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IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF UTAH, CENTRAL DIVISION

UNITED STATES OF AMERICA, Plaintiff, vs. RAPOWER-3, LLC, INTERNATIONAL AUTOMATED SYSTEMS, INC., LTB1, LLC, R. GREGORY SHEPARD, NELDON JOHNSON, and ROGER FREEBORN, Defendants.	Civil No. 2:15-cv-00828 DN **REPLY MEMORANDUM TO DEFENDANTS' OPPOSITION TO UNITED STATES' MOTION TO STRIKE JURY DEMAND** Judge David Nuffer

The United States moved to strike the jury demand filed by defendants RaPower-3, LLC, International Automated Systems, Inc., LTB1, LLC and Neldon Johnson ("defendants") because the remedies sought in this case, an injunction and disgorgement, are equitable in nature and

therefore there is no right to a jury trial.[1] Defendants opposed the United States' motion.[2] Defendants do not dispute that injunctive relief and disgorgement are equitable remedies. Rather they claim that the United States "oversimplifies the issue" because in order to obtain the injunctive relief it seeks under 26 U.S.C. § 7408, the United States must prove that the defendants engaged in conduct that is subject to penalty under 26 U.S.C. § 6700.[3] According to the defendants, if the United States is successful in this injunction suit, it "will try to collect the penalties" provided for in § 6700 and that if they are denied a jury trial in this case, their Seventh Amendment rights will have been violated.[4] As demonstrated below, several erroneous assumptions underpin defendants' argument. The assumptions include:

1. The United States will assess penalties pursuant to 26 U.S.C. § 6700;
2. The Court will find facts that prohibit them from contesting a money judgment for §6700 penalties; and
3. The Court will exclusively rely on § 7408, and not § 7402 to enjoin the defendants from promoting their solar energy tax scheme.

Defendants' reliance on these erroneous assumptions, misunderstanding of the nature of this action and unsuccessful attempt to distinguish case law that is unfavorable to them, demonstrate that the Court should grant the United States' motion to strike the defendants' jury demand.

I. This case presents only equitable claims.

The United States seeks two types of relief: an injunction and disgorgement. The cases cited in the United States' motion demonstrate that injunctive and disgorgement claims are purely

[1] Doc. No. 31.
[2] Doc. No. 32.
[3] *Id.* at 2.
[4] *Id.* at 3.

equitable. A jury trial is only available when "the plaintiff's claims are legal rather than equitable."[5]

The defendants do not cite any authority disputing that injunctive and disgorgement claims are equitable. Instead, defendants cite *Ross v. Bernhard*[6] and note that entitlement to a jury trial "depends on the nature of the issue to be tried rather than the character of the overall action." *Ross v. Bernhard* was a shareholders derivative suit in which the "corporation's claim [was], at least in part, a legal one" and sought "money damages."[7] The holding in *Ross* does not apply here because there are no legal claims at issue.

Further, the Supreme Court has rejected the premise of defendants' objection. Defendants claim that if the court makes factual findings against them in this case, their Seventh Amendment right to a jury trial will be violated if they are collaterally estopped from contesting those facts in a future case. "[A]n equitable determination can have collateral-estoppel effect in a subsequent legal action and [ ] this estoppel does not violate the Seventh Amendment."[8] The Court may make factual findings in this case, and the defendants be collaterally estopped from contesting these facts in a future case which would otherwise be tried before a jury, without violating the Seventh Amendment.

II. The IRS has not assessed any 26 U.S.C. § 6700 penalties.

The United States brought this action: (1) to enjoin defendants from promoting a fraudulent tax scheme; and (2) to disgorge the defendants' ill-gotten gains. These remedies are equitable in

[5] *Thompson v. Kerr-McGee Ref. Corp.*, 660 F.2d 1380, 1386 (10th Cir. 1981).
[6] 396 U.S. 531, 538 (1970)
[7] *Id.* at 542.
[8] *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 335 (1979).

nature and specifically statutorily prescribed in § 7408[9] and within the district court's broad authority under § 7402 to issue orders of injunction and disgorgement[10] "as may be necessary or appropriate for the enforcement of the internal revenue laws." Whether the United States opts to assess § 6700 penalties is an administrative, discretionary decision.

