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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

BROADWOOD INVESTMENT FUND LLC et al., **Plaintiffs,** **vs.** **UNITED STATES OF AMERICA,** **Defendant.**	**Case No.: SACV 08-0295 DOC(ANx)** **ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT**

Before the Court is a Motion for Summary Judgment filed by Defendant United States of America ("Defendant"). (Dkt. 63). After reviewing all papers regarding this motion and three days of oral argument, the Court GRANTS the Motion.

I. Background

The gravamen of the Amended Petition is that the Commissioner of Internal Revenue ("Commissioner") erred in disallowing millions of dollars in tax losses reported by the five Petitioners Broadwood Investment Fund LLC, Mosman Investment Fund LLC, Han Kook LLC

I, Han Kook LLC I-A, and Dragon Coeur LLC I-B (collectively, "Petitioners"). *See* Amended Petition for Review of Final Partnership Administrative Adjustments ("Amended Petition") (Dkt. 29) at ¶ 3. Unless otherwise stated, the parties do not dispute the following facts.

a. Nicholas's CFO analyzes a financial product called Chenery

Henry T. Nicholas ("Nicholas") controls N&S Holdings, LLC ("N&S Holdings"). Statement of Genuine Disputes (Dkt. 65-1) at 3. On August 6, 2001, Nicholas appointed Craig Gunther ("Gunther") as N&S Holdings' Chief Operating Officer. *Id.* On or about November 4, 2001, myCFO, Inc. ("myCFO") provided Gunther with information about a myCFO financial product called the Chenery Distressed Asset Fund ("Chenery"). *See id.* at 5-6. On or before November 28, 2001, Gunther requested additional information from myCFO about Chenery. *Id.* at 7, PSF10.[1]

Gunther prepared his own analysis of myCFO's financial products, including Chenery. *Id.* at PSF11. In a December 12, 2001, email from Gunther to Nicholas, Gunther stated that the email "outlines the negotiated terms of the myCFO/Chenery investment and other transactions" with a "[n]otational value of $300 M (buy price of 6.5M)."[2] *See* Statement of Genuine Disputes (Dkt. 65-1) at 48, PSF11; EX0052.0001. Gunther also made hand-written notes on a document, Exhibit 44. *See* Statement of Genuine Disputes (Dkt. 65-1) at 12-13. That document shows that Gunther's notes are written on top of three columns with typed headings "MyCFO Proposal," "Proposed Response," and "Comments." EX0044.00001. It is undisputed that the hand-written

[1] Petitioners appear to use the acronym "PSF" to refer to paragraphs under the heading "Petitioners' New Facts Creating Genuine Issues" located in their document titled "Statement of Genuine Disputes." *See* Statement of Genuine Disputes (Dkt. 65-1) at 45. For convenience, the Court uses the same terminology and also refers to the page number of that document.

[2] This fact is undisputed because Defendant curiously never responded to Petitioners' Statement of Genuine Issues (Dkt. 65-1).

notes state "Return: 26% on 300M = 78M, plus (5m) = $83m." *See* Statement of Genuine Disputes (Dkt. 65-1) at 12-13.[3]

When asked about the meaning of these hand-written calculations, Gunther had the following lack of explanation:

> Defendant's attorney: "Why were you multiplying or why did you write 26 percent on 300 million equals 78 million?"
>
> Gunther: "I couldn't tell you."
>
> Defendant's attorney: "[W]ere you estimating at that time that Dr. Nicholas would have a savings on taxes as a result of these transactions at a rate of 26 percent?

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[3] At oral argument, Petitioners for the first time adopted the position that Gunther did not make these hand-written notes. Transcript for August 29, 2012, Oral Argument (Dkt. 85) at 13:11-13 (The Court: "Is it your position that these are not [Gunther's] handwritten notes?" Petitioners' attorney: "Yes."). Yet, prior to oral argument, Petitioners filed numerous evidentiary objections to every single one of Defendant's Statements of Fact, yet failed to dispute Defendant's contention that Exhibit 44 contained "Gunther's handwritten notes." *See* Statement of Genuine Disputes (Dkt. 65-1) at 12-13. Rather, Petitioners conceded that "Exhibit 44 contains handwritten notes from Mr. Gunther." *Id.* at 9. Furthermore, Gunther conceded that these were his hand-written notes. *See* Gunther Trans. 4/17/12 at 173:19 – 179:17 (Defendant's attorney: "I'll show you what I've marked as Exhibit 44.", Gunther: ". . . . there are some of my handwritten notes on here.", Defendant's attorney: "Is that section of the handwriting your handwriting [referring to "Return: 26% on 300M = 78M, plus (5m) = $83m"]?" Gunther: "I believe it is."). Petitioners' "oral argument" regarding the authorship of Gunther's hand-written notes is "not evidence, and . . . cannot . . . create a factual dispute sufficient to defeat a summary judgment motion where no dispute otherwise exists." *See British Airways Bd. v. Boeing Co.*, 585 F.2d 946, 952 (9th Cir. 1978); *Enzo Biochem, Inc. v. Gen-Probe, Inc.*, 424 F.3d 1276, 1284 (Fed. Cir. 2005) ("Attorney argument is no substitute for evidence."). Thus, the Court concludes that there is no genuine dispute as to the authorship of Gunther's hand-written notes.

