No. 20-___

IN THE

Supreme Court of the United States

MICHAEL SANG HAN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case concerns the proper test for distinguishing taxable income from non-taxable loan proceeds under the Internal Revenue Code. In *James v. United States*, 366 U.S. 213 (1961), the Court held that the hallmark of a non-taxable loan is the "consensual recognition . . . of an obligation to repay." There is a circuit split regarding implementation of that test, and in particular the role of the parties' intent in defining whether a transaction constitutes a loan. *See Busch v. Comm'r*, 728 F.2d 945, 948 (7th Cir. 1984) (acknowledging split). The First, Second, Fourth, Sixth, and Seventh Circuits focus on the parties' intent and consider other factors solely as indicia of intent. In contrast, the Third, Fifth, Ninth, and Tenth Circuits apply a multi-factor balancing test in which intent is merely one of many co-equal considerations, none of which is dispositive. In the decision below, the D.C. Circuit applied the latter approach, considering the parties' intent and Petitioner's ability to repay on a co-equal basis. *See* Pet. App. 7a–8a.

The question presented is:

May a court consider factors other than the parties' intent in determining whether a transfer of funds constitutes a non-taxable loan under the Internal Revenue Code?

PARTIES TO THE PROCEEDING AND CERTIFICATE OF RELATED CASES

The parties to this criminal proceeding are Petitioner Michael Sang Han, who was the Defendant in the district court and the Appellant in the court of appeals, and Respondent the United States of America, which was the Plaintiff in the district court and Appellee in the court of appeals. Because there are no nongovernmental corporate parties to this case, the disclosure requirement of Rule 29.6 does not apply.

Pursuant to Rule 14(b)(iii), counsel is not aware of any related case currently pending in this Court or any other court.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Michael Sang Han respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

INTRODUCTION

The decision below deepens a longstanding circuit split regarding the proper test for distinguishing taxable income from non-taxable loan proceeds. The Seventh Circuit acknowledged this split in *Busch v. Comm'r*, 728 F.2d 945, 948–49 (7th Cir. 1984), indicating that "[s]ome courts have viewed intent as merely one factor, and then have balanced that intent against various objective factors," whereas other courts have held that "intent is the only factor" and consider "objective factors [solely] as indications of intent."

That split has deepened and expanded since *Busch* identified it in 1984. Today, the Third, Fifth, Ninth, and Tenth Circuits take the former approach by applying a multi-factor balancing test in which intent is merely one of many non-dispositive considerations. The First, Second, Fourth, Sixth, and Seventh Circuits, in contrast, have held that the proper test focuses on the parties' intent at the time of the transaction and that courts may look to other factors only as a means of ascertaining intent.

In the decision below, the D.C. Circuit adopted a test in line with that of the Third, Fifth, Ninth, and

Tenth Circuits by weighing the parties' intent and Petitioner's ability to repay as co-equal factors. *See* Pet. App. 7a–8a. In particular, the court relied on *Welch v. Comm'r*, 204 F.3d 1228, 1230 (9th Cir. 2000), which calls for a balancing test that "consider[s] a number of other factors" beyond intent and in which "no single factor" is dispositive.

The Court should grant the petition to resolve this split of authority. *First*, the question presented implicates a recognized circuit split on a recurring question of federal law, and the disagreement between the courts of appeals shows no signs of abating. *Second*, the amorphous, multi-factor balancing test applied by the Third, Fifth, Ninth, Tenth, and D.C. Circuits is incompatible with this Court's decision in *James v. United States,* 366 U.S. 213, 219 (1961), which identifies intent—i.e., the "consensual recognition, express or implied, of an obligation to repay"—as the focus of the loan-versus-income analysis. *Third*, the question presented has widespread practical significance, and the split on that issue creates uncertainty regarding the tax liability of both individuals and corporations. *Fourth*, and finally, this case presents an excellent vehicle to resolve the issue. Petitioner pressed the issue below, and the D.C. Circuit passed upon it by holding that the transactions in question resulted in income despite significant evidence that the parties intended the transactions to be loans.

OPINIONS BELOW

The court of appeals' decision in this case (Pet. App. 1a–12a) is reported at 962 F.3d 568. The district court's judgment in this case (Pet. App. 15a–30a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 19, 2020. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of Title 26, United States Code, are reproduced in the appendix to the petition. *See* Pet. App. 97a–98a.

