No. 20-645

In The
Supreme Court of the United States

STANDING AKIMBO, LLC, A COLORADO LIMITED LIABILITY COMPANY; PETER HERMES, AN INDIVIDUAL; KEVIN DESILET, AN INDIVIDUAL; SAMANTHA MURPHY, AN INDIVIDUAL; AND JOHN MURPHY, AN INDIVIDUAL,

Petitioners,

v.

UNITED STATES OF AMERICA, THROUGH ITS AGENCY OF THE INTERNAL REVENUE SERVICE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

REPLY BRIEF

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RELATED CASES

Boulder Alternative Care, LLC v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 016495-16

Thomas Van Alsburg & Valerie Van Alsburg v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 003959-20

Steven Brooks & Shannon Brooks v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 003958-20

Mike Miller & Michelle Miller v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 001613-20

Daniel Meskin & Kari Meskin v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 001612-20

Daniel Meskin & Kari Meskin v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 001581-20

Mike Miller and Annette Miller, Deceased v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 001580-20

Mike Miller & Michelle Miller v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 001579-20

Jo Ann Sharp & Randall W. Sharp v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 007196-19

RELATED CASES – Continued

Jo Ann Sharp v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 007077-19

Ryan Foster v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 007073-19

Boulder Alternative Care, LLC, GLG Holdings, LLC, Tax Matters Partner v. Commissioner of Internal Revenue, United States Tax Court, Docket No. 016495-16

Standing Akimbo, Inc. et al. v. USA, United States District Court, District of Colorado, Case No. 1:18-mc-00178-PAB-KLM (*Standing Akimbo II*)

CSW Consulting, Inc. et al. v. USA, United States District Court, District of Colorado, Case No. 1:18-mc-00030-PAB

Eric D. Speidell, et al. v. United States of America, Tenth Circuit Court of Appeals, No. 19-1214, ___ F.3d ___ (10th Cir. October 20, 2020) (Published)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES – Continued

The Petitioners, above named, respectfully submit their Reply to their Petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit.

REPLY

I. Circuit Splits at Issue in this Petition

Contrary to the Government's contention, there are circuit splits which need to be addressed by this Court. The most important split is regarding the definition of constitutional income under the Sixteenth Amendment. As further discussed below, the *Davis* decision by Judge Learned Hand of the Second Circuit conflicts with the Tenth Circuit Panel in *Alpenglow.* The Tax Court is split on the question as demonstrated in the *Northern California Small Business Assistants* case. The definition of "income" under the Sixteenth Amendment is determinative of the constitutionality of Section 280E. It is a serious question which must be resolved.

The second circuit split is whether an argument not brought before the magistrate judge but brought before the Article III judge is waived on appeal. This was brought to the Court's attention in the Petitioner's Petition. The Government did not respond. The Petitioners believe that as long as the argument is brought before final judgment under Rule 54, the argument is not waived.

Finally, there is a circuit split on whether the burden of demonstrating the existence of the summonsed documents is on the government, or if the burden is on the taxpayer to prove the documents do not exist. The Government did not respond to the Petitioners' argument.

II. The Great Federalism Dispute

There were those who thought that the election of President Biden would bring a softening of the federal government's stance against expressly state-legal cannabis. They were wrong. The Biden Administration has doubled down.

> "States may not countermand Congress's decision to prohibit trafficking in marijuana. Such activity violates federal law even when it does not independently violate state law (and even when it is affirmatively permitted by state law)."
>
> * * *
>
> "Colorado may not authorize any individual or business to violate federal law."

Brief in Opposition, p. 10.

Nevertheless, after the Biden Administration made its position known, New Jersey Governor Phil Murphy, signed into law legislation making "adult use" cannabis legal, and allowed the regulation of a New Jersey cannabis marketplace. https://www.nbcnews.com/

news/us-news/new-jersey-governor-signs-laws-legalize-marijuana-use-decriminalize-possession-n1258534.

The Great Federalism Dispute deepens. Certainly, the IRS, as the main infantry battalion of federal government in this federalism dispute, will be arriving in New Jersey soon.

