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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 **UNITED STATES' BRIEF REGARDING ISSUES OF "TRADE OR BUSINESS" AND "PLACED IN SERVICE"** Judge David Nuffer Magistrate Judge Evelyn J. Furse

I. Introduction

This Court has requested briefing on two concepts relevant to whether a taxpayer may lawfully claim a depreciation expense on his federal income tax return: what it means to be in a "trade or business" and what it means to have equipment "placed in service." These concepts are relevant to this case because Defendants make money by selling purported "solar lenses" to customers, which the customers purportedly lease to LTB, LLC. Although LTB is a company that exists only on paper,[1] Defendants tell customers that LTB will operate and maintain the customer's lens for them, as part of a system that will generate electricity. Defendants tell customers that LTB will sell electricity to a third-party power purchaser, and then pay customers "rental income" for use of their lenses.[2] But Defendants' purported technology has not worked, does not work, and will not work, to use solar radiation to generate electricity or other useable energy, much less any rental income from a third-party purchaser.

Nonetheless, Defendants have assured their customers (for more than *10 years*) that, by purchasing lenses, customers may claim a depreciation deduction and a solar energy tax credit.[3] Among the underpinnings of Defendants' solar energy scheme are their statements that

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[1] LTB has never done anything; it has never had a bank account, any employees, or any revenue. ECF No. 256-17, Pl. Ex. 673, Deposition of LTB1, LLC, July 1, 2017, 10:10-11:1, 14:7-16:7, 18:2-9, 42:10-43:5; 69:6-74:21, 90:19-91:8. LTB and Defendant LTB1, LLC, are indistinguishable. *Id.* 11:9-15.

[2] ECF No. 256-15, Pl. Ex. 581, Deposition of International Automated Systems, Inc., June 29, 2017, 162:1-165:9, 171:10-173:20; ECF No. 256-8, Pl. Ex. 532 at 6; *see also* ECF No. 256-7, Pl. Ex. 531 at 1-6.

[3] As explained in more detail in the United States' Proposed Findings of Fact and Conclusions of Law (ECF No. 334 at 92-93), a taxpayer is not allowed the solar energy tax credit under § 48 on property that is not eligible for depreciation. § 48(a)(1); 26 C.F.R. § 1.46-3(d)(1) & (2); § 48(a)(3)(A)(i) & (C); see also 26 C.F.R. § 1.48-9(d)(1). Because the solar lenses are not eligible for depreciation, as explained herein and also in the United States' Proposed Findings of Fact and Conclusions of Law, they are not eligible for the solar energy tax credit and Defendants knew or had reason to know it.

customers may claim a depreciation deduction for the lenses they buy because 1) their customers who bought and then purportedly leased the lenses to LTB were in a "trade or business" and bought the lenses for the purpose of making a profit;[4] and 2) customers' lenses were "placed in service" in the tax year in which the customers bought the lenses.

These statements are false or fraudulent as to material matters under the internal revenue laws, and Defendants knew or had reason to know it.[5] Defendants knew, or had reason to know, that their customers were not in a trade or business with respect to the lenses and were not holding the lenses for the production of income. Defendants knew or had reason to know that their customers' lenses were not "placed in service." And therefore Defendants knew, or had reason to know, that their customers were not allowed a depreciation deduction or the solar energy tax credit. For these and other reasons, Defendants should be enjoined from continuing to make these false or fraudulent statements that harm the United States Treasury.

II. Argument

A district court may enjoin any person from engaging in conduct subject to penalty under 26 U.S.C. § 6700 if injunctive relief is appropriate to prevent recurrence of that conduct or any other activity subject to penalty under the Internal Revenue Code.[6] Section 6700(a)(2)(A) creates a penalty for a person who 1) organizes or sells any plan or arrangement involving taxes and 2) makes or furnishes, or causes another to make or furnish, a statement connecting the allowability

[4] *E.g.*, ECF No. 254-1, Pl. Ex. 1 at 2-3.

[5] 26 U.S.C. § 6700(a)(2)(A); ECF No. 2, Counts VII-XI. The United States incorporates by reference its discussion of these topics in its Proposed Findings of Fact and Conclusions of Law. (ECF No. 334 at 2-65, 70-93.)

[6] 26 U.S.C. § 7408(b).

of a tax benefit with participating in the plan or arrangement, which statement the person knows or has reason to know is false or fraudulent as to any material matter.[7] This standard does not turn on whether the promoter believed his own hype, or whether his customers believed his hype.

Promoters are charged with knowledge of the law governing the tax benefits they promote.[8] Statements about "material matters" include those that "directly address[]" the tax benefits purportedly available to a participant in a tax scheme and those that "concern[] factual matters that are relevant to the availability of tax benefits."[9] "Material matters are those which would have a substantial impact on the decision-making process of a reasonably prudent investor and include matters relevant to the availability of a tax benefit."[10] "There is no matter more material to the sale of a tax avoidance package than whether the package effectively allows customers to avoid taxes."[11]

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[7] 26 U.S.C. § 6700(a)(2)(A).