Petitioners' attorney: "Objection, lack of foundation, also the question is vague."

Gunther: "As I said, I didn't have any recollection on that."

See Gunther Trans. 4/17/12 at 181:22 – 184:16.

b. Chenery sends Nicholas a welcome letter guaranteeing that his investment in Petitioners is "without risk of economic loss"

At some point before December 23, 2001, Chenery created Petitioners. *See* Statement of Genuine Disputes (Dkt. 65-1) at 45, PSF1. In a letter dated December 20, 2001, Chenery welcomed Nicholas and included "documents necessary to purchase your interest in the fund" ("Welcome Letter"). *See id.* at 15-16; EX384.0001.

The Welcome Letter stated "Hopefully you have reviewed the package I sent on November 27, 2001,[4] that contained information regarding the program" and "[a]s noted in our earlier letter, Chenery has arranged the fund so that any of the investments owned by the fund at the time of purchase can be sold or exchanged before December 31, 2001 without risk of economic loss." *Id.* at 16-17. At oral argument, Petitioners conceded that "[t]he reference to the fund" in the Welcome Letter "is [to] the petitioner." Transcript for August 29, 2012, Oral Argument (Dkt. 85) at 15:15-19, 16:1-2 (quoting from letter that "Chenery has arranged the fund so that any of the investments owned by the fund at the time of the purchase can be sold or exchanged before December 31, 2001, without the risk of . . . loss" and stating that "[t]he reference to the fund here—the 'fund' is the petitioner").

c. Formation of sham partnership Petitioners

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[4] The referenced "package" appears to be to the binder accompanying a letter dated November 28, 2001, and which states that "Chenery has arranged the fund so that any of the investments owned by the fund at the time of purchase can be sold or exchanged before December 31, 2001 without risk of economic loss." *See* EX812. Petitioners have objected to these documents as unauthenticated. *See* Statement of Genuine Issues (Dkt. 65-1) at 8-9. As with all of Petitioners' evidentiary objections, Defendant has curiously chosen not to respond.

On December 23, 2001, through a series of transactions, "Nicholas-controlled entities" became partners of Petitioners and held a "98 percent interest" in Petitioners, while Chenery, which was also a partner, was left "with a 1 percent interest" in Petitioners. Transcript for August 30, 2012, Oral Argument (Dkt. 88) at 25:20-25, 26:1-19; *see also* Statement of Genuine Disputes (Dkt. 65-1) at PSF4.[5]

Thus, on December 23, 2012, the alleged sham partnership was formed. Transcript for August 30, 2012, Oral Argument (Dkt. 88) at 25:20-25, 26:1-19 (Defendant's attorney explaining that "when you have an acquisition of more than a 50 percent interest, . . . it is deemed to create a new partnership").

d. The Commissioner disallows Petitioners' tax losses due to their sham partnership status

The Commissioner disallowed millions of dollars of tax losses that Petitioners claimed in their 2002, 2003, and 2004 taxes. *See e.g.*, Amended Petition, Ex. 1 (Dkt. 29-2) (disallowing $31,611,085 in tax losses claimed by Petitioner Broadwood Investment Fund LLC in 2003). One of the reasons stated by the Commissioner was that "it has not been established that the partnership was formed and availed of for the purpose of carrying on a trade or business by partners or for the sharing of profits and losses from such activity." *Id.*

e. Procedural History

On December 1, 2008, Petitioners filed an Amended Petition challenging the Commissioner's decisions to disallow tax losses in its Final Partnership Administrative Adjustments sent to each Petitioner.[6] Amended Petition (Dkt. 29) at 5.

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[5] While PSF 1 and PSF 4 mention only Petitioner Mosman Investment Fund LLC, the Court assumes without deciding that Chenery created all five Petitioners because Petitioners represented that the facts about Mosman Investment Fund LLC are "representative of the other transactions." Opp'n at 5.