STATEMENT OF THE CASE

A. Statutory and Regulatory Framework

An individual's income tax liability is determined based on the amount of "taxable income" earned in a given year. *See* 26 U.S.C. § 1. The Internal Revenue Code defines "taxable income" as "gross income" less any allowed deductions. *Id.* § 63(a). "Gross income," in turn, means "all income from whatever source derived." *Id.* § 61(a); *see also Comm'r v. Schleier*, 515 U.S. 323, 327–28 (1995) (describing broad sweep of this definition); 26 C.F.R. § 1.61-1(a) (gross income consists of "income realized in any form, whether in money, property, or services").

Although the statute and implementing regulations provide examples of gross income, they do not directly address whether loans constitute income. This Court's decision in *James v. United States*, 366 U.S. 213 (1961), resolved that issue. *James* considered the question whether embezzled funds are "gross income." In the course of answering that question, the Court adopted an overarching test for identifying taxable income: "[w]hen a taxpayer acquires earnings,

lawfully or unlawfully, *without the consensual recognition, express or implied, of an obligation to repay* and without restriction as to their disposition, 'he has received income which he is required to return.'" *Id.* at 219 (emphasis added) (quoting *N. Am. Oil Consol. v. Burnet*, 286 U.S. 417, 424 (1932)). Critically, although "[t]his standard brings wrongful appropriations within the broad sweep of 'gross income,'" it also "excludes loans." *Id.* The Court has since confirmed that *James* stands for the proposition that "receipt of a loan is not [taxable] income to the borrower." *Comm'r v. Indianapolis Power & Light Co.*, 493 U.S. 203, 207–08 (1990).

Failure to report taxable income can have criminal consequences. Under 26 U.S.C. § 7201—the statute Petitioner was convicted of violating here—"any person who willfully attempts in any manner to evade or defeat any tax imposed by [Title 26] or the payment thereof" is guilty of a felony. The Government's burden in a prosecution under section 7201 is to demonstrate three elements: (1) the existence of a tax deficiency; (2) an affirmative act constituting an evasion or attempted evasion of the tax; and (3) willfulness on the part of the defendant. *See Sansone v. United States*, 380 U.S. 343, 351 (1965). This case concerns the proper test for determining whether a transfer of funds constitutes taxable income or a nontaxable loan—an issue relevant to all three of those elements.

B. Factual and Procedural Background

This case arises from Petitioner Michael Sang Han's activities as the owner and chief executive of Envion, a startup recycling technology company Han

founded in 2004. *See* Pet. App. 2a. Envion sought to develop and commercialize a process to convert plastic waste into transportation fuel. Although Envion was not successful in its efforts to bring that process to market, it did demonstrate the process on at least two occasions, leading one observer to conclude that the process was "the real deal."[1]

Between 2004 and 2009, Han obtained financing for Envion from investors, including Frank Carlucci and James Russell. Pet. App. 2a. Carlucci and Russell made these initial investments in Envion in the form of convertible loans to the company. The documentation for these loans identified Envion as the borrower, and each was signed by Han in his corporate capacity, on behalf of Envion. Pet. App. 43a, 54a, 78a, 86a.

Han used a portion of the funds that Carlucci and Russell invested in Envion for personal expenditures that ranged from groceries to vehicles. Pet. App. 2a. Han treated these expenditures as shareholder loans from Envion to himself that he would be personally responsible for repaying to the company. Pet. App. 3a.

In 2010, Han sought and obtained additional funds from Carlucci and Russell, totaling $22.3 million. Pet. App. 3a. This time, however, the loan documents identified Han as the borrower, not Envion. Pet. App. 47a, 71a. Furthermore, Han signed the documents in

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[1] *See* Tr. of Trial Proceedings, *United States v. Han*, No. 1:15-cv-142, ECF No. 174, at 83 (D.D.C. May 2, 2018); *see also id.* ECF No. 173, at 17–18 (D.D.C. May 1, 2018) (trial testimony describing "demonstration project" that left observers "enthusiastic" about the technology); *id.* ECF No. 174, at 81 (D.D.C. May 2, 2018) (trial testimony indicating that the technology was believed to have a valuation "in the billions of dollars").

his personal capacity, Pet. App. 54a, 78a, and the funds were wired to Han's personal bank account rather than Envion's corporate account, Pet. App. 45a.

