No. 13-4298

**IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

BARNES GROUP, INC. AND SUBSIDIARIES,

Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

**ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT**

BRIEF FOR THE APPELLEE

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GLOSSARY

A.	Joint appendix
ASA	Associated Spring-Asia PTE Ltd.
Barnes	Barnes Group, Inc.
Bermuda	Barnes Group Finance Company (Bermuda) Limited
Br.	Appellant's opening brief
CFC	Controlled foreign corporation
Delaware	Barnes Group Finance Company (Delaware)
I.R.C. or Code	Internal Revenue Code (26 U.S.C.)
IRS	Internal Revenue Service
PwC	PricewaterhouseCoopers
Subpart F	Sections 951 through 965 of the Code
SA.	Supplemental Appendix
Treas. Reg.	Treasury Regulation (26 C.F.R.)

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ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

On August 20, 2009, the Commissioner issued a notice of deficiency under § 6212(a) of the Internal Revenue Code of 1986 (26 U.S.C.) (the Code or I.R.C.)[1] to Barnes Group, Inc. and Subsidiaries, determining deficiencies in its federal income taxes and accuracy-related penalties for the years 1998, 2000, and 2001. (A.803-29.) On

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[1] Unless otherwise indicated, all statutory references are to the Code, as amended and in effect at the time in question.

November 16, 2009, Barnes filed a timely petition in the Tax Court (A.4-28), contesting the Commissioner's determinations. I.R.C. § 6213(a). The Tax Court had jurisdiction under §§ 6213(a) and 7442.

The Tax Court entered a decision on August 20, 2013. (A.538-39.) The decision was final and disposed of all parties' claims. Barnes filed a timely notice of appeal (A.540-41) on November 8, 2013. I.R.C. § 7483. This Court has jurisdiction under § 7482(a)(1).

STATEMENT OF THE ISSUES

In 2000 and 2001, Barnes engaged in a prearranged series of transactions with its subsidiaries through which it repatriated $62 million of offshore funds from its controlled foreign subsidiary without paying any federal income tax. If the inter-company transactions are characterized as dividends, then the repatriated funds were subject to tax in the years of receipt. The questions presented are:

1. Whether the Tax Court correctly applied the step-transaction doctrine in determining that, in substance, the transactions effected a taxable dividend.

2. Whether the Tax Court correctly determined that the accuracy-related penalty for substantial understatement of tax imposed by I.R.C. § 6662 was applicable with respect to Barnes's underpayment of tax.

STATEMENT OF THE CASE

A. Introduction

This case involves the tax consequences of a carefully structured plan designed to enable a U.S. parent company to repatriate funds from its foreign subsidiary without paying U.S. federal income tax. In a notice of deficiency, the Commissioner increased Barnes's income to reflect the cash that Barnes had routed from the foreign subsidiary through two newly formed subsidiaries and received in 2000 and 2001. (A.803-29.) The Commissioner also imposed accuracy-related penalties. (A.803.) Barnes brought this suit in the Tax Court, challenging the Commissioner's determinations. (A.4-56.) After a trial, the Tax Court issued a memorandum findings of fact and opinion sustaining the deficiencies and penalties. (A.472-537.) The court later entered a decision determining total income tax deficiencies of $3,099,326 and total penalties of $2,040,276 for 1998, 2000, and 2001. (A.538-39.)

B. Barnes's plan to repatriate $62 million from its controlled foreign corporation without paying any tax

1. In 2000, Barnes had a Singapore subsidiary, ASA, that had generated substantial amounts of untaxed earnings from its operations in Southeast Asia. (A.66 ¶11, A.944.) Barnes wanted to use ASA's offshore cash in the United States, primarily to pay off its high-interest rate debt. (A.958-63.) A distribution from ASA to Barnes, however, would have been subject to taxation in full in that year. Sections 301(a), 301(c), and 316 of the Code provide a framework for taxation of corporate distributions of property, including money. *See* I.R.C. § 317(a). A distribution with respect to stock (*i.e.*, not due to the shareholder's status as a creditor, seller, etc.) is a dividend that must be included in the shareholder's ordinary gross income under §§ 301(c)(1) and 61(a)(7) to the extent that it comes out of the corporation's earnings and profits. I.R.C. § 316(a); Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶¶8.02, 8.06 (7th ed. 2014). Barnes does not dispute that ASA had earnings and profits in excess of the amounts Barnes received. (*See* A.479 n.9, A.944, 950.)