[6] This Amended Petition is filed on behalf of Petitioners through their Tax Matters Partner, Broadwood Investment Holdings LP ("Broadwood Holdings"). A "Tax Matters Partner . . . may

II. Legal Standard

Summary judgment is proper if "the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). Summary judgment is to be granted cautiously, with due respect for a party's right to have its factually grounded claims and defenses tried to a jury. *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986). The court must view the facts and draw inferences in the manner most favorable to the non-moving party. *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1992); *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1161 (9th Cir. 1992). The moving party bears the initial burden of demonstrating the absence of a genuine issue of material fact for trial, but it need not disprove the other party's case. *Celotex*, 477 U.S. at 323. When the non-moving party bears the burden of proving the claim or defense, the moving party can meet its burden by pointing out that the non-moving party has failed to present any genuine issue of material fact as to an essential element of its case. *See Musick v. Burke*, 913 F.2d 1390, 1394 (9th Cir. 1990).

Once the moving party meets its burden, the burden shifts to the opposing party to set out specific material facts showing a genuine issue for trial. *See Liberty Lobby*, 477 U.S. at 248-49. A "material fact" is one which "might affect the outcome of the suit under the governing law . . . ." *Id.* at 248. A party cannot create a genuine issue of material fact simply by making assertions in its legal papers. *S.A. Empresa de Viacao Aerea Rio Grandense v. Walter Kidde & Co., Inc.*, 690 F.2d 1235, 1238 (9th Cir. 1982). Rather, there must be specific, admissible evidence identifying the basis for the dispute. *Id.* The court need not "comb the record" looking for other evidence; it is only required to consider evidence set forth in the moving and opposing papers and the portions of the record cited therein. Fed. R. Civ. P. 56(c)(3); *Carmen v. S.F. Unified Sch. Dist.*, 237 F.3d 1026, 1029 (9th Cir. 2001). The Supreme Court has held that "[t]he mere

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challenge a Notice of Final Partnership Administrative Adjustment ('FPAA') in the . . . district court." 14 Mertens Law of Fed. Income Tax'n § 50:149.

existence of a scintilla of evidence . . . will be insufficient; there must be evidence on which the jury could reasonably find for [the opposing party]." *Liberty Lobby*, 477 U.S. at 252.

III. Discussion

The parties agree that Defendant is entitled to summary judgment if it shows Petitioners have failed to establish that they were not "sham partnerships." *See* Opp'n at 16:11-15. The Court first provides some background on Petitioners' burden when seeking review of the Commissioners' decision regarding their sham partnership status. Next, the Court turns to Defendant's argument that Petitioners have failed to establish that they were not sham partnerships. Finally, the Court examines Petitioners' evidence.

a. In an action challenging the Commissioner's decision to disallow tax losses due to sham partnership status, the taxpayer bears the burden to prove that it is not a sham partnership

The Internal Revenue Code subjects a "partnership"[7] to "pass-through tax treatment," meaning that "[p]artnerships do not pay income tax; instead, a partnership's income and losses flow through to its partners." *Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 468-69 (5th Cir. 2011); 26 U.S.C. § 701("A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities."). A taxpayer may challenge the Commissioner's determination that tax losses are disallowed due to sham partnership status through petition for review under 26 U.S.C. § 6226. *See* 26 U.S.C. § 6221.

The Commissioner's "determination that the transaction is a sham is presumptively correct, and [t]axpayers have the burden of producing evidence to rebut [this] determination and burden of persuasion to substantiate the [taxpayers'] deduction." *Sochin v. C.I.R.*, 843 F.2d 351, 356 (9th Cir. 1988) *abrogated on other grounds by Landreth v. Comm'r,* 859 F.2d 643, 648-49 (9th Cir.1988), *as recognized by Keane v. Comm'r,* 865 F.2d 1088, 1092 n. 8 (9th Cir.1989); *Goldberg v. United States,* 789 F.2d 1341, 1343 (9th Cir. 1986) (holding that the taxpayer has

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[7] 26 U.S.C. § 761(a) (defining partnership).

"the burden of producing enough evidence to rebut the deficiency determination [by the Commissioner] and the burden of persuasion in substantiating a claimed deduction"); *Saba P'ship v. C.I.R.*, 85 T.C.M. (CCH) 817 (T.C. 2003) (citing *Sochin* to hold that "[p]etitioner bears the burden of proof"); *Pritired 1, LLC v. United States*, 816 F. Supp. 2d 693, 731 (S.D. Iowa 2011) ("The Commissioner's determinations in a FPAA are generally presumed correct, and a party challenging an FPAA has the burden of proving that the Commissioner's determinations are in error.").

b. Summary of Defendant's and Petitioners' arguments

Defendant contends that sales materials and transactions between Nicholas and Chenery demonstrate that Petitioners' business purpose was not to share losses, and thus they are sham partnerships. Petitioners respond by arguing that: (1) this Court should exclude Defendant's evidence because some of that evidence is hearsay and involves a different transaction than that which was ultimately consummated with MyCFO; (2) expert reports created for this litigation show that Petitioners had the potential for generating profits; and (3) Nicholas devoted a lot of time and resources to analyzing whether to engage in the transactions at issue here.

