holding the bag" for transferee liability imposed by the IRS.

60. Unbeknownst to Plaintiff, Fortrend's efforts to set the stage in this regard dated back to at least 2001. As part of Fortrend's ongoing promotion of Midco transactions, in or about March 2001, Millennium (the Fortrend and Nob Hill affiliate) obtained a portfolio of

distressed Japanese debt then valued at $137,109 for a cost of $137,000. Although Millennium/Fortrend thus acquired the Japanese debt portfolio for only $137,000 in March 2001, it later claimed that its tax basis in that portfolio was actually more than $314 million.

61. As support for this claim, Fortrend looked to a canned opinion letter provided to McNabola at Millennium by Defendants Seyfarth and Taylor on or about August 21, 2003 (the "Seyfarth Opinion Letter"). Without a good-faith basis, the Seyfarth Opinion Letter stated, among other things, that it was appropriate for Millenium to claim more than $314 million in basis for the Japanese debt that it had acquired for a tiny fraction of that amount.

62. By obtaining and claiming an artificially high basis in the Japanese debt – and by "blessing" this maneuver – Fortrend, and Defendants Seyfarth and Taylor, facilitated the Midco transaction that defrauded Plaintiff by effectuating a maneuver that Fortrend, Seyfarth and Taylor all knew to be improper under the tax laws: a distressed asset/debt (or "DAD") scheme.

63. A DAD scheme uses purportedly high-basis, low-value distressed debt acquired from foreign entities that are not subject to United States taxation. The distressed debt is passed through one or more U.S. entities that fail to claim the proper basis for that debt. The U.S. taxpayer that finally ends up holding the debt – here, Westside under Fortrend's ownership – then claims the significant tax loss that has passed through in order to offset other U.S. income or gain. The effect is that the U.S. taxpayer (Westside under Fortrend's ownership) is seeking to benefit from the built-in economic losses in the foreign party's distressed asset when the U.S. taxpayer did not incur the economic costs of that asset.

64. As the Tax Court noted, Seyfarth "gained notoriety for issuing bogus tax-shelter opinions," and the opinion issued to Fortrend in Plaintiff's case "seems par for the course." Rogers conceived of and created a DAD shelter in early 2003, shortly before he became a

Seyfarth partner in July 2003, and Seyfarth, Rogers and Taylor subsequently promoted, facilitated and participated in numerous DAD and other illegal tax shelters thereafter with Fortrend and others. Upon information and belief, numerous clients of Seyfarth, Taylor and Rogers were – like Fortrend – themselves tax shelter promoters who used the purported losses from DAD and similar schemes as part of abusive Midco transactions.

65. Rogers and Taylor were both partners at the law firm Altheimer & Gray before joining Seyfarth, after Altheimer went bankrupt in 2003. Rogers and Taylor both left Seyfarth in 2008, Rogers after the firm – no longer comfortable with him promoting tax shelters – forced him to resign, and Taylor after he pleaded guilty in January of that year to conspiring to commit tax fraud.

66. In 2010, Taylor was disbarred, and the U.S. Department of Justice, based on a years-long investigation, filed a complaint in federal court in Illinois accusing Rogers of tax fraud and other offenses based on his creation and promotion of DAD shelters and similar tax schemes dating back to at least 2003. Rather than contest the complaint's allegations, Rogers agreed, in September 2011, to a permanent injunction against him directly or indirectly organizing, promoting, advising, implementing, carrying out, managing or selling DAD or similar transactions.

67. As was known at the time pertinent to this complaint by Fortrend, Seyfarth, Taylor and Rogers, who were sophisticated practitioners in the tax arena, a DAD shelter violates the legal doctrines of (1) economic substance; (2) substance over form; (3) step transaction; and (4) sham partnership. Even though they violated such doctrines from their inception, DAD shelters were widely promoted in the early 2000s by Fortrend, Seyfarth, Taylor, Rogers and others. As a result, Congress emphasized their illegality by outlawing all DAD schemes via the consideration and passage of the American Jobs Creation Act, with

which Fortrend, Seyfarth, Taylor and Rogers, as sophisticated tax practitioners, must have been familiar. *See* American Jobs Creation Act of 2004, P.L. 108-357 (amending, among other provisions, I.R.C. §§ 704(c), 734 and 743).

68. Fortrend, Seyfarth, Taylor and Rogers likewise knew, at the time pertinent to this complaint, that the DAD aspect of the transaction was a sham because Fortrend incurred no economic loss in connection with the deductions it was claiming.

69. In Plaintiff's case, and unbeknownst to Plaintiff, the second-stage DAD transaction continued (after the Westside stock sale) this way:

a. On November 6, 2003, Millennium contributed to Westside a subset of the Japanese debt portfolio, consisting of two defaulted loans (the "Aoyama Loans"). The Aoyama Loans had a purported tax basis of $43,323,069. Between November 6 and December 31, 2003, Westside wrote off the Aoyama Loans as worthless. On its Form 1120, U.S. Corporation Income Tax Return, for 2003, Westside claimed a bad debt deduction of $42,480,622 on account of that write-off.

b. As the Tax Court found, Westside conducted no meaningful business operations after September 10, 2003; it reported no gross receipts, income, or business expenses relating to its supposed "debt collection" business; and it undertook no efforts to collect the Aoyama Loans or contract with a third party to do so. During this period, Conn Vu served Fortrend as Westside's president, secretary and treasurer, signing Westside's tax returns and nominally presiding over the company's "business" until Fortrend drained it of its last assets.

c. On its tax return for 2003, Westside (under Fortrend's control) reported total income of $66,116,708 and total deductions of $67,840,521. The deductions included purported bad debt losses of $42,480,622 based on the Aoyama Loans. Westside did not pay any amount of taxes.

70. By providing the purported justification for the $42,480,622 deduction claimed regarding the Aoyama Loans, Seyfarth and Taylor knowingly and substantially assisted the fraud that Fortrend perpetrated upon Plaintiff. On information and belief, Seyfarth and Taylor received a substantial fee in return for the Seyfarth Opinion Letter.

71. In addition to their own activities undertaken in or directed toward the Nevada forum, Seyfarth and Taylor, on information and belief, knew or should have known – via their participation in this transaction and otherwise – that their co-conspirators Fortrend, McNabola and Conn Vu were directing and undertaking the acts alleged herein at Plaintiff and in the Nevada forum. Seyfarth and Taylor's actions caused harm to Plaintiff in Nevada.

72. The Seyfarth Opinion Letter in this case was, on information and belief, not the only time that Seyfarth and Taylor were involved in similar transactions with McNabola, Conn Vu and Fortrend. The U.S. Department of Justice, based on its investigation, has stated that McNabola, with the assistance of Taylor, structured and/or assisted with setting up a DAD transaction by which First Active Capital Inc. ("First Active"), in or about August 2005, acquired distressed Chinese debt with a supposed basis of more than $57 million. First Active, which was incorporated in August 2005, and of which McNabola was the sole officer and director until 2006, then used this distressed debt to offset gains in connection with other transactions in which it participated in 2005, 2006, 2008, 2009 and 2010. In each of these transactions, the DoJ has stated, Conn Vu, who replaced McNabola as an officer and director of First Active, used the distressed debt that First Active had obtained to offset gains otherwise incurred. Per the DoJ, First Active had no legitimate business purpose and was used solely to facilitate illegal tax avoidance schemes. Moreover, while Taylor was indicted in November

2005 for tax fraud, and subsequently pleaded guilty to tax evasion, on information and belief, he continued to practice law and provide advice to McNabola through at least 2008.

Defendants and Their Co-Conspirators Fraudulently Concealed Their Acts

73. Defendants and their co-conspirators engaged in affirmative conduct designed to prevent Plaintiff's discovery of their wrongdoing. These acts prevented Plaintiff's discovery of the fraud and other misdeeds. PwC and its personnel were fiduciaries of Plaintiff, and the remaining Defendants and conspirators were in a position of superior knowledge and/or trust, and thus owed Plaintiff a duty to disclose the concealed facts, which they nonetheless concealed or suppressed. Had Plaintiff known these facts, which came to light as a result of the Tax Court trial or thereafter, he would have acted differently, but instead was damaged as a result of the concealment.

74. Defendants' acts of concealment and omission included those set forth above, and also continued after Plaintiff's agreement to and participation in the Fortrend transaction, including: (i) Defendants' concealment of the second-stage DAD transaction with respect to Westside; (ii) Defendants' concealment of their ongoing involvement in similar illegitimate Midco and DAD transactions; (iii) Defendants' concealment of their knowledge of the illegitimacy of these transactions and the transaction involving Plaintiff; (iv) Fortrend's concealment of its ongoing involvement with Midcoast; and (v) Fortrend and Conn Vu's concealment of their post-closing actions despite the fact that Plaintiff's representatives were in touch with them in 2006 and 2007 regarding the filing of a claim for the refund of excise taxes for Westside.

Plaintiff Is Left Holding the Bag as a Result of the Foregoing Events

75. As a result of the foregoing events, the IRS audited Westside's 2003 tax return. At the conclusion of the audit, the IRS disallowed the $42,480,622 bad-debt deduction, and

another $1,651,752 deduction claimed by Fortrend for legal and professional fees (on the ground that these fees were incurred in connection with a transaction entered into solely for tax avoidance). During the audit, the IRS was unable to find any assets or current sources of income for Westside. On February 25, 2009, the IRS mailed a notice of deficiency to Westside determining a deficiency of $15,186,570 and penalties totaling $6,012,777 under the tax code.

76. Westside – which had no assets or resources by this point as a result of Fortrend's actions – did not pay any of these amounts and did not petition the U.S Tax Court for relief. So, on July 20, 2009, the IRS assessed the tax and penalties set forth in the notice of deficiency, plus accrued interest.

77. The IRS also proceeded with a transferee liability examination concerning Westside's 2003 tax liabilities. Transferee liability is a method of imposing tax liability on a person (here, Plaintiff) other than the taxpayer who is directly liable for the tax. This method is used by the IRS when a person transfers property and tax related to that property subsequently goes unpaid. In that case, the IRS goes after the person who made the transfer to recover the taxes.

78. As a result of its examination, the IRS determined that Plaintiff had transferee liability for Westside's tax deficiency and penalties – a total of about $21.2 million. The IRS sent Plaintiff a notice of liability to that effect on June 25, 2012. (Years before, Plaintiff had timely paid the IRS more than $5 million in taxes relating to the long-term gain incurred in 2003 as a result of the sale of Plaintiff's Westside stock.)

79. Plaintiff petitioned the U.S. Tax Court in September 2012 for review of the IRS notice of liability. The matter was litigated during 2013 and 2014, proceeding to a four-day trial in June 2014. After trial, the Tax Court found in October 2015 that – contrary to what Defendants and Fortrend had led Plaintiff to believe – the Fortrend transaction into which Plaintiff had been drawn was an improper Midco transaction, and Plaintiff was liable under

transferee liability principles for Westside's tax deficiency and penalties totaling about $21.2 million, plus interest and interest penalties, which are estimated by Plaintiff to total approximately $17.8 million (and counting).

80. Moreover, as a further result of Defendants' actions, and in addition to such amounts, Plaintiff has been required to spend a considerable amount of money in fees and expenses in the IRS and Tax Court proceedings. To date these fees and expenses exceed about $5 million and continue to be incurred. Additionally, Plaintiff lost other sums in connection with the Fortrend transaction, including a $5.4 million Fortrend "premium" and $125,000 in professional fees paid upfront for review and advice regarding the transaction. All told, Plaintiff has suffered tens of millions of dollars in damages as a result of Defendants' actions.

COUNT I
GROSS NEGLIGENCE AS TO PwC

81. Plaintiff repeats and realleges paragraphs 1 through 80 above as though fully set forth herein.

82. In consulting with and otherwise representing Plaintiff with respect to the sale of Plaintiff's shares of stock in Westside and otherwise with respect to the transaction proposed by Fortrend, Defendant PwC owed a duty to Plaintiff to use such skill, prudence and diligence as commonly possessed and exercised by tax and business professionals in the fields of income taxes, tax savings transactions and business tax consulting.

83. wC breached that duty by committing, among others, one or more or a combination of all of the following acts or omissions:

a. Failing to advise Plaintiff of PwC's prior dealings with Fortrend and advocacy of a Midco transaction in the Bishop deal;

b. Advising Plaintiff that the transaction proposed by Fortrend was legal and proper and in compliance with the tax laws;

c. Failing to properly advise Plaintiff about the significance of the 2001 Tax Notice or, in the alternative, failing to be fully aware of the 2001 Tax Notice and/or its potential adverse consequences to Plaintiff as a result of the Fortrend transaction; and

d. Failing to advise Plaintiff that because of the 2001 Tax Notice, there was an increased likelihood that the transaction might result in an audit by the IRS and possible liability under a theory of transferee liability.

84. Acting in reliance on the advice and opinions given by PwC, Plaintiff proceeded with the Fortrend transaction.

85. As a direct and proximate result of the gross negligence of PwC, Plaintiff has incurred damages in excess of $10,000, including fees incurred to respond to and defend the examination by the IRS and to litigate the matter in Tax Court, the assessment of taxes, penalties and interest by the IRS in sums far greater than Plaintiff would otherwise have had to pay, and other losses.

86. PwC's actions compel Plaintiff to employ an attorney for redress, entitling Plaintiff to obtain attorneys' fees and costs for pursuing this action.

COUNT II
NEGLIGENT MISREPRESENTATION AS TO PwC

87. Plaintiff repeats and realleges paragraphs 1 through 86 above as though fully set forth herein.

88. In consulting and otherwise representing Plaintiff with respect to the sale of Plaintiff's shares of stock in Westside and otherwise with respect to the Fortrend transaction, Defendant PwC owed a duty to Plaintiff to communicate accurate information to Plaintiff.

89. The statements made by PwC to Plaintiff that the transaction proposed was proper and according to the tax laws were false statements of material fact and otherwise communications of inaccurate information to Plaintiff.

90. PwC was grossly negligent in failing to ascertain that these statements were, in fact, false and in otherwise conveying inaccurate information to Plaintiff.

91. PwC made the said false and otherwise inaccurate statements with reckless disregard for their truth.

92. Plaintiff had no knowledge of the falsity or otherwise of the inaccuracy of the said false statements made by PwC.

93. Plaintiff was thereby induced into going forward with and completing the Fortrend transaction.

94. Plaintiff reasonably, justifiably and actually relied upon the said false and otherwise inaccurate statements made by PwC and went forward with and completed the transaction.

95. The said false and otherwise inaccurate statements made by PwC caused Plaintiff to incur damages in excess of $10,000, including but not limited to Plaintiff's expenditure of a considerable amount of money in fees and expenses to respond to and defend the examination by the IRS and to litigate the matter in Tax Court, and the assessment of taxes, penalties and interest by the IRS in sums far greater than Plaintiff would otherwise have had to pay, and other losses.

96. PwC's actions compel Plaintiff to employ an attorney for redress, entitling Plaintiff to obtain attorneys' fees and costs for pursuing this action.

COUNT III
AIDING AND ABETTING FRAUD
AS TO RABOBANK, UTRECHT, SEYFARTH AND TAYLOR

97. Plaintiff repeats and realleges paragraphs 1 through 96 above as though fully set forth herein.

98. Fortrend made false representations to Plaintiff, knowing or believing that such representations were false or that there was insufficient basis to make such representations, intending to induce Plaintiff to act or to refrain from acting in reliance upon such representations. These false representations included the statements that Fortrend was really in the debt-collection business; that, after purchasing Westside's stock, Fortrend would employ Westside and its remaining assets in this debt-collection business; that Fortrend would employ Westside's tax liabilities to legitimately offset tax deductions associated with its debt-collection business; that the transaction it was proposing to Plaintiff would result in legitimate tax benefits and a greater net return to Plaintiff than he would otherwise realize; that Fortrend's affiliate Nob Hill would satisfy Westside's tax obligations for the year 2003; that Nob Hill would indemnify Plaintiff if it failed to satisfy these tax obligations; and that Fortrend / Nob Hill had no intention of causing Westside to engage in an IRS reportable transaction.

99. Plaintiff justifiably relied upon such representations in proceeding with the Fortrend transaction described above, and suffered tens of millions of dollars in damages as a result.

100. As reflected by the Rabobank audit and the steep drop-off in the number of Midco transactions it participated in, Rabobank / Utrecht knew that Fortrend was engaged in fraud, but nonetheless knowingly and substantially assisted Fortrend by loaning Fortrend the lion's share of the funds to purchase the Westside shares and by

serving as the conduit through which funds changed hands at closing, all in return for a substantial "fee." Plaintiff was damaged as a result.

101. Given their background and training as sophisticated practitioners in the tax arena, Seyfarth and Taylor also knew that Fortrend was engaged in fraud, but nonetheless knowingly and substantially assisted Fortrend by providing the Seyfarth Opinion Letter "blessing" the DAD scheme that Fortrend used in order to claim a large deduction supposedly offsetting the Westside tax liabilities it had purchased. Fortrend relied upon the Seyfarth Opinion Letter in effectuating this maneuver. Plaintiff incurred damages in excess of $10,000 as a result.

102. Such actions by Rabobank, Utrecht, Seyfarth and Taylor were oppressive, fraudulent and/or malicious; and/or part of a scheme to defraud Plaintiff entered into by such Defendants, entitling Plaintiff to punitive damages.

103. Such actions by Rabobank, Urecht, Seyfarth, and Taylor compel Plaintiff to employ an attorney for redress, entitling Plaintiff to obtain attorneys' fees and costs for pursuing this action.

COUNT IV
CIVIL CONSPIRACY
AS TO RABOBANK, UTRECHT, SEYFARTH AND TAYLOR

104. Plaintiff repeats and realleges paragraphs 1 through 103 set forth above as though fully set forth herein.

105. The forgoing acts and omissions of the Defendants Rabobank, Utrecht, Seyfarth and Taylor (collectively, the "Conspiring Defendants") constitute and were part of an ongoing scheme or artifice to defraud in which the said Conspiring Defendant(s) agreed and conspired with Fortrend to unlawfully defraud the Plaintiff and others by means of false or fraudulent pretenses, representations, omissions, concealments and suppression of facts.

106. The foregoing acts and omissions of the Conspiring Defendant(s) were done in furtherance of the common scheme, and in concert with Fortrend, Vu, McNabola, Midcoast, Rogers and/or the other Conspiring Defendant(s).

107. As a result of the common scheme, Plaintiff has suffered, and will continue to suffer damages in an amount in excess of $10,000, including but not limited to Plaintiff's expenditure of a considerable amount of money in fees and expenses to respond to and defend the examination by the IRS and to litigate the matter in Tax Court, the assessment of taxes, penalties and interest by the IRS in sums far greater than Plaintiff would otherwise have had to pay, and other losses.

108. Such actions by Rabobank, Utrecht, Seyfarth and Taylor were oppressive, fraudulent and/or malicious; and/or part of a scheme to defraud Plaintiff entered into by such Defendants, entitling Plaintiff to punitive damages.

109. Such actions by Rabobank, Urecht, Seyfarth, and Taylor compel Plaintiff to employ an attorney for redress, entitling Plaintiff to obtain attorneys' fees and costs for pursuing this action.

COUNT V
RACKETEERING – VIOLATION OF NRS 207.400(1)(c)
AS TO RABOBANK, UTRECHT, SEYFARTH AND TAYLOR

110. Plaintiff repeats and realleges paragraphs 1 through 109 set forth above as though fully set forth herein.

111. As reflected by the Bishop, Town Taxi, Checker Taxi, St. Botolph, Slone Broadcasting, Westside, First Active and other transactions described above, Rabobank, Utrecht, Seyfarth and Taylor were part of an enterprise pursuant to NRS 207.380; and participated in racketeering activity pursuant to NRS 207.390 by engaging in at least two crimes related to racketeering within five years that have the same or similar pattern,

intents, results, accomplices, victims or methods of commission, or are otherwise related by distinguishing characteristics and are not isolated incidents.

112. These crimes related to racketeering include obtaining possession of money or property valued at $650 or more, or obtaining signature by false pretenses (NRS 207.360(26)); fraud in connection with the offer, sale or purchase of a security (NRS 207.360(30) and NRS 90.570); and multiple transactions involving fraud or deceit in the course of an enterprise or occupation (NRS 207.360(33) and NRS 205.377).

113. Defendants' actions violate NRS 207.400(1)(c), in that they conducted or participated, directly or indirectly, in the affairs of the enterprise through racketeering activity, or racketeering activity through the affairs of the enterprise. Plaintiff was injured by reason of such violation(s) in an amount in excess of $10,000, and has a cause of action against these Defendants for three times the actual damage sustained, plus attorney's fees and costs of investigation and litigation reasonably incurred, and costs and expenses of the proceeding, pursuant to NRS 207.470 and NRS 207.480.

COUNT VI
RACKETEERING – VIOLATION OF NRS 207.400(1)(h)
AS TO RABOBANK, UTRECHT, SEYFARTH AND TAYLOR

114. Plaintiff repeats and realleges paragraphs 1 through 113 set forth above as though fully set forth herein.

115. As reflected by the Bishop, Town Taxi, Checker Taxi, St. Botolph, Slone Broadcasting, Westside, First Active and other transactions described above, Rabobank, Utrecht, Seyfarth and Taylor were part of an enterprise pursuant to NRS 207.380; and participated in racketeering activity pursuant to NRS 207.390 by engaging in at least two crimes related to racketeering within five years that have the same or similar pattern, intents, results, accomplices, victims or methods of commission, or are otherwise related by distinguishing characteristics and are not isolated incidents.

116. These crimes related to racketeering include obtaining possession of money or property valued at $650 or more, or obtaining signature by false pretenses (NRS 207.360(26)); fraud in connection with the offer, sale or purchase of a security (NRS 207.360(30) and NRS 90.570); and multiple transactions involving fraud or deceit in the course of an enterprise or occupation (NRS 207.360(33) and NRS 205.377).

117. Defendants' actions violate NRS 207.400(1)(h), in that they provided property to another person knowing that the other person intends to use the property to further racketeering activity. Plaintiff was injured by reason of such violation(s) in an amount in excess of $10,000, and has a cause of action against these Defendants for three times the actual damage sustained, plus attorney's fees and costs of investigation and litigation reasonably incurred, and costs and expenses of the proceeding, pursuant to NRS 207.470 and NRS 207.480.

COUNT VII
RACKETEERING – VIOLATION OF NRS 207.400(1)(i)
AS TO RABOBANK, UTRECHT, SEYFARTH AND TAYLOR

118. Plaintiff repeats and realleges paragraphs 1 through 117 set forth above as though fully set forth herein.

119. As reflected by the Bishop, Town Taxi, Checker Taxi, St. Botolph, Slone Broadcasting, Westside, First Active and other transactions described above, Rabobank, Utrecht, Seyfarth and Taylor were part of an enterprise pursuant to NRS 207.380; and participated in racketeering activity pursuant to NRS 207.390 by engaging in at least two crimes related to racketeering within five years that have the same or similar pattern, intents, results, accomplices, victims or methods of commission, or are otherwise related by distinguishing characteristics and are not isolated incidents.

120. These crimes related to racketeering include obtaining possession of money or property valued at $650 or more, or obtaining signature by false pretenses (NRS

207.360(26)); fraud in connection with the offer, sale or purchase of a security (NRS 207.360(30) and NRS 90.570); and multiple transactions involving fraud or deceit in the course of an enterprise or occupation (NRS 207.360(33) and NRS 205.377).

121. Defendants' actions violate NRS 207.400(1)(i), in that they conspired to violate one or more of the provisions of NRS 207.400. Plaintiff was injured in an amount in excess of $10,000 by reason of such violation(s) and has a cause of action against these Defendants for three times the actual damage sustained, plus attorney's fees and costs of investigation and litigation reasonably incurred, and costs and expenses of the proceeding, pursuant to NRS 207.470 and NRS 207.480.

COUNT VIII
UNJUST ENRICHMENT
AS TO RABOBANK AND UTRECHT

122. Plaintiff repeats and realleges paragraphs 1 through 121 set forth above as though fully set forth herein.

123. Approximately $29.9 million of the PUCO settlement proceeds in Westside's bank account were used by Nob Hill to repay the Rabobank / Utrecht loan to Nob Hill. By keeping these funds as part of the improper tax scheme described above, in which they participated, Rabobank and/or Utrecht had and retained a benefit which in equity and good conscience belongs to another, namely, Plaintiff, the sole shareholder of Westside, who was wrongfully drawn into Defendants' scheme, as set forth above.

WHEREFORE, Plaintiff respectfully prays that this Honorable Court enter the following relief in favor of the Plaintiff and against Defendant(s):

A. A judgment for compensatory damages in favor of Plaintiff and against Defendant(s), jointly and severally on all applicable claims in an amount in excess of $10,000 to be determined at trial.

B. A judgment for punitive damages in favor of Plaintiff and against Defendant(s), jointly and severally on all applicable claims in an amount in excess of $10,000 to be determined at trial.

C. A judgment for three times compensatory damages in favor of Plaintiff and against Defendant(s), jointly and severally on all applicable claims in an amount to be determined at trial.

D. Costs of investigation and litigation reasonably incurred;

E. A judgment in favor of the Plaintiff and against such Defendant(s), ordering Rabobank and/or Utrecht, as the case may be, to turn over in restitution the sums unjustly retained, including interest;

F. Attorney's fees and costs and expenses for filing and proceeding with this suit.

G. Any other good and proper relief as this Court deems appropriate.

JURY DEMAND

Plaintiff demands trial by jury on all claims so triable as of right.

DATED this 29th day of April, 2016.

HUTCHISON & STEFFEN, LLC

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Attorneys for Plaintiff

DISTRICT COURT

CLARK COUNTY, NEVADA

A-16-735910-B

MICHAEL A. TRICARICHI,	CASE NO.
	DEPT NO. XV
Plaintiff,	
	INITIAL APPEARANCE FEE DISCLOSURE (NRS CHAPTER 19)
v.	
PRICEWATERHOUSECOOPERS, LLP, COÖPERATIEVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW LLP and GRAHAM R. TAYLOR,	
Defendants.	

Pursuant to NRS Chapter 19, as amended by Senate Bill 106, filing fees are submitted for parties appearing in the above-entitled action as indicated below:

MICHAEL A. TRICARICHI, Plaintiff	$1,530.00
TOTAL REMITTED: **(required)**	**$1,530.00**

DATED this 29th day of April, 2016.

HUTCHISON & STEFFEN, LLC

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Attorneys for Plaintiff

ACCEPTANCE OF SERVICE

Service of Complaint and Summons herein upon Defendant Seyfarth Shaw LLP, is accepted this 16th day of May, 2016, by Matthew J. Gehringer, Esq. of Perkins Coie LLP, who warrants that he is duly authorized to accept service on behalf of named Defendant Seyfarth Shaw LLP specified above without waiving any right to assert any substantive or procedural defenses to the Complaint. Counsel for Plaintiffs and Counsel for Seyfarth Shaw LLP have also stipulated and agreed to extend by 30 days Seyfarth Shaw LLP's time to answer or otherwise plead to the Complaint up to and including July 5, 2016.

Matthew J. Gehringer
Attorney for Defendant Seyfarth Shaw LLP

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DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiffs, v. PRICEWATERHOUSECOOPERS, LLP, COOPERATIVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW, LLP and GRAHAM R. TAYLOR, Defendants.	Case No. A-16-735910-B Dept: XV **MOTION TO DISMISS FOR LACK OF JURISDICTION ON BEHALF OF DEFENDANT SEYFARTH SHAW LLP** **DATE:** __________ **TIME:** __________

MORRIS LAW GROUP
900 BANK OF AMERICA PLAZA · 300 SOUTH FOURTH STREET · LAS VEGAS, NEVADA 89101
702/474-9400 · FAX 702/474-9422

Seyfarth Shaw LLP ("Seyfarth"), a law firm organized as an Illinois limited liability partnership and headquartered in Chicago, Illinois, moves this Court for an order dismissing Plaintiff's complaint for lack of personal jurisdiction over Seyfarth. This motion is based on Nev. R. Civ. P. 12(b)(2), the points and authorities that follow, and the declarations attached hereto.

MORRIS LAW GROUP

By: /s/ STEVE MORRIS
Steve Morris, Bar No. 1543
Ryan M. Lower, Bar No. 9108
900 Bank of America Plaza
300 South Fourth Street
Las Vegas, Nevada 89101

Attorneys for Defendant
Seyfarth Shaw LLP

NOTICE OF MOTION

PLEASE TAKE NOTICE that the undersigned will bring the foregoing Motion to Dismiss for Lack of Jurisdiction on Behalf of Defendant Seyfarth Shaw LLP on for hearing before the above-entitled Court on the ___ day of ________________, 2016 at the hour of ___, _.m., or as soon thereafter as counsel can be heard.

MORRIS LAW GROUP

By: /s/ STEVE MORRIS
Steve Morris, Bar No. 1543
Ryan M. Lower, Bar No. 9108
900 Bank of America Plaza
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POINTS AND AUTHORITIES

I. INTRODUCTION

Plaintiff's decision to move from Ohio to Nevada in 2003 in the midst of the transaction at issue in this lawsuit—a transaction in which Seyfarth played no part—is the only connection between the litigation and Nevada. Plaintiff's wholly-owned non-Nevada corporation entered into a transaction in 2003 that was later found by the IRS to be an illegal tax shelter. After Plaintiff's tax-avoidance transaction left his corporation with no assets, the IRS assessed liability against him individually. In his complaint, he alleges that Seyfarth through its former partner, Graham Taylor ("Taylor"), "facilitated" the invalid transaction by providing a tax opinion to a third party, not to Plaintiff, about a different transaction that occurred two years earlier than the transaction at issue here. The Complaint does not allege any contact at all between Plaintiff and Seyfarth or Taylor; it likewise does not allege contact between Seyfarth and the State of Nevada relating in any way to this case, much less constitutionally sufficient minimum contacts to permit personal jurisdiction over it in this Court. The Court should dismiss the Complaint against Seyfarth because it lacks personal jurisdiction over Seyfarth.

II. FACTUAL BACKGROUND

The Complaint alleges that Plaintiff Michael Tricarichi ("Tricarichi" or "Plaintiff") operated an Ohio cellular telephone business, Westside Cellular, until 2003, when he shut the business down as part of a settlement of litigation with competitors. Compl. ¶¶ 27-28. Westside received $65 million as the result of settlement. Compl. ¶ 28. After paying attorneys' fees and the expenses of winding down its cellular telephone business, Westside realized approximately $40 million of income, which would be taxable both to Westside, a C-corporation, and after distribution, to Plaintiff as its sole shareholder. *Id.* Seeking to avoid a significant part of the income tax on this substantial sum, Plaintiff entered into a transaction with Fortrend International, a California based Delaware company that is now defunct, which agreed to purchase Plaintiff's shares in Westside and to employ Westside in Fortrend's debt collection business. Compl. ¶¶ 29, 32, 41. Westside's substantial income would then be set off for tax purposes against enormous bad debt deductions of Fortrend's debt collection business, thus eliminating Westside's tax liability. Compl. ¶ 32. As part of the stock sale, Fortrend indemnified Plaintiff against Westside's 2003 tax liability. Compl. ¶ 42. None of this activity involved Seyfarth.