Han used a portion of this money in 2010 and 2011 to make additional personal purchases and to pay down the shareholder loan balance he accrued between 2004 and 2009. Pet. App. 3a. Consistent with the understanding that the 2010 transfers were personal loans that would have to be repaid, Han did not declare his use of those funds on his 2010 or 2011 tax returns.

The Government initially charged Han with fraud based on alleged misrepresentations he had made to Carlucci and Russell in order to induce their investments in Envion. However, the Government subsequently dismissed the fraud charges and instead filed a superseding indictment charging Han with two counts of tax fraud under 26 U.S.C. § 7201. Han went to trial on those tax-fraud charges. *See* Pet. App. 15a–16a.

At trial, the Government's theory was that the 2010 transfers from Carlucci and Russell to Han were investments in Envion that Han diverted to personal use. As such, Han should have reported the portion of those investments used for personal expenses as income on his tax returns for 2010 and 2011. Pet. App. 2a, 9a. Han's defense focused on the argument that the 2010 transfers were personal loans that he had the responsibility to repay, such that there was no corresponding duty to report them as income on his tax returns. *See* Pet. App. 3a, 42a–45a.

Although there was evidence to support the prosecution's theory, Pet. App. 9a–10a, there was also

evidence that these transfers were in fact loans. As noted, Han was personally named on the loan documents as the borrower, he signed the loans in his personal capacity, and the funds were wired to his personal bank account. *See* Pet. App. 45a, 47a, 54a, 71a, 78a. Expert testimony provided further support for Han's loan defense. Specifically, Robert Hersh, a certified public account with twelve years of experience at the IRS and thirty years of experience at a private accounting firm, explained that the funds in question constituted personal loans, not taxable income, because the transfer documents showed the borrower was Han personally and the funds were wired directly into Han's personal bank account. Pet. App. 45a.

Even though Han's primary defense was that the 2010 transfers were non-taxable personal loans, the District Court rejected Han's request to issue a theory-of-defense jury instruction on that issue. Pet. App. 9a. As a result, the jury received no instructions from the District Court indicating that personal loans are not taxable income or explaining how to determine whether the transfers constituted personal loans.[2]

Nevertheless, the jury heard witness testimony and attorney argument regarding the tax treatment of loan proceeds. In particular, IRS Agent Laura Manion, an expert witness for the Government, testified

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[2] Throughout Han's trial, the Government repeatedly highlighted the lavish nature of Han's spending, for example by introducing evidence that Han spent the allegedly misappropriated funds on beach house renovations, expensive cars, and other luxury items. *See* Pet. App. 8a–9a. This evidence exacerbated the prejudicial effect of the District Court's failure to instruct the jury regarding the non-taxable nature of loan proceeds.

that "legitimate" loans are not taxable and listed several factors relevant to that inquiry, including the existence of a loan document, repayment terms, repayments made, interest, ability to repay the loan, and the recipient's intent to repay the loan. Pet. App. 34a–36a.[3] On cross-examination, Agent Manion conceded that on its face, the 2010 transfer from Carlucci to Han was a personal loan. Pet. App. 38a.

The jury found Han guilty on both counts of tax evasion. Pet. App. 15a. The District Court sentenced Han to 48 months' imprisonment and ordered $4,954,027 in restitution. Pet. App. 17a, 24a.

Han timely appealed both convictions.[4] Among other things, Han argued on appeal that the District Court erred by (1) admitting evidence that he made misrepresentations to Carlucci and Russell regarding Envion's business prospects, and (2) refusing to instruct the jury that loan proceeds are not taxable income. The latter error was prejudicial and required reversal, Han argued, because the trial testimony and argument on that issue improperly departed from the

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[3] Agent Manion also addressed the factors for determining whether a transfer of funds from a business to a shareholder is a loan, including the extent of control the person receiving the funds has over the company. Pet. App. 36a–38a. In connection with this testimony, the Government introduced an exhibit listing twelve factors used by the IRS in evaluating the legitimacy of shareholder loans. Pet. App. 94a–96a.

[4] The D.C. Circuit granted Han's motion for appointment of substitute counsel and appointed undersigned counsel to represent him pursuant to the Criminal Justice Act.