Petitioners' Opposition gravely misconceives their burden. As the taxpayer "challenging an FPAA," Petitioners have "the burden of proving that the Commissioner's determinations are in error." *Pritired 1, LLC*, 816 F. Supp. 2d at 731. Because Petitioners bear the burden of proving their claim, Defendant can meet its burden on summary judgment by simply pointing out that Petitioner has failed to present sufficient evidence as to an essential element of their claim. *See Musick v. Burke*, 913 F.2d 1390, 1394 (9th Cir. 1990). Here, Defendant has more than met this burden. Not only have Petitioners failed to present admissible evidence proving that Petitioners' partners had a business purpose to share losses and profits, Defendant has gone further and presented evidence that Chenery, which is Petitioners' creator and one of its partners, expressly disclaimed such a business purpose by telling Nicholas that Chenery "arranged" Petitioners to ensure that the Nicholas-controlled entities could be partners "without risk of economic loss." *See* Statement of Genuine Disputes (Dkt. 65-1) at 16-17; EX384.0001.

In addition, the Court notes that Petitioners have raised numerous evidentiary objections to Defendant's evidence, objections which went unanswered by Defendant. However, because Petitioners bear the burden of production, a lacuna in the evidence presented to this Court favors Defendant—not Petitioners.

c. Defendant has met its burden to show that Petitioners have failed to establish a business purpose of sharing losses

i. Transactions between Nicholas and Chenery demonstrate that Petitioners were not to share profits and losses, and thus they are sham partnerships

Under the sham partnership doctrine, a "partnership will be respected for tax purposes" only if its partners formed it: (1) "in good faith"; and (2) "with a business purpose" of "join[ing] together [for] carrying on the business and sharing in the profits and losses." *Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 483-84 (5th Cir. 2011) (quoting *Comm'r v. Culbertson*, 337 U.S. 733, 741-42 (1949)). This is a "totality-of-the-facts-and-circumstances test" in which evidence that may be considered includes "the agreement [to form the partnership], the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent." *Id.* at 484, 484 n. 65.

1. The Court can not draw the inference that Gunther's hand-written notes and later email show that he calculated the tax-benefit of MyCFO's proposed financial product

Gunther's hand-written notes and email show that he calculated *something* regarding MyCFO's financial product, Chenery; Gunther, however, asserts that he does not know what he meant by these calculations. It is undisputed that Gunther prepared his own analysis of MyCFO's financial products, including Chenery, as shown by a December 12, 2001, email by Gunther to Nicholas stating that the email "outlines the negotiated terms of the myCFO/Chenery investment and other transactions" with a "[n]otational value of $300 M (buy price of 6.5M)."

Statement of Genuine Disputes (Dkt. 65-1) at 45 (referred to in document as "PSF11"); EX0052.0001. It is also undisputed that Gunther made hand-written notes on a document, Exhibit 44. *See* Statement of Genuine Disputes (Dkt. 65-1) at 13. That document, the contents of which are not disputed, shows that Gunther's notes are written on top of three columns with typed headings "MyCFO Proposal," "Proposed Response," and "Comments." EX0044.00001. It is undisputed that the hand-written notes state "Return: 26% on 300M = 78M, plus (5m) = $83m." *See* Statement of Genuine Disputes (Dkt. 65-1) at 13.

Defendant argues, and Petitioners have offered no evidence or theory to the contrary, that Gunther's hand-written "26%" refers to the tax rate on the $300 million investment, indicating that a motive for the investment was to obtain the tax benefits of MyCFO's financial products. As noted previously, Gunther appears to simply have no explanation for what his hand-written notes meant. *See* Gunther Trans. 4/17/12 at 181:22 – 184:16 (Defendant's attorney: "[W]ere you estimating at that time that Dr. Nicholas would have a savings on taxes as a result of these transactions at a rate of 26 percent? Petitioners' attorney: "Objection, lack of foundation, also the question is vague." Gunther: "As I said, I didn't have any recollection on that.")

As Petitioners contended at oral argument, however, the issue of whether the hand-written "26%" refers to the tax rate requires an inference and, at summary judgment, the Court must draw all inferences in favor of the non-movant. Thus, although Petitioners have offered no evidence or theory as to the meaning of the "26%," the Court can not draw the inference that this number refers to a tax rate.