[8] *See, e.g.*, *United States v. Campbell*, 704 F. Supp. 715, 725 (N.D. Tex. 1988) ("The Coral program was based on the deduction for research and experimental expenditures allowed by [I.R.C. § 174]. That section permits an electing taxpayer to currently deduct from gross income (rather than to amortize) the amount of expenditures 'paid or incurred' for research and experimental activities. Acquiring a project completed before the date of acquisition would not constitute an expenditure for research and experimentation under Section 174." (citation omitted)); *United States v. Music Masters, Ltd.*, 621 F. Supp. 1046, 1055 (W.D.N.C. 1985) ("Under Section 46(c) of the Code, property must be placed in service in the year for which an investment tax credit is claimed. Music Masters represented to investors that these masters were purchased in 1982 and that the investors could deduct the investment tax credits for that year. These were material false statements, since the availability of credits for the 1982 year would have a substantial impact on a reasonably prudent investor in the investment program." (citations omitted)).

[9] *United States v. Campbell*, 897 F.2d 1317, 1320 (5th Cir. 1990); *United States v. Benson*, 561 F.3d 718, 724 (7th Cir. 2009); *United States v. United Energy Corp.*, No. C-85-3655-RFP (CW), 1987 WL 4787, at *9 (N.D. Cal. Feb. 25, 1987).

[10] *Campbell*, 897 F.2d at 1320; *United States v. Buttorff*, 761 F.2d 1056, 1062 (5th Cir. 1985).

[11] *Benson*, 561 F.3d at 724; see *United States v. Stover*, 650 F.3d 1099, 1111 (8th Cir. 2011) (affirming district court's finding that a promoter's promises of numerous tax advantages induced customers to purchase his tax arrangements).

A statement about a material matter is false in the tax law context if "untrue and known to be untrue when made."[12] A statement about a material matter can also be false because of what a promoter fails to say.[13] A promoter who does not tell customers all of the requirements to lawfully claim a deduction or credit has made a false statement.[14] A promoter who does not tell customers all of the facts relevant to whether the customers may lawfully claim a deduction or credit has made a false statement.[15]

Here, Defendants' statements about "material matters" go to the law and facts applicable to whether their customers were allowed a depreciation expense deduction. Under the proper circumstances, the Internal Revenue Code allows a taxpayer engaged in a trade or business

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[12] *Stover*, 650 F.3d at 1108.

[13] 26 U.S.C. § 7408(c) (conduct subject to injunction is "any action, *or failure to take action*" which is subject to certain penalty provisions or the regulations governing practice before the IRS (emphasis added)); *Stover*, 650 F.3d at 1109 (8th Cir. 2011) ("Stover's statements regarding all three schemes were also false because of what he failed to convey: that deductions taken under 26 U.S.C. § 162(a) must be 'ordinary and necessary' for the deducting business. The district court found that Stover 'advised his clients to set up these entities in order to save taxes without also advising them of the potential pitfalls and the actions necessary to guard against the obvious conclusion that the transaction was a sham and bore no relation to reality.' . . . [C]ourts have repeatedly held that a tax promoter's failure to advise his clients of the requirements for a proper deduction qualifies as a false statement."); *United States v. Gleason*, 432 F.3d 678, 682-683 (6th Cir. 2005) (affirming district court's finding that a defendant "made false statements about the purported home-based business deductions" that the defendant claimed could be derived from using his abusive tax scheme because the defendant "did not properly qualify his assertions about the deductibility of weddings, college, travel, meals, golf, cars, and everyday household expenses by stating that business expenses must be 'ordinary and necessary' to the business, and that personal consumption expenditures must be 'inextricably linked to the production of income[.]'" (internal citations omitted)); *United States v. Elsass*, 978 F. Supp. 2d 901, 935 (S.D. Ohio 2013) (listing "examples of false statements made by [the defendants], keeping in mind that statements can be false based on what they fail to convey").

[14] *E.g.*, *Stover*, 650 F.3d at 1109 ("When Stover's client Donald Clark questioned whether it was a 'legal and standard practice' to create sham management companies solely for tax savings purposes, Stover replied that it was. Stover's statements were false because they untruthfully conveyed that his clients' tax arrangements did not need to have economic substance.").