James test by addressing factors other than the parties' intent at the time of the transaction.[5]

The D.C. Circuit affirmed Han's convictions in a published opinion dated June 19, 2020. *See United States v. Han*, 962 F.3d 568 (D.C. Cir. 2020), *reprinted at* Pet. App. 1a–12a. Two parts of that decision are relevant here.

First, regarding Han's evidentiary challenge, the court of appeals reasoned that "[w]hether a borrower has the intent and ability to repay a purported loan is a factor in judging whether the transaction is in fact a loan for tax purposes." Pet. App. 7a. The court based that conclusion in part on *Welch v. Comm'r*, 204 F.3d 1228, 1230 (9th Cir. 2000), which directs courts to look beyond whether "the parties actually intended repayment" and "conside[r] a number of other factors," such as "whether the borrower had a reasonable prospect of repaying the loan," "in assessing whether a transaction is a true loan." These factors are "non-exclusive, and no single factor"—not even the parties' intent—"is dispositive." *Id.* Applying a similarly open-ended approach, the D.C. Circuit held that testimony regarding the viability of Envion's business prospects was admissible because it indicated that Han "had no intent *or ability* to repay" the funds he received in 2010. Pet. App. 7a (emphasis added).

Second, the D.C. Circuit held that the District Court's refusal to issue Han's requested theory-of-defense jury instruction was harmless error because the jury heard witness testimony and attorney argument

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[5] *See* Opening Br. of Appellant, *United States v. Han*, No. 18-3081, ECF No. 1808727, at 40–47 (D.C. Cir. Sept. 30, 2019) (citing, among other authorities, *James*, 366 U.S. at 219).

regarding tax treatment of personal loans. Pet. App. 10a. The court relied in particular on testimony from Agent Manion, "[t]he government's expert witness," that "personal loans are not taxable." *Id.* As noted above, that testimony identified several factors *other than* the parties' intent as bearing on whether a transaction constitutes a loan. *See* Pet. App. 35a–37a, 94a–96a.

REASONS FOR GRANTING THE PETITION

This case presents an ideal opportunity for this Court to resolve a longstanding circuit split regarding the proper test for distinguishing taxable income from non-taxable loans. Whereas the First, Second, Fourth, Sixth, and Seventh Circuits focus on the intent of the transacting parties, the Third, Fifth, Ninth, and Tenth Circuits consider intent as one of several co-equal inputs to a multi-factor balancing test in which no factor is dispositive. The decision below deepened that split by taking the latter approach. This Court's review is warranted in light of the recurring nature of this issue, the conflict between the multifactor balancing test and the rule adopted by this Court in *James*, and the significant practical importance of the loan-income distinction across a wide range of circumstances.

I. The Decision Below Deepens a Circuit Split Regarding the Definition of a Loan for Tax Purposes.

A. This Court Established the Test for Distinguishing Taxable Income from Non-Taxable Loans in *James.*

The distinction between loans and taxable income traces its roots back to *Commissioner v. Wilcox*, 327 U.S. 404, 408–09 (1946), which held that illegally obtained funds do not constitute "gross income" under the Internal Revenue Code. Specifically, the Court held that embezzled funds are not taxable gains to the embezzler in the years in which the funds were misappropriated because "a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain." *Id.* at 408.

Six years later, however, the Court altered course in *Rutkin v. United States*, 343 U.S. 130, 138–39 (1952), and held that an extortionist, unlike an embezzler, was obligated to pay tax on his ill-gotten gains because he was unlikely to be asked to repay those funds. While the *Rutkin* decision called *Wilcox* into question, the Court did not explicitly abandon its definition of "income" until eight years later in *James v. United States*, 366 U.S. 213 (1961).

James involved a union official who embezzled funds from his union and a related insurance company. *See id.* at 214. The *James* Court determined that *Wilcox* was wrongly decided, and that embezzled

funds do qualify as taxable income. *See id.* at 218–19. In particular, the Court reasoned that:

> When a taxpayer acquires earnings, lawfully or unlawfully, without the *consensual recognition*, express or implied, *of an obligation to repay* and without restriction as to their disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

Id. at 219 (quotation marks omitted, emphasis added). "This standard brings wrongful appropriations within the broad sweep of 'gross income,'" but also "excludes loans." *Id.*

Since *James*, this Court has consistently held that bona fide loan proceeds are not gross income to the borrower, *see Indianapolis Power & Light Co.*, 493 U.S. at 207–08, because the receipt of the loan is offset by a corresponding future obligation to repay, *see Comm'r v. Tufts*, 461 U.S. 300, 308 (1983).