Plaintiff hired Defendant PricewaterhouseCoopers ("PWC") for advice regarding the Westside stock transaction with Fortrend. Compl. ¶ 37. Sometime after he engaged PWC, Plaintiff moved from Ohio to Nevada to avoid state income tax on his personal gain from the sale of his Westside stock. *Tricarichi v. C.I.R*, T.C. Memo. 2015-201, 110 T.C.M. (CCH) 370, at *2, *5 (2015) (attached as Ex. A). The various stock purchase and related transactions executed by Plaintiff were designed to leave Westside with no assets so that, even if the IRS determined that Westside owed taxes on the settlement proceeds, there would be no assets left in Westside to satisfy any such liabilities. *Id.* at *6. Nob Hill, Inc., alleged to be a Fortrend affiliate, then purchased Plaintiff's shares in Westside, and Defendant Rabobank took a security interest in the Westside stock to secure financing for the transaction via Defendant Utrecht. Compl. ¶¶ 44, 45, 47, 54. The stock purchase transaction closed on September 9, 2003. Compl. ¶ 54. None of this activity involved Seyfarth.

In a separate unrelated transaction in 2001, United Finance Co. Ltd., a Japanese lender, contributed approximately $314 million of distressed Japanese debt, with a market value of only $137,000, to an affiliate of Millennium Recovery Fund. Compl. ¶¶ 60-61. In August 2003, Seyfarth

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partner Graham Taylor provided a legal opinion *to Millennium* for that transaction. He opined that Millennium would be treated as a partnership for tax purposes and that the 2001 transfer of the Japanese debt would be treated as a contribution, not a sale; therefore, Millennium's tax basis in the Japanese debt portfolio acquired would be its origination face value, not its greatly reduced market value when it was contributed in 2001. Compl. ¶ 61; *see also* August 21, 2003 Letter attached as Ex. B. Seyfarth's opinion letter is addressed to Millennium at an address in Ireland. It does not reference Plaintiff, Westside, Fortrend, Nob Hill, Rabobank or Utrecht. Rather, it specifically states that it may only be relied upon by Millennium. *See* Ex. B at 64. The opinion letter does not mention the stock purchase between Westside and Fortrend. *See* Ex. B. The Letter has nothing to do with Nevada.

In November 2003, three months after Seyfarth's opinion letter to Millennium, and two months after the sale of Plaintiff's stock in Westside to Fortrend closed, Millennium contributed a portion of its Japanese debt—two defaulted loans with a face value of approximately $43 million—to Westside. Compl. ¶ 69(a). Westside deducted an approximately $42 million bad debt loss based on the bad Japanese debt, thus offsetting settlement income in an effort to avoid federal income tax liability for 2003. *Id.* The deduction allowed Westside to file its 2003 tax return claiming that it did not have owe any federal taxes for income received in 2003. Compl. ¶ 69(c).

The IRS audited Westside's 2003 tax return, and in 2009 rejected the tax deduction, finding the stock sale to Fortrend was substantially similar to a "Midco" transaction, which the IRS had rejected in 2001. Compl. ¶ 75; *see also id.* ¶ 40. In these condemned transactions, Fortrend allegedly stripped Westside of its remaining assets, leaving no assets to satisfy Westside's tax liability. Compl. ¶ 76. The IRS then imposed the tax liability

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on Plaintiff individually. Compl. ¶ 77-78. In a 2015 opinion, the United States Tax Court found Plaintiff individually liable for Westside's tax liability under the Ohio fraudulent transfer statute. Compl. ¶ 79; *see also Tricarichi*, T.C. Memo. 2015-201, Ex. A. Plaintiff then filed this Complaint against PWC, Rabobank, Utrecht, Seyfarth and Taylor, claiming negligence by PWC and aiding and abetting, civil conspiracy and racketeering against the other defendants. None of this alleged activity took place in Nevada or was purposefully directed to the state by Seyfarth.

The Complaint does not allege Plaintiff saw or received the Seyfarth opinion letter to Millennium before entering into the Westside/Fortrend stock purchase agreement that the IRS rejected. The Seyfarth opinion explicitly states that it is exclusively for Millennium, and only Millennium can rely on it—and only with respect to Millennium's transaction. Ex. B at p. 64. In fact, the Tax Court rejected Plaintiff's attempt to rely on the Seyfarth opinion letter to support Westside's bad debt deduction, finding that "[i]t was based on assumed facts ...; those assumed facts are contradicted by the record evidence in this case; and the memorandum explicitly states that no one but Millennium can rely upon it." *Tricarichi*, T.C. Memo. 2015-201, at *14 n.9, Ex. A.

The Complaint does not allege that Seyfarth had any contact whatsoever with Plaintiff or the State of Nevada in connection with the Millennium opinion letter to Millennium or the "Midco transaction" that is the subject of the Complaint. Indeed, the only relevant allegations regarding Seyfarth are that it is a "law firm with its principal office in Chicago, Illinois," and that "one Seyfarth attorney maintains a Nevada bar license and on information and belief Seyfarth partners reside and/or do business in Nevada." Compl. ¶ 13. Plaintiff alleges that by providing the Seyfarth opinion letter to Millennium, "blessing" its claim to a high tax basis in the

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Japanese debt acquired in March 2001, Seyfarth somehow "facilitated the Midco transaction that defrauded Plaintiff" in 2003. Compl. ¶ 62. Although he does not allege any connection between himself and Seyfarth, Plaintiff alleges that Seyfarth and the other defendants "conspired with Fortrend to unlawfully defraud the Plaintiff and others by means of false or fraudulent pretenses, representations, omissions, concealments and suppression of facts." Compl. ¶ 105.

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III. ARGUMENT

A. Plaintiff Has Not Alleged Facts That Would Establish Personal Jurisdiction Over Seyfarth.

Because Seyfarth challenges personal jurisdiction, Plaintiff has the burden to produce evidence that establishes all facts necessary to support personal jurisdiction. *Freeman v. Second Jud. Dist. Ct.*, 116 Nev. 550, 553, 1 P.3d 963, 965 (2000); *Trump v. Eighth Jud. Dist. Ct.*, 109 Nev. 687, 692-93, 857 P.2d 740, 743-33 (1993). Mere conclusory statements in the Complaint unsupported by specific facts are irrelevant to determining jurisdiction and must be disregarded. *See Butcher's Union Local No. 498, UF&CW v. SDC Inv., Inc.*, 788 F.2d 535, 540 (9th Cir. 1986).

Nevada's long-arm statute allows the Court to exercise personal jurisdiction "on any basis not inconsistent with the Constitution of this state or the Constitution of the United States." NRS 14.065(1). Nevada courts thus can exercise jurisdiction only to the extent permitted by the due process clause of the United States Constitution. *Baker v. Eighth Jud. Dist. Ct.*, 116 Nev. 527, 531-32, 999 P.2d 1020, 1023 (2000). To satisfy constitutional due process, a defendant must have certain "minimum contacts" with the forum "such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." *Walden v. Fiore*, 134 S. Ct. 1115, 1121 (U.S. 2014) (internal quotations omitted).

Neither "general or all-purpose jurisdiction" nor "specific or case-linked jurisdiction" exists over Seyfarth in this case. *See Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915, 919 (2011). Specific jurisdiction exists when the cause of action arises out of or has a substantial connection to the defendant's purposeful contacts with the forum. *Id.*; *Walden*, 134 S. Ct. at 1121-22. Alternatively, general jurisdiction may exist over a defendant whose contacts are substantial, continuous, and systematic so as to render it "at home" in the forum even if the suit concerns matters that did not arise out of his contacts with the forum. *Daimler AG v. Bauman*, 134 S. Ct. 746, 749 (U.S. 2014).

Both general and specific personal jurisdiction require Plaintiff to demonstrate a defendant's "purposeful availment" of the benefits and privileges provided by the forum state. *Glencore Grain Rotterdam B.V. v. Shivnath Rai Harnarain Co.*, 284 F.3d 1114, 1123 (9th Cir. 2002). "By requiring that contacts proximately result from actions by the defendant *himself* that create a substantial connection with the forum State, the Constitution ensures that a defendant will not be haled into a jurisdiction solely as a result of random, fortuitous, or attenuated contacts." *Id.* (emphasis in original) (internal quotations omitted).

Plaintiff conclusorily alleges that "[t]his Court has personal jurisdiction over Defendants by virtue of their ongoing contacts with the state of Nevada, and/or because they purposefully availed themselves of, or directed their activities toward, the forum state of Nevada by participating in, substantially assisting and/or conspiring with Fortrend and other parties to advance the transaction that was promoted to and targeted Plaintiff, a Nevada resident, with Plaintiffs injuries arising in Nevada as a result." Compl. ¶ 21. No facts are pleaded to support these allegations against Seyfarth. Thus, there is no basis in fact or law for the Court to exercise either

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general or specific personal jurisdiction over Seyfarth. The Complaint should therefore be dismissed against Seyfarth.

B. Because Seyfarth Is Not "At Home" in Nevada, It is Not Subject to General Jurisdiction.

General jurisdiction is appropriate only when a non-resident defendant's "affiliations with the State are so 'continuous and systematic' as to render [it] essentially at home in the forum State." *Daimler AG v. Bauman*, 134 S. Ct. 746, 751 (U.S. 2014). "This is an exacting standard, as it should be, because a finding of general jurisdiction permits a defendant to be haled into court in the forum state to answer for any of its activities anywhere in the world." *Schwarzenegger v. Fred Martin Motor Co.*, 374 F.3d 797, 801 (9th Cir. 2004).

"With respect to a corporation, the place of incorporation and principal place of business are 'paradig[m] ... bases for general jurisdiction.'" *Daimler AG v. Bauman*, 134 S. Ct. 746, 760 (U.S. 2014). As the attached Affidavit of Lori Roeser shows, Seyfarth is a limited liability partnership organized under the laws of Illinois, with its principal place of business in Chicago, Illinois. Roeser Aff., attached as Ex. C, at ¶ 3. On that basis alone there is no general jurisdiction over Seyfarth in Nevada under *Daimler*. Moreover, Seyfarth lacks any other constitutionally significant connection to this State. Seyfarth is not registered with the Nevada Secretary of State, maintains no offices and owns no property in Nevada, does not employ any staff or attorneys in Nevada, and does not pay taxes in Nevada. Roeser Aff., Ex. C, at ¶¶ 4-8.[1] As a matter of constitutional law, Seyfarth is not "at home"

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[1] Plaintiff alleges "on information and belief" that Seyfarth has offices and is doing business in Nevada, but a brief review of Seyfarth's website shows no offices in Nevada. The allegation is nonetheless false, as established by the affidavit of Lori Roeser. Upon challenge by an affidavit, Plaintiff must support his jurisdictional allegations with evidence; he may not simply rely on the allegations of the complaint to establish personal

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in Nevada. Plaintiff attempts nonetheless to plead a connection between Seyfarth and Nevada, alleging that *one* Seyfarth attorney is licensed in Nevada (Compl. ¶ 13), which is insufficient for jurisdiction as a matter of law. As a matter of fact, that person is a California-licensed attorney who practices in Seyfarth's Sacramento, California, but is also admitted to the Nevada bar. Roeser Aff., Ex. C, at ¶ 9. He is a counsel to Seyfarth, not a partner in the firm. Moreover, he is not domiciled in Nevada. *Id.* These spare facts do not make Seyfarth "at home" in Nevada. Thus there is no general jurisdiction over Seyfarth in Nevada.

This conclusion is confirmed by *Baker v. Eighth Jud. Dist. Court*, 116 Nev. 527, 999 P.2d 1020 (2000), in which the Nevada Supreme Court rejected a claim that an individual defendant was subject to general jurisdiction based on the fact that he was a nonresident member of the Nevada bar. The Supreme Court said, "state bar membership does not necessarily implicate substantial, continuous or systematic conduct." *Id.* at 532-33, 999 P.2d at 1023. Similarly, a law firm headquartered elsewhere is not subject to general jurisdiction in Nevada based on the activities of a small fraction of its attorneys. In *Fulbright & Jaworski LLP v. Eighth Jud. Dist. Court*, 131 Nev. Adv. Op. 5, 342 P.2d 997 (2015), the Supreme Court found that one attorney who was registered as a lobbyist in Nevada and seven attorneys from the firm who were admitted to practice *pro hac vice* in Clark County District Court ("only a fraction of Fulbright & Jaworski's overall business") did not add up to "substantial activities that are so continuous and systematic that Nevada can be considered Fulbright & Jaworski's home." 342 P.2d at 1002; *see also Cromeans v. Morgan Keegan & Co., Inc.*, No. 2:12-CV-04259-NKL, 2014 WL 1375038, at *12-13 (W.D. Mo. Apr. 8, 2014)

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jurisdiction. *Trump v. Eighth Jud. Dist. Ct.*, 109 Nev. 683, 693, 857 P.2d 740, 744 (1993).

(finding no personal jurisdiction where 4 of approximately 800 lawyers in firm maintained active Missouri bar licenses, and rejecting "the sweeping proposition that every legal partnership is subject to general jurisdiction in any state in which one of its partners happens to have an active bar membership"). That ***one*** of Seyfarth's more than 850 attorneys who practices in California also maintains a license in Nevada is insufficient to establish that Seyfarth is "at home" in Nevada.

C. Plaintiff Alleges No Facts That Would Establish Specific Jurisdiction Over Seyfarth.

This Court may only exercise specific personal jurisdiction over a defendant when: (1) the defendant *himself* purposefully establishes contact with Nevada and affirmatively directs his conduct toward the state; and (2) the cause of action arises from such purposeful contact with Nevada. *Baker*, 116 Nev. at 533, 999 P.2d at 1024; *Walden*, 134 S. Ct. at 1122. Additionally, the exercise of jurisdiction must be "reasonable." *Judas Priest v. Second Jud. Dist. Court*, 104 Nev. 424, 426, 760 P.2d 137, 138 (1988) (citing *Asahi Metal Industry Co. v. Superior Court*, 480 U.S. 102 (1987)). Plaintiff has the burden to establish all three of these elements. He fails to do so here because he cannot establish the first requirement: purposeful contact with Nevada by Seyfarth.

Plaintiff's only allegation of direct action by Seyfarth is that Seyfarth provided an "illegitimate" tax opinion to Millennium that it allegedly knew would be used by Fortrend to promote the transaction to Plaintiff, a Nevada resident, who would be damaged in Nevada. Compl. ¶¶ 5, 1-62, 68, 101.[2] Plaintiff does not—nor could he—allege that the tax

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[2] Plaintiff also alleges that Seyfarth knew that the Fortrend transaction was illegitimate but did not disclose that to Plaintiff. ¶¶ 6, 73. There is no duty on the part of Seyfarth to disclose to Plaintiff, and no facts to support any such duty are alleged anywhere in the Complaint. *Cf.* Compl. ¶ 82,

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opinion was created in or sent to Nevada for plaintiff to rely on. The face of the Millennium Opinion Letter shows it was addressed to Millennium Recovery Fund in Ireland, without mention of Plaintiff or any of his transactions. Even if the Opinion Letter suggested some knowledge of Plaintiff's presence in Nevada, that would be wholly insufficient for jurisdiction. The United States Supreme Court's most recent pronouncements in *Walden* are dispositive of the absence of specific jurisdiction in this case. *Walden* explicitly held once again that mere knowledge by an out-of-state defendant that a resident of the forum state may be damaged by an action is insufficient to establish personal jurisdiction over that person. *See Walden*, 134 S. Ct. at 1122 (Supreme Court has "consistently rejected attempts to satisfy the defendant-focused 'minimum contacts' inquiry by demonstrating contacts between the plaintiff (or third parties) and the forum State"); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980) (holding mere fact it was foreseeable that a car might cause injury in another state insufficient to support personal jurisdiction); *Dogra v. Liles*, 129 Nev. Adv. Op. 100, 314 P.3d 952, 956 (2013) (holding owner's knowledge that loaned car might travel to any state insufficient for personal jurisdiction arising from Nevada accident).[3]

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alleging duty by PWC to Plaintiff. Even had Plaintiff alleged a duty to inform or advise Plaintiff, however, the failure to do so would have been a passive act that occurred in California, where Seyfarth, through Taylor, provided legal services to Millennium, not to Plaintiff. This falls far short of the purposeful direction of action in Nevada that due process would require to support specific jurisdiction. *See MGM Grand, Inc. v. Eighth Jud. Dist. Court*, 107 Nev. 65, 69, 807 P.2d 201, 203 (1991).

[3] To the extent that *Davis v. Eighth Jud. Dist.*, 97 Nev. 332, 629 P.2d 1209 (1981), suggested that specific jurisdiction could exist based on the location of the plaintiff's alleged injuries, *id.* at 338-39, 629 P.2d at 1213, it does not

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In *Walden*, two gamblers sued a DEA agent in Nevada for wrongful seizure of cash in a Georgia airport. *Walden*, 134 S. Ct. at 1119. Even though the agent allegedly knew the gamblers resided in Nevada and could foresee that harm from his actions in Georgia could occur in Nevada, all the relevant contacts, including seizing the plaintiffs' money and preparation of a false affidavit, took place in Georgia. *Id.* at 1124. There were no allegations that the DEA agent traveled to, conducted activities in, or sent anything to Nevada. *Id.* Thus, the United States Supreme Court held that Nevada did not have personal jurisdiction over the Georgia DEA agent. *Walden* is directly on point. Although Plaintiff alleges Defendants knew or should have known that Fortrend would target Plaintiff, a Nevada resident, he does not allege any purposeful contact by Seyfarth directed to Nevada.

Just as the plaintiff's allegation did in *Walden*, Plaintiff's allegations here focus on his, not Seyfarth's, personal contacts with Nevada—that ***he*** resides here and allegedly suffered injury here. *E.g.*, Compl. ¶¶ 48, 52, 71. "But the plaintiff cannot be the only link between the defendant and the forum. Rather, it is the defendant's conduct that must form the necessary connection with the forum State that is the basis for its jurisdiction over him." *Walden*, 134 S. Ct. at 1122. For Seyfarth to have minimum contacts with Nevada, it must have "affirmatively direct[ed] conduct" to the forum; mere passive knowledge or foreseeability that Plaintiff would be injured here is jurisdictionally deficient. *Viega GmbH v. Eighth Jud. Dist. Ct.*, 130 Nev. Adv. Op. 40, 328 P.2d 1152, 1157 (2014); *see also Pebble Beach Co. v. Caddy*, 453 F.3d 1151, 1156-57 (9th Cir. 2006) (holding purposeful direction for purposes of minimum contacts requires "something

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survive the United States Supreme Court's and Nevada Supreme Court's explicit holdings in *World-Wide Volkswagen*, *Dogra*, and *Walden*.

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more" than "mere foreseeable effect"; it requires "express aiming" at forum or individualized targeting of plaintiff).

The mere possibility that a letter written to someone in Ireland might be alleged as the basis for liability in Nevada does not satisfy the due process requirement of minimum contacts with this State. *See Rockwood Select Asset Fund XI (6)-1, LLC v. Devine, Millimet & Branch*, 750 F.3d 1178 (10th Cir. 2014), in which a New Hampshire law firm issued an opinion letter regarding a loan to a Utah company. *Id.* at 1179. The letter was addressed to the Utah company, but the law firm did not send it to Utah; instead a third party picked up the letter in New Hampshire and forwarded it to the Utah company. The Utah company subsequently sued the law firm for negligently preparing the letter. Relying on *Walden*, the Tenth Circuit held that, even though the law firm "interacted with the plaintiff after learning of its strong connections to the forum state," there were no direct actions by the defendant law firm to avail itself of the privilege of conducting business in Utah. *Id.* at 1180; *accord, Trierweiler v. Croxton & Trench Holding Corp.*, 90 F.3d 1523, 1534 (10th Cir. 1996) (holding that a Colorado law firm was not subject to personal jurisdiction in Michigan even though the law firm knew its opinion letter would be sent to the Michigan plaintiff and a firm lawyer made one phone call to the plaintiff in Michigan). Plaintiff's case for personal jurisdiction over Seyfarth is far weaker here—the Seyfarth opinion letter is addressed to Millennium Recovery Fund in Ireland, not to Plaintiff Tricarichi in Nevada.

The opinion letter to Millennium does not mention Plaintiff or his transaction by name or description, nor does it refer to contact with the Plaintiff. Here, "as in *Walden*, [Plaintiff's economic] injury ... is not tethered to [Nevada] in any meaningful way. Rather, his injury is entirely personal to him and would follow him wherever he might choose to live or travel.

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The effects of [the defendants'] actions are therefore 'not connected to the forum State in a way that makes those effects a proper basis for jurisdiction.'" *Picot v. Weston*, 780 F.3d 1206, 1215 (9th Cir. 2015) (citing *Walden*). There is no constitutionally sufficient basis for specific personal jurisdiction over Seyfarth. The Complaint against the firm should be dismissed.

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D. Plaintiff's Conspiracy and Aiding and Abetting Claims Do Not Support Specific Jurisdiction.

Plaintiff invokes the "conspiracy theory of jurisdiction" to allege specific jurisdiction based on his conspiracy and aiding and abetting claims. Compl. Counts III and IV, at p. 32-34. But a plaintiff cannot rely on mere allegations to establish personal jurisdiction; rather, he has the burden of "introducing competent evidence of specific facts" to establish either or both of these claims. *Trump*, 857 P.2d at 743.

These allegations cannot support specific jurisdiction against Seyfarth for at least two reasons. First, "the cases are unanimous that a bare allegation of a conspiracy between the [non-resident] defendant and a person within the personal jurisdiction of the court"—which is all Plaintiff alleged here—"is not enough" to establish specific jurisdiction over the non-resident defendant. *Chirila v. Conforte*, 47 Fed. App'x 838, 843 (9th Cir. 2002). *See also Chase Bank USA N.A. v. Hess Kennedy Chartered PLC*, 589 F. Supp. 2d 490, 499 (D. Del. 2008); *First Capital Asset Mgmt., Inc.*, 218 F. Supp. 2d at 394; *Olson v. Jenkens & Gilchrist*, 461 F. Supp. 2d 710, 724 (N.D. Ill. 2006). *Cf.* Compl. ¶ 105.

Second, the Complaint does not allege facts showing that Seyfarth "purposefully" availed itself of Nevada or its laws in connection with the alleged conspiracy. A "corporation can purposefully avail itself of a forum by directing its agents or distributors to take action ***there***." *Daimler*, 134 S. Ct. at 759 n.13 (emphasis added). Under this rule, the foreign corporation (Seyfarth) must specifically instruct its purported "agent" (Taylor) to engage in forum activity relating to the underlying cause of action.

In this case, Plaintiff does not allege specific facts to establish that Seyfarth ***directed*** Taylor to engage in any Nevada conduct relating to the alleged conspiracy. Instead, the Complaint alleges the conclusion that "Fortrend made false representations to Plaintiff" (Compl. ¶98), which at best is passive activity (with respect to Seyfarth) that our Supreme Court recently confirmed cannot satisfy the jurisdictional requirement of "***affirmatively direct[ing] conduct" in the forum state***. *Viega*, 328 P.3d at 1157 (emphasis added). No such affirmatively directed conduct is alleged in this case. *See also Walden*, 134 S. Ct. at 1122 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985) (jurisdiction must be based on contacts that "defendant *himself*" created with the forum state), and *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 291-92 (1980)).

Mere conspiracy allegations are insufficient to establish personal jurisdiction over Seyfarth. The United States Supreme Court has "consistently rejected attempts to satisfy the defendant-focused 'minimum contacts' inquiry by demonstrating contacts between the plaintiff (***or third parties***) and the forum State." *Walden*, 134 S. Ct. at 1122 (emphasis added). Actions of other defendants or non-parties cannot be attributed to Seyfarth or Taylor by pleading a conspiracy theory of personal jurisdiction.

Even before *Walden* was decided, federal courts in Nevada rejected the conspiracy theory of personal jurisdiction. *See In re W. States Wholesale Nat. Gas Litig.*, 605 F. Supp. 2d 1118, 1140 (D. Nev. 2009) ("a co-conspirator's activity directed at the forum, even if in furtherance of a conspiracy of which the foreign defendant is a member, cannot constitute

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purposeful direction at the forum by the foreign defendant. The Court thus concluded that allegations of specific acts committed by a co-conspirator in the forum in furtherance of the conspiracy, alone, are insufficient to establish minimum contacts by a defendant who otherwise has no contacts with the forum"); *Menalco, FZE v. Buchan*, 602 F. Supp. 2d 1186, 1194 n.1 (D. Nev. 2009) (suggesting that a conspiracy theory of jurisdiction would not comport with federal due process requirements).[4]

IV. CONCLUSION

Seyfarth has no connection to Plaintiff Tricarichi or to his sale of his Westside stock in the transaction described in the Complaint. Seyfarth does not have constitutionally significant minimum contacts with the State of Nevada sufficient to subject it to general or specific jurisdiction in this Court. The Court should dismiss all claims against Seyfarth for lack of personal jurisdiction.

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[4] Other courts have also rejected the conspiracy theory as inconsistent with due process. *See, e.g., Foley v. Marquez*, No. C 03-2481 SI, 2004 WL 603566, at *4 (N.D. Cal. Mar. 22, 2004) ("The conduct of a co-conspirator is generally too tenuous to warrant the exercise of personal jurisdiction); *Insolia v. Philip Morris Inc.*, 31 F. Supp. 2d 660, 672 (W.D. Wis. 1998) ("it is clear that jurisdiction under [the conspiracy] theory [of personal jurisdiction] would not comport with due process"); *Kipperman v. McCone*, 422 F. Supp. 860, 873 n. 14 (N.D. Cal. 1976) (calling theory "frivolous").

CERTIFICATE OF SERVICE

Pursuant to Nev. R. Civ. P. 5(b) I certify that I am an employee of MORRIS PETERSON; that I am familiar with the firm's practice of collection and processing documents for mailing; that, in accordance therewith, I caused the following document to be deposited with the U.S. Postal Service at Las Vegas, Nevada, in a sealed envelope, with first class postage prepaid, on the date and to the addressee(s) shown below: **MOTION TO DISMISS FOR LACK OF JURISDICTION ON BEHALF OF DEFENDANT SEYFARTH SHAW LLP**

TO:

Mark A. Hutchison
Todd L. Moody
Todd W. Prall
HUTCHISON & STEFFEN, LLC
10080 West Alta Drive, Suite 200
Las Vegas, Nevada 89145

Scott F. Hessell
Thomas D. Brooks
SPERLING & SLATER, P.C.
55 West Monroe, Suite 3200
Chicago, IL 60603

DATED this 5th day of July, 2016.

By: /s/ PATRICIA FERRUGIA

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EXHIBIT A

T.C. Memo. 2015-201
United States Tax Court.

Michael A. TRICARICHI, Transferee, Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

No. 23630–12.
|
Oct. 14, 2015.

Synopsis
Background: Individual taxpayer petitioned for redetermination of C corporation's tax liability of $21,199,347, plus interest, for which IRS determined taxpayer to be liable as transferee of corporate assets in intermediary company, or "Midco," tax shelter transaction.

Holdings: The Tax Court, Lauber, J., held that:

[1] none of corporation's disallowed legal and professional fees deductions constituted deductible business expenses;

[2] IRS appropriately denied corporation's claimed $42,480,622 bad debt loss deduction;

[3] purported loans to finance purchase of taxpayer's stock were shams;

[4] under Ohio law, taxpayer was direct transferee of corporation's assets;

[5] transfer of assets to taxpayer was fraudulent under Ohio law;

[6] taxpayer had transferee liability for penalties; and

[7] IRS reasonably declined to take further steps to collect from corporation.

Decision for IRS.

Attorneys and Law Firms

Michael Desmond, Bradley A. Ridlehoover, and Craig D. Bell, for petitioner.

Heather L. Lampert, Julie Gasper, Katelynn Winkler, Candace Williams, and Robert Morrison, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

LAUBER, Judge:

*1 In a notice of liability, the Internal Revenue Service (IRS or respondent) determined that petitioner is liable for $21,199,347 plus interest as a transferee of the assets of West Side Cellular, Inc. (West Side). Petitioner was [*2] the sole shareholder of West Side, a C corporation, until he sold his shares to an affiliate of Fortrend International LLC (Fortrend) in September 2003. The type of transaction in which he sold his shares is commonly called an "intermediary company" or "Midco" transaction. The underlying tax liabilities of West Side include a tax deficiency of $15,186,570 and penalties of $6,012,777 for 2003.

Midco transactions, a type of tax shelter, were widely promoted during the late 1990s and early 2000s. MidCoast Credit Corp. (MidCoast), which plays a supporting role in this case, and Fortrend, which plays the principal role, were leading promoters of Midco transactions. Both have been involved in numerous transactions previously considered by this Court.[1] In Notice 2001–16, 2001–1 C.B. [*3] 730, *clarified by* Notice 2008–111, 2008–51 I.R.B. 1299, the IRS listed Midco transactions as "reportable transactions" for Federal income tax purposes.

Although Midco transactions took various forms, they shared several key features, well summarized by the Court of Appeals for the Second Circuit in *Diebold Found. Inc. v. Commissioner*, 736 F.3d 172, 175–176 (2d Cir.2013), *vacating and remanding* T.C. Memo.2010–238. These transactions were chiefly promoted to shareholders of closely held C corporations that had large built-in gains. These shareholders, while happy about the gains, were typically unhappy about the tax consequences. They faced the prospect of paying two levels of income tax on these gains: the usual corporate-level tax, followed by a shareholder-level tax when the gains were distributed to them as dividends or liquidating distributions. And this problem could not be avoided by selling the shares. Any rational buyer would normally insist on a discount to the purchase price equal to the built-in tax liability that he would be acquiring.

Promoters of Midco transactions offered a purported solution to this problem. An "intermediary company" affiliated with the promoter—typically, a shell company, often organized offshore—would buy the shares of the target company. The target's cash would transit through the "intermediary company" to the selling shareholders. After acquiring the target's embedded tax liability, the "intermediary [*4] company" would plan to engage in a tax-motivated transaction that would offset the target's realized gains and eliminate the corporate-level tax. The promoter and the target's shareholders would agree to split the dollar value of the corporate tax thus avoided. The promoter would keep as its fee a negotiated percentage of the avoided corporate tax. The target's shareholders would keep the balance of the avoided corporate tax as a premium above the target's true net asset value (i.e., assets net of accrued tax liability).