Defendants correctly note that in order to obtain injunctive relief against the defendants under § 7408, the United States must demonstrate that the defendants engaged in certain "specified conduct."[11] However, the defendants conflate an issue that is before the Court, *i.e.*, whether defendants' conduct warrants an injunction, with an issue not before the Court, *i.e.*, whether the defendants are liable for a money judgment for § 6700 penalties. Defendants contend that even though the United States did not seek a money judgment for § 6700 penalties in its complaint, the United States "would be entitled to collect such penalties." Defendants are incorrect. In order for the United States to administratively collect monetary penalties under § 6700, the IRS must first assess[12] such penalties. The IRS has not assessed the defendants with any § 6700 penalties and has yet to decide whether to do so in the future. Even assuming the United States prevails in this lawsuit, the United States is not permitted to administratively

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[9] *See United States v. Hansen*, No. 05cv0921-L(NLS), at 2-3, (S.D. Cal. Sept. 30, 2005) (unpublished) (copy attached to this document).

[10] *United States v. Demesmin*, 87 F. Supp. 3d 1293, 1298 (M.D. Fla. 2015)

[11] 26 U.S.C. § 7408(c) defines "specified conduct" as any "any action, or failure to take action," which is subject to penalty under*, inter alia,* section 6700. Section 7408(c)(1). Generally section 6700 requires that the Government prove that the defendant promoted an abusive tax shelter and that he knowingly made false statements about the tax benefits investors would receive if they participated in it. *United States v. Stover*, 650 F.3d 1099, 1106 (8th Cir. 2011). § 6700 penalties also apply when a promoter makes a gross valuation overstatement. *United States v. Campbell*, 897 F.2d 1317, 1320 (5th Cir. 1990).

[12] An assessment of a penalty (or tax) is the determination of the amount of the penalty and the official recording of the liability. *See Capozzi v. United States*, 980 F.2d 872, 874 (2nd Cir.

collect penalties unless, and until, it assesses the liabilities[13] and gives notice and demand to the taxpayer.[14] Contrary to defendants' argument, the United States is not seeking a money judgment "for the penalties allowable" under § 6700. In short, because § 6700 penalties are unassessed and because the United States' complaint does not seek a money judgment for § 6700 penalties, defendants' argument, that even though the United States' complaint "did not reques[t] that the Court award [ ] penalties, [the United States] would be entitled to collect such penalties" under Fed. R. Civ. P. 54(c) is unavailing.

The only remedies sought here are equitable in nature. Defendants do not dispute that, but they speculate as to what legal remedies the United States might seek in the future and ask this Court to ignore otherwise binding Supreme Court and Tenth Circuit precedent that parties to suits in equity are not entitled to a jury trial.[15]

III. Defendants erroneously assume that the Court will make findings of fact here that impair their rights in a hypothetical future suit to obtain a money judgment for § 6700 penalties.

Defendants assume that to support an injunction under § 7408, the Court will make findings of fact that the defendants engaged in penalty conduct under § 6700. The defendants further assume that these factual findings will impair their rights to defend against a future suit by the United States seeking a money judgment for some § 6700 penalties.

First, the IRS may very well decide not to assess § 6700 penalties against the defendants. For example, if the United States successfully enjoins the defendants from promoting their

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1992). 26 U.S.C. § 6203; Treas.Reg. § 301.6203-1. Liabilities cannot be administratively collected until after they are assessed. *Id.* 26 U.S.C. § 6502.

[13] 26 U.S.C. § 6201.

[14] 26 U.S.C. § 6303.

scheme and the Court orders them to disgorge their ill-gotten gains, the IRS could decide against assessing § 6700 penalties because this case will have had an adequate deterrent effect, or because the IRS later determines that paying the disgorgement award effectively rendered any § 6700 penalty judgment uncollectible.

Second, as the defendants note, "[i]n calculating the amount of the penalty," the organizing of a plan or arrangement and the sale of each interest in a plan or arrangement "constitute separate activities."[16] Thus, the amounts of any potential § 6700 penalty assessments depends on facts which are currently unknown. To be sure, the IRS does not presently know the exact number of transactions that the defendants engaged in and the exact amount of each transaction. The defendants are potentially liable for a § 6700 penalty for each transaction they promoted and for which they made false statements. Based on filed cases in the United States Tax Court, the United States has alleged that the defendants have at least 70 customers. The correct number of customers may be significantly higher. This Court may not consider all of the defendants' § 6700 conduct and it could easily resolve this case by considering the defendants' § 6700 conduct with respect to only a subset of all customers. That would involve the Court making narrowly-tailored findings of § 6700 penalty conduct (for some or all of the defendants), that do not necessarily involve determining whether each defendant engaged in § 6700 conduct for the same transactions, and leave some of the defendants' § 6700 penalty conduct unconsidered. The IRS could then potentially assess penalties for § 6700 transactions and conduct that this Court does not even consider in making its findings. Thus, defendants improperly assume that (1) the IRS