Critically, the *James* Court also established the principle that "the consensual recognition, express or implied, of an obligation to repay" is the hallmark of a true loan. *James*, 366 U.S. at 219; *see United States v. Pomponio*, 563 F.2d 659, 662 (4th Cir. 1977) ("[C]onsensual recognition" or "the taxpayer's own intention to repay" is the "sine qua non of a bona fide non-reportable loan.") (collecting cases). In other words, "[l]oans are identified by the mutual understanding between the borrower and lender of the obligation to repay and a *bona fide* intent on the borrower's part to repay the acquired funds." *Collins v. Comm'r*, 3 F.3d

625, 631 (2d Cir. 1993); *see also United States v. Beavers*, 756 F.3d 1044, 1057 (7th Cir. 2014) (explaining that "loan proceeds are not income because the taxpayer has incurred a genuine obligation to repay the loan" and that "the recipient must actually intend to repay" for a transaction to qualify as a loan).

B. The Courts of Appeals Have Split Regarding Implementation of the *James* Test.

The courts of appeals have split regarding whether factors *other than* intent bear on whether a transaction constitutes a non-taxable loan under *James*. As the Seventh Circuit observed in *Busch*, "[s]ome courts have viewed intent as merely one factor, and then have balanced that intent against various objective factors" while other courts have focused on intent alone and look to "objective factors" solely "as indications of intent." 728 F.2d at 948.

1. Under the majority approach, applied by the First, Second, Fourth, Sixth, and Seventh Circuits, the transacting parties' intent to adopt a repayment obligation is the "sine qua non of a bona fide non-reportable loan," *Pomponio*, 563 F.2d at 662–63, and objective factors serve only as "indications of intent," *Busch*, 728 F.2d at 948.

For example, in *Crowley v. Comm'r*, 962 F.2d 1077, 1079 (1st Cir. 1992), the First Circuit, applying *James*, held that "[a] shareholder distribution is a loan, rather than a constructive dividend, if *at the time of its disbursement* the parties *intended that it be repaid*." *Id.* (emphasis added). *Crowley* involved discretionary withdrawals from a closely-held

corporation of which the taxpayer and his three brothers were the only individual shareholders. Addressing a Tax Court finding that the taxpayer had failed to declare these withdrawals as taxable income, the First Circuit explained that the "inquiry concerns itself with the parties' *subjective intent, rather than objective intent*, although recourse to objective evidence is required to ferret out and corroborate actual intent." *Id.* (emphasis added). Thus, courts "determine whether the requisite intent to repay was present by examining available objective evidence of the parties' intention." *See id.*; *see also Bergersen v. Comm'r*, 109 F.3d 56, 59 (1st Cir. 1997) (applying *Crowley* test).

The Seventh Circuit likewise explained in *Busch* that "intent is the only factor" in "determining the character" of a transaction, such that the "better view is to treat such objective factors as indications of intent." 728 F.2d at 948–49 (cleaned up). Although "[a] court may look to various facts to determine intent, . . . once the taxpayer's intent is found, that finding is conclusive of the legal issue of loans versus dividends." *Id.* at 949; *see also VHC, Inc. v. Comm'r*, 968 F.3d 839, 842 (7th Cir. 2020) (holing that "[t]o determine whether [a debtor-creditor] relationship exists, we look to 'a number of factors' as 'indications of intent'"); *Frierdich v. Comm'r*, 925 F.2d 180, 183 (7th Cir. 1991) ("Such intent is demonstrated by the objective facts of each case from which the court has to determine Frierdich's actual intent or motive.").