III. "The Federal Law Reigns Supreme" – the Great OZ Has Spoken.

The Biden Administration's acting Solicitor General, without any analysis required by this Court, claims that under the Supremacy Clause, Colorado may not enact laws legalizing cannabis. "The laws of the United States shall be the supreme Law of the Land." To borrow from a classic movie. The Great OZ has spoken.

> But, oh Great OZ, are we not a nation of dual sovereignty?
>
> *Quiet! Do not look behind that curtain. I am the Great OZ.*
>
> But isn't there a presumption against preemption?
>
> *Do not look behind that curtain!*
>
> Did Congress really intend this outcome?
>
> *Do not look behind that curtain!*
>
> But, oh Great OZ, isn't it true that a federal criminal statute will not prohibit an expressly state-legal act unless "explicitly" directed by

> Congress? Did Congress explicitly direct state-legal cannabis to be unlawful?
>
> *Do not look behind that curtain! The Great OZ has spoken. Federal law has made unlawful expressly state-legal and regulated cannabis.*

Unless and until the preemption analysis is done, it cannot be said that expressly state-legal cannabis violates the federal law criminalizing possession and sale of cannabis. The Tenth Circuit erred by forgoing the analysis and concluding that the Great OZ has spoken – that expressly state-legal cannabis[1] is federally unlawful drug trafficking. The Petitioners are confident that if this Court does the required analysis, it will conclude that expressly state-legal cannabis does not violate federal law.

The Government claims that the preemption analysis does not have to be done because Section 280E allows the violation to be either federal *or* state. This is circular logic. One cannot determine whether expressly state-legal cannabis is a violation of federal law until the preemption analysis is done. The federal *or* state analysis is a red herring. A preemption analysis is essential given that the federal government attempts to make expressly state-legal cannabis

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[1] The Solicitor General uses the term "decriminalize." Colorado did not "decriminalize." It, along with many other states, expressly legalized and regulated cannabis. See Colorado Constitution Amendment 64.

unlawful. Otherwise, we are left with conduct being simultaneously lawful and unlawful.

IV. Sixteenth Amendment and Section 280E

The Government contends that Section 280E is not at issue here because the IRS has not yet applied it. This is not correct. First, the Petitioners can challenge a summons "on any appropriate ground." *Reisman v. Caplin*, 375 U.S. 440, 449 (1964). The illegitimate enforcement of Section 280E through these proceedings was one of the appropriate grounds litigated. The Tenth Circuit did not see any kind of ripeness problem. In fact, it analyzed the legitimate purpose of Section 280E when it said it is "the IRS's obligation to determine whether and when to deny deductions under § 280E" and "it is within the IRS's statutory authority to determine, as a matter of civil tax law, whether taxpayers have trafficked in controlled substances." App., p. 17. The Tenth Circuit went further and specifically denied the Petitioners' challenge to Section 280E on the Sixteenth Amendment, stating "We agree with the [NCSBA] majority, which ruled that § 280E falls within Congress's authority under the Sixteenth Amendment to establish deductions." App., p. 18. Additionally, the Tenth Circuit already decided that the IRS makes the predicate determination of unlawful trafficking before it engages in a Section 280E audit. See *Green Sol. Retail, Inc. v. United States*, 855 F.3d 1111, 1112-13 (10th Cir. 2017) (The IRS made initial findings that Green Solution trafficked in a controlled substance and is criminally culpable under the CSA – then

requested that Green Solution turn over documents and answer questions related to whether Green Solution is disqualified from taking credits and deductions under § 280E). Furthermore, the Tenth Circuit cited to Section 280E no less than twenty-five times in its Opinion. Section 280E and its constitutionality are ripe and directly at issue here.

The Government claims that there is no split of authority on how "income" for Sixteenth Amendment purposes is defined. This is not true. The line of demarcation is Judge Learned Hand in *Davis v. United States*, 87 F.2d 323 (2d Cir. 1937) versus *Alpenglow Botanicals, Ltd. Liab. Co. v. United States*, 894 F.3d 1187 (10th Cir. 2018).