*2 In due course the IRS would audit the Midco, disallow the fictional losses, and assess the corporate-level tax. But "[i]n many instances, the Midco is a newly formed entity created for the sole purpose of facilitating such a transaction, without other income or assets and thus likely to be judgment-proof. The IRS must then seek payment from other parties involved in the transaction in order to satisfy the tax liability the transaction was created to avoid." *Id.* at 176.

In a nutshell, that is what happened here. Petitioner engaged in a Midco transaction with a Fortrend shell company; the shell company merged into West Side and engaged in a sham transaction to eliminate West Side's corporate tax; the IRS disallowed those fictional losses and assessed the corporate-level tax against West Side; but West Side, as was planned all along, is judgment proof. The IRS accordingly seeks to collect West Side's tax from petitioner as the transferee of [*5] West Side's cash. We hold that petitioner is liable for West Side's tax under the Ohio Uniform Fraudulent Transfer Act and that the IRS may collect West Side's tax liabilities in full from petitioner under section 6901(a)(1)[2] as a direct or indirect transferee of West Side. We accordingly rule for respondent on all issues.

FINDINGS OF FACT

The parties filed stipulations of facts with accompanying exhibits that are incorporated by this reference. At the time the Midco transactions were executed, petitioner resided in Ohio. He moved shortly thereafter to Nevada, and he resided in Nevada at the close of the 2003 taxable year and when he petitioned this Court.

Petitioner graduated from Case Western Reserve University and embarked on a career in the cellular telephone (cell phone) business. He incorporated West Side in 1988 as a C corporation. Petitioner was the president and sole shareholder of West Side, and he and his wife, Barbara Tricarichi, served as its directors.

Although petitioner had no formal tax training, he displayed familiarity with tax concepts. At trial he spoke easily about C corporations and S corporations, corporate tax rates, and other tax matters. He explained that he organized West [*6] Side as a C corporation because he thought it might ultimately have more shareholders than an S corporation would be permitted to have.

In 1991 petitioner approached Verizon and other major cellular service providers with a proposal that West Side would become a reseller of cell phone services. From 1991 through 2003 West Side engaged in various telecommunications activities in Ohio, including the resale of cell phone services. West Side had a retail presence in Ohio, customer and vendor relationships, goodwill, know-how, a workforce in place, trade names, and other tangible and intangible assets. At its peak West Side had about 15,000 subscribers throughout Ohio.

Beginning in 1991, West Side purchased network access from the major cellular service providers in order to serve its customers. Petitioner soon came to believe that certain of these providers were discriminating against West Side. In 1993 he engaged the Cleveland law firm of Hahn Loeser & Parks, LLP (Hahn Loeser), to file a complaint with the Public Utilities Commission of Ohio (PUCO) against certain of these providers, alleging anticompetitive trade practices. The PUCO lawsuit was a "bet the company" matter for petitioner, and he took a hands-on role in the lengthy litigation that ensued. Hahn Loeser lawyers described him as a constant presence at the firm throughout this period.

*3 [*7] The PUCO ruled in West Side's favor on the liability issue and the Ohio Supreme Court affirmed that decision. In early 2003 West Side returned to the Court of Common Pleas to commence the damages phase of the litigation. Not long thereafter a settlement was reached, pursuant to which West Side ultimately received, during April and May 2003, total settlement proceeds of $65,050,141. In exchange West Side was required to terminate its business as a retail provider of cell phone service and to end all service to its customers as of June 10, 2003.

Petitioner's "Tax Problem"

Anticipating a large settlement, petitioner began to regret his decision, 15 years earlier, to organize West Side as a C corporation. He asked Jeffrey Folkman, a Hahn Loeser tax partner, to investigate how to "maximize whatever after-tax proceeds were available" from the anticipated settlement. Petitioner's goal was to "pay less tax than what the straight up, you know, 35% or whatever the corporate tax rate was" and avoid the two-level tax on the settlement proceeds.

Mr. Folkman had experience with MidCoast and thought it might help solve petitioner's problem. He arranged a meeting on February 19, 2003, with petitioner and MidCoast representatives. In preparation for this meeting, Hahn Loeser attorneys devoted five days of research and discussion to the "sham transaction" doctrine, "reportable transactions," and Notice 2001–16. Their billing records [*8] describe Notice 2001–16 as addressing (among other things) a transaction involving a "shareholder who wants to sell stock of a target" and "an intermediary corporation." At the February 19 meeting, MidCoast's representatives explained to petitioner that it was in the "debt collection business" and that, as part of its business model, it purchased companies that "had large tax obligations."

Shortly after the meeting with MidCoast, petitioner's brother, James Tricarichi (James), introduced him to Fortrend. On February 24, 2003, petitioner received a letter from Fortrend; he subsequently had several conference calls and at least one face-to-face meeting with Fortrend representatives. Petitioner understood that Fortrend and MidCoast were both involved with "distressed debt receivables" and had basically the same business model. Fortrend told petitioner that it would purchase his West Side stock and would offset the taxable gain with losses, thereby eliminating West Side's corporate income tax liability.

MidCoast and Fortrend each expressed interest in acquiring petitioner's West Side stock, and each made an offer proposing essentially the same transactional structure. An intermediary company would borrow money to purchase the stock. The cash held by West Side would be used immediately to repay the loan. The cash petitioner received from the intermediary company would substantially exceed West Side's net asset value. The intermediary company would receive a [*9] fee equal to a negotiated percentage of West Side's tax liabilities. And after the sale closed, the intermediary company, after merging into West Side, would use bad debt deductions to eliminate those tax liabilities.

*4 Because petitioner regarded MidCoast and Fortrend as competitors, he began negotiating with both in the hope of stirring up a bidding war. James arranged further conference calls with both companies. Rather than compete, MidCoast secretly agreed with Fortrend to step away from the transaction in exchange for a fee of $1,180,000 (ultimately paid by West Side on September 14, 2003). MidCoast's final offer was adjusted to make it seem unattractive, and petitioner therefore chose to pursue discussions with Fortrend in order to "maximize" his profits.

Bringing in PricewaterhouseCoopers

James recommended that petitioner retain PricewaterhouseCoopers (PwC) to advise him about the proposed stock sale. Acting as a conduit between petitioner and PwC, James sent a letter dated April 8, 2003, to PwC partner Richard Stovsky. This letter requested advice concerning a stock sale to MidCoast or Fortrend and a fallback strategy to mitigate petitioner's tax liability if the stock sale did not occur. PwC sent petitioner a draft engagement letter on April 10, 2003.

By this time petitioner had had extensive discussions with Mr. Folkman about Notice 2001–16, and the risk that the contemplated stock sale would give [*10] rise to a "reportable transaction." Upon receipt of PwC's draft engagement letter, petitioner reacted negatively to the following sentence: "You agree to advise us if you determine that any matter covered by this Agreement is a reportable transaction that is required to be disclosed." Petitioner struck this sentence from the engagement letter, initialed the change, and sent the draft back to PwC.[3]

Petitioner testified that he struck this sentence from the draft engagement letter because he wanted to ensure that PwC would thoroughly investigate all relevant issues. The Court did not find this testimony credible. Mr. Stovsky's draft engagement letter stated that PwC would investigate the relevant issues; the sentence about "reportable transactions" was included as a matter of PwC's due diligence to ensure that the client disclosed all relevant facts to it. The Court finds that petitioner struck this sentence from the draft engagement letter because he wanted to keep the paper trail free, to the maximum extent possible, of any references to "reportable transactions."

Working with tax professionals from several PwC offices, Mr. Stovsky prepared an internal memorandum addressing the proposed sale of West Side stock to Fortrend or MidCoast. This memorandum was revised multiple times as the negotiations [*11] evolved, and various drafts were discussed with petitioner and his advisers. The first draft of the memorandum, dated April 13, 2003, stated the following assumptions about the proposed transaction:

• [Buyer will] borrow $36,000,000 and purchase 100% of the Westside shares outstanding from * * * [petitioner]. * * *

• [Buyer will] contribute to Westside * * * high basis/low fair market value property (the assumption is that these are delinquent receivables).

*5 • Westside is now in the business of purchasing "distressed/charged-off" credit card debt * * * at pennies on the dollar and collecting on this debt.

• The business purpose for the acquisition of Westside is based on the new business' need for cash to purchase the charged-off credit card debt as commercial financing for such purchases is apparently difficult. Westside's cash and accounts receivable will provide such needed cash (note that most of the $40,000,000 cash in Westside will be distributed out of Westside and used by * * * [the buyer] to pay back the cash borrowed to purchase * * * [petitioner's] Westside stock).

• Westside writes off (apparently deductible for federal income tax purposes) some of the high basis/low fair market value property contributed by * * * [the buyer]. The deduction offsets the taxable income created within Westside upon the receipt of the $65,000,000 from the legal verdict.

• Westside, now a charged off debt business, utilizes "cost recovery tax accounting" which, apparently, results in tax deductions as a portion of the purchased credit card debt is collected.

• The suggested result, from a federal tax perspective, is as follows:

[*12]• [Petitioner] recognizes long-term capital gain upon the sale of his shares in Westside * * *.

• Westside offsets the taxable income from the legal verdict with the write off of high basis property.

The memorandum notes that petitioner planned to move from Ohio to a State without an income tax so that there would be no State tax on his gains.

PwC understood that Notice 2001–16 applied to Midco transactions described therein and to "substantially similar" transactions. Marginal notes on the memorandum also suggest PwC's understanding that the term "substantially similar" was to be broadly construed. But PwC concluded that "a position can be taken" that the stock sale would not be a reportable transaction. This was because "[a] typical 'Midco' transaction [has] 3 parties (this transaction only has 2), and a typical 'Midco' transaction results in an asset basis step up and the associated amortization deductions going forward (this transaction does not have these characteristics)."

The memorandum concluded that the proposed transaction was not without risk. It noted a particularly high level of risk in the "high basis/low value" debt receivable strategy that the buyer proposed to eliminate West Side's tax liabilities. PwC characterized this as a "very aggressive tax-motivated" strategy and indicated that the IRS would likely challenge the deductibility of the bad debt loss expected [*13] to be reported by West Side after the stock sale. Pointedly absent from the memorandum is any indication that PwC believed this strategy was "more likely than not" to be successful. Regardless, the memorandum suggested that "this is not * * * [petitioner's] concern" since the result would be a corporate tax liability and not petitioner's liability. The memorandum noted that PwC had provided no formal written advice to petitioner but had discussed its conclusions orally with him.

Formation of LXV

*6 Petitioner's representatives communicated with Fortrend after meeting with PwC. During these conversations Fortrend made clear that it did not want to acquire West Side's accounts receivable or any of its other operating assets. Rather, Fortrend wanted all operating assets stripped out of West Side before the closing so that West Side would be left with nothing but cash and tax liabilities.

In order to meet Fortrend's requirements, petitioner and three West Side employees formed LXV Group, LLC (LXV), an Ohio limited liability company, on May 2, 2003, to acquire West Side's operating assets. Each contributed $25,000 for his respective 25% interest in LXV. As mandated by the PUCO settlement agreement, West Side had to discontinue providing cell phone service to its customers by June 10, 2003. On June 11, 2003, LXV purchased all of West [*14] Side's operating assets, namely, its goodwill and its "revenue producing wireless customer base, accounts receivable, Trade names, Trade marks, chattels, fixtures, software and equipment" used in the operation of West Side's business.

The purchase price that LXV paid for these assets was $100,044. That amount was substantially less than the sum of West Side's net physical assets and accounts receivable ($74,564 + $166,940 = $241,504) as stated on West Side's balance sheet.[4] The parties to this transaction thus appear to have attached a value of zero to West Side's wireless customer base, trade marks, and trade names. Mr. Stovsky voiced concern that if fair market value were not paid for these assets, petitioner might face risk because of "the transferee liability issue." Despite this warning, petitioner did not obtain a valuation of the assets thus transferred.

Petitioner testified that his motivation for this sale was to "continue to service West Side's customers." The Court did not find this testimony credible. The parties' placement of zero value on West Side's intangible assets, including its wireless customer base, trade name, and trade marks, belies any intention to serve those customers in the future. Indeed, it is not clear how LXV could continue to [*15] serve West Side's cell phone customers because West Side's principals, who were also LXV's principals, were barred after June 10, 2003, from conducting any form of cell phone business. The Court finds as a fact that petitioner arranged the sale of West Side's operating assets to LXV in order to comply with Fortrend's requirement that West Side have nothing left in it except tax liabilities and cash.

Negotiation of the Stock Purchase Agreement

The parties adopted as their working assumption that West Side's accrued tax liability resulting from the $65 million PUCO settlement would not be paid. Since West Side at closing was to have only cash and tax liabilities, and since cash has a readily ascertainable value, the major item for negotiation was how to carve up the corporate tax liability thus avoided. The parties referred to this exercise as determining the "Fortrend premium." Petitioner actively participated in the negotiation of this point. Neither Hahn Loeser nor PwC participated in the negotiation of the stock purchase price or the "Fortrend premium."

*7 The trial record sheds little light on the early stages of the negotiations, when MidCoast was still involved. During later stages of the negotiations, the dollar amount of the "Fortrend premium" varied, but each iteration of the agreement contained the same formulaic calculation. Fortrend would pay petitioner the amount of cash remaining in West Side at the closing, less 31.875% of West [*16] Side's total Federal and State tax liability for 2003. In other words, the "Fortrend premium" equaled 31.875% of West Side's accrued 2003 tax liability. This left petitioner with a premium, above and beyond West Side's closing net asset value, equal to 68.125% of its accrued 2003 tax liability.

At two points in his testimony, petitioner stated that he did not understand the "Fortrend premium" to have any correlation to West Side's tax liabilities. The Court did not find this testimony credible. Petitioner testified that he participated in negotiating Fortrend's fee, and numerous spreadsheets prepared by his brother explicitly state that Fortrend's fee was to equal 31.875% of West Side's accrued tax liabilities for 2003. Confronted with this evidence, petitioner became visibly uncomfortable. The Court finds as a fact that petitioner knew at all times that the "Fortrend premium" would be computed as a negotiated percentage of West Side's 2003 corporate tax liability.

In preparation for the stock sale, Millennium Recovery Fund, LLC (Millennium), a Fortrend affiliate incorporated in the Cayman Islands, created Nob Hill, Inc. (Nob Hill), a shell company also incorporated in the Cayman Islands. Nob Hill was to be the "intermediary company" that would purchase the West Side stock. John McNabola was the sole officer of Millennium and Nob Hill.

[*17] The Hahn Loeser lawyers negotiated with Fortrend the technical details of the stock purchase agreement. Nob Hill provided covenants aimed at mitigating the risk that the transaction would be characterized as a "liquidation" of West Side. Nob Hill represented that West Side would remain in existence for at least five years after the closing, would "at all times be engaged in an active trade or business," and would "maintain a net worth of no less than $1 million" during this five-year period. (None of these representations was substantially honored.)

Nob Hill also provided purported tax warranties. The agreement represented that Nob Hill would "cause * * * [West Side] to satisfy fully all United States * * * taxes, penalties and interest required to be paid by * * * [West Side] attributable to income earned during the [2003] tax year." The agreement did not specify how Nob Hill would "cause" West Side to satisfy its 2003 tax liabilities or explain the strategy it would use to offset West Side's gain from the $65 million PUCO settlement. Nob Hill agreed to indemnify petitioner in the event of liability arising from breach of its representation to "satisfy fully" West Side's 2003 tax liability. Petitioner's expert, Wayne Purcell, admitted that "there can be problems" enforcing warranties and covenants against offshore entities like

Nob Hill that have no assets in the United States.

*8 [*18] Petitioner's lawyers attempted to include in the stock purchase agreement a provision prohibiting West Side from engaging in a "listed transaction" after Fortrend acquired West Side. Fortrend refused to agree to this provision. Instead, the parties negotiated a statement that Nob Hill "has no intention" of causing West Side to engage in a listed transaction.

Petitioner Accepts Fortrend's Offer
A letter of intent dated July 22, 2003, set forth the terms on which Nob Hill proposed to acquire petitioner's stock. It stated a tentative purchase price of $34.9 million, subject to fine-tuning based on West Side's final cash position. The letter indicated that West Side would deposit $50,000 in escrow to cover fees should the transaction fail to close.

After the transfer of West Side's operating assets to LXV, West Side's balance sheet reflected total assets of $40,577,151, including $39,949,373 in cash, a $577,778 loan receivable from petitioner, and the $50,000 receivable from the escrow agent. West Side's aggregate 2003 tax liabilities were estimated to be $16,853,379. West Side's net asset value as of late July—that is, its assets minus its accrued tax liability—was thus $23,723,772. Nob Hill offered to pay petitioner $34.9 million for his stock-$11.2 million more than West Side was worth—in exchange [*19] for a fee (the "Fortrend premium") comfortably in excess of $5 million. Petitioner decided to accept this offer.

Petitioner's "due diligence" expert, Mr. Purcell, testified that a seller who receives an all-cash offer for his stock is mainly concerned with making sure he gets paid. Mr. Purcell agreed, however, that a seller in petitioner's position must nevertheless exercise a certain level of due diligence. Hahn Loeser's bankruptcy lawyers advised that petitioner needed to assure himself that Nob Hill and Fortrend would live up to their postclosing obligations. And Mr. Purcell agreed that "due diligence did require * * * [petitioner] and his advisors to investigate Fortrend's plans" for eliminating West Side's 2003 tax liabilities.

Neither petitioner nor his advisers performed any due diligence into Fortrend or its track record. Neither petitioner nor his advisers performed any meaningful investigation into the "high basis/low value" scheme that Fortrend suggested for eliminating West Side's accrued 2003 tax liability. Petitioner was evasive when asked how he expected Fortrend to pull off this feat; he testified as to his belief that Fortrend "had some sort of tax reduction process" that would somehow "use bad debt to reduce tax liability." PwC specifically declined to provide assurance that Fortrend's bad debt strategy was "more likely than not" to succeed.

[*20] *Preparation for the Closing*
The stock purchase transaction was carefully structured to ensure that For-trend and its affiliates made no real outlay of cash. Fortrend planned to borrow the entire $34.9 million tentative purchase price: $5 million from Moffatt International (Moffatt), a Fortrend affiliate, and $29.9 million from Coöperatieve Centrale Raiffeisen–Boerenleenbank, B.A. (Rabobank), a Dutch bank.[5] West Side's cash would be used to repay these loans immediately, so that the nominal lenders bore no risk.

*9 The financing process began on August 13, 2003, when Fortrend mailed Chris Kortlandt of Rabobank, requesting a $29.9 million short-term loan. Two weeks later, Mr. Kortlandt requested internal approval of this loan, with Nob Hill as the nominal borrower. Mr. Kortlandt understood that West Side would be required to have cash in excess of $29.9 million on deposit with Rabobank when the stock purchase closed. He therefore considered the risk of nonpayment of the loan [*21] to be essentially zero. The risk rating shown on Nob Hill's credit application was "N/A, or based on collateral: R–1 (cash)." Rabobank uses the R–1 risk rating to denote a loan that is fully cash collateralized.

On August 21, 2003, petitioner received instructions to open at Rabobank an account for West Side with account number ending in 1577, to which West Side's cash would eventually be transferred. To receive the cash proceeds from the stock sale, petitioner opened an individual Rabobank account with account number ending in 1595. To shuttle cash at the closing, Nob Hill opened a Rabobank account with account number ending in 1568.

In connection with the Rabobank financing, Mr. McNabola planned to execute two sets of documents at the closing. He would sign the first set on behalf of Nob Hill as its president. He would sign the second set on behalf of West Side as its postclosing president-to-be.

The Nob Hill documents to be executed by Mr. McNabola included a promissory note for $29.9 million, a security agreement, and a pledge agreement. Pursuant to the security agreement, Nob Hill granted Rabobank a first priority security interest in West Side's Rabobank account to secure Nob Hill's repayment obligation. Pursuant to the pledge agreement, Nob Hill granted Rabobank a first

[*22] priority security interest in the West Side stock and the stock sale proceeds as collateral securing Nob Hill's repayment obligation.

The West Side documents to be executed by Mr. McNabola included security and guaranty agreements in favor of Rabobank and a "control agreement." West Side unconditionally guaranteed payment of Nob Hill's obligations to Rabobank, and the security agreement granted Rabobank a first priority security interest in the West Side Rabobank account. The "control agreement" gave Rabobank control over West Side's account—including all "cash, instruments, and other financial assets contained therein from time to time, and all security entitlements with respect thereto"—to ensure that West Side did not default on its commitments.

As petitioner's UCC expert, Barkley Clark, correctly noted, Mr. McNabola as Nob Hill's president could not grant Rabobank a perfected security interest in West Side's assets until Nob Hill acquired West Side's stock. And Mr. McNabola as West Side's president could not grant Rabobank a perfected security interest in West Side's assets until he became West Side's president. At the closing, however, all of these documents were to become effective simultaneously with the funding of the Rabobank loan, the payment of the stock purchase price, and the resignation of West Side's former officers and directors. These agreements effectively gave Rabobank a "springing lien" on West Side's cash at the moment it [*23] funded the loan. For all practical purposes, therefore, the Rabobank loan was fully collateralized with the cash in West Side's Rabobank account, consistently with the R-1 risk rating that Rabobank assigned to that loan.

The Closing

*10 The closing was scheduled for September 9, 2003. The final stock purchase price was to be $34,621,594 in cash plus a $577,778 check payable to petitioner to zero out his shareholder loan. On September 8, Fortrend deposited the $5 million "loan proceeds" from Moffatt into Nob Hill's Rabobank account. Also on September 8, petitioner deposited West Side's $39,949,373 ending cash balance into West Side's Rabobank account. The funds in these accounts earned overnight interest of $135 and $1,076, respectively.

On September 9, 2003, the following events occurred. Nob Hill's Rabobank account was credited with the $29.9 million Rabobank loan proceeds and $35 million in cash from West Side's Rabobank account. From this account, Nob Hill transferred $34,621,594 into petitioner's Rabobank account; transferred $29.9 million to repay the Rabobank loan (which bore no interest); transferred $5 million to repay the Moffatt loan (which bore no interest); transferred $150,000 to cover Rabobank's fees; and transferred $150,000 to West Side's Rabobank account. Petitioner immediately withdrew the entire balance of his Rabobank account and [*24] deposited it into a personal account at Pershing Bank. When the dust settled at the end of the day, petitioner's Rabobank account had a balance of zero; petitioner's Pershing Bank account had a balance of $34,621,594; West Side's Rabobank account had a balance of $5,100,450; and Nob Hill's Rabobank account had a balance of $78,541.

The next day, Nob Hill merged into West Side with West Side surviving. The $5,100,450 remaining in West Side's Rabobank account and the $78,541 remaining in Nob Hill's Rabobank account were later transferred into a West Side account at the Business Bank of California. West Side eventually transferred $4,766,000 out of that account to Fortrend affiliates and various promoters, including MidCoast, which on September 14, 2003, received the promised $1,180,000 for stepping away from the transaction. By late 2004, West Side's bank accounts had been drained of funds and were closed.

The Bad Debt Strategy

The background of Fortrend's strategy for eliminating West Side's 2003 tax liability begins in 2001. On March 7, 2001, United Finance Co. Ltd. (United Finance) purportedly contributed a portfolio of charged-off Japanese debt (Japanese debt portfolio) to Millennium in exchange for Millennium class B shares. (Millennium eventually became Nob Hill's, and then West Side's, parent.) The Japanese [*25] debt portfolio was valued at $137,109. Two days later, United Finance sold the Millennium class B shares it had just acquired to Barka Limited, another Cayman Islands entity, for $137,000. Although Millennium had acquired the Japanese debt portfolio with property worth only $137,000, it claimed that its tax basis in that Portfolio was $314,704,037 as of June 30, 2003.

On November 6, 2003, Millennium contributed to West Side a subset of the Japanese debt portfolio, consisting of two defaulted loans (Aoyama loans). The Aoyama loans had a purported tax basis of $43,323,069. Between November 6 and December 31, 2003, West Side wrote off the Aoyama loans as worthless. On its Form 1120, U.S. Corporation Income Tax Return, for 2003, West Side claimed a bad debt deduction of $42,480,622 on account of that writeoff.

*11 There is no evidence that West Side conducted meaningful business operations after September 10, 2003. It had no employees after that date. It reported no gross receipts, income, or business expenses relating to its supposed "debt collection" business. There is no evidence that it made any effort to collect the Aoyama loans or contracted with any third party to do so. Although Nob Hill had represented that West Side would "maintain a net worth of no less than $1 million" during the five-year period following the closing, West Side did not do so. The following table shows West Side's asset balances as reported to the IRS:

[*26] *Tax year*	*Asset balance as of 12/31*
2003	$1,829,395
2004	313,300
2005	1,171,609
2006	942,589
2007	–0–

Petitioner offered no evidence to show that the actual value of West Side's assets corresponded to these reported amounts. Given Fortrend's track record, we do not take these reported amounts at face value.

West Side's Tax Returns and IRS Audit

West Side's Form 1120 for 2003 described it as incorporated in the Cayman Islands, doing business in Ireland, and having its address in Las Vegas, Nevada. It described its parent, Millennium, as incorporated in the Cayman Islands and doing business in Ireland. West Side reported for 2003 total income of $66,116,708 and total deductions of $67,840,521. The deductions included salaries and wages of $8,315,605, other deductions of $16,542,448, and bad debt losses of $42,480,622.

On January 9, 2006, West Side filed Form 1120X, Amended U.S. Corporation Income Tax Return, for 2003. Apart from correcting minor errors and listing a new address in Reno, Nevada, the amended return did not differ materially from the original. Both returns were prepared using the accrual method of accounting.

[*27] The IRS examined West Side's 2003 return. During the examination, the IRS was unable to find any assets or current sources of income for West Side; a March 28, 2008, memorandum details the steps the IRS took in search thereof. At the conclusion of the audit, the IRS disallowed the $42,480,622 bad debt deduction and $1,651,752 of the deduction claimed for legal and professional fees, on the ground that these fees were incurred in connection with a transaction entered into solely for tax avoidance.

West Side's authorized representative executed successive Forms 872, Consent to Extend the Time to Assess Tax, that extended to December 31, 2009, the time for assessing West Side's 2003 tax liability. On February 25, 2009, the IRS mailed a timely notice of deficiency to West Side determining a deficiency of $15,186,570 and penalties of $61,851 and $5,950,926 under section 6662(a) and (h), respectively. West Side did not petition this Court and, on July 20, 2009, the IRS assessed the tax and penalties set forth in the notice of deficiency, plus accrued interest. On April 5, 2011, West Side's corporate charter was canceled by the Ohio secretary of state.

Notice of Transferee Liability

*12 Petitioner and Barbara Tricarichi jointly filed Form 1040, U.S. Individual Income Tax Return, for 2003 showing a Nevada address. This return reported a[*28] tax liability of $5,303,886, resulting chiefly from gain on the sale of petitioner's West Side stock. On Schedule D, Capital Gains and Losses, petitioner reported the proceeds from this sale as $35,199,357, reflecting both the cash he received and the $577,778 check, resulting in a long-term capital gain of $35,170,793.

The IRS did not audit petitioner's Form 1040, but it did open a transferee-liability examination concerning West Side's 2003 tax liabilities. Upon completion of that examination, the IRS sent petitioner a Letter 902–T, Notice of Liability. This notice of liability was timely mailed to petitioner on June 25, 2012.[6] The notice determined that petitioner is liable as transferee for the following liabilities of West Side:

[*29]Deficiencyi	Penalty sec. 6662(a), (d)	Penalty sec. 6662(h)
$15,186,570	$61,851	$5,950,926

Petitioner timely petitioned this Court for review of the notice of liability.[7]

OPINION

I. *Legal Standard and Burden of Proof*

Petitioner resided in Nevada when he filed his petition. The parties have stipulated that any appeal of this case will lie to the U.S. Court of Appeals for the Ninth Circuit. *See* sec. 7482(b)(1)(A); *Golsen v. Commissioner,* 54 T.C. 742, 757, 1970 WL 2191 (1970), *aff'd,* 445 F.2d 985 (10th Cir.1971). That Court has held that "the tax decisions of other circuits should be followed unless they are demonstrably erroneous or there appear cogent reasons for rejecting them." *Popov v. Commissioner,* 246 F.3d 1190, 1195 (9th Cir.2001) (quoting *Unger v. Commissioner,* 936 F.2d [*30] 1316, 1320 (D.C.Cir.1991), *aff'g* T.C. Memo.1990–15), *aff'g in part, rev'g in part and remanding* T.C. Memo.1998–374.

Under section 6901, the Commissioner may proceed against a transferee of property to assess and collect Federal income tax, penalties, and interest owed by a transferor. Respondent contends that petitioner, as transferee, is liable for the unpaid 2003 Federal tax liabilities of West Side. Petitioner contends that Nob Hill purchased his stock moments before it received West Side's cash; that Rabobank and Moffat were the source of the cash used to purchase his stock; and that he thus received no "transfer" from West Side that could make him liable as its "transferee."

[1] [2] Section 6901 does not impose substantive liability on the transferee but simply gives the Commissioner a remedy or procedure for collecting an existing liability of the transferor. *Commissioner v. Stern,* 357 U.S. 39, 42, 78 S.Ct. 1047, 2 L.Ed.2d 1126 (1958). To take advantage of this procedure, the Commissioner must establish an independent basis under applicable State law for holding the transferee liable for the transferor's debts. Sec. 6901(a); *Commissioner v. Stern,* 357 U.S. at 45; *Hagaman v. Commissioner,* 100 T.C. 180, 183, 1993 WL 69243 (1993). State law thus determines the transferee's substantive liability. *Ginsberg v. Commissioner,* 305 F.2d 664, 667 (2d Cir.1962), *aff'g* 35 T.C. 1148, 1961 WL 1326 (1961). In this respect, section 6901 places the Commissioner [*31] in "precisely the same position as that of ordinary creditors under state law." *Starnes v. Commissioner,* 680 F.3d 417, 429 (4th Cir.2012), *aff'g* T.C. Memo.2011–63. The parties agree that the State law applicable here is that of Ohio, where petitioner resided, West Side did business, and the principal transactions occurred. *See Commissioner v. Stern,* 357 U.S. at 45; *Estate of Miller v. Commissioner,* 42 T.C. 593, 598, 1964 WL 1217 (1964).

*13 [3] Once the transferor's own tax liability is established, the Commissioner may assess that liability against a transferee under section 6901 only if two distinct requirements are met. First, the transferee must be subject to liability under applicable State law, which includes State equity principles. Second, under principles of Federal tax law, that person must be a "transferee" within the meaning of section 6901. *See Diebold Found., Inc.,* 736 F.3d at 183–184; *Starnes,* 680 F.3d at 427; *Swords Trust v. Commissioner,* 142 T.C. 317, 336, 2014 WL 2218977 (2014).

