No. _____

IN THE SUPREME COURT OF THE UNITED STATES

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JOHN VISCONTI,

Petitioner,

-v-

UNITED STATES OF AMERICA,

Respondent.

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PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Whether an unlawful diversion may be deemed a "distribution . . . with respect to [a corporation's] stock," the question expressly left open in *Boulware v. United States*, 552 U.S. 421, 439 (2008).

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Petitioner John Visconti respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINION BELOW

The court of appeals affirmed petitioner's conviction. *United States v. Visconti*, No. 17-50091 (9th Cir. 2018).[1] It denied a petition for rehearing en banc without analysis.[2]

JURISDICTION

On November 7, 2018, the court of appeals denied the timely petition for rehearing en banc. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS

The Fifth Amendment provides: "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty,

[1] A copy of the memorandum is attached as Appendix A.

[2] A copy of the order denying the petition for rehearing en banc is attached as Appendix B.

or property, without due process of law; nor shall private property be taken for public use, without just compensation."

The Sixth Amendment provides: "In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence."

26 U.S.C. § 301(c) provides: "(1) That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income. (2) That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock."

26 U.S.C. § 316(a) provides: "the term 'dividend' means any distribution of property made by a corporation to its shareholders – (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

STATEMENT OF THE CASE

A. Axium's rise and fall.

Axium was a payroll services company for the entertainment industry. ER:207, 456-61.[3] In the late 1990s, with revenues in decline, it began looking for a buyer. ER:473-74. John Visconti first heard about Axium from his attorney, Ronald Garber. ER:483, 951-52. Although Mr. Visconti did not have payroll or tax expertise, he had a vision for turning Axium into a Hollywood powerhouse. He purchased the company for $4 million, and further capitalized it through a real estate transfer worth over $8 million. ER:191, 265, 953, 969-71.

Given his lack of experience in the payroll business, however, Mr. Visconti counted on Mr. Garber – naming him Chief Operating Officer – to run day-to-day operations. ER:37, 955-56. This allowed Mr. Visconti to focus on growing the company. ER:956-60. As a result of his efforts, within a few years, overall payroll processing increased from $560 million to $1.8 billion. ER:34, 466, 472, 955, 957.

Unfortunately, while the company expanded, Mr. Visconti's personal life collapsed. In 2006, he and his wife began contentious divorce and custody

[3] "ER" refers to the Excerpts of Record on file with the Ninth Circuit.

proceedings. ER:980-83. The divorce dominated Mr. Visconti's life. ER:986-87.

While his attention turned toward his family, Axium's internal operations faltered. The people running the core business – that is, ensuring proper payroll tax withholdings – made egregious mistakes. ER:38, 44. They miscalculated the company's tax obligations, such that the IRS issued Axium a $31 million tax deficiency. ER:513, 985-86. Mr. Visconti was forced to use the money in Axium's accounts to pay its tax obligations, leaving the company insolvent. ER:38-39, 988. Shortly thereafter, Axium declared bankruptcy. ER:28-29, 39, 716, 741.

Predictably, the bankruptcy trustee's investigation revealed negligent accounting practices. ER:38. It also identified a number of questionable transactions involving Mr. Garber and Mr. Visconti. ER:31-36. According to the trustee, they used funds from Axium for their personal benefit, but did not declare them as income. ER:31-36.

B. The district court proceedings.

1. *The charges*.

The bankruptcy investigation led to a criminal prosecution. ER:1. The government filed a three-count indictment against Mr. Visconti, charging:

- Count 1 – Conspiracy to defraud the United States, a violation of 18 U.S.C. § 371. ER:1.

- Count 2 – Attempted evasion of income tax, a violation of 26 U.S.C. § 7201. ER:20.

- Count 3 – Making a false tax return, a violation of 26 U.S.C. § 7206(1). ER:24.

Underlying the charges was the government's theory that Mr. Visconti and Mr. Garber failed to declare money diverted from Axium. ER:5. Mr. Visconti did not dispute that the subject transfers occurred. Nor was there any question the money was unreported as income. Rather, his defense was that the payments constituted non-taxable events – i.e., return of his capital investment in Axium. ER:185-86.

2. *The preclusion of Mr. Visconti's return-of-capital defense.*

In support of this defense, Mr. Visconti provided notice to the government of his intent to call as an expert witness a certified public accountant to testify the transfers were non-taxable returns of capital. ER:185-86, 193-94. [4] The

[4] The return-of-capital defense is based on Internal Revenue Code § 301, which provides, "a distribution of property" that is "made by a corporation to a shareholder" shall, if not a dividend, be applied against the shareholder's basis in the corporation's stock. In plain English, a non-dividend distribution is treated as "nontaxable return of capital." *Boulware*, 552 U.S. at 425. As such, because it is a nontaxable event, the distribution cannot serve as the basis for tax fraud, tax evasion, or false tax return charges. *See id.*

government moved to preclude Mr. Visconti from asserting the return-of-capital defense and sought to exclude any expert testimony on the issue. ER:162-84.