Judge Learned Hand, in *Davis*, followed *Eisner v. Macomber*, 252 U.S. 189 (1920), concluding that constitutional income is equivalent to "gain." He concluded that there were two levels of deductions, one that could be disallowed by legislative grace such as charitable contributions, and others which could not be disallowed such as "cost of property sold; ordinary and necessary expenses incurred in getting the so-called gross income; depreciation, depletion, and the like in order to reduce the amount computed as gross income to what is in fact income under the rule of *Eisner v. Macomber*." *Davis v. United States*, 87 F.2d at 324.

The *Alpenglow* court rejected *Davis* as being dicta and concluded that income for constitutional purposes was "gross income," meaning only gross receipts less costs of goods sold. The *Alpenglow* court, borrowing

from excise tax law, went as far as to claim that "the mere fact of intake being less than outgo does not relieve the taxpayer of an otherwise lawfully imposed tax." *Alpenglow Botanicals*, 894 F.3d at 1201-02. Thus, the *Alpenglow* court completely divorced the concept of gain being part of constitutional income.

A majority of the Tax Court, *en banc*, embraced *Alpenglow* and rejected *Davis. N. Cal. Small Bus. Assistants, Inc. v. Commissioner*, 153 T.C. 65 (2019). However, three of the Tax Court Judges rejected *Alpenglow* and followed *Davis.*

" 'Income' is gain . . . The Court of Appeals explicitly so held in *Davis v. United States*, 87 F.2d 323, 324-325 (2d Cir. 1937)." *N. Cal. Small Bus. Assistants, Inc. v. Commissioner*, 153 T.C. at 81. "The result of section 280E is that the determination of the supposed 'income tax' liability of a taxpayer trafficking in illegal drugs bypasses altogether any inquiry as to his gain." *Id.* at 83. Thus, the Dissent concluded that Section 280E was unconstitutional under the Sixteenth Amendment. *Id.* at 84.

The Government, as well as the *Alpenglow* court, relies heavily on *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934) for the proposition that Sixteenth-Amendment constitutional income means "gross income." However, *New Colonial Ice* was not a Sixteenth Amendment case. The Court was construing the federal tax statutes. The question presented was whether a new corporation which took over the assets of an older corporation could take the older corporation's

previous tax losses on the new corporation's current tax return. The Court was looking at whether the losses could be deducted under the tax law. To this end, the Court stated that the "power to tax income like that of the new corporation is plain and extends to the gross income." *Id.* 440.

"Gross income" at the time was a statutory definition. The Revenue Act of 1934 defined gross income in Section 22 of the Act. P.L. 216, Sec. 22. Importantly, "gross income" at the time was defined as "gains" or "profits" of "business." *Id.*

Over the last ninety years, the IRS has changed the definition of "gross income" greatly expanding government tax power. However, this Court has never determined that "gross income" is constitutional income. *New Colonial Ice* does not make that connection.

Also, it was Judge Learned Hand's panel that decided *New Colonial Ice* for the Court of Appeals. *New Colonial Ice v. Comm'r*, 66 F.2d 480 (2nd Cir. 1933), *aff'd*, 292 U.S. 435. Certainly, Judge Hand was fully aware of *New Colonial Ice* when his panel decided *Davis* three years later. If Judge Hand thought that *Davis* was in any way inconsistent with Supreme Court precedent, a judge of his caliber would have brought it up. He did not. He knew *New Colonial Ice* was not a Sixteenth Amendment case.

Constitutional income means "gain," not "gross income." Section 280E is unconstitutional.

V. Fourth Amendment

The Government claims that Standing Akimbo as an entity does not have Fourth Amendment rights. This Court has previously rejected these same contentions by the IRS. *G.M. Leasing Corp. v. United States*, 429 U.S. 338 (1977). The Government's contention is clearly meritless.

The Government contends that the information summonsed is covered by the Third-Party Doctrine. However, in all cases cited by the Government, the third party is a business or natural person. The undersigned is unable to find a third-party doctrine case where the "third party" is a governmental entity. In fact, the undersigned has been unable to find any appellate case where the IRS successfully summonsed a state agency at all. There is no authority that the Government can summons a state agency under the Third-Party Doctrine.