[4] The Commissioner bears the burden of proving that a person is liable as a transferee. Sec. 6902(a); Rule 142(d). The Commissioner does not have the burden, however, "to show that the taxpayer was liable for the tax." Sec. 6902(a). Under normal burden-of-proof rules, therefore, petitioner has the burden of proving that West Side is not liable for the $21,199,347 of tax and penalties that the IRS assessed against it for 2003. Rule 142(a)(1), (d); *Welch v. Helvering,* 290[*32] U.S. 111, 115 (1933); *see United States v. Williams,* 514 U.S. 527, 539, 115 S.Ct. 1611, 131 L.Ed.2d 608 (1995) (noting that "the Code treats the transferee as the taxpayer" for this purpose); *L.V. Castle Inv. Grp., Inc. v. Commissioner,* 465 F.3d 1243, 1248 (11th Cir.2006).

[5] The burden of proof on factual issues may be shifted to the Commissioner if the taxpayer introduces "credible evidence" with respect thereto and satisfies other requirements. Sec. 7491(a)(1) and (2). Petitioner asked that we shift to respondent the burden of proof with respect to West Side's 2003 tax liability. We decline this request. Petitioner introduced no "credible evidence" concerning the $42,480,622 bad debt deduction that generated West Side's 2003 deficiency. In any event, it does not matter who bears the burden of proof because the preponderance of the evidence favors respondent's position as to all material facts.[8]

II. *West Side's 2003 Federal Tax Liability*

In the notice of deficiency to West Side, the IRS disallowed a deduction of $1,651,752 for legal and professional fees and a deduction of $42,480,622 for bad [*33] debts. The notice also determined an accuracy-related penalty of $61,851 and a penalty of $5,950,926 for a "gross valuation misstatement" under section 6662(h).

[6] The deduction for legal and professional fees was disallowed on the ground that these fees were incurred in connection with a tax-avoidance transaction. We conclude below that the transaction by which Nob Hill acquired petitioner's West Side stock was indeed entered into for the sole purpose of tax avoidance. Petitioner provided no evidence to establish that any of the disallowed professional fees were incurred in connection with some other, legitimate, transaction. Petitioner has thus failed to carry his burden of proving that any portion of these fees constituted deductible business expenses of West Side under section 162. *See Agro Sci. Co. v. Commissioner,* 934 F.2d 573, 576 (5th Cir.1991), *aff'g* T.C. Memo.1989–687; *Simon v. Commissioner,* 830 F.2d 499, 500–501 (3d Cir.1987), *aff'g* T.C. Memo.1986–156; *Cullifer v. Commissioner,* T.C. Memo.2014–208, at *45.

***14** [7] West Side's claimed $42,480,622 bad debt loss was based on the assertion that the two Aoyama loans had a tax basis of $43,323,069. That assertion is preposterous because those loans were a subset of a larger portfolio of loans that had [*34] a tax basis of approximately $137,000. Petitioner introduced no credible evidence to substantiate the basis claimed.[9]

Petitioner does not seriously dispute West Side's liability for the $61,851 accuracy-related penalty.[10] For returns filed on or before August 17, 2006, a "gross valuation misstatement" exists where the basis claimed equals or exceeds 400% of the correct amount. Sec. 6662(h)(2); sec. 1.6662–5(e)(2), Income Tax Regs. Claiming a tax basis of $43,323,069 for the Aoyama loans, which had an actual basis of substantially less than $137,000, is unquestionably a "gross valuation misstatement." Apart from challenging the deficiency on which the penalty is based, petitioner introduced no evidence to show that respondent's [*35] calculation of a section 6662(h) penalty of $5,950,926 was incorrect. Petitioner has thus failed to prove that respondent erred in determining against West Side for 2003 a tax deficiency of $15,186,570 and penalties of $61,851 and $5,950,926 under section 6662(a) and (h), respectively.

III. *Petitioner's Liability as Transferee of West Side*

Section 6901 permits the Commissioner to assess tax liability against a person who is "the transferee of assets of a taxpayer who owes income tax." *Salus Mundi Found. v. Commissioner,* 776 F.3d 1010, 1017 (9th Cir.2014), *rev'g and remanding* T.C. Memo.2012–61. To impose that liability on a transferee, a court must first determine whether "the party [is] substantively liable for the transferor's unpaid taxes under state law," and next determine whether that party is a "transferee" within the meaning of section 6901. *Slone v. Commissioner,* — F.3d ——, 2015 WL 5061315, at *2 (9th Cir. Aug.28, 2015) *vacating and remanding* T.C. Memo.2012–57; *see Commissioner v. Stern,* 357 U.S. at 44–45. The two prongs of this inquiry are independent of one another. *See Feldman v. Commissioner,* 779 F.3d 448, 458 (7th

Cir.2015), *aff'g* T.C. Memo.2011–297; *Salus Mundi Found.*, 776 F.3d at 1012; *Diebold Found., Inc.*, 736 F.3d at 185; *Frank Sawyer Trust of May 1992 v. Commissioner*, 712 F.3d 597, 605 (1st Cir.2013), *aff'g* T.C. Memo.2011–298; *Starnes*, 680 F.3d at 429.

[*36] A. *Petitioner's Substantive Liability Under Ohio Law*

[8] [9] In deciding matters of State law, we are generally guided by the decisions of the State's highest court. If there is no relevant precedent from the State's highest court, but there is relevant precedent from an intermediate appellate court, "the federal court must follow the state intermediate appellate court decision unless the federal court finds convincing evidence that the state's supreme court likely would not follow it." *Ryman v. Sears, Roebuck & Co.*, 505 F.3d 993, 994 (9th Cir.2007); *see Commissioner v. Estate of Bosch*, 387 U.S. 456, 465, 87 S.Ct. 1776, 18 L.Ed.2d 886 (1967) (Federal court should apply what it "find[s] to be the state law after giving 'proper regard' to relevant rulings of other courts of the State"); *Swords Trust*, 142 T.C. at 342; *Estate of Young v. Commissioner*, 110 T.C. 297, 300, 302, 1998 WL 235975 (1998). "Only where no state court has decided the point in issue may a federal court make an educated guess as to how that state's supreme court would rule." *Flintkote Co. v. Dravo Corp.*, 678 F.2d 942, 945 (11th Cir.1982) (quoting *Benante v. Allstate Ins. Co.*, 477 F.2d 553, 554 (5th Cir.1973)).

*15 In 1990 Ohio enacted the Uniform Fraudulent Transfer Act of 1984 (UFTA) as chapter 1336 of its Commercial Transactions Code. *See* Ohio Rev.Code secs. 1336.01 to 1336.12 (hereafter OUFTA; all references to the OUFTA are to the version in effect during 2003). Forty-three States and the District of Columbia [*37] have adopted the UFTA in whole or in part. The version of the UFTA that Ohio adopted corresponds almost verbatim to the uniform law.

When interpreting Ohio statutes derived from uniform or model laws, the Ohio Supreme Court has regularly consulted opinions from sister State courts interpreting parallel provisions of their own statutes. *See Stein v. Brown*, 18 Ohio St.3d 305, 480 N.E.2d 1121 (Ohio 1985) (discussing other States' treatment of the Uniform Fraudulent Conveyance Act (UFCA), the UFTA's predecessor); *Ohio Ins. Guar. Ass'n v. Simpson*, 1 Ohio App.3d 112, 439 N.E.2d 1257 (Ohio Ct.App.1981) (noting relevance of opinions from courts of other States when interpreting model or uniform laws).[11] Federal Courts of Appeals for five different Circuits, examining Midco transactions similar to that here, have recently issued opinions interpreting state laws that substantially incorporate the UFTA or its predecessor. *See supra* p. 2 and note 1. We believe that the Ohio Supreme Court would give proper regard to these decisions, and to the State court precedents on which they are based, when interpreting parallel provisions of the OUFTA.

[10] [*38] The Ohio Supreme Court has emphasized that the OUFTA is a remedial statute that should be liberally construed to protect creditors. *See Wagner v. Galipo*, 50 Ohio St.3d 194, 553 N.E.2d 610, 613 (Ohio 1990); *Locafrance United States Corp. v. Interstate Distrib. Servs., Inc.*, 6 Ohio St.3d 198, 451 N.E.2d 1222, 1225 (Ohio 1983) (interpreting the OUFTA's predecessor). The OUFTA defines "transfer" very broadly to include "every direct or indirect, absolute or conditional, and voluntary or involuntary method of disposing of or parting with an asset or an interest in an asset." OUFTA sec. 1336.01(L). Respondent argues that petitioner is a liable as a "transferee" of West Side's cash under four distinct sections of the Ohio statute. *See id.* secs. 1336.04(A)(1) and (2), 1336.05(A) and (B). The first of these is an actual fraud provision; the latter three are constructive fraud provisions.

OUFTA section 1336.04(A)(1), the actual fraud provision, applies in the case of any creditor regardless of whether his "claim * * * arose before or after the transfer was made." A transfer is fraudulent under this provision if the debtor made the transfer "[w]ith actual intent to hinder, delay, or defraud any creditor of the debtor." The statute sets forth 11 nonexclusive "badges of fraud" that may give rise to an inference of actual fraudulent intent. *See id.* sec. 1336.04(B).

[11] Two of the constructive fraud provisions apply in the case of a creditor "whose claim arose before the transfer was made." *Id.* secs. 1336.05(A) and (B). [*39] Section 1336.05(A), the provision most relevant here, provides that "[a] transfer made * * * by a debtor is fraudulent as to [such] a creditor" if the debtor made the transfer without receiving a reasonably equivalent value in exchange and the debtor "was insolvent at that time or * * * became insolvent as a result of the transfer." This provision applies regardless of a transferor's or transferee's actual intent. *See Sease v. John Smith Grain Co.*, 17 Ohio App.3d 223, 479 N.E.2d 284, 287 (Ohio Ct.App.1984) (holding that with respect to the OUFTA's predecessor, "[n]either the intent of the debtor nor the knowledge of the transferee need be proven"); *Nelson v. Walnut Inv. Partners, L.P.*, 2011 U.S. Dist. LEXIS 75534 (S.D.Ohio 2011) (same).

*16 [12] [13] The third constructive fraud provision applies whether the creditor's claim arose "before or after the transfer was made." OUFTA sec. 1336.04(A). "A transfer made * * * by a debtor is fraudulent as to [such] a creditor" if the debtor made the transfer "without receiving a reasonably equivalent value in exchange" and either: (1) "[t]he debtor was engaged * * * [in a] transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction," or (2) "[t]he debtor intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due." *Ibid.* This provision likewise applies regardless of the debtor's [*40] intent or transferee's actual knowledge. If the stated conditions of any constructive fraud provision are met, "the transfer is fraudulent as a matter of law." *See Sease,* 479 N.E.2d at 288.

1. *Petitioner's Status Under Ohio Law as a "Transferee"*

Under all four OUFTA provisions, a "transfer" of some kind must have been made from West Side as tax debtor to petitioner as transferee. This issue is the focus of the parties' dispute and its resolution affects analysis of the other OUFTA tests. We may thus conveniently discuss it first.

Petitioner insists that he was not literally a transferee of West Side's cash. According to petitioner, the cash he got came from Nob Hill, and the sources of that cash were the "loans" from Rabobank and Moffat. Nob Hill supposedly did not get West Side's cash, which it used to repay those "loans," until later that same day. For this reason, petitioner contends that he received no West Side assets that could subject him to liability as a fraudulent transferee under Ohio law.

Respondent contends that Ohio law would treat petitioner in substance as the transferee of West Side's cash. We agree with respondent for at least two reasons, each of which constitutes an alternative ground for sustaining his position. First, the "loans" from Rabobank and Moffat were shams, and West Side was the true source of the cash petitioner received. Second, the stock sale transaction would be [*41] recharacterized under Ohio law as a de facto liquidation of West Side, with petitioner receiving in exchange for his stock a $35.2 million liquidating distribution.[12]

a. *Sham Loans*

[14] In order to "finance" the purchase of West Side's stock from petitioner, Nob Hill "borrowed" $29.9 million from Rabobank and $5 million from Moffatt, a Fortrend affiliate. Ohio courts have consistently allowed finders of fact, in appropriate circumstances, to disregard transactions as shams. *See, e.g., Rowe v. Standard Drug Co.,* [*42] 132 Ohio St. 629, 9 N.E.2d 609, 613 (Ohio 1937) ("Of course a lease, valid on its face, may be a mere sham or device to cover up the real transaction; but such a subterfuge will not be permitted to become a cloak for illegal practices. The courts will always pierce the veil to discover the real relationship."); *Selanders v. Selanders,* 2009 WL 1365226, at *11 (Ohio Ct.App.2009) (affirming the trial court's decision and agreeing that "the entire transaction was quite possibly nothing more than a sham"); *Galley v. Galley,* 1994 WL 191431, at *5 (Ohio Ct.App.1994) ("When that reason for the transfer of property * * * is disregarded as a sham, the * * * [finder of fact] could well conclude that the transfer was a fraudulent transfer[.]"); *Phillips v. Phillips,* 1994 WL 179950 (Ohio Ct.App.1994). We believe that an Ohio court would disregard as shams the "loans" purportedly extended by Rabobank and Moffat.

*17 The Rabobank "loan" should be disregarded as a sham for at least three reasons. First, this "loan" was extended and repaid the same business day, literally moments after Nob Hill received the alleged loan proceeds. The essence of a loan is an extension of credit. It is obvious that the parties to this transaction did not desire to receive from Rabobank, and that Nob Hill did not in fact receive, a true extension of credit.

[*43] Second, the "loan" by its terms did not bear interest. Instead, Rabobank received a "fee" of $150,000. This fee cannot represent interest: Since the "loan" was outstanding for less than a day, this fee would translate to annual interest of $54,750,000, almost twice the magnitude of the "loan." What Rabobank received was not interest on a loan but a fee for facilitating a tax shelter transaction. Rabobank was presumably able to charge such an outlandish fee because (1) from its vantage point, it was incurring reputational or business risks by accommodating a questionable transaction and (2) from petitioner's vantage point, the fee was being paid by the U.S. Treasury and not by him.

Third, the Rabobank "loan" was fully collateralized by the cash in West Side's Rabobank account. Nob Hill's credit application described the risk rating on this loan as "N/A, or based on collateral." ("N/A" presumably means "not applicable.") Rabobank gave the loan an R–1 risk rating, which denotes a loan that is fully cash collateralized. The documents executed at the closing gave Rabobank control over West Side's Rabobank account and a "springing lien" on West Side's cash the moment it funded the loan. Cash is fungible, and the consideration used to pay petitioner for his stock came in substance from West Side.

For essentially the same reasons, the $5 million "loan" extended by Moffat must also be disregarded as a sham. Like the Rabobank loan, it bore no interest; [*44] instead, Fortrend received a $5 million fee for assembling the entire tax shelter package. This "loan" did not represent a true extension of credit. It was simply an overnight shuffling of funds between two Fortrend entities designed to facilitate a tax-avoidance transaction.

We conclude that an Ohio court would apply the sham transaction doctrine to these loans, and we find that both loans were in fact shams. The totality of the circumstances shows that the nominal lenders provided these funds, not as bona fide extenders of credit, but simply as accommodation parties recruited by Fortrend to conceal the true nature of what was happening. What actually happened is that Rabobank electronically transferred cash from West Side's Rabobank account through Nob Hill's Rabobank account into petitioner's Rabobank account; the "loans" were utterly unnecessary and had no purpose except obfuscation. Since both loans were shams, Rabobank's transfer of funds from West Side's account into petitioner's account constituted a "direct or indirect * * * method of disposing of or parting with an asset." *See* OUFTA sec. 1336.01(L). Petitioner was thus was a "transferee" of West Side under Ohio law.

b. *De Facto Liquidation of West Side*

***18** [15] Respondent alternatively contends that the transfers among West Side, Nob Hill, and petitioner should be collapsed and recharacterized under Ohio law as a[*45] partial or complete liquidation of West Side, with petitioner receiving in exchange for his shares a $35.2 million liquidating distribution ($34.6 million of cash plus a check for $577,778). Although the Ohio courts have not addressed this precise scenario, judicial interpretations of fraudulent transfer provisions similar to Ohio's establish that such transactions may be "collapsed" if the ultimate transferee had constructive knowledge that the debtor's debts would not be paid.

The Court of Appeals for the Ninth Circuit recently addressed the application of New York's fraudulent transfer provisions to a Midco transaction resembling that here. It concluded that multiple transfers could be collapsed under State law if the conduct of the ultimate transferees "show[ed] that they had constructive knowledge of the fraudulent scheme." *Salus Mundi Found.,* 776 F.3d at 1020. Addressing the application of New York law to that same Midco transaction in *Diebold Found., Inc.,* the Court of Appeals for the Second Circuit held that multiparty transactions can be collapsed where the debtor's property is "reconveyed * * * for less than fair consideration" and the ultimate transferee had "constructive knowledge of the entire scheme." 736 F.3d at 186.

The Court of Appeals for the Fourth Circuit, addressing the application of North Carolina's UFTA provisions to another Midco transaction, similarly ruled that multiple transfers can be collapsed if the ultimate transferee has constructive [*46] knowledge that the debtor's tax liabilities will not be paid. If the ultimate transferees are on "inquiry notice" and fail to conduct a sufficiently diligent investigation, "they are charged with the knowledge they would have acquired had they undertaken the reasonably diligent inquiry required by the known circumstances." *Starnes,* 680 F.3d at 434.

The Ohio courts have regularly consulted and followed the decisions of sister courts when interpreting the provisions of model laws, including the OUFTA's predecessor. *See supra* pp. 36–37 and note 11. The North Carolina UFTA provisions governing constructive fraud are substantially identical to Ohio's, and New York's fraudulent transfer provisions are similar in material respects. We conclude that the Ohio Supreme Court, if confronted with this question, would find persuasive and would follow these three Federal decisions and the state court precedents on which they are based. The transfers at issue here may thus be collapsed under the OUFTA if petitioner had constructive knowledge that West Side's Federal and Ohio tax liabilities would not be paid.[13]

[16] [*47] Petitioner argues that he was not aware of Fortrend's "plan as a whole" to avoid West Side's income taxes. If this is true, it is irrelevant. Finding that a person had constructive knowledge does not require that he have actual knowledge of the plan's minute details. It is sufficient if, under the totality of the surrounding circumstances, he "should have known" about the tax-avoidance scheme. *HBE Leasing Corp. v. Frank,* 48 F.3d 623, 636 (2d Cir.1995).

***19** [17] Constructive knowledge also includes "inquiry knowledge." "Inquiry knowledge" exists where the transferee was "aware of circumstances that should have led * * * [him] to inquire further into the circumstances of the transaction, but * * * [he] failed to make such inquiry." *HBE Leasing Corp.*, 48 F.3d at 636. Some cases define constructive knowledge as the knowledge that ordinary diligence would have elicited, while other cases require more active avoidance of the truth. *Diebold Found., Inc.*, 736 F.3d at 187. We need not decide which of these formulations is appropriate because petitioner had "constructive knowledge" under either standard.

Petitioner's "due diligence" expert, Mr. Purcell, testified that a seller who receives an all-cash offer for his stock is mainly concerned with ensuring that he [*48] gets paid. But he agreed that a seller in petitioner's position must nevertheless exercise a certain level of due diligence. Specifically, echoing the contemporaneous advice of Hahn Loeser's bankruptcy lawyers, Mr. Purcell testified that "due diligence did require [petitioner] and his advisors to investigate Fortrend's plans" for eliminating West Side's 2003 tax liabilities.

Neither petitioner nor his advisers performed any due diligence into For-trend or its track record. Neither petitioner nor his advisers performed any meaningful investigation into the "high basis/low value" scheme that Fortrend suggested for eliminating West Side's accrued 2003 tax liabilities. Petitioner and his advisers were clearly suspicious about Fortrend's scheme. But instead of digging deeper, they engaged in willful blindness and actively avoided learning the truth.

Petitioner and his advisers knew that the transaction Fortrend was proposing was likely a "reportable" or "listed transaction." Before meeting with Fortrend, Hahn Loeser lawyers spent several days researching Notice 2001-16, "reportable transactions," "sham transactions," and transactions involving "an intermediary corporation." PwC insisted on including in its engagement letter a requirement that petitioner advise it if he determined "that any matter covered by this Agreement is a reportable transaction." Petitioner attempted to strike this sentence from the engagement letter, evidencing his active avoidance of learning the truth.

[*49] PwC advised petitioner orally that "a position can be taken" that the proposed stock sale would not be a reportable transaction. In tax-speak, this translates to a low level of confidence on PwC's part.[14] Petitioner's lawyers attempted to include in the stock purchase agreement a provision prohibiting West Side from engaging in a "listed transaction" after Fortrend acquired West Side. Fortrend refused to agree to this provision. Any reasonably diligent person would infer from this refusal that a "listed transaction" was very likely what Fortrend, a tax shelter promoter, had in mind.

Though alerted by these warning signs, petitioner and his advisers failed to conduct a diligent inquiry into the "high basis/low value" debt strategy that Fortrend proposed for eliminating West Side's tax liabilities. PwC had advised that this appeared to be "a very aggressive tax-motivated strategy" that was "subject to IRS challenge." PwC specifically declined to give "more likely than not" assurance on this point. Petitioner turned his back on this red flag. He testified that [*50] Fortrend's tax-elimination strategy was of no concern to him because "that was their business."

*20 Mr. Purcell testified that petitioner could not have sought an opinion from PwC concerning Fortrend's bad debt strategy because, as of the closing date, Fortrend had put no specific high-basis/low-value plan on the table. The Court did not find this testimony persuasive. If ordinary diligence required petitioner and his advisers to investigate Fortrend's plan, as Mr. Purcell admitted, ordinary diligence required them to dig more deeply into what Fortrend's bad-debt strategy was. Fortrend obviously had to know, as of September 9, 2003, how it envisioned eliminating a $16.9 million corporate tax liability in fewer than 12 weeks. Reasonable diligence required petitioner and his advisers to insist that Fortrend explain its debt reduction strategy in sufficient detail to enable PwC to evaluate it.

Numerous other features of Fortrend's proposal raised red flags that demanded further inquiry. Fortrend offered to pay petitioner $11.2 million more than the net book value of West Side—representing a premium of 47%—while insisting that West Side's assets be reduced to cash. Petitioner was a sophisticated entrepreneur who had built a company and knew how to value a business. It should have provoked tremendous skepticism to discover that Fortrend was [*51] willing to pay a 47% premium to acquire cash, which by definition cannot be worth more than its face value.

The business purpose alleged for the transaction, moreover, made absolutely no sense. Petitioner and his advisers were told that Fortrend intended to put West Side into the "distressed debt" business. "[T]he business purpose for the acquisition," according to PwC's memo, was "based on the new business' need for cash to purchase the charged-off credit card debt as commercial financing for such purposes is apparently difficult."

This explanation demanded further inquiry from any reasonably diligent person. In order to purchase West Side's stock, Fortrend needed to have cash or be able to borrow cash. If Fortrend had cash or could easily borrow cash, why would it want to acquire West Side in order to get cash? Moreover, as PwC noted in a parenthetical, "most of the $40,000,000 cash in Westside will be distributed out of Westside and used by * * * [Fortrend] to pay back the cash borrowed to purchase * * * [petitioner's] Westside stock." Since there was going to be precious little cash left in West Side after the deal closed, the "business purpose" alleged for the transaction did not pass the straight-face test.

The icing on the cake was the manner in which the purchase price was determined. Numerous spreadsheets prepared by petitioner's brother explicitly [*52] state that the purchase price would equal West Side's closing cash balance plus 68.125% of its accrued tax liabilities. A sophisticated businessman like petitioner should have been curious as to why the purchase price for his company was being computed as a percentage of its tax liabilities, and why this was the only number that Fortrend seemed to care about. In effect, Fortrend was offering to assume a $16.9 million tax liability in exchange for a $5 million fee. Because the economics of the deal made it obvious that Fortrend was not going to pay West Side's tax liabilities, this fact alone put petitioner on "inquiry knowledge."[15]

*21 Petitioner testified that he had no contemporaneous understanding that the "Fortrend premium" was correlated to West Side's accrued tax liabilities. The Court did not find this testimony credible. Petitioner actively participated in negotiating [*53] Fortrend's fee. When confronted with his brother's spreadsheets that invariably compute Fortrend's fee as 31.875% of West Side's tax liabilities, petitioner became visibly uncomfortable. Petitioner's evasive testimony is further evidence that he had at least constructive knowledge that Fortrend planned to use a tax-avoidance scheme to eliminate West Side's tax liability.

To conclude that the totality of these circumstances did not give rise to constructive knowledge on petitioner's part "would do away with the distinction between actual and constructive knowledge." *Diebold Found., Inc.*, 736 F.3d at 189. And to relieve petitioner and his advisers of the duty to inquire, when the surrounding circumstances cried out for such inquiry, "would be to bless the willful blindness the constructive knowledge test was designed to root out." *Ibid.* We find as a fact that petitioner had constructive knowledge that Fortrend intended to implement an illegitimate scheme to evade West Side's accrued tax liabilities and leave it without assets to satisfy those liabilities. The various steps of the Midco transaction may thus be "collapsed" in determining whether petitioner was a "transferee" of West Side under Ohio law.[16]

[*54] The remaining question is whether these steps, once collapsed, yield a de facto "liquidation" of West Side from which petitioner received a $35.2 million liquidating distribution. Petitioner appears to believe that, for this to occur, there must have been a *complete* liquidation of West Side. We do not see the logic of this position: under state corporate law, as well as under Federal tax law, a corporation can be the subject of either a partial or a complete liquidation.[17] In either event, petitioner received a $35.2 million liquidating distribution upon surrendering his stock. We fail to see how it matters which kind of liquidation it was.

In any event, we find as a fact that West Side was in substance completely liquidated. There is no evidence that West Side conducted any bona fide business operations after September 10, 2003. It had no employees after that date. It reported no gross receipts, income, or business expenses relating to its supposed [*55] "debt collection" business. There is no evidence that it made any effort to collect the Aoyama loans or contracted with any third party to do so. Those loans were not operational assets of a business; they were simply tools for implementing a sham tax-avoidance scheme. In reality, West Side was nothing but a shell company immediately after the Midco deal closed.

At the insistence of petitioner's lawyers, West Side was kept in formal existence for several years. It filed tax returns; it cut checks to Fortrend affiliates; and it maintained a nominal cash balance. But keeping West Side in notional existence was simply a charade designed to create a defense to the precise argument the IRS is advancing here, an argument that petitioner and his attorneys knew the IRS would advance if this Midco transaction came to its attention. Such lawyerly stratagems cannot hide the fact that West Side had been liquidated in substance. It continued as a Potemkin village intended to deceive the IRS, just as the original was designed to fool Catherine the Great.

*22 In sum, we find that petitioner had constructive knowledge of Fortrend's tax-avoidance scheme; that the multiple steps of the Midco transaction must be collapsed; and that collapsing these steps yields a partial or complete liquidation of West Side from which petitioner received in exchange for his stock a $35.2 million liquidating distribution. *See Salus Mundi Found.*, 776 F.3d at 1019–1020[*56] (following the Second Circuit's analysis to the same effect in *Diebold Found., Inc.*). Under the OUFTA, petitioner is thus a direct transferee of West Side's assets under respondent's "de facto liquidation" theory as well as under the "sham loan" theory discussed previously.[18]

2. *Petitioner's Liability Under Ohio Law as a "Transferee"*

OUFTA section 1336.05(A) provides that a transfer is fraudulent with respect to a creditor where: (1) the creditor's claim arose before the transfer; (2) the transferor did not receive "a reasonably equivalent value in exchange for the transfer"; and (3) the transferor became insolvent as a result of the transfer. We find that all three of these elements are satisfied here. Petitioner is thus liable as a transferee of West Side under Ohio law.

a. *When the IRS Claim Arose*

[18] During April and May 2003, West Side received proceeds of $65 million from the PUCO settlement. This yielded a large gain that generated a tax liability of approximately $16.9 million. West Side thus had an accrued tax liability of [*57] approximately $16.9 million before September 9, 2003, the day the Midco deal closed.

The OUFTA defines the term "claim" expansively to mean "a right to payment." *Id.* sec. 1336.01(C). A right to payment constitutes a claim regardless of whether it is "reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *Ibid.* A "creditor" is any person who has a "claim." *Id.* sec. 1336.01(D). Given this broad definition, transfers are fraudulent as to creditors whose claims have not been finally determined, and even as to creditors whose claims are not yet due. *See Zahra Spiritual Tr. v. United States,* 910 F.2d 240, 248 (5th Cir.1990). Because "unmatured tax liabilities are taken into account in determining a debtor's solvency, they are 'claims' and should be treated as such under the expansive definition of the term 'claim' " in the UFTA. *Stuart v. Commissioner,* 144 T.C. ——, ——, (slip op. at 15) (Apr. 1, 2015).

Petitioner does not seriously dispute that the IRS had a "claim" against West Side before the stock sale. Rather, he argues that the IRS had no claim against *Nob Hill* when his stock was purchased because West Side had not yet transferred its cash into Nob Hill's Rabobank account. The precise timing of the back-to-back cash transfers is immaterial under our analysis. We have found that the various [*58] transactions must be collapsed for purposes of determining the OUFTA's proper application. Because collapsing the transactions yields a transfer of cash from West Side to petitioner, it is irrelevant in what order the subsidiary transfers are thought to have occurred.

*23 West Side's Federal tax liability had accrued by late May 2003. The IRS had a claim against West Side at that time. The transfer of West Side's assets to petitioner occurred on September 9, 2003. Respondent's claim thus "arose before the transfer was made." OUFTA sec. 1336.05(A).

b. *"Reasonably Equivalent Value"*

[19] OUFTA section 1336.05(A) imposes, as a second condition of liability, that the debtor not have received "a reasonably equivalent value in exchange for the transfer." Whether the debtor received "reasonably equivalent value" is a question of fact. *See Shockley v. Commissioner,* T.C. Memo.2015–113, at *50.

[20] On September 9, 2003, West Side consisted of nothing but cash and tax liabilities. The value of petitioner's stock thus equaled West Side's net asset value, which was about $23.7 million (cash equivalents of $40.6 million minus accrued tax liabilities of $16.9 million). West Side transferred $35.2 million to petitioner in exchange for his shares. Since his shares were worth only $23.7 million, West [*59] Side did not receive "a reasonably equivalent value in exchange for the transfer." OUFTA sec. 1336.05(A).