Mr. Visconti responded by proffering that he owned 85% of Axium's shares through his personal corporation – his "alter ego," ER:30-31 – and the distributions were a return of his substantial capital investment. ER:217-18. He attached exhibits showing that, between payments and real estate, he had a $13,130,143.16 capital investment in Axium. ER:215-16.

Specifically, Mr. Visconti tendered signed checks representing payment of $4,886,143.16 for his Axium purchase. ER:215, 228-43. Additionally, he provided the district court with a deed for the transfer of real property from Mr. Visconti to Axium, which he swore had "a fair market cash value in excess of $8,250,000.00." ER:216, 225, 246. Mr. Visconti further denied receiving from Axium anything beyond a "single payment of $4,000,000.00," as a formal distribution. ER:227.

This proffer, he argued, provided a sufficient evidentiary basis to present his defense. ER:220 (because the "return of capital that John Visconti took from Axium . . . was much less than the $13,130,143.16 he invested in Axium," he was entitled to pursue the return-of-capital defense). And it was a question for the jury – not the judge – whether to accept that defense. ER:221-22.

The district court disagreed. It precluded the defense in its entirety, including the testimony of Mr. Visconti's expert accountant. ER:302, 312, 405. The ruling left Mr. Visconti with no ability to explain or argue his return-of-capital theory, and the jury convicted him. ER:1170.

C. The panel's decision.

On appeal, Mr. Visconti argued the district court erred in precluding his return of capital defense. AOB:24. The court of appeals disagreed, concluding:

> Visconti failed to establish that his stock basis exceeded the value of the distributions. Visconti presented checks showing he paid $4,886,143.16 to purchase Axium through its parent company, Unity America Fund. He also provided a declaration stating that he transferred a deed of valuable property to Axium, which he estimated to have a value of $8,250,000 at the time of the transfer, making his total capital basis $13,136,143.16. Despite being given the opportunity to do so, Visconti provided no evidence of the property's value aside from his own estimate, which he provided no basis for. Visconti also stated that Axium paid Unity America Fund $4,000,000 for redemption of stock, but he did not "recall" any other payments.
>
> The government presented the declaration of a CPA involved in Axium's bankruptcy proceedings who stated that "according to escrow documents," the property Visconti transferred "was assigned a value of $6.25 million," making Visconti's total capital basis in Axium $10,250,000. It also presented a declaration that Visconti submitted in his divorce proceedings, in which Axium's CPA stated that Axium repaid Unity America Fund a total of $12,250,000 in three separate payments. The government submitted the bank records for each payment.

> The defendant bears the burden to establish factual support for a finding that his stock basis exceeded the value of the distributions. *See Boulware*, 552 U.S. at 438 n.14. Visconti's lone declaration giving his estimate of the value of the property as $8,250,000 and stating that he only recalled one $4,000,000 payment is insufficient to meet the third element of the *Boulware* test. *See Boulware*, 558 F.3d at 974. He did not provide evidentiary support for his valuation, nor evidence to rebut the documents establishing that Axium paid Visconti $12,250,000 for redemption of stock. Because the evidence did not establish that Visconti had a stock basis in Axium in excess of the value of the distributions, the district court did not abuse its discretion in finding that he failed to establish a factual basis for a return-of-capital defense.

App. A at 2-4 (certain citations omitted).

Mr. Visconti now asks the Court to clarify the return-of-capital defense under *Boulware*. The question is whether unlawful diversions can be deemed a "distribution . . . with respect to [a corporation's] stock[.]" *Boulware*, 552 U.S. at 439.

REASON FOR GRANTING THE PETITION

Review is necessary to answer the question left open in *Boulware*.

"[T]he Constitution guarantees criminal defendants 'a meaningful opportunity to present a complete defense.'" *Holmes v. South Carolina*, 547 U.S. 319, 324 (2006) (internal citation omitted). To safeguard that right, it is critical to delineate the contours of any given defense – i.e., what does and does not fall within

a particular theory. As to the return-of-capital defense, that inquiry began with *Boulware*.

A. *Boulware.*

In *Boulware*, as here, the district court granted a motion "in limine to bar evidence in support of Boulware's return-of-capital theory." *Boulware*, 552 U.S. at 427. The court of appeals affirmed. *Id.* This Court reversed. *Id.* at 427-28.