Therefore, if ASA made distributions to Barnes, the distributions would be subject to tax in full during the years in issue.

2. Subpart F of the Code, which governs the taxation of the income of U.S.-owned controlled foreign corporations, dictates that although such income is not taxable in the United States when earned, it *is* subject to taxation if it is ever invested in "United States property." I.R.C. §§ 951-964; *Merck & Co., Inc. v. United States*, 652 F.3d 475, 476-77 (3d Cir. 2011). The provisions of Subpart F were enacted in part to eliminate perceived deficiencies in the existing tax scheme resulting from the deferral of U.S. tax on income earned by CFCs. H.R. Rep. No. 1447 (1962); S. Rep. No. 1881 (1962). Congress imposed a tax on CFC investments in U.S. property in order "to prevent the repatriation of income to the United States in a manner which does not subject it to U.S. taxation," H.R. Rep. No. 1447, at 58, and because the use of a CFC's earnings to make such investments "is substantially the equivalent of a dividend" to shareholders of the CFC, S. Rep. No. 1881, at 88.

For purposes of Subpart F, United States property includes any debt obligation of United States companies. § 956(c)(1)(C). In other

words, if a controlled foreign corporation lends money to its U.S. parent, the CFC has invested in U.S. property, and the parent corporation owes federal income tax on the amount of the loan, to the extent that the transferred funds had not previously been subject to tax. The parties have stipulated that ASA was a controlled foreign corporation within the meaning of Subpart F. (A.66 ¶10.) Therefore, ASA could not make a loan to Barnes without the proceeds being subject to taxation in full in that year.

3. Barnes understood that either a dividend or a loan from ASA to Barnes would trigger a U.S. tax liability (A.127, 962, 3129), and did not want to pay the federal income tax that would be due if it simply caused ASA to distribute or loan to it ASA's substantial excess cash (A.143-44, 233, 958-63). Accordingly, it sought advice from Ernst & Young and Deloitte & Touche on how to repatriate ASA's funds without incurring a tax. (A.321.) After rejecting the ideas proposed by those two firms, Barnes contacted PricewaterhouseCoopers (PwC) and discussed several "repatriation strategies for funds from Singapore." (A.3132; *see* A.321-22.)

Barnes chose a cash repatriation strategy described in entry number 1365 of PwC's internal "ideasource" database of tax strategies. (A.1746, 3058-61.) According to PwC, the strategy "can be used by U.S. multinational companies to repatriate cash from foreign subsidiaries without triggering an income inclusion for U.S. income tax purposes." (A.3058.) The "user profile" for the strategy included "U.S. multinational companies that have large pools of low taxed cash offshore that they would like to bring back to the U.S." (A.3058.) The strategy called for a CFC to purchase preferred stock from a domestic finance company in a way that gave the CFC a zero basis in the preferred shares. (A.3059.) Although the structure "can be left in place for long periods of time," PwC warned that "clients should be cautioned that they should plan on actually paying a return on the preferred stock at some point in time[.]" (A.3059.)

Joseph DeForte, Barnes's vice president of tax, took the lead in working with PwC to develop the repatriation scheme. (A.174, 1124.) DeForte recommended to William Denninger, Barnes's senior vice president of finance and chief financial officer, that Barnes proceed with "the transfer of cash plan that [PwC] and I have been developing."

(A.959.) In DeForte's view, the strategy was an opportunity to "transfer cash from Singapore to the US without a tax liability." (A.958.) DeForte explained that without a repatriation strategy, Barnes would incur a U.S. tax cost of 35 percent for repatriating earnings from foreign subsidiaries. (A.358, 962.) DeForte informed Denninger that PwC had quoted a fee of $500,000 for the idea plus $100,000 to $200,000 for implementation costs. (A.959.) Denninger approved proceeding with the plan. (A.141-42, 152.)