Likewise, the Second, Fourth, and Sixth Circuits have maintained that consensual recognition of the obligation to repay sets a loan apart from taxable income, and that courts may look to objective criteria as

indicia of intent. *See Collins v. Comm'r*, 3 F.3d 625, 631 (2d Cir. 1993) (citing *James,* 366 U.S. at 219) ("Loans are identified by the mutual understanding between the borrower and lender of the obligation to repay and a *bona fide* intent on the borrower's part to repay the acquired funds."); *Buff v. Comm'r*, 496 F.2d 847, 848 (2d Cir. 1974) (explaining that "the lack of consensual recognition of an obligation to repay" element of *James* "distinguish[es] embezzlement from a loan"); *United States v. Amick*, No. 99-4557, 2000 WL 1566351, at *4 (4th Cir. 2000) (rejecting taxpayer's proposed jury instructions which "would have permitted the jury to discount intention to repay and place more emphasis on other factors"); *Pomponio*, 563 F.2d at 662–63 (reciting "sine qua non" rule quoted above); *Jaques v. Comm'r*, 935 F.2d 104, 107 (6th Cir. 1991) ("To determine whether the taxpayer intended to repay the withdrawals, courts have looked to a number of objective factors . . . .").[6]

2. In contrast, other circuits have transformed the *James* analysis into an amorphous multifactor test in which a variety of non-exclusive factors *going beyond intent to repay* are weighed to determine if a transfer

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[6] Tax Court rulings have repeatedly applied similar reasoning. *See, e.g.*, *M.J. Byorick, Inc. v. Comm'r*, 55 T.C.M. (CCH) 1037, 1047 (T.C. 1988) (inquiring into subjective intent, as borne out by objective factors); *Faist v. Comm'r*, 40 T.C.M. (CCH) 1128, 1132 (T.C. 1980) (same); *Pizzarelli v. Comm'r*, 40 T.C.M. (CCH) 156, 159 (T.C. 1980) (same); *Koufman v. Comm'r*, 35 T.C.M. (CCH) 1509, 1523 (T.C. 1976) (objective indicia provide "helpful guideposts" in determining "whether repayment was actually intended").

constitutes a loan. *See Busch*, 728 F.2d at 948 (collecting cases). The Third, Fifth, Ninth, and Tenth Circuits fall into this camp.

The Ninth Circuit's decision in *Welch*—which the D.C. Circuit cited and relied upon here—illustrates this intent-plus approach. The *Welch* court acknowledged that "[t]he conventional test is to ask whether, when the funds were advanced, the parties actually intended repayment." 204 F.3d at 1230 (citing the First Circuit's decision in *Bergersen*, 109 F.3d at 59, as one example). "However, courts have considered a number of other factors as relevant in assessing whether a transaction is a true loan," including "whether the promise to repay is evidenced by a note or other instrument" and "whether the borrower had a reasonable prospect of repaying the loan." *Id.* Under this more flexible test, "the factors are non-exclusive and no single factor is dispositive." *Id.* Subsequent authority reaffirms the Ninth Circuit's view that, "in addition to 'ask[ing] whether . . . the parties actually intended repayment,' courts are to employ [a] non-exhaustive, seven-factor test when determining whether a transaction constitutes a 'true loan.'" *Engstrom, Lipscomb & Lack, APC v. Comm'r*, 674 F. App'x 617, 619 (9th Cir. 2016) (citing *Welch*, 204 F.3d at 1230).

The Fifth Circuit likewise has applied multi-factor tests that reach beyond intent, under which "no one factor is controlling." *Estate of Mixon v. United States*, 464 F.2d 394, 402 (5th Cir. 1972); *see also MoneyGram Int'l, Inc. v. Comm'r*, 153 T.C. Rep. (CCH) 185, 215 (T.C. 2019) (collecting Fifth Circuit decisions "adopt[ing] . . . multi-factor (and partially overlapping) tests" to determine whether a transaction is a

loan for tax purposes). Consistent with this view, the Fifth Circuit upheld a Tax Court decision that relied on application of *Welch*'s seven-factor test in *Todd v. Comm'r*, 486 F. App'x 423, 426 (5th Cir. 2012).

Third Circuit precedent follows a similar path. For example, in *Merck & Co. v. United States*, 652 F.3d 475, 484–85 (3d Cir. 2011), the court, having evaluated both direct and indirect evidence of the taxpayer's intent to repay, went on to consider evidence of a novel third factor—"third-party involvement." In contrast to the Seventh Circuit's warning that the loan analysis begins and ends with intent, *see Busch*, 728 F.2d at 948, the *Merck* court went on to consider third party involvement even *after* determining that "consensual recognition" or "intent to repay" had been established, *see* 652 F.3d at 484; *see also Fin Hay Realty Co. v. United States*, 398 F.2d 694, 697 (3d Cir. 1968) ("neither any single criterion nor any series of criteria can provide a conclusive answer" for whether a transaction constitutes a loan).[7]

Rulings from the Tenth Circuit follow the same general approach. *See, e.g.*, *Williams v. Comm'r*, 627 F.2d 1032, 1034–1035 (10th Cir. 1980) (holding, based in part on Third and Fifth Circuit precedent, that objective circumstances must be balanced against shareholders' declarations of subjective intent to repay).