2. However, Chenery's Welcome Letter shows that it promised Nicholas investments without economic loss

In a letter dated December 20, 2001, Chenery welcomed Nicholas and included "documents necessary to purchase your interest in the fund" ("Welcome Letter"). *See* Statement of Genuine Disputes (Dkt. 65-1) at 15-16; EX384.0001. The Welcome Letter stated "Hopefully you have reviewed the package I sent on November 27, 2001, that contained information regarding the program" and "[a]s noted in our earlier letter, Chenery has arranged the fund so that any of the investments owned by the fund at the time of purchase can be sold or exchanged

before December 31, 2001 *without risk of economic loss*." *Id.* 16-17 (emphasis added). At oral argument, Petitioners conceded that "[t]he reference to the fund" in the Welcome Letter "is [to] the petitioner." Transcript for August 29, 2012, Oral Argument (Dkt. 85) at 15:15-19, 16:1-2 (quoting from letter that "Chenery has arranged the fund so that any of the investments owned by the fund at the time of the purchase can be sold or exchanged before December 31, 2001, without the risk of . . . loss" and stating that "[t]he reference to the fund here—the 'fund' is the petitioner").

Petitioners object to the Welcome Letter on two grounds, neither of which persuade this Court. First, Petitioners argue that the Welcome Letter is hearsay. *Id.* 16. The Court OVERRULES that objection because the letter is admissible under the hearsay exception for statements of the declarant's "intent" or "plan." Fed. R. Evid. 803(3). Specifically, Chenery's representations that Nicholas's investments with Chenery were "without risk of economic loss" reveals Chenery's intent and plan to act with a business purpose other than sharing profits and losses. *See United States v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 234 F.3d 1278, 1280, 1280 n.4 (9th Cir. 2000) (admitting declarant's statement that non-declarant "would soon be" terminated under Rule 803(3)); *Samsung Electronics Co., Ltd. v. Quanta Computer, Inc.*, C-00-4524 VRW, 2006 WL 2850028 (N.D. Cal. Oct. 4, 2006) (admitting "daily planner" under Rule 803(3)).

Alternatively, Petitioners object on the grounds that this Welcome Letter discusses a "transaction that was [not] ultimately consummated with myCFO." *See* Statement of Genuine Disputes (Dkt. 65-1) at 16; Opp'n at 20. This argument is irrelevant given that Petitioners have also conceded that the "reference to the fund" in the Welcome Letter "is [to] the petitioner." Transcript for August 29, 2012, Oral Argument (Dkt. 85) at 15:15-19, 16:1-2. In the Welcome Letter, Chenery promises Nicholas that Petitioners would be "arranged . . . without risk of economic loss"; this fact is not negated by the possibility that Chenery's promise included the possibility of investing in *other* partnerships that could be formed "without risk of economic

loss" *in addition to Petitioners*. *See* Statement of Genuine Disputes (Dkt. 65-1) at 16-17; EX384.0001.[8]

Petitioners also contend without authority that the Welcome Letter is not relevant because it was sent prior to the tax years that Petitioners are challenging. In fact, the evidence that may be considered to show a sham partnership includes "the agreement [to form the partnership], the conduct of the parties in execution of its provisions, [and] their statements . . . ." *See Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 484, 484 n. 65 (5th Cir. 2011). Here, the Welcome Letter is a "statement[]" by one of the partners (Chenery) to the person (Nicholas) who controls the other partners (Petitioners). This statement is made in a Welcome Letter dated December 20, 2001, just three days before the formation of the sham partnerships at issue here. Thus, the Welcome Letter is highly relevant evidence whether the partners who formed the sham partnerships at issue here acted "in good faith" and "with a business purpose" of "sharing in the profits and losses." *Id.* at 483-84.

3. Conclusion

In sum, Chenery's Welcome Letter shows an intent to act without risk of economic loss, not to share profits and losses. Because Defendant has produced evidence that Petitioners were not formed with "a business purpose" of "join[ing] together [for] carrying on the business and sharing in the profits and losses," Defendant has met its burden on summary judgment to show

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[8] At oral argument, Petitioners attempted to raise new creative arguments as to the admissibility of the Welcome Letter that were not raised before in its papers. The Court STRIKES those arguments because allowing Petitioners to orally file a new opposition to the summary judgment based on entirely new arguments not set out in the written opposition is profoundly unfair to the movant. *See Palacios v. City of Oakland*, 970 F. Supp. 732, 744 n.17 (N.D. Cal. 1997) (granting movant summary judgment and declining to consider non-movant's argument "raised for the first time at oral argument" because movant had "not had an opportunity to respond to [non-movant's] argument") *aff'd*, 152 F.3d 928 (9th Cir. 1998).

that Petitioners have failed to establish that they are not sham partnerships. *See Southgate Master Fund, L.L.C.*, 659 F.3d at 483-84.