Also, the governmental entity here is the State of Colorado. It is subject to Fourth Amendment restrictions. See *Ferguson v. City of Charleston*, 532 U.S. 67, 69 (2001) (State hospital and staff members are subject to Fourth Amendment's strictures).

The Government contends that the METRC information compelled by the Colorado Department of Revenue does not have privacy interests. However, the State of Colorado has determined that information given by taxpayers to the Colorado Department of Revenue is cloaked in privacy. *People v. Gutierrez*, 222 P.3d 925 (Colo. 2009). "Taxpayers are entitled to expect that

this information will not be open to scrutiny by state or federal agencies responsible for the investigation or prosecution of non-tax crimes absent particularized suspicion of wrongdoing meeting the demands of the Fourth Amendment." *Id.* at 936.

The Government does not contest that the information compelled by the summonses can be shared with law enforcement for non-tax crime purposes. See 26 U.S.C. §6103(i)(3)(A); *United States v. One Coin-Operated Gaming Device*, 648 F.2d 1297 (10th Cir. 1981). Thus, the information the IRS seeks is covered by privacy interest and the Government needs a warrant to obtain it.

As *People v. Gutierrez* demonstrates, the information the Petitioners provided to the Department of Revenue under METRC is still their property. Contrary to the Government's contentions, their information did not become property of the State of Colorado. They still have privacy interests in that information.

The Government claims that since Colorado amended the confidentiality statute to allow access to law enforcement, the Court should determine the Petitioners have no expectation of privacy. This is so even though the Petitioners gave the State the information under the previous statute.

First, a state statute that takes away substantive rights after the fact "is repugnant to the constitution of the United States." *Proprietors of Charles River Bridge v. Proprietors of Warren Bridge*, 36 U.S. 420, 581 (1837). Second, since the amendment happened after

the Petitioners provided the information, it should be considered a broken promise. This Court takes a dim view of broken promises of confidentiality. See *CIA v. Sims*, 471 U.S. 159 (1985). Finally, as stated in the Petitioners' Petition, the statute should be construed as it was at the time the summons was issued. See *United States v. Rue*, 819 F.2d 1488, 1493 (8th Cir. 1987) (Rights become fixed on the date the summons is issued).

The Government further contends that Fourth Amendment analysis should never apply when the IRS is issuing a summons under *Powell*. Since summonses and subpoenas are considered equivalent, the statement by this Court in *Carpenter* resolves that question: "If the choice to proceed by subpoena provided a categorical limitation on Fourth Amendment protection, no type of record would ever be protected by the warrant requirement." *Carpenter v. United States*, 138 S. Ct. 2206, 2222 (2018).

VI. This Court Does Not Allow the Weighing of Evidence on Summary Judgment

The Government contends that in a summons proceeding, the court may weigh evidence on a summary judgment motion. This violates Fed.R.Civ.P. 56. The fact that at a hearing, an affidavit of the investigating agent may suffice, does not change the rules on summary judgment.

There were counter affidavits and much documentary evidence submitted on the motion and responses

for summary judgment. The Panel should not have weighed the evidence on the motion.

VII. Burden Shifting

The Government did not respond to the Petitioners' claim of error regarding how the Panel improperly shifted the burden on to the Petitioners from the Government regarding the existence of summonsed documents. The circuits are split on this issue and Certiorari should be granted to resolve the circuit split.

CONCLUSION

The Court should grant certiorari and determine that, as a matter of law, Colorado state legal cannabis is not superseded by the federal Controlled Substances Act, that Section 280E is unconstitutional being violative of the Sixteenth Amendment, that if the IRS wants cannabis information compelled by the State of Colorado, it must do so by warrant, that a summary judgment standard must be applied in accordance with Rule 56 with no special exceptions for summons actions, resolve the circuit splits as to the procedural issues, and provide such other and further relief as the Court deems proper.

Respectfully submitted,

JAMES D. THORBURN

February 25, 2021