[15] *United Energy Corp.*, 1987 WL 4787, at *9 (among the false statements that the defendants made were "representations that [solar energy equipment] modules would be installed by the end of the year of purchase and that the solar farms were operational, letters stating that modules were installed and available for service, and statements reflecting payments for power that was never produced. The income projections also constituted false statements, as did, in some instances, the statement that a module existed at all.").

certain tax deductions for expenses the taxpayer incurs while generating income. One "business" deduction is for depreciation, the "wear and tear" on property either used in the taxpayer's "trade or business" or held by the taxpayer "for the production of income."[16] If a taxpayer is *not* in a trade or business, or is *not* holding property for the production of income, the analysis ends. The taxpayer is *not* eligible for a deduction for depreciation on that property.[17]

If the taxpayer is in a trade or business, or is holding property for the production of income, however, the analysis continues. The period of depreciation for an asset in an ongoing business begins when the property is "placed in service."[18] "Property is first placed in service when first placed in a condition or state of readiness and availability for a specifically assigned function."[19] If the property is not placed in service, the analysis ends. The taxpayer is not allowed a depreciation deduction.

A. Defendants knew, or had reason to know, that their customers were not in a trade or business with respect to solar lenses and were not holding the lenses for the production of income.

When a court is evaluating an individual's income tax liability, the first step in the analysis of whether a taxpayer is in a "trade or business" (such that depreciation and/or the solar energy credit may be allowed) is to determine whether the taxpayer has undertaken activity for

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[16] 26 U.S.C. § 167(a).

[17] § 167(a). "Depreciation . . . [is] not allowed on assets acquired for a business that has not begun operations." *Piggly Wiggly S., Inc. v. Comm'r of Internal Revenue*, 84 T.C. 739, 745 (1985); *United Energy Corp.*, 1987 WL 4787, at *11 ("[T]he term 'placed in service' refers to an asset that is 'available for service' but not yet actually in use only if the taxpayer is engaged in an ongoing trade or business and the asset is not yet in service for reasons beyond the taxpayers control."); *see also id.* at *10.

[18] 26 C.F.R. § 1.167(a)-10(b).

[19] 26 C.F.R. § 1.167(a)-11(e)(1)(i) (26 C.F.R. § 1.46-3(d)(1)(ii) and (d)(2) "shall apply for the purpose of determining the date on which property is placed in service").

that purported "trade or business" in good faith, with the primary purpose of the activity to make a profit – or, instead, has bought into an abusive tax scheme designed to create tax losses.[20] But in this case, this Court is not called upon to determine the individual income tax liability for any of Defendants' customers (much less *all* of Defendants' customers[21]). Here, the Court is examining *Defendants' statements* that their customers were in the trade or business of holding out solar lenses for lease, and whether Defendants knew, or had reason to know, that those statements were false or fraudulent.[22]

Defendants briefly acknowledge this standard, and claim that "Defendants[] Believed Customers were in the 'Trade or Business.'"[23] Defendants never squarely address however, exactly what "trade or business" they believed their customers were in or why Defendants purportedly believed it. Defendants never squarely address the facts about the solar energy scheme that they knew or had reason to know. Instead, they state the vague conclusion that they believed customers were in "the" trade or business. Then they invite the Court to examine the subjective beliefs of each and every customer to determine whether each customer believed or

[20] 26 U.S.C. §§ 162(a), 183, 7701(o)(1)(A) (for a transaction to be recognized for tax purposes, the transaction must "change[] in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position"); *Nickeson v. Comm'r*, 962 F.2d 973, 976-77 (10th Cir. 1992). Often, this question is before a court when an individual taxpayer claims to have a "trade or business" and therefore seeks business-related tax deductions and/or credits. *E.g.*, *Sala v. United States*, 613 F.3d 1249 (10th Cir. 2010), *as amended on reh'g in part* (Nov. 19, 2010); *Nickeson*, 962 F.2d at 976-78; *Keeler v. Comm'r*, 243 F.3d 1212, 1218-20 (10th Cir. 2001); *Jackson v. Comm'r*, 966 F.2d 598, 601 (10th Cir. 1992).

[21] *C.f.* ECF No. 384 at 6-7.

[22] *E.g.*, *Campbell*, 704 F. Supp. at 726-28; *United Energy Corp.*, 1987 WL 4787, at *9; *Music Masters*, 621 F. Supp. at 1056.

[23] ECF No. 384 at 5.

hoped he might someday profit (apart from the promoted tax benefits) from the lenses.[24] The court should decline that invitation. The Court is not evaluating Defendants' customers' subjective beliefs or their individual income tax liabilities. It is evaluating Defendants' statements about tax benefits from the solar energy scheme in light of the facts that Defendants knew, or had reason to know, about the solar energy scheme.

At minimum, Defendants had "reason to know" that their solar energy scheme is an abusive tax scheme rather than a bona fide trade or business for their customers, and that their statements about tax benefits were false or fraudulent. Common red flags that courts have identified as showing an abusive tax scheme include: 1) continued failure of a purported "business" to perform and earn income; 2) control of the purported business remaining with the promoter, rather than the customer; 3) illusory contract documents with little cash outlay by the customer and substantial debt or obligation that the customer is unlikely to pay; and 4) a promoter's heavy emphasis on greatly reducing or eliminating a customer's tax liability by buying in to the plan.[25] Courts have rejected abusive tax schemes with these features.[26] The

[24] *See generally* ECF No. 384 at 5-10.