d. Petitioners have failed to meet their burden to show that there is a genuine issue of material fact as to whether the transactions on December 23, 2012, were in good faith and with a business purpose of sharing losses

Because Defendant has met its summary judgment burden, the burden now shifts to Petitioners to set out specific material facts supported by admissible evidence that show a genuine issue for trial. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-49 (1986). The court need not "comb the record" looking for such evidence; it is only required to consider evidence set forth in the moving and opposing papers and the portions of the record cited therein. Fed. R. Civ. P. 56(c)(3); *Carmen v. S.F. Unified Sch. Dist.*, 237 F.3d 1026, 1029 (9th Cir. 2001).

i. Petitioners' fleeting reference to their experts' conclusions that there was a potential to generate profits does not raise a genuine issue of material fact

Petitioners argue that several expert reports created for this litigation show that Petitioners had the potential for generating profits. This argument fails for two reasons. First, as Defendant explains, the potential for generating profits is relevant to a different legal doctrine—economic substance—that is not at issue here. Alternatively, even if Petitioners' expert reports were relevant to the doctrine that is at issue here—sham partnership—the Court does not rely on those reports because Petitioners' fleeting reference to these reports' *opinions* is insufficient to raise a genuine issue of material fact.

1. The experts opinion introduced by Petitioners are irrelevant to the sham partnership doctrine

A transaction may have "economic substance" but yet still be a "sham partnership" because the two doctrines have different elements. Under the "economic substance" doctrine, a transaction will "be respected for tax purposes" if it: "(1) has economic substance compelled by business or regulatory realities, (2) is imbued with tax-independent considerations, and (3) is not

shaped totally by tax-avoidance features." *Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 480 (5th Cir. 2011). In contrast, under the "sham partnership" doctrine, a "partnership will be respected for tax purposes" only if its partners formed it: (1) "in good faith"; and (2) "with a business purpose" of "join[ing] together [for] carrying on the business and sharing in the profits and losses." *Id.* at 483-84 (quoting *Comm'r v. Culbertson*, 337 U.S. 733, 741-42 (1949)).

In one paragraph, Petitioners contend that summary judgment is inappropriate because the experts Petitioners retained for this litigation have concluded that some of Petitioners' transactions "had a reasonable expectation of profit" and that some Petitioners "expected to receive some payout." Opp'n at 8-9 ("Petitioners' expert Cosimo Borrelli . . . has opined that both . . . transaction[s] . . . had a reasonable expectation of profit"), Statement of Genuine Disputes (Dkt. 65-1) at PSF15 ("Professor Oh . . . determined that Petitioners would have reasonably expected to receive some payout"). However, even if this Court could somehow substitute an experts' opinion in lieu of its own reasoning, these experts' conclusions that some Petitioners had a reasonable expectation for profit does not show that they were formed with a "business *purpose*" of "*sharing* in the profits and losses." *Southgate Master Fund, L.L.C.*, 659 F.3d at 483-84 (emphasis added). Indeed, other courts have found that a sham partnership existed despite also concluding that its partners' transactions contained economic substance. *Id.* at 484 (upholding district court's ruling that partnership was a sham because partners' conduct outside the partnership's formation "discloses no intent to conduct that business as a partnership," even while "[c]onced[ing]" that NPL transactions by members had economic substance because the members had the "intent at the time they acquired the NPLs . . . to conduct the business of realizing value from the loans"); *see also Andantech L.L.C. v. C.I.R.*, 331 F.3d 972, 980 (D.C. Cir. 2003) (holding that partnership was a sham, even "[t]hough it is possible that the . . . business could have been profitable and beneficial to any one of the parties involved").[9]

[9] Furthermore, the sham partnership doctrine differs from the economic substance doctrine in that the former can be established through evidence that is not considered under the latter. For

Because the Court concludes that Petitioners' expert reports are irrelevant to the question of whether Petitioners are sham partnerships, the Court EXCLUDES them from evidence.

2. Alternatively, even if Petitioners' expert opinions are relevant, Petitioners' fleeting reference to them is inadequate to raise a genuine issue of material fact

"A party asserting that a fact . . . is genuinely disputed must support the assertion by citing to *particular parts* of materials in the record . . . ." Fed. R. Civ. P. 56(c)(1)(A) (emphasis added). A court is "not required to comb the record to find some reason to deny a motion for summary judgment." *Carmen v. San Francisco Unified Sch. Dist.*, 237 F.3d 1026, 1029 (9th Cir. 2001). In addition, a district court is "under no obligation to take factual claims made by the parties and fashion them into legal arguments." *Smith v. Marsh*, 194 F.3d 1045, 1052 n.5 (9th Cir. 1999) ("Judges are not like pigs, hunting for truffles buried in briefs."); *Keenan v. Allan*, 91 F.3d 1275, 1279 (9th Cir. 1996) ("[I]t is not our task, or that of the district court, to scour the record in search of a genuine issue of triable fact. We rely on the nonmoving party to identify with reasonable particularity the evidence that precludes summary judgment."). In short, summary judgment is the "put up or shut up" moment in a lawsuit when the nonmoving party must show what evidence it has that would convince a trier of fact to accept its version of events. *See e.g., Berckeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195, 201 (3d Cir. 2006); *Weinstock v. Columbia University*, 224 F.3d 33 (2d Cir. 2000); *Schacht v. Wisconsin Dep't of*