The only other thing West Side got at the closing was a representation from Nob Hill that it would "cause" West Side to pay its 2003 tax liabilities in full. As we have found previously, this representation was not worth the paper it was printed on. Nob Hill was a shell company, incorporated offshore, with no assets in the United States (or anywhere else). Nob Hill's parent, Millennium, was also a Cayman Islands company with no assets in the United States. Both were affiliates of a tax shelter promoter. The value of Nob Hill's promise was zero.

c. *West Side's Insolvency*

[21] OUFTA section 1336.05(A) imposes, as a third condition of liability, that the debtor making the transfer "was insolvent at that time or * * * became insolvent as a

result of the transfer." Petitioner asserts that West Side was solvent when he received Nob Hill's cash because, at that moment, West Side had not yet transferred its cash to Nob Hill. Thus, West Side supposedly had assets in excess of its tax liabilities when the transfer to petitioner occurred.

As with petitioner's argument about when the IRS claim arose, the precise timing of the back-to-back cash transfers is immaterial under our analysis. We have found that the various transactions must be collapsed for purposes of determining [*60] the OUFTA's proper application. Because collapsing the transactions yields a transfer of cash from West Side to petitioner, West Side's solvency must be judged on that basis.

Under OUFTA sections 1336.02 and .05, solvency is measured at the time of the transfer. A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation. *Id.* sec. 1336.02(A)(1). Following the transfer of $35.2 million to petitioner, West Side was left with tax liabilities of $16.9 million and assets of $5.1 million (consisting of a Rabobank account soon to be emptied by payments to tax shelter promoters). West Side thus "became insolvent as a result of the transfer." *Id.* sec. 1336.05(A).

*24 In sum, we find that the IRS claim arose before West Side's assets were transferred to petitioner; that West Side made this transfer without having received "a reasonably equivalent value in exchange"; and that this transfer caused West Side to become insolvent. Petitioner is thus liable for West Side's tax debts under OUFTA section 1336.05(A).[19]

[*61] 3. *Petitioner's Liability Under Ohio Law For Penalties*

[22] Even if he can be held liable for West Side's unpaid tax, petitioner contends that the penalties assessed against West Side cannot be collected from him as its "transferee" under Ohio law. According to petitioner, "the distressed debt transaction giving rise to those penalties was not entered into until after petitioner sold his stock and petitioner had nothing whatsoever to do with that transaction." In support of this proposition he relies on *Stanko v. Commissioner*, 209 F.3d 1082 (8th Cir.2000), *rev'g* T.C. Memo.1996–530.

In *Stanko*, the Eighth Circuit interpreted Nebraska law in effect before 1989, when Nebraska adopted the UFTA. *See id.* at 1084 n. 1. The Court reasoned that "penalties for negligent or intentional misconduct by the transferor that occurred many months after the transfer * * * are not * * * existing at the time of the transfer." *Id.* at 1088. The Eighth Circuit concluded that "[a] creditor whose debt did not exist at the date of the * * * [transfer] cannot have the conveyance [*62] declared fraudulent unless he pleads and proves that the conveyance was made to defraud subsequent creditors whose debts were in contemplation at the time." *Id.* at 1087 (quoting *U.S. Nat'l Bank of Omaha v. Rupe*, 207 Neb. 131, 296 N.W.2d 474, 476 (Neb.1980)).

[23] We find the *Stanko* case to have no application here. The instant case is governed by Ohio law, and the governing Ohio law differs from the pre-UFTA Nebraska statute that the Eighth Circuit was construing. The OUFTA defines "claim" expansively to include any "right to payment" even if it is "unliquidated" and "unmatured." OUFTA sec. 1336.01(C). The IRS may thus have a "claim" for the penalties whether or not they are thought to have been "existing at the time of the transfer." *Stanko*, 209 F.3d at 1088. The OUFTA, moreover, does not require proof that the transfer was made to defraud specific creditors; nor does it require proof that the debts in question "were in contemplation at the time" the assets were conveyed. *Id.* at 1087.

[24] Finally, the OUFTA provides that a transfer may be held fraudulent as to future as well as present creditors. Liability as to future creditors exists if the transfer was made without the debtor's receiving "a reasonably equivalent value in exchange" and the debtor "intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became [*63] due." OUFTA sec. 1336.04(A)(2)(b). Thus, even if respondent's claim for the penalties were regarded as not being "in existence" on the date of the transfer, petitioner would have transferee liability to the IRS under OUFTA section 1336.04(A)(2) in its capacity as a "future creditor" with respect to those penalties. *See supra* pp. 60–61 and note 19.

*25 For these reasons, we conclude that petitioner is liable under Ohio law as a transferee both with respect to West Side's unpaid tax deficiency and with respect to the penalties properly assessed against it. We have reached the same conclusion concerning transferee liability for penalties under the fraudulent transfer laws of other States. *See, e.g., Kreps v. Commissioner*, 42 T.C. 660, 670, 1964 WL 1376 (1964) (New York law), *aff'd*, 351 F.2d 1 (2d Cir.1965); *Cullifer*, T.C. Memo.2014–208, at *30, *74 (Texas law); *Feldman v. Commissioner*, T.C. Memo.2011–297, 102 T.C.M. (CCH) 613, 623 (Wisconsin law).[20]

[*64] B. *Petitioner's Status as a "Transferee" Under Federal Law*

Whether a person is a "transferee" within the meaning of section 6901 is "undisputedly [a question] of federal law." *Starnes,* 680 F.3d at 427; *see Slone,* — F.3d ——, 2015 WL 5061315; *Feldman,* 779 F.3d at 458. "Transferee" is an expansive term that includes a "donee, heir, legatee, devisee, and distributee." Sec. 6901(h). The term also includes "the shareholder of a dissolved corporation," "the successor of a corporation," and "the assignee * * * of an insolvent person." Sec. 301.6901–1(b), Proced. & Admin. Regs.

In determining "transferee" status for Federal law purposes, the Ninth Circuit has recently held that a court must consider whether to disregard the form of the transaction by which the transfer occurred. *See Slone,* — F.3d at ——, 2015 WL 5061315, at *5. "[F]or purposes of transferee liability under § 6901," the Ninth Circuit ruled, relevant precedent requires that the court "look through the form of a transaction to consider its substance." *Id.* at ——, 2015 WL 5061315, at *4. Analyzing a transaction similar to that here, the Ninth Circuit explained in *Slone:*

> [W]hen the Commissioner claims a taxpayer was "the shareholder of a dissolved corporation" for purposes of 26 C.F.R. § 301.6901–1(b), but the taxpayer did not receive a liquidating distribution if the form of the transaction is respected, a court must consider the relevant subjective and objective factors to determine whether the formal transaction "had any practical economic effects other than the creation of income tax losses."

[*65] *Id.* at ——, 2015 WL 5061315, at *5 (quoting *Reddam v. Commissioner,* 755 F.3d 1051, 1060 (9th Cir.2014), *aff'g* T.C. Memo.2012–106).[21]

In performing this "substance over form" inquiry, the Ninth Circuit does not engage in a rigid two-step analysis. Rather, it focuses "holistically on whether the transaction had any practical economic effects other than the creation of income tax losses." *Id.* (quoting *Reddam,* 755 F.3d at 1060). Following a commonsense review of the transaction, if the court concludes that the transaction lacks a nontax business purpose, has no economic substance, and was entered into solely to generate illegitimate tax benefits, the Commissioner may disregard the form the parties have selected and tax the transaction on the basis of its underlying economic substance. *Id.* at ——, 2015 WL 5061315, at *5–*6.

*26 [25] For the reasons discussed previously, we find that the transaction by which Nob Hill "purchased" petitioner's West Side stock relied on sham transactions, had no economic substance, had no bona fide business purpose, and was entered into solely to evade West Side's Federal and Ohio tax liabilities. *See supra* p. 40[*66] and note 11 and pp. 41–55. We therefore disregard the form of the transaction and find that petitioner in substance was a direct recipient of West Side's cash, i.e., as a "distributee," "the shareholder of a dissolved corporation," or "the assignee * * * of an insolvent person." Sec. 6901(h); sec. 301.6901–1(b), Proced. & Admin. Regs. In any of those capacities, he was a "transferee" of West Side within the meaning of section 6901.

IV. *Respondent's Collection Efforts*

[26] In certain circumstances the IRS may be required to show that it exhausted all reasonable efforts to collect the tax liability from the transferor before proceeding against the transferee. *See Sharp v. Commissioner,* 35 T.C. 1168, 1175, 1961 WL 1287 (1961); *Shockley v. Commissioner,* T.C. Memo.2015–113, at *54; *Kardash v. Commissioner,* T.C. Memo.2015–51, at *22–*24; *Zadorkin v. Commissioner,* T.C. Memo.1985–137, 49 T.C.M. (CCH) 1022, 1028 (1985). The reasonableness of the IRS' collection efforts against the tax debtor must be assessed in the light of the facts of the particular case. Where "the transferor is hopelessly insolvent, the creditor is not required to take useless steps to collect from the transferor." *Zadorkin,* 49 T.C.M. (CCH) at 1028.

[27] In 2008, during the course of its examination of West Side, the IRS searched for any existing West Side assets upon which to levy. Unsurprisingly, it [*67] found none. In 2008, as in late September 2003, West Side had no meaningful assets. What little cash it had post closing was quickly dissipated by payments to Fortrend, MidCoast, and their tax shelter promoter affiliates. Millennium, West Side's postclosing parent, was likewise immune from IRS collection efforts because it was a Cayman Islands company with no assets in the United States. We find that the IRS acted completely reasonably in declining to take further, useless, steps to collect this liability from West Side.

Petitioner also argues that the IRS failed to make collection efforts against Moffatt, whose $5 million "loan" was allegedly repaid with some of West Side's cash. We have already determined that the Moffatt loan was a sham. In substance, West Side's cash went directly to petitioner, and the Moffatt "loan" was simply an overnight shuffling of funds between two Fortrend affiliates. Under these circumstances, it is not certain that Moffatt was a transferee of West Side.

[28] Even if Moffatt were thought to be a transferee of West Side, collection efforts against it would almost certainly have been futile. As far as the trial revealed, Moffatt was a shadowy entity that appeared and quickly disappeared. There is no evidence in the record about what assets Moffatt had or where they were. It is a fair assumption that Fortrend established this affiliate, like Nob Hill, [*68] Millennium, and its other affiliates, in a manner that effectively immunized them from the reach of U.S. tax authorities.

*27 [29] In any event, the IRS is not required to pursue collection efforts against Transferee A before seeking to collect from Transferee B. "Transferee liability is several" under section 6901. *Alexander v. Commissioner*, 61 T.C. 278, 295, 1973 WL 2542 (1973); *Cullifer v. Commissioner*, T.C. Memo.2014–208, at *74 (same). "It is well settled that a transferee is severally liable for the unpaid tax of the transferor to the extent of the assets received and other stockholders or transferees need not be joined." *Estate of Harrison v. Commissioner*, 16 T.C. 727, 731, 1951 WL 126 (1951) (citing *Phillips v. Commissioner*, 283 U.S. 589, 51 S.Ct. 608, 75 L.Ed. 1289 (1931) (construing predecessor statute)). "In the event that one transferee is called upon to pay more than his pro rata share of the tax, he is left to his rights of contribution from the other transferees." *Id.* Petitioner is free to pursue against Moffat any right of contribution he may have.

We accordingly conclude (1) that petitioner is liable under Ohio law for the full amount of West Side's 2003 tax deficiency and the penalties and interest in connection therewith and (2) that the IRS may collect this aggregate liability from petitioner as a "transferee" under section 6901. *See* OUFTA sec. 1336.08(B); *Shussel v. Werfel*, 758 F.3d 82 (1st Cir.2014) (discussing the calculation of [*69] prejudgment interest on transferee liability), *aff'g in part, rev'g in part and remanding* T.C. Memo.2013–32. To reflect the foregoing,

Decision will be entered under Rule 155.

1 For Fortrend, see *Slone v. Commissioner*, T.C. Memo.2012–57, *vacated and remanded*, — F.3d ——, 2015 WL 5061315 (9th Cir. Aug.28, 2015); *Salus Mundi Found. v. Commissioner*, T.C. Memo.2012–61, *rev'd and remanded*, 776 F.3d 1010 (9th Cir.2014); *Frank Sawyer Trust of May 1992 v. Commissioner*, T.C. Memo.2011–298, *rev'd and remanded*, 712 F.3d 597 (1st Cir.2013); *Diebold v. Commissioner*, T.C. Memo.2010–238, *vacated and remanded sub nom. Diebold Found., Inc. v. Commissioner*, 736 F.3d 172 (2d Cir.2013). For MidCoast, see *Stuart v. Commissioner*, 144 T.C. ——, (Apr. 1, 2015); *Cullifer v. Commissioner*, T.C. Memo.2014–208; *Hawk v. Commissioner*, T.C. Memo.2012–259; *Feldman v. Commissioner*, T.C. Memo.2011–297, *aff'd*, 779 F.3d 448 (7th Cir.2015); *Starnes v. Commissioner*, T.C. Memo.2011–63, *aff'd*, 680 F.3d 417 (4th Cir.2012); *Griffin v. Commissioner*, T.C. Memo.2011–61. Samyak Veera, a principal of MidCoast, has been indicted for his role in promoting these arrangements. *United States v. Veera*, No. 12–444 (E.D.Pa. Oct. 1, 2013) (superseding indictment alleging Veera's involvement in MidCoast schemes to evade taxes by using fraudulent losses to eliminate target's gains).

2 Unless otherwise noted, all statutory references are to the Internal Revenue Code as in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. We round all dollar amounts to the nearest dollar.

3 Petitioner's effort to strike this language from the engagement letter was ultimately unsuccessful. Mr. Stovsky insisted on retaining this language and, after further negotiations, petitioner acquiesced.

4 West Side's balance sheet at the relevant time listed $302,357 in assets (less $227,793 in accumulated depreciation) and accounts receivable of $50,936 and $116,004. The assets consisted of computers, software, furniture/fixtures, office equipment, shop equipment, and leasehold improvements. LXV did not assume any of the liabilities reflected on West Side's balance sheet.

5 The $29.9 million loan was provided through a Rabobank subsidiary, Utrecht–America Finance Co. For simplicity, we will refer to these entities collectively as Rabobank. Rabobank frequently partnered with Fortrend in executing Midco deals. It has been involved in numerous transactions previously considered by this Court. *See, e.g., Salus Mundi Found.*, T.C. Memo.2012–61; *Slone*, T.C. Memo.2012–57; *Frank Sawyer Trust of May 1992*, T.C. Memo.2011–298; *Diebold*, T.C. Memo.2010–238; *LR Dev. Co. LLC v. Commissioner*, T.C. Memo.2010–203.

6 In his petition, petitioner challenged the timeliness of the notice of liability. The Commissioner generally

must assess transferee liability within one year after expiration of the period of limitations on the transferor, but the applicable period of limitations may be extended by agreement. *See* sec. 6901(c) and (d). Petitioner executed successive Forms 977, Consent to Extend the Time to Assess Liability at Law or in Equity for Income, Gift and Estate Tax Against a Transferee or Fiduciary, extending to June 30, 2012, the time for assessing transferee liability against him, and the notice of liability was timely issued on June 25, 2012. Petitioner abandoned in his posttrial briefs any challenge to the timeliness of the notice of liability, and that argument is thus deemed conceded.

7 In addition to the amounts listed in the notice of liability, petitioner proposed as a finding of fact (to which respondent did not object) that respondent determined "assessed interest" of $8,475,655 as well as "accrued interest and penalties" of $12,362,425. In their posttrial briefs the parties have not addressed the proper computation of interest or the existence of penalties other than those determined by respondent under section 6662(a), (d), and (h). We will accordingly enter decision in this case under Rule 155.

8 Whether the burden has shifted matters only in the case of an evidentiary tie. *See Polack v. Commissioner,* 366 F.3d 608, 613 (8th Cir.2004), *aff'g* T.C. Memo.2002–145. In this case, we discerned no evidentiary tie on any material issue of fact. *See Payne v. Commissioner,* T.C. Memo.2003–90, 85 T.C.M. (CCH) 1073, 1077 (2003).

9 Petitioner argues that a memorandum solicited by Millennium from the Seyfarth Shaw law firm was sufficient to substantiate the bad-debt deduction. We give no weight to that memorandum. It was based on assumed facts provided by Mr. McNabola; those assumed facts are contradicted by the record evidence in this case; and the memorandum explicitly states that no one but Millennium can rely upon it. Seyfarth Shaw gained notoriety for issuing bogus tax-shelter opinions, and this document seems par for the course. *See, e.g., Kenna Trading, LLC v. Commissioner,* 143 T.C. 322, 2014 WL 5471973 (2014), *aff'd,* 728 F.3d 676 (7th Cir.2013); *Superior Trading, LLC v. Commissioner,* 137 T.C. 70, 2011 WL 3875649 (2011); *Rogers v. Commissioner,* T.C. Memo.2014–141; *Rogers v. Commissioner,* T.C. Memo.2011–277, *aff'd,* 728 F.3d 673 (7th Cir.2013); *Sterling Trading, LLC v. United States,* 553 F.Supp.2d 1152 (C.D.Cal.2008).

10 Petitioner disputes his liability for the penalties principally on the ground that the penalties for which West Side is liable cannot be collected from him as its transferee. We address this argument *infra* pp. 61–63.

11 Ohio Supreme Court opinions considering the treatment of uniform acts by courts of other States include *Al Minor & Assoc., Inc. v. Martin,* 117 Ohio St.3d 58, 881 N.E.2d 850 (Ohio 2008) (Uniform Trade Secrets Act); *Cruz v. Cumba–Ortiz,* 116 Ohio St.3d 279, 878 N.E.2d 620 (Ohio 2007) (Uniform Interstate Support Act and Uniform Reciprocal Enforcement of Support Act); *Erie Ins. Grp. v. Fisher,* 15 Ohio St.3d 380, 474 N.E.2d 320 (Ohio 1984) (Uniform Declaratory Judgments Act); *Levi v. Levi,* 170 Ohio St. 533, 166 N.E.2d 744 (Ohio 1960) (Uniform Reciprocal Enforcement of Support Act).

12 Respondent advances the "economic substance" and "substance over form" doctrines as additional theories to support his position, contending that the Ohio courts would disregard the form of the Midco transaction because it was not a true multiparty transaction, had no business purpose, and was engineered for the sole purpose of avoiding West Side's Federal and Ohio tax liabilities. The Ohio courts have recognized and employed both doctrines. *See, e.g., First Banc Grp., Inc. v. Lindley,* 68 Ohio St.2d 81, 428 N.E.2d 427, 428 (Ohio 1981) (affirming decision of Ohio Board of Tax Appeals and agreeing that "[t]o hold otherwise would allow form to control over substance"); *Bloomingdale v. Stein,* 42 Ohio St. 168 (Ohio 1884) (concluding in fraudulent transfer case that equity "look[s] through the form to the substance of the transaction"); *Macior v. Limbach,* 86 Ohio App.3d 204, 620 N.E.2d 227, 229 (Ohio Ct.App.1993) (citing *Humana, Inc. v. Commissioner,* 881 F.2d 247, 255 (6th Cir .1989), *aff'g in part, rev'g in part* 88 T.C. 197, 1987 WL 49269 (1987)) (employing Federal "economic substance" doctrine). The "business purpose" petitioner now alleges for the Midco transaction—to generate greater after-tax profit for West Side's sole shareholder—is not cognizable under these two doctrines because it is simply a corollary of the tax-avoidance scheme. And the facts we find to support respondent's position on the "sham loan" and "de facto liquidation" theories also show that the Midco transaction lacked economic substance. In view of our disposition, however, we need not address these alternative theories as an independent justification for respondent's submission that petitioner is liable as a transferee under Ohio law.

13 Petitioner argues that Ohio law does not permit transactions to be collapsed, citing *Official Comm. of*

Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri, Inc., 313 B.R. 219, 230 (N.D.Ohio 2004) (declining to collapse a leveraged buyout where there was "no evidence of knowledge on the part of the Lenders that the acquisition would harm future creditors"). This case is inapposite because petitioner had at least constructive knowledge that Fortrend's tax-avoidance scheme would harm two creditors, the United States and Ohio.

14 Under regulations in effect during 2003, "[a] position * * * [was] considered to have a realistic possibility of being sustained on its merits" if a well-informed tax professional would conclude that it had "approximately a one in three, or greater, likelihood of being sustained on its merits." Sec. 1.6694–2(b)(1), Income Tax Regs. Stating that "a position can be taken" suggests a lower level of confidence than this. Virtually any position "can be taken."

15 In the stock purchase agreement, Nob Hill represented that it would "cause * * * [West Side] to satisfy fully all United States * * * taxes, penalties and interest required to be paid by * * * [West Side]." This representation was not worth the paper it was printed on. Petitioner and his advisers knew that Nob Hill was a shell corporation, that West Side would have virtually no assets left after the closing, and that neither would have the wherewithal to pay a $16.9 million tax liability. And because Nob Hill and Millennium (its parent) were offshore companies with no U.S. assets, this representation was completely unenforceable. The language in the stock purchase agreement allocating West Side's 2003 tax obligation to Nob Hill did not relieve petitioner of his duty to inquire. *See Diebold Found., Inc.*, 736 F.3d at 189 ("[T]he knowledge requirement for collapsing a transaction was designed to 'protect[ ] innocent creditors or purchasers for value.' * * * It was not designed to allow parties to shield themselves, when having knowledge of the scheme, by simply using a stock agreement to disclaim any responsibility." (quoting *HBE Leasing Corp.*, 48 F.3d at 636)).

16 As the Second Circuit explained in *Diebold Found., Inc.*, "collapsing" the transactions in this way requires, not only that the ultimate transferee have "constructive knowledge of the entire scheme," but also that the debtor's property "be reconveyed * * * for less than fair consideration." 736 F.3d at 186. We address the absence of "fair consideration" below in discussing the requirements of OUFTA section 1336.05. *See infra* pp. 58–59.

17 *See, e.g.*, sec. 302(b)(4)(B), (e) (defining "partial liquidation"); *Armstrong v. Marathon Oil Co.*, 32 Ohio St.3d 397, 513 N.E.2d 776 (Ohio 1987) (noting that corporation was considering complete or partial liquidation to prevent hostile takeover); *Cleveland Tr. Co. v. Hickox*, 32 Ohio App. 69, 167 N.E. 592, 595–596 (Ohio Ct.App.1929) ("If there is liquidation of a corporation, partial or complete, the determining element of the transaction is whether the stockholders surrender and cancel the stock which is given in exchange[.]"); 18B Am.Jur.2d Corporations sec. 1064 (noting that shareholders' right to receive accumulated dividends on liquidation applies identically in partial and complete liquidations).

18 Respondent advances the alternative contention that Nob Hill was a direct transferee of West Side and that petitioner has transferee-of-transferee liability as a subsequent transferee of Nob Hill. *See* sec. 6901(c)(2); *Frank Sawyer Trust of May 1992 v. Commissioner*, T.C. Memo.2014–59 (finding transferee-of-transferee liability). Because we find that petitioner is liable as a direct transferee of West Side, we need not consider respondent's alternative position.

19 The result would be the same if the IRS' claim were thought to have arisen after West Side's assets were transferred to petitioner. OUFTA section 1336.04(A)(2) provides that a transfer is fraudulent with respect to a present *or future* creditor if the transfer was made without the debtor's receiving "a reasonably equivalent value in exchange" and if (among other things) the debtor "intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due." As discussed in the text, West Side did not receive "a reasonably equivalent value in exchange" for its transfer to petitioner. And if the IRS claim were regarded as arising after, rather than before, this transfer, West Side knew that it would incur tax debts "beyond * * * [its] ability to pay as they became due." *Ibid.* In view of our disposition, however, we need not discuss in any detail petitioner's liability under this alternative provision. We likewise need not decide whether petitioner would be liable under the OUFTA's "actual fraud" provision.

20 In *Frank Sawyer Trust of May 1992 v. Commissioner*, T.C. Memo. 2014128, at *10–*11, this Court cited *Stanko*, 209 F.3d. at 1088, in holding that a transferee was not liable for accuracy-related penalties assessed against the transferors. The facts of the instant case, which must be evaluated under Ohio law, differ substantially from those of *Frank Sawyer Trust*, which

involved Massachusetts law. The First Circuit accepted our "factual finding that the Trust lacked knowledge—actual or constructive—of the new shareholders' tax avoidance intentions." *Frank Sawyer Trust of May 1992*, 712 F.3d at 599. Here, we have found that petitioner had at least constructive knowledge that West Side's tax liabilities would not be satisfied.

21 At least two other Circuits have previously ruled similarly. *See Feldman*, 779 F.3d at 454–457 (7th Cir.2015); *Owens v. Commissioner*, 568 F.2d 1233 (6th Cir.1977) ("[T]he law does not permit a taxpayer * * * to cast transactions in forms when there is no economic reality behind the use of the forms. 'The incidence of taxation depends on the substance of a transaction.' " (quoting *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334, 65 S.Ct. 707, 89 L.Ed. 981 (1945))), *aff'g in part, rev'g in part*, 64 T.C. 1, 1975 WL 3075 (1975).

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EXHIBIT B

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DISTRICT COURT

CLARK COUNTY, NEVADA

MICHAEL A. TRICARICHI, Plaintiffs, v. PRICEWATERHOUSECOOPERS, LLP, COOPERATIVE RABOBANK U.A., UTRECHT-AMERICA FINANCE CO., SEYFARTH SHAW, LLP and GRAHAM R. TAYLOR, Defendants.	Case No.: A-16-735910-B Dept. No.: XV **AFFIDAVIT OF MATTHEW J. GEHRINGER IN SUPPORT OF MOTION TO DISMISS FOR LACK OF JURISDICTION ON BEHALF OF DEFENDANT SEYFARTH SHAW LLP**

STATE OF ILLINOIS)

) ss:

COUNTY OF COOK)

Before me, the undersigned authority, personally appeared MATTHEW J. GEHRINGER, who first being duly sworn, deposes and states as follows:

1. I am an attorney at law duly licensed to practice in the State of Illinois. I am a partner in the law firm of Perkins Coie LLP, which has been retained to represent Defendant Seyfarth Shaw LLP in connection with this matter.

2. This Declaration is submitted in support of Seyfarth Shaw's Motion to Dismiss for Lack of Personal Jurisdiction to authenticate Exhibit B attached hereto.

3. On May 2, 2016, I received a courtesy copy of the Complaint in this matter from Scott F. Hessel, one of the attorneys for Plaintiff.

4. On May 3, 2016, I asked Mr. Hessel by email to provide me with a copy of the August 21, 2003 Seyfarth/Taylor Opinion Letter that is referenced on page 23 of the Complaint.

5. Exhibit B is a true and correct copy of the document that Mr. Hessel provided to me by email in response to my request.

FURTHER AFFIANT SAYETH NAUGHT.

Matthew J. Gehringer

MORRIS LAW GROUP
900 BANK OF AMERICA PLAZA · 300 SOUTH FOURTH STREET · LAS VEGAS, NEVADA 89101
702/474-9400 · FAX 702/474-9422

SWORN TO AND SUBSCRIBED before me by Matthew S. Gehringer who is personally known to me / ~~or who produced~~ ________________________ ~~as identification~~ this 30th day of June, 2016.

(Signature of Notary)

____

(Name ~~of Notary Typed or prin~~ted or stamped)

OFFICIAL SEAL
DONNA SPEARS
NOTARY PUBLIC - STATE OF ILLINOIS
MY COMMISSION EXPIRES:07/19/18

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Exhibit B

Exhibit A

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August 21, 2003

Mr. John P. McNabola, Director
Millenium Recovery Fund
98 Lower Baggot Street
Dublin 2
Ireland

Dear Mr. McNabola:

You have requested our opinion regarding the U.S. federal income tax consequences of certain transactions ("Transactions"), summarized below.

I. Summary of the Transactions

United Finance Co. Ltd., a nonbanking but registered lending corporation organized under the laws of Japan ("United Finance"), lent in its ordinary course of business Thirty One Billion Four Hundred Sixty Million One Hundred and Eight Thousand and Two Hundred and Fourteen Japanese Yen (¥31,460,108,214) to unrelated Japanese borrowers (all such debt shall be referred to hereinafter as the "Japanese Debt Portfolio"). In March 2001, United Finance contributed the Japanese Debt Portfolio, then valued at $137,109.24 with an outstanding principal balance of Twenty Two Billion Nine Hundred Sixty Six Million Seven Hundred Eighty Eight Thousand and Two Hundred and Nineteen Japanese Yen (¥22,966,788,219) (as detailed below), in exchange for Class B Shares in Millenium Recovery Fund LDC, incorporated as an exempted company under the provisions of the Companies Law (2003 Revision) of the Cayman Islands ("MRF"). After the contribution, MRF's capitalization was as follows:

Class A Shares	
100	Tread Limited, a British Virgin Islands Corporation ("Tread") wholly owned by Investment Capital Associates (Europe) Limited.
900	Graham Investments LLC, a Delaware limited liability company ("Graham") wholly owned by Douglas J. Mullins, a resident of the United Kingdom

Class B Shares

250	Graham
. 137.11	United Finance

As part of the Loan Assignment Agreement dated as of March 7, 2001, United Finance made the following representations with respect to the Japanese Debt Portfolio:

- It was the sole owner and creditor of the debt and that it received fair value for the debt.
- It had full right and authority to sell and assign the debt.
- Except for the security interest, the debt was being transferred free and clear of any and all rights of retention, liens, pledges or other kind of security or encumbrance encumbering the debt.
- It held true and complete originals of all agreements executed in accordance with the debt and each was legally binding on the debtor and guarantor.
- The debt had not been amended in any respect and was free from any counter-claim by the debtor, guarantor, issuer or endorser.
- There was no dispute as to the existence of validity of the debt.
- No further payment was required by United Finance with respect to the debt.
- The debt would not conflict with applicable laws and regulations.
- The outstanding balance of principal of, interest on, or late payment fee of, each of the loans as of the closing date was not less than the amount set forth in the details provided in conjunction with the contribution.
- To United Finance's knowledge, no debtor, guarantor, issuer or endorser of any of the loans was affiliated with any criminal organization or any gangster group member.
- It provided all information in its possession regarding the loans, which were requested by MRF, and the contents of such information were accurate and complete.
- It did not hold any funds or property of, or have any obligation to, the debtors or guarantors.

- It had not received nor anticipated any notice, assertion, claim or demand on the loans that such assets were subject to a security interest (not disclosed by United Finance to MRF) or invalid or illegal or that any guarantee was invalid or that the loans were contrary to law or the terms of the agreements entered into relation to the debt.

- Neither it nor its officers or employees had any capital relationship with (or any other type of relationships) with the debtors and guarantors.

- United Finance was an original lender of, and had not acquired from a third party, the loans and there were no predecessors in interest.

- No judgment or order which may materially and adversely affect the debt existed and no lawsuit was pending or threatened in relation to the debt.