[25] *E.g.*, *Nickeson*, 962 F.2d at 976-77; *Music Masters*, 621 F. Supp. at 1049-50; *United Energy Corp.*, 1987 WL 4787, at *1-8.

[26] *See Rose v. Comm'r*, 88 T.C. 386, 413 (1987) (collecting cases), *aff'd* 868 F.2d 851 (6th Cir. 1989), *not followed on other grounds as stated in Bank of New York Mellon Corp. v. Comm'r*, 106 T.C.M. (CCH) 367 (T.C. 2013); *United States v. Philatelic Leasing*, 794 F.2d 781, 782-85 (2d Cir. 1986); *United States v. Petrelli*, 704 F. Supp. 122, 124 (N.D. Ohio 1986) (concluding that defendants violated § 6700 when they "entered into lease agreements with investors who leased master photographs and plates from the defendants. Defendants advised the lessees of the master photographs and plates to claim investment tax credits and deductions for the leased art work and plates allegedly made therefrom, some of which never existed.").

objective facts of a particular scheme weigh heavier in this analysis than self-serving statements about a customer's profit motivation for entering the scheme.[27]

These red flags are present here.[28] Defendants knew, or had reason to know, that no customer would earn income from buying solar lenses because they knew that their purported solar energy technology did not, and would not, work to generate electricity or other useable energy from solar radiation. Therefore, no customer would earn income from "leasing out" his lenses for the purpose of generating electricity or other useful energy. In fact, no customer has made any money from his lenses being used in a system to generate electricity or other useful energy.[29] No customer has been paid for the use of his lenses for *any* reason. And, despite their misrepresentation to this Court about Robert Rowbotham's testimony,[30] Defendants knew it.

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[27] *E.g.*, *Cooper v. Comm'r*, 88 T.C. 84, 109 (1987).

[28] The United States incorporates by reference its more detailed discussion of these topics in its Proposed Findings of Fact and Conclusions of Law. (ECF No. 334 at 73-88.)

[29] Johnson has testified that he or RaPower-3 (and not a third party power purchaser) paid a single customer a single check for having used her lenses to generate electricity that was used at Johnson's former grocery store in 2010. (ECF No. 256-25, Pl. Ex. 682, Deposition of RaPower-3, LLC ("RaPower-3 Dep.") 6:18-7:23; ECF No. 254-42, Pl. Ex. 188,) There is no evidence to support this story other than Johnson's self-serving testimony. The credible evidence shows that Johnson's purported system has never worked to generate electricity. *E.g.*, Trial Tr. 85:24-87:1. Further, correspondence to and from Johnson before the check was sent out leads to the conclusion that this customer was not paid for the production of any electricity. Instead, Johnson sent her a check because her CPA asked why she had not received promised income from "energy sales" using her lenses. (RaPower-3 Dep. 18:9-19:3; ECF No. 256-32, Pl. Ex. 690, Deposition Designations for Roger Halverson 43:22-53:24 (Oct. 18, 2016); ECF No. 254-40, Pl. Ex. 185; ECF No. 254-41, Pl. Ex. 186. ECF No. 256-27, Pl. Ex. 685, Deposition of R. Gregory ("Shepard Dep.") 34:18-35:24, 67:1-12 93:17-94:13; ECF No. 255-8, Pl. Ex. 279, at 1.

[30] Defendants claim that Rowbotham testified that "he was paid five years' rent." ECF No. 384 at 5. The citation at the end of that sentence does not support this assertion. Instead, Rowbotham clearly testified that any income he had received as a result of participating in the solar energy scheme was from sales of lenses made by people in his multi-level marketing "downline." These payments were *not* from rental payments for use of his lenses to generate electricity or other useful energy:

Q. Mr. Rowbotham, what income, if any, have you received from your lenses?

A. I have received a monthly check from RaPower3 for the last three, four or five years.

(continued...)

Further, Defendants knew, or had reason to know, that their customers never took control of their purported solar lenses. Johnson controlled the entire process, from start to finish, of their customers' purported foray into the "solar lens leasing business." Johnson controlled all terms of the transaction, and all of the entities with which the customer enters the transaction. He decided whether and when to install a customer's lens in a tower, which (according to Defendants' transaction documents) is a prerequisite to the lens generating any income. Defendants told customers how little effort they will be required to expend in their "solar lens leasing business." Customers know nothing, for example, about LTB, the entity to which they have purportedly "leased" their lenses.

Defendants also knew, or had reason to know, that the transaction documents underlying the solar energy scheme were illusory and would never be enforced. They feature substantial

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(…continued)

Q. And what's that check for?
A. The distribution of sales based upon the RaPower3 multilevel marketing system.
Q. Okay. You testified about the multilevel marketing system earlier. And you described a commission based payment scheme?
A. Yes.
Q. Okay. Would it be fair to say that you get commissions from your downline?
A. Yes.
. . .
Q. What income have you received from your solar lenses besides commission checks?
A. Nothing.