In order to "help[ ] to support the business purpose" behind the repatriation scheme (A.3079), PwC addressed its engagement letter (A.1683-88) to John Locher, Barnes's treasurer, instead of to DeForte, even though DeForte had negotiated PwC's fee arrangement (A.155, 182, 332, 359). The engagement letter provided that PwC's services would include "designing an appropriate structure; working closely with personnel of [Barnes] and its subsidiaries to implement the structure; and providing tax opinions in the countries with subsidiaries affected by the structure," including the United States. (A.1683.) The fee arrangement included two components. The first component required Barnes to pay 70 percent of PwC's standard rates for work performed.

(A.1684.) The second component, to be paid at the completion of the engagement, was based on an agreement at that time as to the quality of PwC's services. (A.1684.) The factors to be considered in determining the quality of PwC's services included, among other factors, the "value added" to Barnes by PwC. (A.1684.)

PwC provided Barnes with a "draft" of a "business purpose" for the repatriation scheme. (A.3075-76; *see* A.261-62.) PwC had used a similar template for other clients. (A.262.) The template therefore included "XXXXX" in place of a company name and described the company as a "multinational transportation company," which Barnes was not. (A.3075-76; *see* A.261, 889, 919.) Barnes incorporated the template's bullet-point list of ten separate business purposes, substantially verbatim, into a document that it then sent back to PwC. (A.1134-36.)

Barnes and PwC developed the transaction structure for the repatriation scheme during the summer of 2000. (A.188, 1689.) DeForte took the lead for Barnes. (A.174, 1124, 1153-60.) PwC's team included James Parent, the engagement manager responsible for PwC's services to Barnes, and Paul Coneys, a partner who had worked on the

same transaction for another client. (A.358-59, 444, 449-52, 3078.) With assistance from PwC, Barnes's legal department drafted the board of director resolutions to implement the repatriation scheme. (A.3099-3102, 3111.) PwC was concerned that if the board did not support the business purpose, the plan could be viewed as "tax planning only." (A.3123.)

C. Implementation of the tax scheme

To accomplish the goal of repatriating ASA's cash without triggering any U.S. tax, Barnes formed two new wholly owned subsidiaries, Barnes Group Finance Company (Bermuda) Limited ("Bermuda") and Barnes Group Finance Company (Delaware) ("Delaware"). (A.66 ¶12, A.67 ¶15, A.378-79.) Bermuda, like ASA, was a CFC. (A.66 ¶13.) Consistent with its tax-avoidance strategy, Barnes included Bermuda and Delaware in the plan because

> [a] loan directly into US will result in [ASA] having a basis in the investment (the loan) equal to the loan amount and the US parent company will have an income pickup. By running the transaction through [Bermuda] and in turn through [Delaware], [ASA] will still have an investment but the Barnes Group US income pickup will be zero.

(A.3129.) Bermuda and Delaware had no paid employees and nominal amounts of cash in 2000 and 2001. (A.494-95, 669-75, 713-47, 1709-10; SA.266-72, 329-49.) Denninger, Locher, and David Sinder (Barnes's assistant treasurer) were members of the boards of directors of both Bermuda and Delaware. (A.80 ¶¶7-8, A.856-60.)

The boards of directors of ASA, Bermuda, and Delaware executed an agreement and plan of reinvestment as of December 6, 2000. (A.830-37.) Denninger signed the agreement on behalf of Barnes, Locher signed the agreement on behalf of Delaware, Sinder signed the agreement on behalf of Bermuda, and Barnes's general counsel signed the agreement on behalf of ASA. (A.837.) Sinder was responsible for the movement of all of the cash under the plan, in accordance with instructions from Barnes's senior management. (A.81 ¶¶10-11.)