- To United Finance's best knowledge, it disclosed all of the documents and information pertaining to the loans and such information was accurate, correct and valid and all documents provided to MRF were authentic originals or legitimate reproductions of authentic originals.

- It had not sold, assigned or transferred to anyone else any of its rights, title or interest in and to any of the loans, it had obtained executed releases for and on any and all previously granted releases, satisfactions or waivers and none of the loans have been prepaid or otherwise redeemed, in whole or in part, except as indicated in an exhibit attached to the Loan Assignment Agreement.

- It was a duly registered moneylender but deregistered on January 14, 1995.

- It complied in all material respects with all applicable laws, rules, regulations and orders.

At the time of contribution from United Finance to MRF, the Japanese Debt Portfolio consisted of the following loans:

Borrower	Sum of Original Loan Amount (Face)
Aoyama Building Development Company	¥12,600,000,000
C.Y.L. Company	¥1,147,500,000
H.T. Enterprise Company	¥800,000,000

Hukusei Denshi Company	¥140,000,000
Japan Consultant Service Company	¥200,000,000
Koushin Kensetsu Kougyo	¥230,000,000
Kyouei Development Company	¥450,000,000
M.K.F. Company	¥1,000,000,000
Minato Land	¥10,100,000,000
Ando Nennzou	¥100,000,000
Shiino Ikuta	¥40,000,000
Nihon Tatemano Company	¥300,000,000
Real Roy Company	¥192,608,214
Taihei Koumuten, Ltd.	¥2,160,000,000
Tousei Shoji	¥2,000,000,000

In a Notice Concerning Foreign Investment Company dated January 22, 2001 and the Confidential Private Offering Memorandum for Class B Shares, as amended on February 22, 2001, the stated investment purposes of MRF are to realize short and long-term appreciation from under-performing or non-performing loans and the application of derivative and structured arbitrage strategies through a variety of investments in international markets. MRF retained Bricolage Capital, LLC, an unrelated Delaware limited liability company, to act as its investment advisor. See Investment Management Agreement dated December 10, 2000.

On September 1, 2001, MRF entered into an Asset Management Agreement with Global Asset Management Co., Ltd., a corporation established under the laws of Japan ("GAMCO" or the "Servicer") to assist in the collection of the MRF debt.

On March 9, 2001, United Finance sold all of its Class B Shares in MRF to Barka Limited, an unrelated corporation organized in the Cayman Islands ("Barka") for One Hundred Thirty Seven Thousand One Hundred U.S. dollars and twenty-four cents ($137,109.24). After the purchase, MRF's capitalization was as follows:

Class A Shares	
100	Tread
900	Graham
Class B Shares	
250	Graham
137.11	Barka

On or before July 15, 2003, Tread, Graham and Barka sold their respective membership interests in MRF to Maxton Financial, Ltd., a Delaware corporation ("Maxton") and Finalworld Trust Limited, an Irish private limited liability company ("Finalworld") for Four Hundred Fifty Seven Thousand Eight Hundred Eighty Three Dollars and Forty Cents ($457,883.40). After the purchase, Maxton owned thirty percent (30%) and Finalworld owned seventy percent (70%) of MRF.

As of June 30, 2003, the Japanese Debt Portfolio consisted of the following loans:

Borrower	No.	Total Outstanding Balance + Accrued But Unpaid Interest
Aoyama Building Development Company	1	¥2,034,983,374
Aoyama Building Development Company	2	¥1,412,895,006
Aoyama Building Development Company	3	¥12,767,436,945
Aoyama Building Development Company	4	¥3,586,298,234
Aoyama Building Development Company	5	¥3,746,882,534
Aoyama Building Development Company	6	¥4,275,513,698

Aoyama Building Development Company	7	¥1,423,527,397
Real Roy Company	1	¥3,218,517
Real Roy Company	2	¥56,145,076
Real Roy Company	3	¥56,145,076
M.K.F. Company	1	¥2,688,424,657
H.T. Enterprise Company	1	¥1,618,396,575
Ohira Komuten (formerly Taihei Koumuten, Ltd.)	1	¥262,608,082
Ohira Komuten (formerly Taihei Koumuten, Ltd.)	2	¥262,608,082
Kyoei Development Co.	1	¥835,343,834
Nihon Tatemano Company (Japan Housing Co.) (KK)	1	¥752,758,904
Japan Consultant Service Company (KK)	1	¥367,518,838
Koushin Kensetsu Kougyo	1	¥320,247,260
Fussa Denshi (Hukusei Denshi Company) (KK)	1	¥166,880,723
Tousei Shoji	1	¥275,017,253
Toshizo Ando (Ando Nennzou)	1	¥176,307,663

II. Representations

For purposes of rendering this opinion, Nobuyuki Matsukura of GAMCO has represented that the information about the loans comprising the Japanese Debt Portfolio are true and accurate by certifying the information in the statement of account dated June 30, 2003.

Sean McNabola, director of MRF since July 15, 2003, based on information provided by the former directors of MRF, has represented to us in a formal representation letter attached hereto, and confirms such representations by acceptance of this opinion, as follows with respect to the Transactions:

(1) Since its inception, MRF has elected to be treated as a partnership for U.S. federal income tax purposes.

(2) To the best of MRF's knowledge and belief, MRF determines its members' distributive shares of income, gain, loss, deduction, or credit and maintain their members' capital accounts in accordance with Section 704 of the Internal Revenue Code of 1986, as amended ("Code") and Treasury Regulations ("Treas. Reg." or "Regulations") promulgated thereunder.

(3) To the best of MRF's knowledge and belief, all members' interests in MRF share proportionately in the profits, losses and capital as required under relevant partnership tax law, including Code Section 704(c).

(4) To the best of MRF's knowledge and belief, MRF has not made an election under Code Section 754 and will not do so for the taxable year or years in which the Transactions occur.

(5) At the time of the contribution of the Japanese Debt Portfolio to MRF, the Japanese Debt Portfolio was not subject to any liabilities and none of the parties have assumed any such liability or distributed any money or other property to the relevant contributing party in connection with such contribution.

(6) There existed no understanding, agreement, obligation, or arrangement pursuant to which any of the parties described herein were obligated, committed or compelled to undertake all or any of the Transactions upon the happening of any other transaction.

(7) Every transaction described herein in which the parties participated did in fact occur.

(8) To the best of MRF's knowledge and belief, each of the loans was acquired by United Finance by lending cash to unrelated borrowers in Japan.

(9) To the best of MRF's knowledge and belief, neither MRF nor any other owner, has waived in whole or in part the right to collect all or any portion of the Japanese Debt Portfolio.

(10) Each debt constituting the Japanese Debt Portfolio had a demonstrable value (i.e., opportunity to collect more than a trivial amount) to third parties at the time of its contribution to MRF.

(11) At all times, MRF was an accrual basis taxpayer.

(12) At the time of contribution by United Finance to MRF, the outstanding principal balance of the Japanese Debt Portfolio was equal to Twenty Two Billion Nine Hundred Sixty Six Million Seven Hundred Eighty Eight Thousand and Two Hundred and Nineteen Japanese Yen (¥22,966,788,219) according to the statement of account dated June 30, 2003 supplied by GAMCO.

(13) As of June 30, 2003, the outstanding principal balance and any accrued but unpaid interest for tax purposes of the Japanese Debt Portfolio was equal to Thirty Seven Billion Four Hundred Eighty One Million Two Hundred Fifty Thousand and Eight Hundred Fifty Four Japanese Yen (¥37,481,250,854) according to the statement of account dated June 30, 2003 supplied by GAMCO.

(14) Prior to the completion of the Transactions, none of the parties involved in the Transactions were related to United Finance within the meaning of Code Section 267(b) or Code Section 707(b).

(15) MRF is not a "dealer" and has not elected to be treated as a "dealer" in securities within the meaning of Code Section 475, nor has elected mark to market treatment for U.S. federal income tax purposes.

(16) To the best of MRF's knowledge and belief, promissory notes associated with the Japanese Debt Portfolio were not issued in registered form and did not include interest coupons.

(17) To the best of MRF's knowledge and belief, all statements of fact set forth herein are true and correct.

III. Conclusions

In rendering our opinions, we have reviewed the representations and advice from various parties to the transactions described herein, which representations and advice are referred to below. We have assumed that all facts, statements and representations made in any of the documents referred to herein were true and correct at the time given to us and continue to be true and correct through the date of this opinion, and that any statement made "to the knowledge of" or "to the best knowledge of" any person or party or similarly qualified is correct without such qualification. We have assumed that the facts certified to us set forth all facts relevant to the Transactions and that these certifications contain no unreasonable factual or legal assumptions or any such assumption that the certifying party knew or had reason to know were untrue. In rendering our opinions, we have also examined such corporate records and such other agreements, certificates, instruments, and documents, and we have made such other inquires of officers, owners and representatives of the entities involved in the transactions described herein as we have considered necessary to render the opinions set forth herein. We have made no independent verification of such representations, advice, records, agreements, certificates, instruments, documents, and responses to such inquiries. If any such representations, advice, records, agreements, certificates, instruments, documents, or responses are inaccurate in any material respect, the opinions contained herein may not be relied upon. In addition, if such descriptions or assumptions are inaccurate in any material respect, or the documents prove not to be authentic, the opinions contained herein may not be relied upon. In rendering our opinion, we have reviewed the applicable provisions of the Code and of the final, temporary, and proposed Regulations promulgated thereunder; relevant decisions of the U.S. federal courts; published Revenue Rulings ("Rev. Rul." or "Ruling") and Revenue Procedures ("Rev. Proc.") of the Internal Revenue Service ("IRS" or the "Service"); and such other materials as we have considered relevant. In certain instances we have determined that there is no authority directly on point, and in such instances we have reached our opinion reasoning from such other authority as we believe to be relevant to the issues addressed. However, there can be no guarantee that following an audit, the IRS will not take a position contrary to the opinion set forth herein, which ultimately may be sustained by the courts, since an opinion of counsel is binding on neither the IRS nor the courts. In addition, our opinions are based on the current law and other authorities, which are subject to change, possibly with retroactive effect. Any such changes could affect the opinions expressed herein. We assume no obligation to update our opinion in light of any subsequent change in law.

All opinions expressed herein relate solely to the U.S. federal income taxes discussed. No opinions are expressed as to any other federal income tax issues or any foreign, state or local tax issues. Furthermore, all opinions expressed herein are based on facts as described as of the date of this opinion. If any of these facts change prior to the conclusion of any of the Transactions, the conclusions herein may also change.

Based on and subject to the Summary set out at I above, the Representations set out at II above, and the analysis set forth in IV below, all as of the date hereof, and subject to the assumptions and limitations set forth above, we are of the opinion that for U.S. federal income tax purposes:

(1) MRF more likely than not will be classified as a partnership and each member of MRF should be treated as a partner for U.S. federal income tax purposes.

(2) More likely than not, no gain or loss will be recognized by United Finance with respect to the Japanese Debt Portfolio contributed by United Finance to MRF.

(3) Based on GAMCO's representation, it is more likely than not that United Finance had an initial basis for U.S. federal income tax purposes in the Japanese Debt Portfolio of One Hundred Ninety One Million Four Hundred Thirty Seven Thousand and Seven Hundred Sixty One Dollars ($191,437,761), if converted into dollars, on the date of contribution to MRF.

(4) MRF's tax basis in the Japanese Debt Portfolio will more likely than not equal the tax basis of the Japanese Debt Portfolio in United Finance's hands immediately before its contribution to MRF.

(5) MRF's basis in the Japanese Debt Portfolio for U.S. federal income tax purposes consists of outstanding principal balance and accrued but unpaid interest. Based on representations given by GAMCO and MRF, it is more likely than not that MRF's tax basis in the Japanese Debt Portfolio, converted into U.S. dollars, would be approximately Three Hundred Fourteen Million Seven Hundred and Four Thousand and Thirty Seven Dollars ($314,704,037) as of June 30, 2003.

(6) Barka's purchase of a portion of United Finance's interest in MRF from United Finance more likely than not will not affect MRF's tax basis in the Japanese Debt Portfolio.

(7) Barka's initial tax basis in Barka's membership interest in MRF more likely than not will be equal to the amount paid by Barka to United Finance for such interest in MRF.

(8) Each loan comprising the Japanese Debt Portfolio is more likely than not entitled to a bad debt deduction under Section 166 in an amount equal to the face value for the nonperforming loans which became totally worthless in 2003 and an amount equal to any charge-off from face value of nonperforming loans which did not become worthless in 2003 (i.e., became partially worthless).

(9) The IRS more likely than not would be unsuccessful were it either to assert under Treas. Reg. § 1.701-2 that the Transactions are inconsistent with the intent of Subchapter K or to assert that MRF should be disregarded entirely under Treas. Reg. § 1.701-2 or under common law principles.

(10) The step transaction doctrine more likely than not will not apply to the Transactions.

(11) The sham transaction doctrine more likely than not will not apply and, based on representations by the parties, the Transactions should have the requisite business purpose and economic substance.

(12) Based on the facts above, representations of the parties and the information available to us, the requisite profit motive more likely than not should exist to support a bad debt deduction under Section 166 for the loans comprising the Japanese Debt Portfolio.

IV. Analysis

A. MRF Treated as a Partnership

Regulations § 301.7701-2(b)(1)-(8) describes certain entities that are classified as corporations for U.S. federal income tax purposes. Regulations § 301.7701-3 provides that an entity not described in Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) is considered to be an "eligible entity," which may elect to be classified as either a corporation or, if it has two or more owners, a partnership. Regulations § 301.7701-(3)(b)(2) provides that a foreign eligible entity that has two or more members and that does not elect to be classified as a partnership will be classified as a corporation for U.S. federal income tax purposes if all the members have limited liability.

As an exempted company incorporated under the provisions of the Companies Law (2003 Revision) of the Cayman Islands, MRF is neither a "per se" corporation nor any other type of entity described in Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8). Therefore, MRF should constitute a foreign eligible entity. It has been represented that MRF has made a valid election to be classified as a partnership under Treas. Reg. § 301.7701-3 since its inception and therefore MRF should be treated as a partnership for U.S. federal income tax purposes.

Under common law the courts have held that a partnership is respected for tax purposes if the parties join together to jointly conduct a business and share the profits. See e.g., *Comr. v. Culbertson*, 337 U.S. 733 (1949). In *Culbertson*, supra, at 741, the Court stated that whether a partnership existed for tax purposes depends on "whether the partners really and truly intended to join together for the purpose of carrying on the business and sharing in the profits and losses or both."

In Private Letter Ruling 199914006, a limited liability company ("LLC") was owned by a partnership and by a corporation, all of the stock of which was owned by the partnership. Under the LLC agreement, the corporation was not entitled to receive any distributions, and did not receive any allocations of income, gain, profit, loss, deduction, credit, or other amount from the LLC. One of the issues in the ruling was whether the LLC was a partnership for tax purposes. The IRS cited *Culbertson*, supra, and *Comr. v. Tower*, 327 U.S. 280 (1946), for the general principles applicable to determine whether a partnership exists. The ruling states that "[t]he primary inquiry is whether the parties intended to join together to operate a business and share in its profits and losses." Because the corporation in the ruling had no interest in the profits and losses of the LLC, the IRS concluded that the corporation was not a partner, and that therefore the partnership was the sole owner of the LLC. Thus, the critical issue in this ruling was whether the purported partners joined together to conduct a business and share the profits and losses. In the present situation, having acquired an interest in MRF, United Finance and the other members agreed to jointly conduct the business of acquiring, managing and realizing on distressed assets and sharing the profits and losses therefrom.

In *ASA Investerings P'ship v. Comr.*, T.C.M. (CCH) 1998-305, aff'd 201 F.3d 505 (D.C. Cir. 2000), cert denied 531 U.S. 871 (2000), the court found that a partnership formed by Allied Signal and ABN, a foreign partner, was not a valid partnership arrangement for U.S. federal income tax purposes. The court based its holding, in part, on what it viewed as the two parties' different investment objectives. In the court's view, Allied Signal only wanted capital losses while ABN was only interested in earning a specified rate of return on its investment and did not want to share in any losses. The court found that Allied Signal was obligated to pay all expenses and guarantee ABN a minimum profit and that Allied Signal made all the critical management decisions. As a result, the court concluded that ABN was not a partner in a partnership, but rather was a mere lender. The court noted that Allied Signal agreed to enter into the transaction before it even knew that ABN would be involved.

The *ASA Investerings* case is distinguishable from the Transactions in several key respects. All of the members of MRF have the potential for profit or loss with respect to their investments. Each member shares proportionately in the income, gain, loss and deductions of such funds, so that there is no issue of recharacterization as in the *ASA Investerings* case. In addition, there are no agreements requiring one party to pay all expenses and there are no minimum profit guarantees to any member. Finally, as discussed below, the parties have a significant non-tax business purpose. for engaging in the Transactions.

Based upon the foregoing, MRF should be classified as a partnership for U.S. federal income tax purposes and United Finance, Tread, Graham, Barka, Maxton and Finalworld and any other members should be treated as partners or former partners of MRF.

B. **Contributions**

1. **General Rules for Contributions.**

Section 721(a) provides that no gain or loss is recognized by a partnership or any of its partners upon a contribution of property to a partnership in exchange for a partnership interest. While neither the Code nor the Regulations define the term "property" under Section 721, that section is similar to Section 351 in the corporate context, where the term "property" is given a broad interpretation and serves to distinguish services from property. See *Stafford v. U.S.*, 611 F.2d 990 (5th Cir. 1980); Priv. Ltr. Rul. 82-25-069 (Mar. 24, 1982); McKee, Nelson & Whitmire, FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS ¶ 4.02[1] (3rd ed. 1997). Under Section 721, a taxpayer does not recognize gain or loss on the contribution of property, but will recognize gain on the contribution of services in exchange for an ownership interest.

2. **Investment Company Exception.**

Notwithstanding the general rule described above, Section 721(b) provides that the non-recognition rule of Section 721(a) does not apply to gain realized upon a transfer of property to a partnership that would be treated as an investment company (within the meaning of Section 351(e)) if the partnership were incorporated. Because the value of the Japanese Debt Portfolio that was contributed to MRF did not exceed its tax basis in United Finance's hands at the time of the contribution to MRF, any amounts realized in connection with the contribution of the Japanese Debt Portfolio would be loss, not gain. Therefore, Section 721(b) should not be applicable, and United Finance should not recognize gain or loss under Section 721 on the contribution of the Japanese Debt Portfolio to MRF.

3. **Disguised Sale Rules Not Applicable on Contribution to MRF.**

Code Section 707 and the Regulations thereunder contain a "disguised sale" rule, which could convert a contribution to capital of a partnership as part sale and part contribution.

Treas. Reg. § 1.707-3(b) provides:

> (b) Transfers treated as a sale--(1) In general. A transfer of property (excluding money or an obligation to contribute money) by a partner to a partnership and a transfer of money or other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part, by the partner to the partnership only if based on all the facts and circumstances—
>
> (i) The transfer of money or other consideration would not have been made but for the transfer of property; and
>
> (ii) In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

As to (b)(1)(i) there is no written agreement to transfer money and there is no "other consideration." The subsequent purchase by Barka is a later independent transaction arising separate from the initial contribution of the Japanese Debt Portfolio to MRF.

The IRS might assert that "other consideration" arose by recasting the transfer as United Finance as an assignee taking the MRF interest subject to the anticipated purchase of MRF by Barka. The IRS should not prevail in such an assertion because:

1. The IRS would be inserting a step in the assignment that does not in fact occur.
2. No realization event has occurred, since the payment terms have not changed.
3. MRF is an entity for these purposes and not a mere aggregation of its members.

We discuss each of these in order.

a. **Step Transaction**.

At the time of contribution to MRF by United Finance, the purchase by Barka was totally contingent. No obligation existed to which Barka was bound. To say otherwise the IRS would be inserting a step in the transaction. The IRS cannot test the transfer as a different transaction by inserting fixed contract where there was none. *Esmark*, supra. See Terence F. Cuff, Directing the Regulations On Partnership Disguised Sales - Part II; TAXES MAGAZINE, Sept. 1993, p. 566, fn. 7 at p. 567.

b. **No Realization Event Has Occurred**.

Realization is required for triggering of gain under Section 1001 and the Supreme Court's decision in *Cottage Savings and Loan*, 91-1 USTC 50,187. Under Treas. Reg. § 1.1001-3, as to a promissory note, a change in payment terms which is significant is required for there to be a realization event. In the assignment of interests in MRF no change in payment terms of the underlying notes has occurred and so, no realization event has occurred. Accordingly, the IRS could not bifurcate the transaction into a partial sale and partial contribution. See also *Jackson v. U.S.*, 83-1 USTC § 9427 (9th Cir. 1983) for the proposition that any change in payment terms must be material to cause a realization event.

c. **MRF is a Separate Taxable Entity**.

MRF is treated as a separate taxable entity for purposes of sale of interests and transactions between partners and between partners and the partnership. Accordingly, Barka and MRF should not be disregarded as separate persons entering into contracts as principals and not as agents for one another. A review of the legislative history of the 1954 Code makes this explicitly clear.

C. United Finance's Basis in MRF

Section 722 provides, in general, that the basis of a partnership interest acquired by a partner for its contribution of property (including money) to the partnership is equal to the amount of money plus the adjusted basis of the property contributed to the partnership, increased by the amount of gain, if any, recognized by the partner on the contribution under Section 721(b). United Finance lent Thirty One Billion Four Hundred Sixty Million One Hundred and Eight Thousand and Two Hundred and Fourteen Japanese Yen (¥31,460,108,214) in cash to unrelated Japanese borrowers. In March 2001, United Finance contributed the Japanese Debt Portfolio, then valued at $137,109.24 with an outstanding principal balance of Twenty Two Billion Nine Hundred Sixty Six Million Seven Hundred Eighty Eight Thousand and Two Hundred and Nineteen Japanese Yen (¥22,966,788,219). Thus, as discussed below, United Finance should have basis in the Japanese Debt Portfolio equal to this amount.

D. MRF's Initial Tax Basis in the Japanese Debt Portfolio

Section 723 provides that the tax basis of property contributed to a partnership is the tax basis of the property in the hands of the contributing partner at the time of the contribution, increased by any gain recognized by contributory partner under Section 721(b) upon the contribution. Because no gain or loss should have been recognized by United Finance on the contribution of the Japanese Debt Portfolio to MRF, MRF's tax basis in the Japanese Debt Portfolio should equal United Finance's tax basis in the Japanese Debt Portfolio immediately before the assets were contributed to MRF by United Finance.

1. United Finance's Basis in the Japanese Debt Portfolio.

a. Applicability of U.S. Tax Principles.

In determining the tax basis of the Japanese Debt Portfolio in United Finance's hands, U.S. federal income tax principles should be used.[1] For example, Section 1016(a)(2) was applied to foreign assets in *Gutwirth v. Comr.*, 40 T.C. 666 (1963), acq. 1966-2 C.B. 5. In *Gutwirth*, the Tax Court held that not only must capital expenditures be added to basis, but the basis of property must be reduced by the amount allowable under Section 1016(a)(2). *Gutwirth*, at 676. In sum, the adjusted basis of the property must be decreased by allowable depreciation attributable to the period during which the taxpayer was not subject to U.S. taxation. Although the *Gutwirth* case turned on the interpretation of a tax provision regarding war reparations, it stands for the proposition that U.S. tax principles apply when determining the basis of foreign property.

Subchapter K of the Code, which provides a comprehensive set of rules for the tax treatment of partnerships, makes no distinction between foreign and domestic entities. For example, Subchapter K (Sections 7701 through 7777) applies to "partnerships" as defined in Treas. Reg. §§ 301.7701-1, 301.7701-2, and 301.7701-3 (the so-called "check-the-box" regulations). Section 761(a); Treas. Reg. § 1.761-1(a). Under the check-the-box regulations, both foreign and domestic entities can be partnerships and, therefore, subject to Subchapter K and other Code provisions. This view has been accepted by both the courts and the IRS. See e.g., Treas. Reg. § 1.701-2(d), Example

[1] See ILM 200303021 (Oct. 1, 2002) reasoning that generally "United States tax concepts apply to determine the tax consequences of events even if those events occur outside of the United States and even if those events result from activities conducted by foreign persons." *See also* FSA 200242004 (July 19, 2002) in which this rule was implicit in the Service's analysis of a similar transaction.

3 (foreign partnership between domestic corporation and foreign corporation is subject to partnership anti-abuse rules); Rev. Rul. 80-293, 1980-2 C.B. 128 (a partnership formed under the laws of another country terminated under Section 708 when two U.S. individuals, within the same calendar year, bought 70 percent of the interests in partnership capital and profits); *Travelers Ins. v. U.S.*, 28 Fed. Cl. 602 (1993) (taxpayer's Section 761 election with respect to an Indonesian oil venture meant the taxpayer had no "distributive share of partnership income" from that venture for purposes of applying Section 907(c)(3)(D)); Priv. Ltr. Rul. 93-06-008 (basis of property contributed by a domestic corporation to foreign partnership was subject to the carryover basis rules of Section 723).

Subchapter K includes specific rules (or incorporates other Code provisions by reference) for purposes of determining a partner's basis in its partnership interest, a partnership's basis in its assets and its items of income. For example, Section 742 requires a taxpayer who acquires a partnership interest by purchase to establish its basis under part II of Subchapter O (Sections 1011 through 1023). Thus, if a U.S. taxpayer joins a foreign partnership, the taxpayer's income from the partnership should be computed under Subchapter K (including the rules for calculating the basis in partnership assets and items of partnership income) as if the foreign partnership were always a domestic partnership. *Atlantic Veneer Corp. v. Comr.*, 85 T.C. 1075 (1985), aff'd 812 F.2d. 158 (4th Cir. 1987), General Counsel Memorandum ("GCM") 34572 (Aug. 3, 1971) and Technical Advice Memorandum (TAM) 8749008 (Aug. 18, 1987) provide added support for this conclusion.

In *Atlantic*, the Service required a taxpayer to follow the rules of Subchapter K with respect to the taxpayer's interest in a West German partnership. The taxpayer, the Atlantic Veneer Corporation, had purchased a one-third interest in the partnership at the end of 1972 by paying approximately $5,270,000 for the interests of two limited partners. When Atlantic's interest in the partnership became effective on January 1, 1973, its one-third interest in the adjusted basis of the partnership's property was only $2,015,000. Under German law, the partnership increased Atlantic's basis in its share of partnership assets by $3,255,000 ($5,270,000 minus $2,015,000) and allocated that difference among the partnership's assets.

Because Atlantic never filed a Section 754 election, the Service denied Atlantic's attempt to increase the basis in its share of partnership's assets. The Tax Court, after acknowledging that a taxpayer could apply Section 743 to make basis adjustments with respect to a foreign partnership, agreed with the IRS. Thus, notwithstanding that the foreign partnership had increased the basis in its assets under foreign law, Atlantic could not claim any adjustments. The basis in its share of partnership assets was controlled by Subchapter K.

Similarly, GCM 34572 holds that basis must be determined under the ordinary rules of Subchapter O in the case of a taxpayer who acquires property in the capacity of a nonresident alien and then sells the property after becoming a resident. Moreover, the GCM remarks that applying any different system (such as requiring basis to equal the property's fair market value when the taxpayer became a resident) could only be accomplished through legislation.

Finally, TAM 8749008, which concerns a foreign corporation rather than a foreign partnership, also requires the basis rules of the Code to control the taxation of income from assets brought into the United States. Specifically, the TAM applies Sections 1012 and 1016 to determine the depreciation of foreign property that the foreign corporation purchased with foreign currency and then brought into the country. Citing *Gutwirth* supra, Rev. Rul. 78-281, 1978-2 C.B. 204, and Rev. Rul. 54-105, 1954-1 C.B. 12, the IRS concluded that the original basis of the property was its cost in foreign currency under Section 1012 (valued at the dollar exchange rate in effect at the time of purchase). As for the purpose of taking depreciation, the Service concluded that the adjusted basis of the property when it started operating in the United States was its original cost under Section 1012, adjusted for the depreciation allowed (but not less than the amount allowable) for the years the property was operated outside the United States. In short, basis in the property is determined by applying the regular basis rules of Sections 1012 and 1016 as if the property had always been United States property.

b. Application of U.S. Tax Principles.

Code Section 1011(a) provides:

> The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under Section 1012 or other applicable sections of this Subchapter and Subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in Section 1016. [*emphasis added*]

Section 1012 provides in relevant part:

> The basis of property shall be the cost of such property, except as otherwise provided in this Subchapter and Subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses).

Consequently, as a general rule, the tax basis of property is its cost, as adjusted by rules specifically provided in the Code. For purposes of calculating basis, the cost of property purchased with foreign currency is the United States dollar equivalent of the purchase price, based on the exchange rate in effect on the date of original purchase. Section 988(b)(1) and (2). These rules are codified in Sections 985 through 988. Recent legislative proposals have contemplated a "fresh start" method that would require incoming foreign property to be marked to market. However, none of these proposals have been enacted.[2]

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[2] Although primarily aimed at abusive attribute importation transactions, the fresh-start proposal would also eliminate built-in gains (and any other favorable foreign-generated tax attributes as well), thus operating in a neutral manner. It would also work a considerable administrative simplification by obviating the need to recreate tax histories of entities and assets when they had little or no connection to the United States. On the other hand, marking to market can raise difficult valuation issues, especially for hard to value attributes, such as intangibles (a situation, however, that is equally present when making a Section 338 election, or when a corporation is subject to the built-in gain or loss rules of Section 382). 2000 AOD 027-2 (CCH).

Therefore, as stated above, under Section 1012 the basis of property is its cost unless provided differently elsewhere in the Code. While the Code contains a number of exceptions to the "cost" rule of Section 1012, it does not contain a formal definition of the term cost. Thus, any definition must be derived from administrative and judicial decisions. The vast majority of case law finds that in an arm's length transaction, absent a motivating element such as disguising compensation or a gift, cost has its plain meaning – the amount paid for the property, regardless of the property's true value.[3] Therefore, more likely than not, United Finance's tax basis in the Japanese Debt Portfolio will be the amount lent by United Finance to unrelated borrowers in Japan plus accrued but unpaid interest, reduced by any principal payments received prior to the contribution to MRF.