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example, whether a sham partnership exists is determined by looking at the totality of the circumstances, including evidence of the partnership's business purpose at any point in time; "in contrast," whether a transaction has economic substance is "evaluated based on the information available to a prudent investor at the time the taxpayer entered into the transaction." *Southgate Master Fund, L.L.C. v. United States*, 659 F.3d 466, 484 n.66 (5th Cir. 2011) (explaining that conclusion that post-partnership-agreement conduct demonstrated a sham partnership "does not undercut our previous conclusion that the initial acquisition of the [investments] had economic substance").

Corrections, 175 F.3d 497 (7th Cir.1999); *Cox v. Kentucky Dep't of Transportation*, 53 F.3d 146 (6th Cir. 1995).

Here, denying Defendant's Motion would require this Court not only to comb the record but also to impermissibly refashion facts into legal arguments on Petitioners' behalf. In one sentence, Petitioners argue that summary judgment should be denied because their experts "concluded that the assets Petitioners acquired had significant value at the time of the transactions." Opp'n at 17-18. Petitioners do not discuss nor cite the specific facts on which these experts relied in reaching their conclusions. While a experts' opinions may be useful in helping a jury understand facts established by other evidence, this Court may not substitute experts' opinions on the ultimate issue—whether Petitioners' partners acted in good faith and with the business purpose of sharing losses when forming Petitioners—for actual facts.

In sum, Petitioners' fleeting references to their experts' conclusions without citation or discussion of the bases for those conclusions is insufficient to raise a material issue of genuine fact to defeat summary judgment.

ii. Petitioners' remaining evidence and argument is similarly irrelevant to the sham partnership doctrine

On the second day of oral argument, Petitioners presented this Court with a binder comprised of hundreds of pages of evidence that, Petitioners contended, this Court had overlooked in its tentative opinion. The Court reproduces here the entire extent to which that evidence was marshaled in any argument advanced by Petitioners in their written Opposition[10]:

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[10] The section of Petitioners' Opposition labeled "Argument" comprises only eleven pages. *See* Opp'n at 12-23. The first on-and-a-half pages of this section is devoted to the contention that Defendant did not properly meet and confer prior to filing this summary judgment motion, in violation of Local Rule 7-3. *See* Opp'n at 12-13. The Court concludes that this contention is without merit for several reasons, one of them being that this Court held a special hearing specifically to discuss when and if the parties would be filing summary judgment motions, and, at that hearing, Defendant informed everyone that it would be filing a summary judgment

> Prior to entering into these transactions, Dr. Nicholas and his advisors carefully analyzed the transaction. Morgan Stanley researched these transactions, myCFO provided a detailed analysis, and Mr. Gunther prepared his own analysis. PSF ¶¶ 9-11. Based upon that due diligence, Dr. Nicholas decided to invest in the transactions and enter into a one year contract with myCFO for professional services. PSF ¶ 12. Petitioners, thereafter, attempted to collect on the underlying investments—collecting millions from the Chinese and Korean debtors. PSF ¶¶ 18, 21.

Opp'n at 17.

> [Defendant's] argument ignores the management role Chenery undertook over several years to collect on the investment by interfacing and working with the foreign servicers. PSF ¶18 (citing Dep. Tr. of Tim Albertson at 36:23-37:12 ("But I can tell you that during the course of the years I worked [at Chenery], my sole job was to go and collect every dime that we could get through whatever means lawfully available to us. That was my entire duty."); *see also id.* ¶ 21. Chenery had a role in the partnership, it performed that role, and it shared in the proceeds. PSF ¶¶ 22, 24.

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motion by the deadline set in the Court's Scheduling Order. Thus, this case is quite distinguishable from *Singer v. Live Nation Worldwide, Inc.*, in which this Court denied a summary judgment motion filed six days before Christmas because the movant's attorney failed to substantially comply with Local Rule 7-3 when he emailed and faxed his opponent's attorney, who was on vacation, a mere three days before filing the motion. No. SACV 11-0427 DOC (MLGx), 2012 WL 123146, at *3 (C.D. Cal. 2012) (Carter, J.). Furthermore, the Court's denial of the summary judgment order in *Singer v. Live Nation Worldwide, Inc.*, did not mean that this Court blithely proceeded to trial, as Petitioners urge; rather, the movant in that case was able to once again file for summary judgment at a later date. *See* February 22, 2012, Mot. for Summary J. (CV 11-427 Dkt. 13).