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[15] *See, e.g.*, *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 311 (1982); *United States Securities and Exchange Commission v. Maxxon, Inc.* 465 F.3d 1174, 1179 (10th Cir. 2006).
[16] H.R. Rep. 101-247, at 1397 (1989).

will assess the penalties; (2) that the United States will seek a money judgment, and (3) that this court will make findings about *all* § 6700 conduct when the United States will likely not present evidence about *all* of defendants' false statements in this case.[17]

If the IRS later determines that penalties are appropriate, the IRS will make assessments. Because there is no statute of limitations on the assessment of § 6700 penalties,[18] Congress permits the IRS an unlimited period of time to make this determination. Defendants are attempting to force the United States to litigate the issue of whether the defendants are liable for a money judgment for unknown, unassessed § 6700 penalties before the IRS has even determined whether to assess any § 6700 penalties, let alone determined which specific transactions or conduct might form the basis for a penalty assessment, and before the statutory pre-requisites are present for either a refund suit brought by a taxpayer under 26 U.S.C. § 7422[19], or a suit by the United States to reduce assessments to judgment. If the IRS assesses the defendants with § 6700 penalties, and the issue of their liability for a money judgment arises in a case before a district court, the defendants will then be entitled to a jury trial because that claim will be legal in nature.[20]

Only when "equitable and legal claims *are joined in the same action*" is a party entitled to have the legal portions of the case heard by a jury.[21] In this case legal and equitable claims are

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[17] Indeed, it is unlikely that this Court, or any other court, would allow the United States to call 70 or more witnesses.
[18] *Capozzi*, at 875.
[19] 26 U.S.C. § 7422 requires a taxpayer to fully pay the tax assessment, file an administrative claim for refund, and if it is denied, only them may the taxpayer file a suit for refund in the district court. *See Flora v. United States*, 362 U.S. 145 (1960).
[20] *Nagy v. United States*, 519 F. Appx. 137, 139 (4th Cir. 2013).
[21] *Ross v. Bernhard*, 396 U.S. 531, 538 (1970) (emphasis added) (*citing Beacon Theatres Inc. v. Westover*, 359 U.S. 500 (1959); *Dairy Queen Inc. v. Wood*, 369 U.S. 469 (1962)).

not joined. The purpose of this suit is to stop the harmful conduct and disgorge the defendants' ill-gotten gains. The United States is ***not*** now seeking a money judgment for any penalties. Whether the United States seeks a judgment for some amount of § 6700 penalties is yet to be determined.

Finally, defendants also ignore the possibility that the Court could issue an injunction solely under 26 U.S.C. § 7402, which does not require the United States to prove, or the Court to make, any specific findings of § 6700 penalty conduct. § 7402 only requires that the Court conclude that an injunction "is necessary or appropriate for the enforcement of the internal revenue laws." Because the Court could grant the United States' request for an injunction under § 7402, and not § 7408, then defendants' arguments about the need for a jury trial further lack merit.[22]

IV. The Defendants' attempt to distinguish *Hempfling* is unavailing.

Defendants cite *United States v. Hempfling*,[23] in which a district court denied a defendants' jury demand in a similar context. Defendants attempt to distinguish *Hempfling* because they claim to be "legitimate" and "engaged in a business the public deems important enough to incentivize" with tax credits. Defendants' self-serving statements are unsupported by any evidence in the record. Whether defendants are conducting a legitimate business is an issue that this Court will decide in due course. Defendants' favorable self-characterizations do not distinguish this case from the simple matter of law stated in *Hempfling*: in a case brought by the United States seeking an injunction under § 7408, defendants are not entitled to a jury trial.

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[22] The United States believes there are grounds for an injunction under both §§ 7402 and 7408, and will pursue this case under both statutory authorities, however this decision ultimately rests with the Court.

[23] 2007 WL 1994069 (E.D. Cal.).

Other district courts have made similar rulings.[24] In *Hansen*, the court specifically noted that both §§7402 and 7408 do not provide for a jury trial when the United States seeks injunctive relief and that § 7408 "expressly states that the *court* is to issue an injunction should the evidence show the defendant engaged in certain specified conduct"[25] (emphasis added). The *Hansen* court considered whether § 7408 injunctions were historically tried to juries and whether the relief sought is legal or equitable in nature and found in favor of the United States. Because a suit for injunctive relief "sounds in equity," neither party is entitled to a jury trial.[26]

CONCLUSION

For these reasons, the United States requests that the Court grant the United States' motion to strike the defendants' jury demand.

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[24] *See Hansen*, *supra* at 3, n.9.
[25] *Id.*, at 4, n. 3
[26] *Id.,* at 4.

CERTIFICATE OF SERVICE

I hereby certify that on March 18, 2016. The foregoing document was electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to the following:

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