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[7] Although some Third Circuit cases recognize that "intent to repay" is the "one essential [factor] without which a transaction cannot be recognized as a loan," these cases also state that "various factors" beyond intent "must be weighed in determining for income tax purposes the true character of a purported loan." *Estate of Taschler v. United States*, 440 F.2d 72, 75 (3d Cir. 1971) (quoting *Comm'r v. Makransky*, 321 F.2d 598, 600 (3d Cir. 1963)).

The D.C. Circuit's decision in this case deepens the split. In the decision below, the D.C. Circuit held based on *Welch* and *United States v. Swallow*, 511 F.2d 514, 519 (10th Cir. 1975), that "[w]hether a borrower has the intent and ability to repay a purported loan is a factor in judging whether the transaction is in fact a loan for tax purposes." Pet. App. 7a. That test replaces the "consensual recognition" standard with an open-ended analysis in which the intent of the parties is simply one co-equal, non-dispositive factor. Indeed, the D.C. Circuit addressed intent to repay and ability to repay on equal footing, rather than treating ability to repay as a factor bearing on the ultimate question of intent, as in *Busch* and the other cases applying the majority rule. Although the D.C. Circuit considered intent, it concluded that the 2010 transfers between Han, Carlucci, and Russell were taxable income based in part on ability to repay, a separate issue. *See* Pet. App. 7a–8a.

II. Multifactor Tests that Consider Factors Other than the Parties' Intent Are Incompatible with *James* and Unworkable.

The test adopted in *James* turns on intent—i.e., whether there is a "consensual recognition, express or implied," that the transferee has "an obligation to repay" the transferor. 366 U.S. at 219. As a result, considerations other than the parties' intent have no independent legal relevance.[8] Tests that look to additional factors only as means of discerning intent are

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[8] Although *James* also refers to whether a transfer is "without restriction as to [the funds'] disposition," 366 U.S. at 219, that consideration is often not implicated, making "the taxpayer's

consistent with that framework, whereas tests that treat intent as a non-dispositive factor to be balanced against other considerations are not. *See Busch*, 728 F.2d at 948–49.

The latter, intent-plus approach invites error in two interrelated ways.

First, it encourages factfinders to determine that a transaction is (or is not) a bona fide, non-taxable loan without ever considering the parties' intent. For example, when a court treats factors such as whether repayment is evidenced by a note, or whether there is an ability to repay on the part of the borrower, as co-equal to the parties' intent, a factfinder may find that a party who intended to take out a loan, but did not memorialize it in a note, or whose ability to repay is contested, did not enter into a valid loan and therefore must pay tax on the proceeds without reaching the issue of intent. This risk is most acute when the factfinder lacks proper instruction regarding how to weigh each factor in the analysis. If no one factor is dispositive, the factfinder may choose any one factor and make a decision solely based on that factor, or a variety of factors, none of which include the intent of the parties at the time of the transaction.

Second, the intent-plus approach makes it possible to find that the parties genuinely intended a transaction to be a loan, but that the transaction nevertheless resulted in taxable income based on other factors. Alternatively, the intent-plus approach also

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own intention to repay" the only relevant factor in most cases. *Pomponio*, 563 F.2d at 662. Even when a use restriction is relevant, it constitutes the *only* other factor that may be considered under *James*.

makes it possible to find that a transaction is a loan based on other factors, despite the parties' intent that the transaction *not* be classified as such. The Third Circuit's decision in *Merck* illustrates this risk.

In *Merck*, the parties argued that their transaction was not, and was never intended to be, a loan. *See* 652 F.3d at 478–80. The Third Circuit came to a different conclusion after analyzing the parties' intent, whether there was an obligation to repay, and if the presence of a third party affected the nature of the transaction. *See id.* at 482–88. In this case, the intent-plus approach led to the transaction being considered a loan, contrary to the parties' stated intent. *See id.* at 481.