Trial Tr. 933:19-934:7, 935:14-16; *see also id.* at 933:11-18, 934:8-935:13.

deferred debt "borrowed" at no interest, backed by non-recourse promissory notes, which will purportedly be paid out of proceeds from the never-operational solar energy technology itself.[31]

Further, Defendants sold lenses by emphasizing that customers could greatly reduce or eliminate his income tax liability.[32] They told people to calculate the number of lenses to buy based on their anticipated tax liability. According to Shepard's sample Form 1040, a customer should end up buying enough lenses so that the amount of their depreciation deduction would "get [their adjusted gross income] low enough for zero taxes."[33] If that was not enough, Shepard told customers to claim solar energy tax credits "if needed" to reach the goal of "zero" taxable income.[34]

These objective facts show that Defendants knew or had reason to know that their statements to customers that they were in a "trade or business" with respect to the lenses, or were holding the lenses for the production of income, were false or fraudulent as to both facts and law. But Defendants' brief ignores these objective facts, just as Defendants have ignored them for the

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[31] *See Nickeson*, 962 F.2d at 977 (one hallmark of an abusive tax scheme is nonrecourse indebtedness); *Philatelic Leasing*, 794 F.2d at 786; *see Music Masters, Ltd..*, 621 F. Supp. at 1054.

[32] *Blum v. Comm'r*, 737 F.3d 1303, 1311 (10th Cir. 2013) ("Evidence that a transaction was designed to 'produce a massive tax loss' indicates the transaction lacks economic substance."); *Stover*, 650 F.3d at 1110 (that money would "forever escape taxation" was a "key selling point" and an indicator of an abusive tax scheme). *See also United States v. Hartshorn*, 751 F.3d 1194, 1204 (10th Cir. 2014) ("Paying income taxes is a statutory duty; some also consider it a civic duty. Few gladly pay, but most faithfully do. Faithful compliance is tested, sometimes beyond elastic limits, by the siren's song of the unscrupulous — pay 10% of your income to the 'church' and completely avoid the much higher extractions demanded by the taxman AND do so without changing your life circumstances in any significant manner. Sounds great! To the unprincipled or the naïve, it is precisely what the doctor ordered. It is also illegal.") (O'Brien, J., concurring); *Nickeson*, 962 F.2d at 977 (one hallmark of an abusive tax scheme is "marketing on the basis of projected tax benefits"); *Keeler*, 243 F.3d at 1220 ("the fact that taxpayer's losses offset almost all of his income--100% and 97%, respectively, in 1981 and 1982--indicates his primary motivation was tax avoidance and not profit potential").

[33] ECF No. 254-12, Pl. Ex. 40 at 13; ECF No. 255-40, Pl. Ex. 490, at 9-10.

[34] Pl. Ex. 40 at 13; Shepard Dep. 240:4-11. *See also* ECF No. 254-36, Pl. Ex. 158 at 15; Shepard Dep. 243:3-9; Pl. Ex. 490 at 9-10.

past 10-plus years. Instead, they argue that if the Court finds that just one customer believed or hoped to make a profit someday (even after 10 years of nothing) then all of their customers must have been in business and, therefore, Defendants' statements about being engaged in a business were not false or fraudulent. They attempt to use Robert Rowbotham as an example of what Defendants' customers may have believed about whether they were in a trade or business related to the solar lenses. But Defendants' customers' subjective beliefs are not relevant under the standard for § 6700(a)(2)(A).

And even if Defendants' customers' subjective beliefs were somehow relevant here, they would not exonerate Defendants. As an initial matter, and contrary to Defendants' unsupported assertion,[35] Rowbotham could not have been more clear: he has a business in the fitness industry, called Bigger, Faster, Stronger.[36] He is not in a trade or business related to solar lenses.[37] And even if Defendants' customers state a belief that they are in a trade or business with respect to solar lenses, that belief was instilled *by Defendants' false statements*. Of course their customers are going to say, for example, that they thought they would make a profit if they bought lenses[38]: Defendants *told them* to expect a profit from rental income and bonus income.[39] Defendants *told them* about "[g]reat progress" being made on the purported solar energy technology.[40] The only

[35] ECF No. 384 at 10 (that Rowbotham "believes he is in a trade or business" related to solar lenses).

[36] Trial Tr. 897:6-898:19, 901:8-903:4, 908:17-909:3, 909:16-23.

[37] Trial Tr. 909:16-23.

[38] *See* ECF No. 384 at 7.

[39] *E.g.* Trial Tr. 920:15-921:1.