It began by explaining, "Sections 301 and 316(a) of the Internal Revenue Code set the conditions for treating certain corporate distributions as *returns of capital, nontaxable to the recipient*." *Id.* at 424 (emphasis added). According to § 301(a), "a 'distribution of property' that is 'made by a corporation to a shareholder with *respect to its stock* shall be treated in the manner provided in [§ 301(c)].'" *Id.* at 424-25 (emphasis added).

Section 301(c), in turn, provides: "the portion of the distribution that is a 'dividend,' as defined by § 316(a), must be included in the recipient's gross income; and the portion that is not a dividend is, depending on the shareholder's basis for his stock, either *a nontaxable return of capital* or a gain on the sale or exchange of stock, ordinarily taxable to the shareholder as a capital gain." *Id.* at 425 (emphasis added).

The last piece of the puzzle, section 316(a), "defines 'dividend' as 'any distribution of property made by a corporation to its shareholders--

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made." *Id.*

Accordingly, "[s]ections 301 and 316(a) together [] make the existence of 'earnings and profits' the decisive fact in determining the tax consequences of distributions from a corporation to a shareholder with respect to his stock." *Id.* Thus, "a distributee accused of criminal tax evasion may claim return-of-capital treatment without producing evidence that either he or the corporation intended a capital return when the distribution occurred." *Id.* at 424. Regardless of intent, a transfer from a corporation to an equity owner is considered a non-taxable return of capital when it is "with respect to [] stock" and the corporation does not have sufficient profits to pay that money as a dividend. *Id.* at 425.

The Court, however, further noted, it was "not the time or place to home in on the 'with respect to . . . stock' condition. Facts with a bearing on it may range from the distribution of stock ownership to conditions of corporate employment (whether,

for example, a shareholder's efforts on behalf of a corporation amount to a good reason to treat a payment of property as salary)." *Id.* at 437-38. Thus, the Court "decline[d] to take up the question whether an unlawful diversion may ever be deemed a 'distribution . . . with respect to [a corporation's] stock[.]'" *Id.* at 439.

On remand, the court of appeals also declined to address the "with respect to" stock question: "The Supreme Court declined the opportunity to define the contours of the phrase 'with respect to stock,' leaving that for another day. So do we." *United States v. Boulware*, 558 F.3d 971, 977 (9th Cir. 2009) (*Boulware II*). And that is the current state of the law.

B. The Court should pick up where *Boulware* left off.

It is time for an update. This case shows why. Underlying the lower courts' exclusion of petitioner's return-of-capital theory was the fact he allegedly skimmed the funds from Axium.

The district court was uncomfortable allowing the defense to attempt to legitimatize that conduct using the tax code. On the surface, the court's reluctance was understandable. How can a diversion hidden from corporate accountants qualify as a legitimate return of capital? The reflexive answer is, of course, it cannot. And thus, the judicial instinct was to kill the defense before its saw the

light of the courtroom, thereby preventing the jury from being hoodwinked by crafty defense lawyers and their tax experts.

The problem, however, is that this "remedy" runs headlong into the constitutional right to present a complete defense. Additionally, it usurps the jury's role, and it ignores this Court's animating rationale in *Boulware*, that "economic reality," not intent, is the measure for all tax classifications. 552 U.S. at 429. Accordingly, while the Court previously "decline[d] to take up the question whether an unlawful diversion may ever be deemed a 'distribution . . . with respect to [a corporation's] stock,'" the time has come. *Id.* at 439.

Consider, for instance, a partial owner of a small LLC. He makes an initial capital contribution of $10,000. He then skims $5,000 from the corporate coffers, which is not declared as income. Shortly thereafter, the company goes bankrupt, and the person is charged with tax fraud.

There is no legal reason why this defendant – like the petitioner here – should not be permitted to raise a return-of-capital defense. Taking intent out of the picture, as *Boulware* requires, the economic reality is that the person received half of his initial capital contribution back from the now-defunct LLC. And for tax purposes, the fact that the money was improperly taken cannot change that conclusion.

Thus, the jury should make the determination of whether the $5,000 payment was with respect to the defendant's equity interest, not the district judge. But, as this case demonstrates, that is not what's happening. Instead, the lower courts are stepping in and taking a factual issue from the jurors.

For this reason, review is necessary. The Court needs to answer the question left open in *Boulware* and delineate the contours of the with-respect-to-stock requirement.

CONCLUSION

The Court should grant the petition for a writ of certiorari to determine whether unlawful diversions can be deemed distributions with respect to stock.

Respectfully submitted,

Dated: December 13, 2018

s/ Devin Burstein
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