In addition, open-ended multi-factor tests often make it impossible to know what role "consensual recognition . . . of an obligation to repay" played in the factfinder's analysis. Here, for example, one cannot know whether the jury found that Han, Carlucci, and Russell intended the 2010 transfers to constitute loans at the time of the transactions because the only instruction the jury received on the issue—Agent Manion's testimony—referred to several other factors on a co-equal basis. *See* Pet. App. 35a–36a (referring to whether there was a loan document, whether there were repayment terms or actual repayments made on the loan, whether interest was imputed on the loan, whether there was an ability to repay the loan, and whether the recipient intended to repay the amount received). Similarly, because the D.C. Circuit looked to intent *and* ability to repay, it is unclear whether the court would have come to the same conclusion had intent served as the sole consideration, as under *Busch* and other cases employing the majority rule. A test

that prevents appellate courts from knowing what the factfinder concluded about the first (and often only) valid consideration identified in this Court's precedent is not workable, particularly in the context of criminal proceedings.

III. The Question Presented Has Practical Importance in a Broad Range of Circumstances.

The question presented also warrants this Court's review because it recurs frequently across a wide spectrum of circumstances. As the Fifth Circuit has observed, the "problem of recognizing genuine debt from spurious ones . . . arises in many contexts." *Alterman Foods, Inc. v. United States*, 505 F.2d 873, 876 (5th Cir. 1974); *see also* Steven L. Gleitman & Anatole Klebanow, *How To Establish That An Advance To A Shareholder Was A Loan*, 40 Tax'n for Acct. 100 (1988), *available at* 1988 WL 294292 ("One of the most common problems facing a closely held corporation is an IRS contention that an advance made to a shareholder was a dividend, not a loan."). Indeed, the split of authority described above has implications that go well beyond tax fraud prosecutions and has the potentiality to affect every taxpayer who borrows money from a third party.

Taxpayers, accountants, tax lawyers, the Internal Revenue Service, and courts alike, depend on certainty in the Tax Code. This Court has thus recognized the need to avoid inconsistent treatment of taxpayers and to prevent "inequalities in the administration of the revenue laws." *Comm'r v. Sunnen*, 333 U.S. 591, 599 (1948); *see also Rudolph v. United States*, 370 U.S. 269 (1962) (granting certiorari where

case presented important questions concerning the definition of terms under the Internal Revenue Code); *Colony, Inc. v. Comm'r*, 357 U.S. 28, 32 (1958) (granting certiorari where issue presented was "one of substantial importance in the administration of the income tax law"). With the courts of appeals applying diverging tests to identify loans, stakeholders cannot know with confidence how their transactions will be classified for tax purposes. As a result, taxpayers with even modest loans from friends or family may be adversely affected by the confusion regarding application of the *James* test.

IV. This Case Is an Excellent Vehicle to Address the Proper Test for Distinguishing Loans from Taxable Income.

Review is also warranted because this case squarely presents the issue that has divided the courts of appeals. Han pressed the issue below, arguing that the test outlined by Agent Manion's testimony did not comport with *James*. *See* note 5, *supra*. The D.C. Circuit then passed upon the issue, holding that a transferee's "intent *and* ability to repay" bear on "whether [a] transaction is in fact a loan for tax purposes." Pet. App. 7a (emphasis added). Indeed, the sole fact recited in the D.C. Circuit's opinion—that Han "did not have any independent money," Pet. App. 8a—focuses on ability to repay.

Further, the issue is potentially dispositive in this case, because it bears on a core element of the charged offense—whether the funds Han received in 2010 were non-taxable loan proceeds as opposed to unreported taxable income. *See Sansone,* 380 U.S. at 351. Although the Government presented evidence that

the funds were not loan proceeds, *see* Pet. App. 7a–8a, there was also considerable evidence (including expert testimony) that the transactions were valid loans, *see* Pet. App. 42a–46a. There is thus a reasonable probability that, had the jury been correctly instructed, it would have found Han not guilty on the ground that the 2010 transfers were non-taxable loans.

Finally, the shapeless multi-factor test applied by the D.C. Circuit opened the door to inflammatory and otherwise irrelevant evidence of alleged fraud, such as Han's expenditures on luxury items, on the theory that this evidence showed Han's knowledge, motive, and state of mind. *See* Pet. App. 6a–7a. This evidence tended to paint Han as guilty of fraud charges that were dismissed before trial and should not have played any role in the case.

CONCLUSION

For all of the reasons given above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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