[40] *E.g.*, ECF No. 254-3, Pl. Ex. 8A at 10; ECF No 254-37, Pl. Ex. 159.

information Defendants' customers had about the technology and the transactions in the solar energy scheme came from Defendants themselves.[41] Therefore, their customers' subjective beliefs are not worth an ounce of weight in contrast to the objective facts that Defendants knew, or had reason to know, about the solar energy scheme.[42]

For all of these reasons, Defendants knew, or had reason to know, that their customers were not allowed a depreciation expense deduction. Defendants' statements to the contrary were false or fraudulent. The analysis on this issue is over.

B. Defendants knew, or had reason to know, that their customers' solar lenses were not "placed in service."

Assuming a taxpayer has begun operations in a bona fide trade or business, however, the analysis of whether depreciation may apply to a particular asset in that business continues. The taxpayer may begin depreciating an asset in the tax year during which it is "placed in service."[43] "Property is first placed in service when first placed in a condition or state of readiness and availability for a specifically assigned function."[44] Defendants have offered multiple reasons that lenses were placed in service in the tax year in which the customer bought them, none of which are consistent with the internal revenue laws.

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[41] *E.g.* Trial Tr. 920:15-921:1, 928:14-929:22, 931:18-933:18.

[42] *See Cooper v. Comm'r*, 88 T.C. 84, 109 (1987). The majority of cases Defendants cite regarding the "trade or business" issue result in the court rejecting the taxpayer's subjective statement of intent in favor of the objective facts showing that the taxpayer was not in a trade or business.

[43] 26 C.F.R. § 1.167(a)-10(b).

[44] 26 C.F.R. § 1.167(a)-(11)(e)(1)(i) (26 C.F.R. § 1.46-3(d)(1)(ii) and (d)(2) "shall apply for the purpose of determining the date on which property is placed in service").

1. The solar lenses were not "placed in service" when Defendants' customers signed an illusory agreement to "lease" the lenses to LTB, a company that has never done anything.

The first explanation is that the lenses were "placed in service" in their customers' "lens leasing businesses."[45] To Defendants, the fact that customers signed a contract to "lease" their lenses to LTB was sufficient to show that their lenses were in a "state of readiness" to be leased, and therefore were placed in service.[46] Defendants rely on two cases as ostensible support for the idea that property is "placed in service" when someone "holds it out for lease": *Cooper v. Comm'r*, 88 T.C. 84, 109 (1987) and *Waddell v. Comm'r*, 86 T.C. 848, 898 (1986).

But in those cases, the Tax Court first found that the objective facts showed that the taxpayers entered into leasing activities with a bona fide profit objective – meaning that (unlike Defendants' customers) the taxpayers actually had a leasing business.[47] In *Cooper*, the taxpayers "purchased the [solar hot water heater] equipment from one party (A.T. Bliss) and leased it to another (Coordinated). Coordinated had an identity separate from A.T. Bliss."[48] The taxpayers "realized a small but steady profit in every year."[49] The installation company's "efforts to install the systems on homes were vigorous, and ultimately successful."[50] Similarly, in *Waddell*, the

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[45] *See* ECF No. 384 at 5.

[46] *E.g.*, Pl. Ex. 1 at 3; ECF No. 162-3, Pl. Ex. 231 at 4.

[47] *Cooper*, 88 T.C. at 109 ("we believe that petitioners entered into their leasing activities with a bona fide objective to make a profit"); *Waddell v. Comm'r*, 86 T.C. 848, 894 (1986) ("Based on the entire record, we are persuaded that petitioners acquired and operated their ECG terminal franchises with the actual and honest objective of earning real monetary profits.").

[48] *Cooper*, 88 T.C. at 103.

[49] *Cooper*, 88 T.C. at 110.

[50] *Cooper*, 88 T.C. at 110.

trial court found a "strong inference of and operation of ECG terminal franchises by experienced business persons and investors" like the taxpayers.[51] The firms from which the taxpayers bought the franchise and then leased the ECG terminals to were independent of one another.[52] The taxpayers and their advisor engaged in a business analysis made regarding the market for the ECG terminal franchise.[53] Further, the terminals were placed with third-party end-users.[54] The facts of *Cooper* and *Waddell* are not the same as (or even similar to) the facts in this case. As described above, the objective facts about the transactions and purported solar energy technology informed Defendants that the "lens leasing" businesses they promoted to customers did not and would never generate income, or otherwise be bona fide and ongoing businesses.

Only after the courts in *Cooper* and *Waddell* determined that the taxpayers had a bona fide trade or business did the courts then determine that the property was placed in service when the taxpayer held it out for lease.[55] Critically, the taxpayers were holding the property out for lease to a company independent of the entity which sold the taxpayer the property *and* the property was actually placed with end users and used to generate income. No such things happened in this case. Here, Defendants knew, or had reason to know, the following: Johnson controls both RaPower-3 and LTB. LTB has never done anything. No customer has been paid for the use of his lens for any reason. No customer has ever even *inquired* about LTB, the company

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[51] *Waddell*, 86 T.C. at 892.

