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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' MEMORANDUM REGARDING PLAINTIFF'S BURDEN UNDER 26 U.S.C. §§ 6700 AND 7408** Judge David Nuffer Magistrate Judge Evelyn J. Furse

The Court should reject Defendants' ill-supported, eleventh-hour attempt to saddle the United States with a heightened standard of proof[1] – albeit on a narrow aspect of this case that will not affect the result in any event. A clear majority of courts, including the Tenth Circuit,

[1] ECF No. 369.

have expressly stated that the Government's standard of proof under 26 U.S.C. § 6700 is a preponderance of the evidence. That standard is consistent with the lower mental-state requirement of that statute, which penalizes not only intentional fraud but also negligent or reckless falsehoods.

To be sure, the United States will prove to the Court at trial – under any standard of proof – that Defendants made fraudulent statements concerning the tax benefits to be derived from their scheme. Nevertheless, Defendants admit that the text of § 6700 is disjunctive ("false or fraudulent statements"), and they do not challenge that the Government need only prove that they made false statements (as opposed to fraudulent statements) by a preponderance of the evidence. Nor do they argue that a heightened standard of proof applies to any other elements of § 6700, or to the appropriateness of injunctive relief under 26 U.S.C. § 7408(b)(2), or to the necessity of injunctive relief under 26 U.S.C. § 7402(a). Therefore, the Court could grant all of the relief sought by the United States against all of the Defendants using the preponderance standard, without even considering the issues of whether Defendants made any fraudulent statements or what standard of proof would apply to such statements. In that sense, Defendants' foray into standards of proof is an unnecessary academic exercise. Moreover, it is an exercise in futility, for at least three reasons.

First, the Government's claims in this case are for injunctive relief under §§ 7408 and 7402. The traditional standard of proof for injunctive relief is preponderance of the evidence.[2] There is nothing in the text or legislative history of §§ 7408 and 7402 suggesting that Congress intended to disturb that traditional standard for injunction actions brought under those statutes.

[2] *See Citizens Concerned for Separation of Church & State v. Denver*, 628 F.2d 1289, 1299 (10th Cir. 1980) ("[T]he party seeking the injunction must prove his own case and adduce the requisite proof, by a preponderance of the evidence, of the conditions and circumstances upon which he bases the right to and necessity for injunctive relief.").

Second, the balance of caselaw on this issue supports the Government. In *United States v. Hartshorn*,[3] the Tenth Circuit reviewed whether a tax-scheme promoter's statements were false or fraudulent under § 6700, as a predicate for injunctive relief under § 7408. The court expressly stated: "For injunctive relief to be warranted under § 7408, the government was required to prove by a preponderance of the evidence that … [the defendant] made false or fraudulent statements concerning the tax benefits to be derived from the entity. . . ."[4] Defendants admit that decision "provides authority" in this case.[5] Yet they encourage the Court to disregard a clear statement by the Tenth Circuit and hold to the contrary. To the extent that the Court needs to decide this issue at all, the Government urges the Court to follow not only the Tenth Circuit's statement but also the great weight of authority from other courts holding that the preponderance standard applies to actions based on § 6700.[6]

Finally, even without considering any of the prior caselaw on this issue, Defendants' argument for a "clear and convincing" standard is faulty because it overlooks key text in § 6700. Defendants rely on the canon that Congress intends to incorporate the established common-law

[3] 751 F.3d 1194 (10th Cir. 2014).

[4] *Id.* at 1198.

[5] ECF No. 369 at 3.

[6] *See United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000) (applying preponderance standard in § 7408 case); *United States v. Masters*, 816 F.2d 674, 674 (4th Cir. 1987) (per curiam) (same); *United States v. Stover*, 731 F. Supp. 2d 887, 889 (W.D. Mo. 2010) (same), *aff'd*, 650 F.3d 1099 (8th Cir. 2011); *United States v. Pinnacle Quest Int'l*, 2008 WL 2096381, at *1 (N.D. Fla. 2008) (same), *aff'd*, 309 Fed. Appx. 333 (11th Cir. 2009); *see also Barr v. United States*, 67 F.3d 469, 469-70 (2d Cir. 1995) (per curiam) (applying preponderance standard in § 6700 penalty case); *Weir v. United States*, 716 F. Supp. 574, 580 (N.D. Ala. 1989) (same); *American Technology Resources v. United States*, 709 F. Supp. 610, 617 (E.D. Pa. 1989) (same). *But see United States v. Fontenot*, 2011 WL 13195835, at *6 & n.10 (E.D. Tex. 2011) (applying clear-and-convincing standard in § 7408 case); *United States v. Campbell*, 704 F. Supp. 715, 725 (N.D. Tex. 1988) (same), *aff'd as modified by* 897 F.2d 1317 (5th Cir. 1990).

meanings of terms it uses in a statute.[7] But they ignore an important caveat to that rule of construction: "unless the statute otherwise dictates." And here the text of § 6700 strongly suggests that Congress did not intend a wholesale importation of the common-law meaning of "fraud." Section 6700 penalizes not only statements that a person *knew* were false or fraudulent but also statements that a person *had reason to know* were false or fraudulent. Yet the standard mental-state requirement for fraud is actual knowledge of the falsity and an intent to deceive.[8] Defendants admit as much.[9] Conversely, only having "reason to know" is indicative of negligence or recklessness, but not of intentional fraud. Because the statute indicates that Congress was not merely intending to penalize traditional fraud, the Court should not presume that Congress intended to incorporate the traditional standard of proof for fraud into the statute.

Carlson v. United States,[10] cited by Defendants,[11] actually supports the United States in this regard. In that case, a tax-return preparer sued to determine her liability for penalties imposed under 26 U.S.C. § 6701 for aiding and abetting her customers' understatements of their tax liabilities. The Eleventh Circuit held that the Government's standard of proof was clear and convincing evidence because that statute required the Government to prove fraud.[12] The court rested its decision on its belief that § 6701 requires actual knowledge. "In other words, the IRS must prove that the preparer deceitfully prepared a return knowing it misrepresented or

[7] ECF No. 369 at 4-5.

[8] *Zell v. Comm'r*, 763 F.2d 1139, 1144 (10th Cir. 1985).

[9] ECF No. 369 at 2-3.

[10] 754 F.3d 1223 (11th Cir. 2014).

[11] ECF No. 369 at 5 n.17.

[12] *Carlson*, 754 F.3d at 1225.

concealed something that understates the correct tax. This is a classic case of fraudulent conduct."[13] In contrast, § 6700 does not require actual knowledge but only having "reason to know." Therefore, that statute does not simply address classic cases of fraudulent conduct, and thus the classic standard of proof for fraudulent conduct should not apply.

In sum, Defendants' position on the standard of proof is both incorrect and unnecessary for the Court to consider.

Dated: April 3, 2018

Respectfully submitted,

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[13] *Id.* at 1227; *see also id.* at 1229 ("Whereas both [26 U.S.C.] § 6694(a) and § 6694(b) penalties can apply when a tax preparer is negligent or reckless, § 6701 requires proof that the tax preparer knew his or her conduct would defraud the Government.").

CERTIFICATE OF SERVICE

I hereby certify that on April 3, 2018, 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 all counsel of record.

/s/ Erin Healy Gallagher
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