However, a narrow exception to the general "cost" rule has developed in certain situations where the amount paid in excess of fair market value is treated, for example, as a gift, a contribution to capital or a dividend, as the case may be, and not as part of cost. Furthermore, the IRS has the authority under Section 482 to allocate items among two organizations under common control. Thus, there is a risk that the IRS may assert that United Finance's tax basis in the Japanese Debt Portfolio was less than the amount lent by United Finance to unrelated borrowers in Japan plus accrued but unpaid interest, reduced by principal payments received prior to the contribution to MRF.

c. <u>Mark to Market Rules.</u>

Whether United Finance continues to maintain its tax basis in the Japanese Debt Portfolio after the lending of money to unrelated borrowers in Japan depends on whether, under U.S. tax principles, United Finance was required to mark the assets to market prior to their contribution to MRF. A taxpayer who is considered a dealer in securities generally must comply with the mark to market rules in Section 475. This must be done at least annually and at that time the dealer will recognize ordinary gain or loss on the marking to market or sale of this inventory. If a dealer wants to hold a security for investment and thus obtain capital gain treatment, the security must be clearly identified as an investment.

Even if United Finance is treated as a dealer of securities, it should not be subject to the mark to market requirements, as United Finance's activities should fall under the "negligible sales" exception to that Section. Treas. Reg. § 1.475(c)-1(c) provides that a taxpayer that regularly purchases securities from customers in the ordinary course of its trade or business but engages in no more than "negligible sales" of the securities is not treated as a dealer within the meaning of Section 475 unless the taxpayer elects to be so treated or, for purposes of Section 471, the taxpayer accounts for any security as inventory. A taxpayer engages in negligible sales only if it has annual sales of all or part of fewer than 60 debt instruments or if the total adjusted bases of the debt instruments (or parts thereof), regardless of how acquired, that the taxpayer sells is less than five percent of the total basis, immediately after acquisition, of the debt instruments that it acquires in that year.[4]

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[3] <u>See</u> <u>e.g.</u>, *Commissioner v. Matheson*, 82 F.2d 380 (5th Cir. 1936) (purchase from estate at agreed price); *Hall v. Commissioner*, 9 T.C. 53 (1947) (<u>acq.</u>); *Poncin Corp. v. Commissioner*, 27 B.T.A. 328 (1932).

[4] Treas. Reg. § 1.475(c)-1(c)(2)(i) and (ii).

In the instant transaction, United Finance should qualify for the negligible sale exception. Prior to March 2001, United Finance did not sell any of its loan portfolio to third parties.

d. **The Foreign Currency Rules of Subchapter J Do Not Change the Result.**

The Code requires that the dollar basis of foreign owned property be determined at the time of acquisition or capital improvement using the currency exchange rates then in effect. In 1986, Congress adopted a complicated set of rules to account for the existence of foreign currency fluctuations in applying the provisions of the Code. These rules do not override the historic method for determining the basis of foreign assets.

Section 985(a) provides that all income tax determinations are to be made in a taxpayer's functional currency. Section 987 goes on to provide that if a taxpayer has business units (e.g., branches) with functional currencies other than the dollar, then the taxpayer's taxable income is determined by (1) determining income or loss separately for each business unit using its own functional currency, (2) translating that income or loss into dollars at the appropriate exchange rate and (3) making adjustments for transfers of property between business units with different functional currencies. Covered business units are referred to as Qualified Business Units ("QBUs").

The implementing regulations under these two provisions contain rules for determining the basis of property transferred to a QBU. Treasury Regulation Section 1.985-5 provides rules regarding a QBU that changes its functional currency. Among these rules is a provision that requires the QBU to restate the basis of its assets in its new functional currency using the spot exchange rate between the old and new currencies in existence at the end of the taxable year preceding the currency change.

This Regulation does not apply to the Transactions because it only applies to changes in a functional currency.[5] The formation of the partnership represents an initial adoption of a functional currency, not a change in currencies, and falls outside the scope of the Regulation. Any contrary results were not contemplated by Congress.

See e.g., Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2001 Revenue Proposals 205-207 (Feb. 2000) (hereinafter "2001 Administration Proposals") ("Under current law, a taxpayer that becomes subject to U.S. taxation may take the position that it determines its beginning bases in its assets under U.S. tax principles as if the taxpayer had historically been subject to U.S. taxation."); see also Tech. Adv. Mem. 87-28-002 (Oct. 29, 1986) ("In order to determine the application of the installment method rules to the contract payments in 1983 and 1984, it must be determined what the U.S. tax treatment would have been in 1981 if taxpayer had been a resident at the time of the sale."); Hugh J. Ault, COMPARATIVE INCOME TAXATION: A COMPARATIVE ANALYSIS 373 (1997) (stating that in order to establish the tax history of a new subject it is necessary "to reconstruct past events as if they had taken place while the

[5] This Regulation is only applicable to actual and not potential taxpayers. This is in contrast to the definition in Section 7701(a)(14). It is unknown whether United Finance, as an intra Japan lender, has ever been subject to actual U.S. taxation

taxpayer was subject to the taxing system."); Jeffery Colon, Changing U.S. Tax Jurisdiction: Expatriates, Immigrants, and the Need for a Coherent Tax Policy, 34 SAN DIEGO L. REV. 1, 74 ("The tax history [of a foreign asset brought into the U.S.] must be recreated under U.S. tax principles using U.S. dollars. Although it is possible to recreate the basis of property in simple cases, there is no guidance on how to take into account, for example, elections to deduct or capitalize certain expenses."); Keith E. Engel, Importing Assets into Domestic Taxing Jurisdictions: Learning from Canada, 52 TAX LAW. 275, 315 (1999) (noting that applying the U.S. basis adjustment provisions to assets brought into the United States is "a logical extension of a pure historic basis entry system that views entering assets as if they had always been within the U.S. taxing jurisdiction.").

e. **United Finance's Basis in the Japanese Debt Portfolio is Correct and is Not Subject to Reduction for Deductions Prior to Contribution to MRF.**

All of the Japanese Debt Portfolio was of value and not worthless at the time of contribution to MRF. Valuable assets were transferred. There was a contribution of value and the line of cases holding no contribution where the contributed assets were valueless is not applicable. See *Seaboard Commercial Corp. v. Commissioner*, 28 T.C. 1034 (1957), acq. 1958-2 C.B. 7; *Hayutin v. Commissioner*, T.C. Memo 1972-127, aff'd 508 F.2d 462 (10th Cir. 1974).

Additionally, no bad debt deduction was available to United Finance prior to contribution to MRF. Treas. Reg. § 1.166-3(b) requires that the debt be totally worthless to be deductible as a bad debt under Section 166(a). Debt may be totally worthless within the meaning of the Regulations when the taxpayer has no prospect of recovering more than a trivial amount. *Buchanan v. United States*, 87 F.3d 197 (7th Cir. 1996), cert. denied, 519 U.S. 950 (1996); *Washington Trust Co. of Pittsburgh v. Commissioner*, T.C.M. (CCH) 5 (1942); Rev. Rul. 71-577, 1971-2 C.B. 129. These authorities show a trivial amount may be defined to be only cents on the dollar, that is, a very small percentage of the total amount, which is not the situation here. However, here reliance on the percentage of recovery is not appropriate as amounts that could be received are substantial both as a percentage of face value and as an absolute amount. See *Los Angeles Shipbuilding & Drydock Corp. v. United States*, 166 F. Supp. 914 (S.D. Cal. 1958), vacated on another issue, 289 F.2d 222 (9th Cir. 1961). MRF has represented that this is true for all notes in the Japanese Debt Portfolio.

United Finance's basis in the Japanese Debt Portfolio is correct. There was no duty to reduce basis by deductions in prior years. As previously explained, United States tax law is applied to determine a foreign entity's proper basis. *Ahadpour v. Commissioner*, 2002-1 USTC 50,274 (9th Cir.); *Gutwirth v. Commissioner*, 40 T.C. 666, 678-79 (1963), acq. in result, 1966-2 C.B. 5; *Antuna v. Commissioner*, T.C. Memo 1970-290. The taxpayer must establish basis in the notes for them to be recognized for tax purposes. See *Grace v. Commissioner*, T.C. Memo 1981-624; *Antuna*, supra.

See *Benedum v. Granger*, 180 F.2d 564 (3d Cir.) cert. denied, 340 U.S. 817 (1950); *J.E. Hawes Corp. v. Commissioner*, 44 T.C. 705 (1965). Partnership basis need not be reduced as United Finance should not have deducted its bases in the notes as bad debts prior to contribution. A corporation has the option of deducting a debt when it becomes wholly worthless or partially worthless. Section 166(a). The deduction of a partially worthless debt requires that the taxpayer charge off the loan in the year it is deducted. Section 166(a)(2); Treas. Reg. § 1.166-3(a)(2). This charge off was not made nor was it required to be made by United Finance or MRF.

The taxpayer may not delay the deduction of a debt that is totally worthless. *Seiberling Rubber Co. v. Commissioner*, 169 F.2d 595 (6th Cir. 1948); *Seaboard Commercial, 28 T.C. at 1054; W.L. Moody Cotton Co. v. Commissioner*, 2 T.C. 347 (1943), aff'd, 143 F.2d 712 (5th Cir. 1944). However, a taxpayer is not required to write off debt as partially worthless. *Reed v. Commissioner*, 129 F.2d 908 (4th Cir. 1942); *American Cigarette & Cigar Co. v. Bowers*, 92 F.2d 596 (2d Cir. 1937); *Harlan v. United States*, 312 F.2d 402 (Ct. Cl. 1963). For example, in *American Cigarette*, the taxpayer had loaned money to a corporation that had steadily declined over a number of years. The taxpayer delayed writing off all the debt until the corporation had gone out of business and the assets had been sold off. The government argued that because the debt was in the form of a number of notes, the notes should have progressively been found to be worthless as the business died. The Second Circuit rejected this argument, finding that a creditor may allocate payments among notes as it pleases and could therefore wait until the entire debt was worthless before writing it off.

2. **MRF Has Basis In The Japanese Debt Portfolio That Exceeds Its Fair Market Value.**

It is possible a taxpayer may have basis in a debt acquired that exceeds its fair market value upon receipt when, as in this case, the acquirer takes a carryover basis in the asset that equals the basis of the transferor. See *American Credit Corp. v. Commissioner*, T.C. Memo 1973-33; *Hayutin*, supra. *American Credit* explicitly found such an exception in the context of a corporate reorganization. It also distinguished *Mountain Wholesale*, 17 T.C. 870 (1951), because that case involved circumstances where the taxpayer acquired its own basis. Like the present case, *Hayutin* involves the contribution of a note to a partnership, where the note was arguably worth less than the partner's basis. The Tax Court allowed the partnership to have the partner's basis in the note. The Commissioner has acquiesced in *American Credit*, 1973 AOD LEXIS 156, and *Hayutin*, 1973 AOD LEXIS 51.

Further, the loans in this case were not worthless when made and therefore do comprise bona fide debt. See *Garret v. Commissioner*, 39 T.C. 316 (1962); *Stark v. Commissioner*, T.C. Memo 1982-639. Bona fide debt arises when there is a reasonable expectation that an advance will be repaid. *Litton Business Systems, Inc. v. Commissioner*, 61 T.C. 367, 377 (1973), acq. 1974-2 C.B. 3; *Klaue v. Commissioner*, T.C. Memo 1999-151. To determine that loans are bona fide, courts look to see if there was a reasonable expectation of repayment at the time individual advances were made. *C.M. Gooch Lumber Sales Co. v. Commissioner*, 49 T.C. 649 (1968), remanded on another issue, 406 F.2d 290 (6th Cir. 1969); *Weis v. Commissioner*, T.C. Memo 1983-178; *Stark*, supra.

3. **MRF's Basis in the Japanese Debt Portfolio as of June 30, 2003.**

MRF has represented it is an accrual basis taxpayer and that the outstanding principal and accrued but unpaid interest associated with the Japanese Debt Portfolio is Thirty Seven Billion Four

Hundred Eighty Million Two Hundred Fifty Thousand and Eight Hundred Fifty Four Japanese Yen (¥37,480,250,854) at the time of contribution. This presumably is MRF's tax basis in the Japanese Debt Portfolio on June 30, 2003. In accordance with TAM 8749008 (Aug. 18, 1987) and Rev. Rul. 78-281, 1978-2 C.B. 204, the basis of the Japanese Debt Portfolio should be approximately the U.S. dollar equivalent of Three Hundred Fourteen Million Seven Hundred and Four Thousand and Thirty Seven Dollars ($314,704,037) as reflected on the statement of account dated June 30, 2003.

E. **Purchase of Interest from United Finance**

The purchase of the interest in MRF by Barka from United Finance should not result in a change in the basis of the Japanese Debt Portfolio held by MRF. Section 708(b)(1)(B) provides that if within a twelve-month period there is a sale or exchange of 50% or more of the total interest in the capital and profits of a partnership, the partnership will be considered to have terminated for U.S. federal income tax purposes. Treas. Regs. § 1.708-1(b)(1)(iv) provides that if such a termination occurs on or after May 9, 1997, the terminated partnership is treated as contributing all of its assets and liabilities to a new partnership and immediately thereafter distributing the interests in the new partnership to the remaining partners of the terminated partnership and the purchasing partner in accordance with their interests. The consequence of this is that the tax basis of the assets of the terminated partnership's assets carries over to the new partnership. Section 723. Consequently, even if the purchase by Barka constituted a 50% or greater interest in profits and capital of MRF and is a termination of MRF within the meaning of Section 708(b)(1)(B), MRF's tax basis in the Japanese Debt Portfolio should not change.

Regulations Section 1.708-1(b)(5) provides that, if a partnership is terminated under Section 708(b)(1)(B), a Section 754 election that is in effect applies with respect to the incoming partner. Furthermore, Treas. Reg. § 1.761-1(e) provides that the deemed distribution of an interest in a "new" partnership by a partnership that terminates under Section 708(b)(1)(B) is treated as an exchange of an interest in the new partnership for purposes of Section 743(b). If a Section 754 election is in effect, the bases of partnership's assets are adjusted under Sections 743 and 755 prior to their deemed contribution to the new partnership. The consequence of this adjustment is that the tax basis of the interests in the "new" partnership are the same as that of the terminated partnership, after taking into account the effect of the Section 754 adjustment, discussed below, under Section 723. However, MRF has represented that it has not made an election under Section 754 and will not do so for the taxable year or years in which the Transactions occur. Consequently, the tax basis of MRF's Japanese Debt Portfolio should not be adjusted pursuant to Section 743 or 754.

Legislation that would make Section 743(b) mandatory in the case of the transfer of a partnership interest has been introduced in the House of Representatives in prior years. Such legislation has never left Committee. Such proposals would have made Section 743(b) mandatory in the case of the transfer of a partnership interest with respect to which there is a substantial built-in loss on a prospective basis.[6]

[6] H.R. 25210, the Abusive Tax Shelter Shutdown Act of 2001, would make Section 743(b) mandatory where the partnership has a substantial built-in loss. This bill was introduced on July 17, 2001, and was referred to the House

The purchase by Barka of an interest in MRF from United Finance may also affect the basis of the Japanese Debt Portfolio as if it were treated as a direct sale of the Japanese Debt Portfolio from United Finance to Barka or otherwise as an event requiring the recognition of loss with respect to the Japanese Debt Portfolio. This opinion addresses the possible application of certain loss disallowance and anti-abuse rules to the Transactions and concludes that it is more likely than not that the principles discussed therein would not apply to treat the sale of the interests in MRF by United Finance to Barka as a direct sale of the Japanese Debt Portfolio. In addition, the purchase should not result in loss recognition under Section 704(c)(1)(B), which requires an allocation to the contributing partner of gain or loss relating to contributed property if the property is distributed (directly or indirectly) to a partner other than the contributing partner within a seven-year period. The rule should not apply because the sale of a partnership interest for consideration provided by an unrelated third party and not funded by the partnership itself should not be treated as a direct or indirect distribution to a partner. In addition, Section 704(c)(1)(B) should not apply in any event, because there is an exception to the allocation rule in the case of a distribution to the contributing partner. Such recharacterization of the transaction as an asset sale is barred, in any event, by the purposes of Section 754 and Section 743 to treat a partnership interest as a capital asset and to bar application of the aggregate theory.

Based upon the foregoing, even if the purchase by Barka constitutes a 50% or greater interest in profits and capital of MRF from United Finance more likely than not it will not change the basis of MRF's Japanese Debt Portfolio.

F. Barka's Initial Tax Basis in MRF

The tax basis of a partner's interest in a partnership is the partner's cost for such interest if it is purchased from a third party, according to Sections 742 and 1012. Barka's initial tax basis for Barka's interest in MRF should be the cost of the MRF interest purchased by Barka and the total amount of all fees and expenses required to be capitalized under applicable provisions of the Code.

G. Section 166

1. General Requirements under Section 166.

Section 166 allows taxpayers a deduction for any debt, which becomes wholly worthless during the taxable year. In addition, Section 166(a)(2) provides that "[w]hen satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction." A deduction on account of partially worthless debts is allowable with respect to specific debts only.[7] Thus, each debt must be properly charged off and, if there are multiple worthless or partially worthless debts, the charge off must be debt specific.[8] Section 166(b) provides that the taxpayer's basis for determining the amount of a bad

Committee on Ways and Means. A similar proposal was also made by the Clinton administration in its 2001 revenue proposals. See GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2001 REVENUE PROPOSALS.

7 Treas. Reg. § 1.166-3(a)(1).

8 *International Properties, Inc. v. Comr.*, 18 T.C. 133 (1952).

debt deduction is the adjusted basis as determined under Section 1011.[9] In order for an individual to claim a deduction for partial worthlessness, the taxpayer must show that the debt was a business debt, i.e., that it was created or acquired (as the case may be) in connection with a trade or business of the taxpayer.[10]

2. **Business Debt.**

As noted above, a taxpayer claiming a deduction under Section 166 will need to show that the debt was created or acquired in connection with a trade or business of the taxpayer. The term "trade or business" is not separately defined for purposes of Section 166 and should be interpreted based on general tax principles.

Whether the taxpayer is engaged in a trade or business is a factual inquiry. A taxpayer will generally be considered to be engaged in a trade or business where the activities of the taxpayer are conducted in good faith, with continuity and regularity, and for the purpose of making a profit or income.[11] Section 166 and the applicable Regulations explicitly contemplate that loans acquired (as opposed to loans originated) in connection with a trade or business may give rise to a business bad debt deduction.[12] In addition, the examples in Treas. Reg. § 1.166-5(d) suggest that when a debt is acquired it may be treated as a business debt in the acquiror's hands, even though the acquiror may be engaged in a different trade or business than the party who originated the loan.[13] Therefore, even if United Finance and MRF each held the Japanese Debt Portfolio in connection with different businesses, as long as the party holding the Japanese Debt Portfolio at the time the deduction is claimed acquired them in connection with its trade or business, a business bad debt deduction should be allowed.

There are a number of authorities discussing when originated or purchased notes are treated as held in connection with a trade or business. Evidence that the debt has been created or acquired in connection with a trade or business can be found where the success or failure of the loan will have some direct effect on the business of the taxpayer and on the taxpayer's income from such business.[14] The focus would generally be on the scope of activities with regard to the notes, the

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[9] See also Treas. Reg. § 1.166-1(d).

[10] Section 166(d)(1); Treas. Reg. § 1.166-5(b).

[11] FSA 199911003.

[12] See Section 166(d)(2)(a); Treas. Reg. § 1.166-5(b)(1).

[13] See Treas. Reg. § 1.166-5(d), Example (4) (where A, engaged in a trade or business, dies and leaves a business to C and a note to D, D cannot take a bad debt deduction because the debt was not acquired in connection with "a trade or business of D," suggesting that the debt might have qualified as a business debt if D were in fact engaged in a related trade or business even though original business was transferred to C).

[14] *Hunsaker v. Comr.*, 615 F.2d 1253, 1256 (9th Cir. 1980) (applying this rule and finding insufficient evidence to sustain a Section 166 deduction; taxpayer motivated to protect investments and aid father, rather than to expand existing business.

continuity of the activities and the time and care devoted thereto, in order to distinguish those taxpayers who acquire notes in connection with a business from a passive investor. For example, in *Kasachkoff v. Comr.*, 19 T.C.M. (CCH) 1393 (1960), the purchaser of notes demonstrated continuous efforts doing appraisal work and on collections, including referring the acquired notes to a bank for collection. If the bank did not receive payment the taxpayer was notified and thereafter would try to collect personally. In *Hutton v. Comr.*, 35 T.C.M. (CCH) 16 (1976), debts acquired by the taxpayer were treated as business debts where the evidence showed that, as an employee of the bank, the taxpayer knew the borrowers and believed he could collect on a sufficient number of the notes to derive a profit from the overall transaction.[15] See also FSA 199911003 (after reviewing applicable authority, concluding that purchase of notes was part of taxpayer's money lending business; taxpayer in practice of originating and purchasing loans in the ordinary course of business for many years).

In the present case, MRF was engaged in the business of managing and servicing the Japanese Debt Portfolio. The business of MRF is conducted in part by contracting with a third party to actively pursue collection efforts and manage the Japanese Debt Portfolio on its behalf. In this situation, MRF should be considered to be engaged in a trade or business by reason on this activity. Courts have held that where an agent is acting on behalf of an owner, the owner is considered to be engaged in a trade or business if the agent's activities rise to the level of a trade or business.[16] Thus since MRF is engaged on an ongoing basis in the active and continuous supervision and monitoring of these collection efforts (and the collective activities of the Servicer and MRF are substantial and continuous enough to constitute the conduct of a trade or business), MRF should be considered to be engaged in a trade or business. MRF has outsourced merely routine and ministerial functions of the business to reduce overhead.

3. **Amount of Deduction.**

In the case of a deduction for partial worthlessness, the amount of the deduction under Section 166 is limited to the amount actually charged-off within the taxable year.[17] An effective "charge-off" for this purpose has been made if accounting entries have eliminated the amount of the debt, or that part which is worthless, from the book assets of the taxpayer.[18]

For both partial and total worthlessness deductions, the deduction is also limited to the taxpayer's basis in the debt, as determined under Section 1011. Section 1011 provides that the basis

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[15] See also *Ruppel v. Comr.*, 53 T.C.M. (CCH) 829 (1987) (taxpayer entitled to bad debt deduction in connection with personal lending business).

[16] See e.g., *Whyte v. Comr.*, T.C. Memo 1986-486, aff'd, 852 F.2d 306 (7th Cir. 1988); *Gilford v. Comr.*, 201 F.2d 735, 736 (2d Cir. 1953); *Murtaugh v. Comr.*, T.C. Memo 1997-319.

[17] Treas. Reg. § 1.166-3(a)(2).

[18] *Brandtjen & Kluge, Inc. v. Comr.*, 34 T.C. 416 (1960); *Hamlen v. Welch*, 116 F.2d 413, 419 (1st Cir. 1940); *Findley v. Comr.*, 25 T.C. 311 (1955), affd. Per curiam, 236 F.2d 959 (3rd Cir. 1956).

for determining gain or loss on property means the basis as determined under Subchapter C (if a corporation or shareholder), Subchapter K (if a partnership or partner) or Subchapter P (if capital gain or loss). *Hayutin v. Comr.*, 31 T.C.M. (CCH) 509, T.C. Memo 1972-127, aff'd, 508 F.2d 462 (10th Cir. 1974), involved a deduction on account of a note that had been contributed to a partnership at a time when payment was somewhat uncertain. The Service conceded that to the extent the taxpayer could establish tax basis, the bad debt deduction was allowable. Because the court found that the partner would have a carryover basis equal to the face amount of the notes, the deduction for that amount was permitted. The Tax Court reached a similar result in the reorganization context in *American Credit Corp. v. Comr.*, 32 T.C.M. (CCH) 122 (1973).

The foregoing rule assumes that the notes have value at the time of the contribution transaction. If instead the notes are worthless at the time of the transaction, there would have been nothing of value transferred and thus no "contribution" for purposes of Section 721 and no carryover tax basis. More generally, if a transaction is characterized as a sale because it fails to qualify for nonrecognition treatment for any reason, the transferee will take a basis equal to fair market value. See *Elmore Milling Co. v. Helvering*, 70 F.2d 736 (D.C. Cir. 1934) (contribution transaction was a sale rather than a Section 351 transaction; therefore corporation could not deduct losses in excess of fair market value at time of contribution). Presumably for this reason, the applicable regulations provide that in the case of notes or accounts receivable that are purchased, or that are valued for tax purposes at fair market value rather than face amount, the bad debt deduction is limited to the fair market value or purchase price, as the case may be, rather than the full face amount.[19]

4. **Timing of Deduction.**

In order to take a deduction for a debt that has become wholly worthless, the taxpayer must establish that the debt became worthless during the particular tax year in which the deduction is taken. The rules for partial worthlessness deductions are more flexible, requiring only that the taxpayer be able to prove that the debt was partially worthless by the time of the deduction and that the deduction claimed by the taxpayer does not exceed the amount charged-off for accounting purposes. In *Estate of Denton*, 11 T.C.M. (CCH) 802 (1952), the Tax Court specifically acknowledged this difference, noting that the taxpayer "may, if he chooses, pass over the partial worthlessness of the debt and charge it off in a later year, or may let the whole matter remain and take a deduction for the debt in full in a later year, if in such later year the debt becomes wholly worthless."[20] Thus, a taxpayer should be allowed a deduction for partial worthlessness in any year starting with the year in which it determines that any debt has become partially worthless and also charges them off for accounting purposes, and ending in the year in which the debt becomes completely worthless, at which time the deduction will have to be taken or will be lost. If a recovery is later made, it is includible in income.

[19] Treas. Reg. § 1.166-1(d)(2)(i).

[20] See also *Moock Electric Supply Co. v. Comr.*, 41 B.T.A. 1209 (1940); *Jems A. Messer Co. v. Comr.*, 57 T.C. 848 (1972); *E. Richard Meinig Co. v. Comr.*, 9 T.C. 976 (1947).

There is, however, a line of authority, which provides that a note or other instrument will be treated, as wholly worthless if the expected recovery is trivial in amount.[21] If that doctrine were to apply to the Japanese Debt Portfolio, then the Service might assert (applying U.S. tax principles to United Finance or MRF) that the proper time for a total worthlessness deduction was prior to the contribution to MRF. This doctrine has been applied in extreme cases where the notes had an approximate value of zero, taking into account collection costs.[22] In this case, the aggregate recovery is expected to be in excess of an immaterial amount,[23] so the Japanese Debt Portfolio should not be treated as worthless as of the time of the contribution to MRF.

5. **Overlap with Worthless Security Rules in Section 165.**

Section 166(e) provides that the bad debt deduction does not apply to debt, which is evidenced by a security as defined in Section 165(g)(2)(C). A security (as defined in that section) would include a bond or note issued by a corporation "with interest coupons or in registered form." While there is no definition in either Section 166 or Section 165 of what "registered form" means, the legislative history for Section 163 (which disallows interest deduction on securities in registered form) provides that "an obligation is in registered form if the right to principal and interest is transferable only through a book entry."[24] MRF has represented that the Japanese Debt Portfolio were not issued in registered form and did not include interest coupons. It therefore should not be excluded from Section 166 by operation of Section 166(e).

6. **Asset by Asset Determination.**

The determination of partial worthlessness must be made on an asset-by-asset basis.[25] In the context of the Japanese Debt Portfolio this requires that each loan be assessed for recoverability each time an initial deduction for partial worthlessness is claimed, and thereafter, each time an additional amount of partial worthlessness is claimed, until each loan is determined to be completely worthless. Once the Japanese Debt Portfolio (or any notes that are separately

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21 See e.g., Rev. Rul. 71-577, 1971-2 C.B. 129.

22 See *Washington Trust Co. v. Comr.*, 1 T.C.M. (CCH) 5 (1942) (treating as wholly worthless bonds with a value of 0.5% of face amount; value would be even lower taking into account deductions for expenses). In fact, the Seventh Circuit has held that total worthlessness cannot be established unless the debt is completely uncollectible, holding that a recovery resulting from embezzlement should have been foreseen and thus forecloses the taxpayer's total worthlessness deduction. *Buchanan v. United States*, 87 F.3d 197 (7th Cir. 1996).

23 In FSA 200242004, the Service acknowledged that there is an issue whether reliance on the small percentage of expected recovery is appropriate when the amounts to be received are substantial, citing to *Los Angeles Shipbuilding & Drydock Corp. v. United States*, 166 F. Supp. 914 (S.D. Cal. 1958), vacated on another issue, 289 F.2d 222 (9th Cir. 1961).

24 Committee Report on P.L. 97-248 at .035.

25 See Treas. Reg. § 1.166-3(a)(1).

identifiable) is treated as totally worthless, the taxpayer would be required to claim the deduction for total worthlessness that same year, or otherwise forfeit the deduction.[26]

7. **Treatment as an Accounting Method.**

Section 446(e) states that a taxpayer that changes its method of accounting must first get the consent of the Secretary. Treas. Reg. § 1.446-1(a)(1) provides that the term "method of accounting" includes not only a taxpayer's overall method of accounting but also the accounting treatment of any item. Treas. Reg. § 1.446-1(e)(2)(ii) provides that a change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A "material item" is any item that involves the proper time for the inclusion of the item in income or the taking of a deduction.[27] However, a change of accounting method does not include a change in treatment resulting from a change in underlying facts.[28]

A taxpayer's choice to begin taking partial worthlessness deductions should not be deemed to be an accounting method, even if either the taxpayer chooses to take deductions for some of the loans and not others. As noted above, the deduction for partial worthlessness is permissive and may be taken in any year up to and including the year in which the debt becomes completely worthless. Furthermore, the deduction for partial worthlessness is applied to specific debts only, requiring an affirmative act on the part of the taxpayer regarding the charge-off of worthlessness debts. Finally, the language of the Code and the Regulations clearly states that a taxpayer is allowed a bad debt deduction.[29] It does not suggest that such a deduction is mandatory or that the Service may require such a deduction under any circumstances. It would therefore be at odds with both the language of the Code and Regulations as well as the relevant case law regarding the proper year for taking deductions with respect to partially worthless debt to require either a taxpayer to assess and take the entire available deduction for each loan each year or be required to seek the permission of the Secretary not to do so.

In addition, it should not be a change of accounting method for a taxpayer to elect additional deductions as the loans becomes increasingly worthless. Rather, such deductions should be considered the result of a change in the underlying facts regarding the loans and not as a change in accounting method.[30]

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[26] Section 166(a)(1).

[27] Treas. Reg. § 1.466-1(e)(2)(ii)(a).

[28] Treas. Reg. § 1.446-1(e)(2)(ii)(b).

[29] Section 166(a)(1) and (2); Treas. Reg. § 1.166-1(a).