[52] *Waddell*, 86 T.C. at 893.

[53] *Waddell*, 86 T.C. at 852-53.

[54] *Waddell*, 86 T.C. at 860-61.

[55] *Cooper*, 88 T.C. at 113-14; *Waddell*, 86 T.C. at 849.

to which they blithely "leased out" their lenses to generate the "profit" Defendants told them was coming. Signing an illusory "agreement" to lease lenses to LTB did not magically create a "lens leasing business" for Defendants' customers – and Defendants knew, or had reason to know it. *Cooper* and *Waddell* show that Defendants' customers have never actually "held property out for lease" in any real way.[56]

2. The solar lenses were not "placed in service" because Defendants' purported solar energy technology was not, and is not, operational.

Defendants' other explanation for their statements that the lenses are "placed in service" is that the lenses have been installed on IAS towers; they have been used for "research and development purposes"; and have been used to "create solar process heat."[57] Defendants cite no facts to support these conclusory statements. This failure is unsurprising because Defendants have never been clear on facts that might support these statements. For example, although Defendants have told customers that their lenses have been placed in service by IAS, RaPower-3, and/or LTB,[58] those entities all denied, under oath, placing lenses in service[59].

Defendants also never identify a bona fide and ongoing trade or business in which the lenses have been used for these asserted purposes. It cannot be the customers' purported "lens

[56] The facts of this case show that it is closer akin to the cases concluding that property that does not exist cannot be depreciated. *Hudson v. Comm'r*, 71 F.3d 877, 1995 WL 725812, at *5 (5th Cir. 1995). *See also Gregg v. Dep't of Revenue*, No. TC-MD 160068R, 2017 WL 5900999, at *5-6 (Or. T.C. Nov. 30, 2017); *United Energy Corp.*, 1987 WL 4787, at *2-4, 11.

[57] ECF No. 384 at 5.

[58] *E.g.*, Pl. Ex. 534 (letters signed by Johnson claiming that IAS "put into service" customers' lenses in 2009) (attached); Pl. Ex. 546 (letters signed by Johnson claiming that RaPower-3 "put into service" customers' lenses in different years) (attached); Pl. Ex. 547 (attached); ECF No. 255-37, Pl. Ex. 473 at 1-3 (Shepard explaining that RaPower-3 "put into service" customers' lenses); ECF No. 256-13, Pl. Ex. 558.

[59] ECF No. 381-1, Pl. Ex. 449 at 2, Resp. to Interrog. No. 11; ECF No. 381-2, Pl. Ex. 450 at 4, Resp. to Interrog. No. 15; ECF No. 381-4, Pl. Ex. 452 at 2, Resp. to Interrog. No. 11.

leasing businesses," because no customer has ever been paid for the use of his lens for "research and development purposes" or to "create solar process heat." Regardless, if the lenses are "[m]aterials and parts acquired to be used in the construction" of equipment like Defendants' solar energy technology, they "shall not be considered in a condition or state of readiness and availability for a specifically assigned function."[60]

Further, there is no evidence that Defendants' solar lenses have ever been used as an individual component within a system to concentrate solar radiation to accomplish any kind of useful function or application – or to generate electricity. "[A]n individual component, incapable of contributing to the system in isolation, is not regarded as placed in service until the entire system reaches a condition of readiness and availability for its specifically assigned function."[61] For facilities that are intended to generate power, factors that go to whether the system as a whole is placed in service (such that any individual component could be deemed "placed in service") are: "1) whether the necessary permits and licenses for operation have been obtained; 2) whether critical preoperational testing has been completed; 3) whether the taxpayer has control of the facility; 4) whether the unit has been synchronized with the transmission grid; and 5) whether daily or regular operation has begun."[62]

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[60] 26 C.F.R. § 1.46-3(d)(2)(iv).

[61] *Sealy Power, Ltd. v. Comm'r*, 46 F.3d 382, 390 (5th Cir. 1995); *Armstrong World Indus., Inc. v. Comm'r*, 974 F.2d 422, 434 (3d Cir. 1992) ("courts appear to agree that individual components will be considered as a single property for tax purposes when the component parts are functionally interdependent-when each component is essential to the operation of the project as a whole and cannot be used separately to any effect"); *accord Pub. Serv. Co. of N.M. v. United States*, 431 F.2d 980, 984 (10th Cir. 1970).

[62] *Sealy Power*, 46 F.3d at 395. "The most important . . . factor appears to be . . . that the unit has gone into ordinary daily operation." *In re Mitchell*, 109 B.R. 434, 438 (Bankr. W.D. Wash. 1989), *aff'd*, No. C90-484M, 1990 WL 142016 (W.D. Wash. Aug. 31, 1990), *judgment rev'd on other grounds*, 977 F.2d 1318 (9th Cir. 1992).