Opp'n at 22-23. As previously noted, the acronym "PSF" does not refer to any specific part of the record, but rather to paragraphs under the heading "Petitioners' New Facts Creating Genuine Issues" located in their document titled "Statement of Genuine Disputes." *See* Statement of Genuine Disputes (Dkt. 65-1) at 45.

Even taking Petitioners' assertions as true, none of this "evidence" contradicts the fact that Chenery expressly disclaimed a business purpose of sharing losses when it told Nicholas that Chenery "arranged" Petitioners to ensure that the Nicholas-controlled entities could be partners "without risk of economic loss." *See* Statement of Genuine Disputes (Dkt. 65-1) at 16-17; EX384.0001. First, even if "Nicholas and his advisors carefully analyzed the transaction[s]," this fact does not assist Petitioners because the issue here is whether Petitioners were formed in good faith and with the business purpose of sharing losses, not whether Nicholas devoted enough resources and energy to analyzing the transaction. *See* Opp'n at 17. Indeed, this fact is entirely consistent with Defendant's theory that Nicholas devoted significant resources to analyzing exactly how much he could claim in bogus tax losses, as evinced by Gunther's hand-written notes.

Second, even assuming that "Chenery had a role in the partnership, it performed that role, and it shared in the proceeds," this fact does not assist Petitioners because the issue here is whether Petitioners were formed in good faith and with the business purpose of sharing losses, not whether the transactions had some economic substance. Indeed, Petitioners' argument is nearly identical to that rejected by other courts. *See Southgate Master Fund, L.L.C.*, 659 F.3d at 484 (upholding district court's ruling that partnership was a sham because partners' conduct "discloses no intent to conduct that business as a partnership," even while "[c]onced[ing]" that NPL transactions by members had economic substance because the members had the "intent at the time they acquired the NPLs . . . to conduct the business of realizing value from the loans").

Third, to the extent that Petitioners' hundreds of pages of evidence could be refashioned into a relevant legal theory, Petitioners' failure to explain how this constellation of facts coheres into a cognizable legal argument renders this evidence meaningless. *See Smith v. Marsh*, 194

F.3d 1045, 1052 n.5 (9th Cir. 1999) ("[A] district court [is] under no obligation to take factual claims made by the parties and fashion them into legal arguments").

Finally, Petitioners advanced another unsupported theory at oral argument that summary judgment is per se precluded whenever the legal issue involves a determination of the intent of a party. This argument has no merit. Summary judgment is entirely appropriate where, as here, the movant has presented evidence of the non-movant's failure to prove an essential element of its claim—namely, that Petitioners were formed in good faith and for a business purposes of sharing losses—and the non-movant has failed to raise a genuine issue of material fact. *See Musick v. Burke*, 913 F.2d 1390, 1394 (9th Cir. 1990). Taken to its logical conclusion, Petitioners' argument would require every court to hold a lengthy bench trial whenever any tax payer challenged the Commissioner's decisions to disallow tax losses. Such a rule would allow wealthy tax payers to bring the Internal Revenue Service to its knees by first dragging the Commissioner through years of litigation[11] and then forcing the Commissioner to expend tens of thousands of dollars on a bench trial—here, estimated to last twenty days—despite the tax payers' abject failure to produce any relevant evidence over the course of those years of litigation.

e. Conclusion

In sum, Defendant could have met its burden on summary judgment by merely pointing out Petitioners' *absence* of evidence establishing their good faith or business purpose of joining together for carrying on the business and sharing in the profits and losses. However, Defendant went further and introduced admissible evidence that Petitioners' partner, Chenery, expressly disclaimed such a business purpose by telling Nicholas that Chenery "arranged" Petitioners to ensure that the Nicholas-controlled entities could be partners "without risk of economic loss." *See* Statement of Genuine Disputes (Dkt. 65-1) at 16-17; EX384.0001. Petitioners' rebuttal "evidence" consists only of inadmissible expert opinions regarding a legal doctrine not at issue

[11] Indeed, this case has already consumed three years.

here and other similarly irrelevant evidence. Thus, the Court GRANTS Defendant's Motion for Summary Judgment.

IV. Disposition

For the forgoing reasons, the Court GRANTS Defendant summary judgment on all of Plaintiffs' claims.

DATED: September 21, 2012

David O. Carter

DAVID O. CARTER
UNITED STATES DISTRICT JUDGE