[30] In an analogous situation, the applicable Regulations provide that for a taxpayer who allocates indirect overhead costs to the value of inventories on a fixed percentage of direct costs, an increase in the ratio of indirect overhead costs to direct overhead costs would result in a change in the underlying facts, rather than a change in accounting method. Treas. Reg. § 1.466-1(3)(2)(iii), Ex. 4. Similarly, where a taxpayer railroad company changed its method for valuing its

H. Rules Relating to Limitation of Deductions

1. The Partnership Anti-Abuse Regulations; Disregard of Partnership under Common Law.

In December 1994, the IRS issued Treas. Reg. § 1.701-2 (the "Anti-Abuse Regulations" or the "Rules") in an effort to stop what it perceived were abuses of the partnership form. These Regulations consist of two broad rules: the "abuse of Subchapter K rule" and the "abuse of entity rule." Notwithstanding a transaction's literal compliance with the Code and Regulations, the Anti-Abuse Regulations claim the IRS may recast the transaction for federal tax purposes as it deems appropriate if the requirements of the Anti-Abuse Regulations are satisfied. The IRS claims it may (1) disregard the partnership in whole or in part; (2) treat one or more partners as not partners; (3) adjust the method of accounting used by the partnership or a partner to clearly reflect the partnership's or the partner's income; (4) reallocate the partnership's income, gain, loss, credit, or deduction; or (5) otherwise adjust or modify the claimed tax treatment. Treas. Reg. § 1.701 2(b). In addition, the IRS claims it may treat a partnership as an aggregate of its partners to carry out the purpose of the Code or the Regulations. Treas. Reg. § 1.701-2(e).

The Rules specifically provide that in addition to the powers granted by the Rules, the IRS can continue to assert and rely upon non-statutory principles and other statutory and regulatory authorities to challenge transactions, and that the Rules were not intended to limit the applicability of such principles and authorities. Treas. Reg. § 1.701-2(i).

The Transactions meet the requirements of Treas. Reg. § 1.701-2(a)(1) and (2) in that MRF is a bona fide partnership and each partnership transaction and each series of related transactions were entered into for a substantial business purpose.

Trading in the Japanese Debt Portfolio is fraught with legal exposure under lender liability and similar rules. The form chosen provided additional legal protection available to Barka not available through direct transactions with United Finance.

The Transactions and the tax consequences to each partner of MRF accurately reflect the partner's economic agreement and clearly reflect the partner's income so that the third requirement of the Regulations is met, clear reflection of income. Proper reflection of income is achieved in the Transactions because the application of each applicable provision of Subchapter K to the Transactions and the ultimate tax results, taking into account all the relevant facts and circumstances are clearly contemplated by that applicable provision. See examples 3, 4, 5 and 6 of Regulation 1.701-2(d). Example 7 is not relevant as no partner is nominal or temporary.

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rail to a more accurate method, resulting in a lower valuation, the court said "a change to the correct factual value is merely a change in the underlying facts . . . [which was] brought about by the adoption of a more accurate valuation formula." *Baltimore and Ohio R.R. Co. v. United States*, 603 F.2d 165 (U.S. Ct. Cl. 1979). Likewise, the reduced valuation of the non-performing loans resulting from changes in collectability is a change in the underlying facts of the valuation.

Absence of a Section 754 election is consistent with the Regulations. Example 8 is not relevant as there is no intent to duplicate losses.

In Example 9, the failure to make a Section 754 election is defined as consistent with the intent of Subchapter K. That rule should apply to the Transactions as well as there is no duplication of loss transaction arising from the Transactions nor is there a generation of an "artificial" loss involved since United Finance has contributed historic cost basis as a taxpayer within the meaning of Section 7701(a)(14) and the cases noted above. The other examples apply to other sections of Subchapter K.

Accordingly, the results of the Transactions are clearly contemplated by Section 754 and ancillary provisions of Subchapter K such as Section 743, including the treatment of MRF as a separate taxable entity under Regulation Section 1.701-2(e).

In FSA 200242004 (July 19, 2002) the Service considered whether it could challenge losses bearing superficial resemblance to those present in the Transactions pursuant to Treas. Reg. § 1.701-2. In FSA 200242004, supra, the Service premised that Treas. Reg. § 1.701-2, in pertinent part provides that Subchapter K is intended to permit taxpayers to conduct joint business (including investment) activities through a flexible economic arrangement without incurring an entity-level tax. Implicit in the intent of Subchapter K are the following requirements: (1) the partnership must be bona fide and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose; (2) the form of each partnership transaction must be respected under substance over form principles; and (3) except as otherwise provided, the tax consequences under Subchapter K to each partner of the partnership operations and of transactions between the partnership and the partner must accurately reflect the partners' economic agreement and clearly reflect the partner's income.

However, certain provisions of Subchapter K and the Regulations thereunder were adopted to promote administrative convenience and other policy objectives, with the recognition that the application of those provisions to a transaction could, in some circumstances, produce tax results that do not properly reflect income. Thus, the proper reflection of income requirement is treated as satisfied with respect to a transaction that satisfies requirements 1 and 2 to the extent that the application of such a provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by the provision.

Section 1.701-2(b) provides that if a partnership is formed or availed of in connection with a transaction a principal purpose of which is to reduce substantially the present value of the partners' aggregate federal tax liability in a manner that is inconsistent with the intent of Subchapter K, the Commissioner can recast the transaction for federal tax purposes as appropriate to achieve tax results that are consistent with the intent of Subchapter K. Thus, even though the transaction may fall within the literal words of a particular statutory or regulatory provision, the Commissioner can determine, based on the particular facts and circumstances, that to achieve tax results that are consistent with the intent of Subchapter K: (1) the purported partnership should be disregarded in whole or in part, and the partnership's assets and activities should be considered, in whole or in part, to be owned and conducted, respectively, by one or more of its purported partners; (2) one or more of the purported partners of the partnership should not be treated as a partner; (3) the methods of accounting used by the partnership or a partner should be adjusted to reflect clearly the partnership's or the partner's income; (4) the partnership's items of income, gain, loss, deduction or credit should be reallocated; or (5) the claimed tax treatment should otherwise be adjusted or modified.

Under the Regulations, whether a partnership was formed or availed of with a principal purpose to reduce substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K is determined based on all of the facts and circumstances, including a comparison of the purported business purpose for a transaction and the claimed tax benefits resulting from the transaction. Treas. Reg. § 1.701-2(c). Section 1.701-2(c) lists various factors that may be considered in making the determination.

Treas. Reg. § 1.701-2(d), Example 8, provides an example of a plan to duplicate losses through the absence of a 754 election through the use of a partnership that in the view of the Service may not be consistent with the intent of Subchapter K. In Example 8, A wanted to sell land to B with a basis of $100x and a fair market value of $60x. A and B devised a plan a principal purpose of which was to permit the duplication, for a substantial period of time, of the tax benefit of A's built-in loss in the land. A, C, and W formed a partnership ("PRS"). A contributed the land and C and W each contributed $30x. PRS invested the $60x in an investment asset. In year 3, at a time when the values of the partnership's assets had not materially changed, PRS agreed with A to liquidate A's interest in exchange for the investment asset held by PRS. Under 732(b), A's basis in the asset was $100x. A sold the investment asset to X, an unrelated party, recognizing a $40x loss.

PRS did not make an election under Section 754. Accordingly, PRS's basis in the land contributed by A remained at $100x. PRS sold the land to B for $60x, its fair market value. Thus, PRS recognized a $40x loss that was allocated equally between C and W, and they each reduced the bases in their partnership interests to $10x. Thus, upon liquidation of PRS (or their interests therein), each of C and W would recognize $20x of gain. However, PRS's continued existence defers recognition of that gain indefinitely.

In Treas. Reg. § 1.701-2(d), Example 8, the Service concluded PRS was used with a principal purpose of reducing substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K. Therefore (in addition to possibly challenging the transaction under judicial principles or other statutory authorities, such as the substance over form doctrine or the disguised sale rules under Section 707), the Regulations assert that the Commissioner may recast the transaction as appropriate under Treas. Reg. § 1.701-2. Compare, § 1.701-2(d), Example 9, in which the use of a partnership for which no election under Section 754 had been made is considered consistent with the intent of Subchapter K. The outcome under the Regulations is dependent on numerous variables not simply the choice not to make a Section 754 election.

In the FSA the Service concluded the transactions could be subject to recharacterization under Treas. Reg. § 1.701-2, based on the following factors: First, any purported business purpose for the transaction was insignificant in comparison to the tax benefits that would result if the transactions were respected for federal tax purposes (e.g., the partnership carried on no activities). In MRF's case there is a business purpose to the Transactions because in fact there are substantive business activities directly carried on by MRF and the Servicer. MRF's tax returns should reflect income and expenses from its operations. The relationship of such business activity to the Transactions is significant in comparison to the tax benefits that result from the Transactions. It should be noted that it is MRF's business activities, not United Finance's or Barka's which should be scrutinized and determined if any business purpose was served by contributing the property to the partnership rather than selling it directly to Barka. Indeed it was essential to transfer the Japanese Debt Portfolio directly to MRF because MRF had marshaled the resources to extract maximum value from the Japanese Debt Portfolio and MRF protected Barka from various legal claims possibly available to debtors.

Second, the sale of interests in MRF to Barka rather than the direct sale of the assets is not relevant. That form of transaction would not happen due to the unacceptable increase in risk profile to Barka. Additionally, Sections 724, 754 and 743 etc. with rare exception specifically provide that MRF is to be treated as an entity not as an aggregate of its members for purposes of sales of partnership interests among members. Moreover, it is possible but unlikely that resolution of the Japanese Debt Portfolio could result in no loss to Barka. Lastly, Barka entered into the Transactions for a profit potential purpose versus the amount it paid for its interests in MRF and, in contrast to the FSA, the Japanese Debt Portfolio acquired by MRF was not worthless prior to acquisition.

Third, as discussed separately, the various Transactions should not able to be stepped together by the Service. It has been represented that Barka and United Finance enjoyed no contractual relationship prior to sale of the interests in MRF to Barka by United Finance.

Accordingly, we conclude that more likely than not no argument could be made that the contribution by United Finance of the Japanese Debt Portfolio to MRF, and United Finance's subsequent sale of its membership interest in MRF to Barka, were in substance a sale by United Finance of the Japanese Debt Portfolio to Barka and a contribution by Barka of the Japanese Debt Portfolio to MRF.

2. **Validity of the Regulations.**

Based on the preceding discussion, it should not be necessary to attack the validity of the Regulation. Nonetheless, while apparently very broad, there is no clear guidance as to how the Rules will be applied by the IRS, and there can be no assurances that the IRS will not attempt to apply the Rules to the parties. There has, however, been some indication from the IRS that the Rules were intended to affect a relatively small number of partnership transactions. 60 Fed. Reg. 23 (1995); Announcement 94-87, 1994-27 I.R.B. 124 (in an examination, the appropriateness of a Section 1.701-2 determination must be coordinated with an Issue Specialist and the National Office).

These Regulations were severely criticized by practitioners and commentators when they were adopted as being invalid, and the controversy has not been resolved.[31] It is reasonable to believe that the validity of these Regulations will be challenged in court.

The thrust of the legal commentary is that the Rules are unworkable and invalid because they are inherently vague, excessively broad in scope, and lack clear and workable standards, which can be reasonably utilized by practitioners to correctly and confidently apply the tax law.[32] The language of the Regulations is exceedingly broad, and even the inclusion of examples in the final Regulations does not help to elucidate the meaning of the broad terms. Both supporters and detractors of the Rules agree that the apparent implied standard for application by the IRS of the Rules consists of "we'll know it when we see it."[33] This type of ambiguous standard for application of the Rules makes drawing the line between legitimate tax planning and prohibited tax abuse virtually impossible.[34] Courts have found Regulations to be invalid when they are so vague as to permit arbitrary and discriminatory enforcement due to a lack of explicit guidelines.[35]

In finalizing the Rules, the Treasury cited the provisions of Subchapter K (Sections 701 through 761) and Section 7805 as providing the authority for the Rules.[36] Section 7805(a) authorizes the Treasury Department to prescribe "all needful rules and regulations" required for the enforcement of the internal revenue laws. Such section has been held to authorize only interpretative Regulations.[37]

a. **Section 7805(a) of the Internal Revenue Code**

Section 7805(a) of the IRC grants the Secretary of the Treasury the power to "prescribe all needful rules and regulations for the enforcement" of the tax laws. This general grant of rulemaking authority appears to have originated in Section 1005 of the Revenue Act of 1917, Ch. 63, 40 Stat.

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[31] See, e.g., McKee, Nelson and Whitmire, Federal Taxation of Partnerships and Partners (3rd Ed. 1999 Sup. #4), at ¶1.05; William P. Wasserman and Terence Floyd Cuff, "IRS Attempts to Demonize" the Partnership: The Final Section 701 Regulations – Anti-Abuse Regulations or Simply Abusive Regulations?," 439 PLI/Tax 887 (June 1999) ("Wasserman & Cuff Article"); Sheryl Stratton, "They're Back . . . Washington lawyers Attack Anti-Abuse Rules," 95 TNT 178-4 (September 12, 1995) ("Stratton Article"); Sheldon I. Banoff, "Anatomy of an Anti-Abuse Rule: What's Really Wrong with Reg. Section 1.701-2," 95 TNT 56-84 (March 22, 1995) ("Banoff Article") Gouwar, "The Proposed Partnership Anti-Abuse Regulation: Treasure Oversteps Its Authority," 11, No. 4 Journal of Partnership Taxation 287 (Winter 1995).

[32] *Id.*

[33] Banoff Article.

[34] *Id.*

[35] *Big Mama Rag, Inc. v. U.S.*, 631 F.2d 1030 (D.C. Cir. 1980); *Edward L. Stephenson Trust v. Comr*, 81 T.C. 283 (1983).

[36] Subchapter K Anti-Abuse Rule, 60 Fed. Reg. 23 (1995).

[37] See, e.g., *U.S. v. Vogel Fertilizer*, 455 U.S. 16 (1982); *Bankers Life and Casualty Co. v. U.S.*, 142 F.3d 973 (7th Cir 1998).

300 which gave the Commissioner of Revenue the power to promulgate, with the approval of the Secretary of the Treasury, "all needful Rules and Regulations for the enforcement of the provisions of this Act." *Id.* at 326. Congress did not attach any statutory sanctions to violations of the Regulations promulgated under this general grant. In contrast, Sections 1001 and 1002 of the 1917 Act included specific grants of authority for the Commissioner to regulate returns, *Id.* at 325 and Section 1004 attached penalties to the failure to make any returns required by regulation. *Id.* at 325-26. The general grant conferred only interpretive power upon the Commissioner, while the specific grants conferred legislative power. The Revenue Act of 1918 Ch. 18, 40 Stat. 1057 (1919) and the Revenue Act of 1921 Ch. 136, 42 Stat. 227, 309 included the same combination of general and specific rulemaking grants, using similar language. See Revenue Act of 1918, 1308, 40 Stat. at 1143; Revenue Act of 1921, 1302-1303, 42 Stat. at 309. Like the Revenue Act of 1917, the 1918 Act did not attach any statutory sanctions to violations of the rules and regulations promulgated under the general rulemaking grant. Yet penalties were provided in the 1918 Act for violations of rules and regulations promulgated under specific rulemaking grants. Like the 1917 and 1918 Revenue Acts, the 1921 Act attached statutory sanctions only to rules and regulations promulgated under certain specific rulemaking grants.

When the IRC was enacted in 1939 and subsequently amended in 1954, Congress continued to attach statutory sanctions solely to rules and regulations promulgated under specific rulemaking grants. Under the convention's framework, this absence of sanctions leads to the conclusion that the rules and regulations promulgated under Section 7805(a)'s general rulemaking grant are interpretive, which is in fact the common understanding today among tax lawyers.

b. **The Supreme Court Confirms That Section 7805(a) Is Interpretive**

In *Rowan Cos. v. United States*, 452 U.S. 247 (1981) the Court noted that "the Commissioner interpreted Congress' definition [of the word "wages"] only under his general authority to "prescribe all needful rules." 26 U.S.C. 7805(a). Because the regulation was merely interpretive, the Court held that it deserved "less deference than a regulation issued under a specific grant of authority." Similarly, in *United States v. Vogel Fertilizer Co.*, 455 U.S. 16 (1982) the Court considered a regulation, issued by the Commissioner under Section 7805(a), which interpreted the statutory term "brother-sister controlled group." The Court again observed that because the Commissioner had issued the regulation under his general rulemaking grant, the interpretation was entitled to "less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision."

Vogel Fertilizer and *Rowan* confirm that a facially ambiguous general rulemaking grant authorizes only interpretive, not legislative, rules. Because the Supreme Court has endorsed that view, it will probably remain secure, unless and until Congress amends the Code. See *Lomont v. O'Neill*, 285 F.3d 9, 16 (D.C. Cir. 2002) (stating that Section 7805(a) "is nothing more than a general grant of interpretative rulemaking power"); see also Michael Asimow, Public Participation in the Adoption of Temporary Tax Regulations, 44 TAX LAW. 343, 358 & nn. 75-76 (1991) (citing *Rowan* and *Vogel Fertilizer* for the proposition that the tax world continues to adhere to the view that rules adopted pursuant to the Treasury's general rulemaking grant are interpretive in nature).

c. Why Section 7805(a) Is Interpretive

The understanding that Section 7805(a) authorizes only interpretive rules, originated with a series of articles written in the 1940s by several eminent tax scholars. They include Erwin Griswold, who later became Dean of Harvard Law School and Solicitor General of the United States, and Stanley Surrey, who has been called "the most influential tax theorist of his generation." These authors argued that there were general and specific grants of rulemaking authority. General grants were said to authorize only interpretive rules, whereas specific grants authorized legislative rules. Surrey buttressed this contention with two arguments: first, the specific rulemaking grants in the IRC would be redundant if the general grant were construed to give the agency general legislative rulemaking authority; and second, the delegation of a general grant of legislative rulemaking authority would raise serious constitutional questions under the nondelegation doctrine, because the general grant lacks an intelligible principle to guide agencies in making rules. See Erwin N. Griswold, A Summary of the Regulations Problems, 54 HARV. L. REV. 398, 400-01 (1941).

The redundancy issue is set forth in several judicial decisions recognizing this point in the regulatory context. See *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 408 (1999) (Thomas J., concurring in part and dissenting in part) (arguing that the majority's construction of a general rulemaking grant in the Communications Act to extend to new authority conferred on the FCC by the Telecommunications Act of 1996 renders specific grants of rulemaking authority in the latter Act redundant); and *In re Permanent Surface Mining Regulation Litigation*, 653 F.2d 514, 524 (D.C. Cir. 1981) (considering but rejecting the same argument in the context of the general rulemaking grant in the Surface Mining Control and Reclamation Act of 1977). For commentary recognizing the point in connection with the Internal Revenue Code, see Ellsworth C. Alvord, Treasury Regulations and Wilshire Oil Case, 40 COLUM. L. REV. 252, 257 (arguing that "some difference was intended by Congress" or else it would not have granted the Treasury both specific and general rulemaking powers); and Stanley S. Surrey, The Scope and Effect of Treasury Regulations Under the Income, Estate, and Gift Taxes, 88 U. PA. L. REV. 556, 558 (1940) (contending that rules issued under specific rulemaking grants must be construed to possess different attributes than rules issued under the general rulemaking grant, because otherwise "the careful particularization of Congress in these other sections would be without meaning").

3. The Section 1.701-2 Regulation Is Not Entitled to Judicial Deference.

The latest Supreme Court word on the deference to be accorded agency interpretations of the laws they administer is *United States v. Mead Corporation*, 121 S. Ct. 2164 (2001), a case involving the United States Customs Service. That government agency had determined that day planners were "bound diaries," taxed at a 3.6 percent duty rate; *Mead* maintained that they were neither "bound" nor "diaries" and should be in duty-free "other" category. The government argued that the Customs decision should be reviewed under the *Chevron* rule and thus could be set aside only if it was not a reasonable interpretation. But the Supreme Court, with one dissent, took the occasion to spell out how and when *Chevron* deference applies. It cited *Skidmore v. Swift & Co.*, 323 U.S. 134 (1994), under which an agency decision is owed respect in accordance with "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." Thus, deference to agency decisions will vary with the circumstances. The *Chevron* rule would apply so that the agency would "speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law." The Court did not go so far as to limit *Chevron* deference to situations when notice-and-comment-rulemaking was involved. "[W]e have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded."

But in Mead's customs battle, the Court found that classification rulings were not entitled to *Chevron* deference. Instead, a classification ruling would be entitled to some respect, "proportional to its power to persuade," and remanded the case to allow the lower courts to weigh what that would mean when applied to the day planners.

Justice Scalia dissented. "Today's opinion makes an avulsive change in judicial review of federal administrative action . . . Whereas previously a reasonable agency application of an ambiguous statutory provision had to be sustained so long as it represented the agency's authoritative interpretation, henceforth such an application can be set aside unless 'it appears that Congress delegated authority to the agency generally to make rules carrying the force of law' . . . and the agency interpretation claiming deference was promulgated in the exercise of that authority."

Because taxes are forced exactions, special standards apply in tax cases. As Supreme Court Justice Clarence Thomas states in his concurring opinion in *United Dominion Industries Inc. v. Commissioner*, 87 AFTR2d ¶ 2001-986 (S. Ct. 2001) which involved a consolidated return product liability loss carryback . . . "in cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter. See *Leavell v. Blades*, 237 Mo. 695, 700-701, 141 S.W. 893, 894 (1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it"); *United States v. Merriam*, 263 U.S. 179, 188 (1923) ("If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer"); *Bowers v. New York & Albany Literage Co.*, 271 U.S. 346, 350 (1927) ("The provision is part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers"). Accord *American Net & Twine Co. v. Worthington*, 141 U.S. 468, 474 (1891); *Benziger v. United States*, 192 U.S. 38, 55 (1904)."

See generally Michael I. Saltzman, IRS PRACTICE AND PROCEDURE ¶ 3.02[4] [a]-[b] (2d ed. 1991) (explaining that regulations issued pursuant to a specific authorization in particular sections of the Code are "legislative or substantive" and that those issued under the Code's general grant of rulemaking authority are "interpretative"); Ellen P. April, Muffled Chevron: Judicial Review of Tax Regulations, 3 FLA. TAX REV. 51, 56-57 (1996) ("Regulations promulgated under the general authority of Section 7805(a) are considered interpretive, and regulations promulgated pursuant to a grant of authority under a particular code section are considered legislative." (*footnote omitted*)); Linda Galler, Emerging Standards for Judicial Review of IRS Revenue Rulings, 72 Rulings, 72 B.U. L. REV. 841, 849 n.53 (1992) ("It has generally been assumed that Treasury regulations adopted pursuant to I.R.C. 7805(a) are interpretive, while Treasury regulations adopted pursuant to specific delegations of rulemaking authority are legislative."); see also John F. Coverdale, Court

Review of Tax Regulations and Revenue Rulings in the Chevron Era, 64 GEO. WASH. L. REV. 35, 69-70 (1995) (citing and summarizing authorities in support of the distinction between general authority regulations and specific authority regulations and the deference given to each type).

Post *Mead* it is no longer the rule that Treas. Reg. § 1.701-2 and other Interpretive Regulations will receive deference so long as they implement congressional mandates in some reasonable manner. As described above, the Rules apply only to transactions involving partnerships that are contrary to the "intent" of Subchapter K. The Treasury Department derived this intent from the whole of Subchapter K, even though the Rules themselves discuss how certain provisions contained in Subchapter K do not meet this intent, resulting in the need for exceptions from the Rules. See Treas. Reg. § 1.701-2(a)(3) (certain provisions of Subchapter K were adopted to promote administrative convenience or other policy objectives). As a result, the scope of the Rules is uncertain and is not limited in application to clearly abusive transactions, despite statements from the IRS to the contrary. See Wasserman & Cuff Article; Banoff Article.

Furthermore, in enacting Subchapter K in 1954, Congress stated as its motivation its desire to eliminate confusion and provide certainty, flexibility, and equity with respect to the tax treatment of partnerships and partners.[38] Thus, contrary to Congress' strong desire to provide certainty, flexibility, and equity in the area of the taxation of partnerships and partners, the Rules cannot be applied by practitioners to partnership transactions in a meaningful manner. See Wasserman & Cuff Article; Roy Stroud and Hal Gann, "The Recent Evolution of Anti-Abuse Rules," 95 TNT 36-98 (Feb. 23, 1995). As a result of such uncertainty, voluntary compliance with the Code and commerce in general will be adversely affected. *Id.*

Though there was no express or implied grant of authority in Section 701 or Subchapter K in general to issue an anti-abuse rule, it is clear that the Rules did not merely restate current law, but instead extended existing law.[39] In finding an interpretive Regulation invalid, the Tax Court has stated that "courts should be wary of broad-scale incorporation of the doctrine of 'tax avoidance,' or 'business purpose,' or 'sham'" and at the very least, such judicially developed doctrines should be limited to situations in which they were intended to apply.[40] Accordingly, it would appear that, to the extent the Rules go beyond current law, their validity is in grave doubt. See Banoff Article.

Further, it has been argued that the Rules are invalid as they were adopted in violation of Executive Order 12866. This Executive Order provides that all "significant regulatory actions" are subject to various procedural safeguards to ensure that the regulatory process is conducted so as to meet applicable statutory requirements and with due regard to the discretion entrusted to federal

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[38] H.R. Rep. No. 1337, 83rd Congress, 2d Session 65 (1954); S. Rep. No. 1622, 83rd Congress, 2d Session 89 (1954).

[39] See Treas. Reg. § 1.701-2(h) (Commissioner can continue to assert and rely upon other statutory and regulatory authorities and nonstatutory principles; such principles and authorities are not limited by the Rules); See also, Banoff Article; Lee A. Sheppard, "News Analysis: Final Partnership Anti-abuse Rule – Grudging Acceptance," 95 TNT 28-5 (Feb. 10, 1995).

[40] *Edward L. Stephenson Trust v. Comr*, 81 T.C. 283, 291 (1983).

agencies. Exec. Order No. 12866, 58 Fed. Reg. 51, 735 (1993). Significant regulatory action, as defined in the Order, means any regulatory action likely to result in a rule that may: (1) have an annual effect on the economy of $100 million or more; (2) adversely affect the economy, or sector of the economy, in a material way; or (3) raise novel legal or policy issues. *Id.* It would appear that the Rules satisfy each of these requirements, yet in finalizing the Rules, the Treasury declared that the Rules were not a significant regulatory action as defined by Executive Order 12866. 60 Fed. Reg. 23 (1995).

Commentators have also asserted that the Regulations are invalid because they are an unconstitutional usurpation of legislative and judicial powers. The Regulations grant the IRS the power to disregard the language of the statute when literal compliance with specific provisions was not consistent with the "intent" of Subchapter K, and then creates that intent without relying on anything of Congressional origin. In adopting Subchapter K as part of the Internal Revenue Code of 1954, Congress specifically considered and rejected the type of tax avoidance test that appears in the Regulation. See S. Rep. No. 938, 94th Cong., 2d Sess 100 (1976). The courts have held that the IRS does not have the authority to disregard statutory provisions merely to reach the result that the IRS desires.[41] Furthermore, the Regulations attempt to supersede the statute and add restrictions not found in Subchapter K.

4. **Abuse of Subchapter K Rule.**

Treas. Reg. § 1.701-2(b), the abuse of Subchapter K rule, provides that:

> [I]f a partnership is formed or availed of in connection with a transaction a principal purpose of which is to reduce substantially the present value of the partners' aggregate federal tax liability in a manner that is inconsistent with the intent of Subchapter K, the Commissioner can recast the transaction for federal tax purposes, as appropriate to achieve tax results that are consistent with the intent of Subchapter K, in light of the applicable statutory and regulatory provisions and the pertinent facts and circumstances.

Thus, two requirements must be met to invoke this rule: a principal purpose of the transaction must be to reduce the present value of the partners' aggregate tax liability, and the tax reduction must be inconsistent with the intent of Subchapter K.

The Anti-Abuse Regulations provide that the intent of Subchapter K is "to permit taxpayers to conduct joint business (including investment) activities through a flexible economic arrangement without incurring an entity-level tax." Treas. Reg. § 1.701-2(a). Implicit in this intent is the following requirements:

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[41] See *Crooks v. Harrelson*, 282 U.S. 55 (1930); *Comr v. Brown*, 380 U.S. 504 (1940); *Busse v. U.S.*, 479 F.2d 1147 (7th Cir. 1973); *Woods Inv. Co. v. Comr*, 85 T.C. 274 (1985). See also, *RLC Indus. Co. v. Comr*, 98 T.C. 457 (1992), aff'd 58 F.3rd 413 (9th Cir. 1995); *Gitlitz v. Commissioner*, 531 U.S. 206 (2001).

(1) The partnership must be bona fide and each partnership transaction or series of related transactions (individually or collectively) must be entered into for a substantial business purpose;[42]

(2) The form of each partnership transaction must be respected under substance over form principles; and

(3) Generally, the tax consequences under Subchapter K to each partner of the partnership's operations and of transactions between the partner and the partnership must accurately reflect the partner's economic agreement and clearly reflect the partner's income (collectively, the "proper reflection of income").[43]

However, because certain provisions of the Code and Regulations were adopted for administrative convenience and other policy objectives, this test will be satisfied if the ultimate results are clearly contemplated by that provision.

a. The Intent of Subchapter K.

The Regulations provide that the first implicit intent of Subchapter K is that a partnership is bona fide and that transactions be entered into for a business purpose, seems to be a restatement of well established principles. See e.g., *Comr. v. Culbertson*, supra, *Gregory*, supra, and *Rice's Toyota World, Inc. v. Comr.*, 752 F.2d 89 (4th Cir. 1985). However, the Regulations do not elaborate on what is meant by these terms, and also insert the term "substantial" in the business purpose requirement. *Culbertson* held that a partnership would be respected for tax purposes if the parties had joined together to jointly conduct a business and share the profits. As Justice Frankfurter expressed in his concurring opinion:

> In plain English, if an arrangement among men is not an arrangement, which puts them, all in the same business boat, then they cannot get into the same boat merely to seek the benefits of [partnership tax provisions]. But if they are in the same business boat, although they may have varying rewards and responsibilities, they do not cease to be in it when the tax collector appears.

337 U.S. at 754. *Culbertson* only requires that the partnership and the transaction be real, and that there be "a" business purpose, not that there be a "substantial" business purpose.

The IRS elaborated on the business purpose requirement in *Mimeo* 6797, 1952-1 C.B. 111, 117 by stating "[t]he presence or absence of a tax avoidance motive is one of many factors to be weighed in the determination of the reality of an intra family gift, sale, or loan, and the existence of bona fide partnership intent. The presence of a tax motive, however, is of no consequence if the reality of the transfer of interest and the good faith of the parties are satisfactorily satisfied."

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42 See Statement of John Rooney, attorney advisor in the Treasury's Office of Tax Legislation Counsel to the ABA Tax Section on January 29, 1995, reprinted in Sheppard, 66 Tax Notes 776, 778 (1995), that "[s]ubstantial business purpose and principal purpose of tax avoidance cannot co-exist."

43 *Id.*