The evidence here shows that Defendants' purported solar energy technology does not work, and never will.[63] It is a collection of mismatched components that do not work together as a system. Accordingly, there is no "daily or regular operation" of any system; nothing has been "synchronized with the transmission grid"; "critical preoperational testing" has not yet been completed, and there is no evidence that it has even begun.[64] Defendants know this, and have known it for more than 10 years. In fact, Defendants themselves continually assert the need for additional research and development before they will be "operational."[65]

These facts distinguish Defendants' purported solar energy technology from the biomass facility in *Sealy Power, Ltd.* In *Sealy Power*, the Fifth Circuit concluded that the biomass facility was "operat[ed] on a regular basis" when the parties did not dispute "that the electric generating operation was conducted regularly in 1984 even though its performance was sporadic and the volume of its output was disappointing."[66] Further, it was also undisputed that:

> the power facility was run on a regular basis by several . . . employees. In addition to operating the landfill's gate and collecting tipping fees, these employees monitored the performance of the plant from the facility's control room, which contained a computer and equipment for measuring pressure and temperature levels for the various components of the facility. The employees took notes on the plant's performance and copied them onto the computer printouts, creating daily reports of the facility's

[63] Trial Tr. 49:15-50:7; 69:1-145:15, 147:6-170:9.

[64] This is not a situation that has presented in other cases, when a nearly operational power plant was seeking "placed in service" status for certain property in a particular tax year. *E.g.*, *Sealy Power*, 46 F.3d at 395-97; *Pub. Serv. Co. of N.M. v. United States*, 431 F.2d 980, 984 (10th Cir. 1970); *Consumers Power Co. v. Comm'r*, 89 T.C. 710, 725-26 (1987).

[65] *E.g.*, ECF No. 384 at 5.

[66] *Sealy Power*, 46 F.3d at 396–97.

generating operations.[67]

For these reasons, the *Sealy Power* plant, as a whole, was "placed in service."[68] There is no evidence of such operations ever having gone on for Defendants' purported solar energy technology, much less on a regular basis. Therefore, Defendants' so-called solar energy technology as a whole has not been "placed in service."[69]

Because Defendants' purported system as a whole has not been placed in service, its component parts – the lenses – are not placed in service and never have been.[70] Defendants' citation to *Northern States Power Co. v. United States* does not change this conclusion. In that case, an *operational* power plant was seeking "placed in service" status for certain replacement parts in a particular tax year.[71] The taxpayer was already producing electricity when it received replacement nuclear fuel assemblies.[72] The assemblies were "fully constructed and tested according to detailed technical specifications and quality assurance plans. Before it could use the assemblies, NSP merely had to verify that they had not been damaged when they were shipped to the plant. NSP did so in the same year that it acquired them."[73] Therefore, the Eighth Circuit held that "on a fundamental level, the assemblies were ready and available for their assigned function, *i.e.*, to refuel a nuclear reactor, in the same year that NSP acquired them. And, as such, the

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[67] *Sealy Power*, 46 F.3d at 396–97.

[68] *Sealy Power*, 46 F.3d at 396–97.

[69] *See United Energy Corp.*, 1987 WL 4787, at *11.

[70] *E.g.*, *Sealy Power, Ltd.* 46 F.3d at 395-97; *Consumers Power Co. v. Comm'r*, 89 T.C. 710, 725-26 (1987).

[71] *Northern States Power Co. v. United States*, 151 F.3d 876, 877, 880 (8th Cir. 1998).

[72] *Northern States Power*, 151 F.3d at 880-83.

[73] *Northern States Power*, 151 F.3d at 881.

assemblies were 'in a condition or state of readiness and availability' within the meaning of Treasury regulations sections 1.167(a)–1(e)(i) and 1.46–3(d)."[74]

III. Conclusion

Defendants' brief fails to justify Defendants' assertions that their customers are allowed a depreciation expense deduction because their customers are in a trade or business related to their solar lenses, which lenses have been placed in service. Instead, the brief reveals the truth about those statements: they are totally disconnected from the internal revenue laws and the objective facts that Defendants have known, or had reason to know, for more than 10 years. This Court should enjoin them from continuing to make these, and other, statements that Defendants know, or have reason to know, are false or fraudulent, and enter all of the other equitable relief the United States seeks.

[74] *Northern States Power*, 151 F.3d at 881. The court arrived at the same result in *Connecticut Yankee Atomic Power Co. v. United States*, 38 Fed. Cl. 721, 722, 728-31 (1997), when addressing whether nuclear fuel assemblies were "placed in service" in a particular year by a "Connecticut public service company which owns and operates a 582,000 kilowatt, single-unit nuclear electric generating plant in Haddan Neck, Connecticut." There was no dispute that the public service company was operating.

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CERTIFICATE OF SERVICE

I hereby certify that on April 20, 2018 the foregoing document, along with its exhibits, was electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to all counsel of record.

/s/ Erin Healy Gallagher
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