The funds that Barnes would repatriate from ASA came from three sources: (i) cash from ASA's operations, (ii) ASA's borrowings from a third-party bank, and (iii) debt that foreign affiliates repaid to ASA out of funds that Barnes lent to them for that purpose. (A.365-67, 1154-60, 1695-97, 3104, 3125, 3131.) To maximize the amount of the repatriation, the reinvestment plan was structured in two parts, with

the same entities performing a similar set of transactions twice. (A.830-33.) There was no doubt that every step of the plan would be implemented once the initial step was implemented. (A.148, 830-33.)

Part 1 of the reinvestment plan took place in December 2000 and is summarized below.

1. Barnes transferred Singapore dollars (equivalent to $222,000) to Bermuda in exchange for common stock of Bermuda. (A.68 ¶20.)

2. Barnes then contributed all of the shares of Bermuda and Singapore dollars (equivalent to $2,950,000) to Delaware in exchange for Delaware's common stock. (A.68 ¶21.)

3. Next, ASA transferred Singapore dollars (equivalent to $39 million) to Bermuda in exchange for 39 million shares of Bermuda's common stock. (A.68 ¶22.)

4. Bermuda then transferred Singapore dollars (equivalent to $39,222,000) and 2,950,000 shares of its own common stock to Delaware in exchange for Delaware's issuance of 42,172 shares of Delaware preferred stock to Bermuda. (A.68 ¶23.)

5. Finally, Delaware converted the Singapore dollars to $42,114,815 (A.68 ¶24) and transferred $42,105,000 to Barnes as a "loan" (A.1111). The vast majority of that "loan" was cash from ASA.[2]

In part 2 of the repatriation scheme, Barnes performed essentially the same transactions in July 2001, but this time, ASA borrowed three billion Japanese yen from a third-party bank instead of using cash that it already held. (A.69 ¶27, A.964-1084.) Barnes guaranteed the loan. (A.1085-1108.) After a set of preliminary transactions similar to those in part 1 of the plan (A.69 ¶¶25-26, 28), Bermuda transferred 2.9 billion Japanese yen (equivalent to $23,444,009) and 1,750,000 shares of its own common stock to Delaware in exchange for Delaware's issuance of 25,127 shares of Delaware preferred stock to Bermuda (A.69 ¶29). Part 2 of the repatriation scheme resulted in Delaware's transfer of $25.5 million to Barnes as a "loan," with the vast majority of that "loan"

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[2] The balance consisted of a circular cash flow from Barnes. Specifically, the "loan" amount included: the $39 million that ASA transferred to Bermuda (step 3, *supra*) and Bermuda then transferred to Delaware (step 4); the $222,000 that Barnes had transferred to Bermuda (step 1) and Bermuda then transferred to Delaware (step 4); and the $2,950,000 that Barnes had transferred to Delaware (step 2). *See* A.492 n.27-28.

coming from ASA's third-party bank loan. (A.1115.) In total, as a result of both parts of the repatriation scheme, Delaware, in form, loaned $67,605,000 to Barnes (the "Delaware loans"). (A.1111-18.) Barnes used the cash from the loans to pay off its own external debt. (A.148.)

Barnes did not sign contemporaneous notes or loan agreements for the Delaware loans. Instead, Lawrence O'Brien signed notes and loan agreements sometime after he was hired as Barnes's vice president and treasurer in August 2001, but the documents were backdated to December 26, 2000, and July 10, 2001.[3] (A.80 ¶¶3-4; A.1111-18.) The loan agreements had no fixed repayment schedule; instead, they provided for repayment of the principal upon Delaware's demand but required Barnes to make annual interest payments on the unpaid principal balance at a fixed rate equal to 7.5 percent commencing

[3] In what Barnes contended to be a typographical error (A.497 n.34), Inter-company Loan Agreement #1 is dated "as of December 26, 2001." (A.1111.) The corresponding note "of even date herewith" is dated "December 26, 2000." (A.1114.) The note corresponding to Inter-company loan agreement #2 includes a handwritten change from "July 10, 2000" to "July 10, 2001." (A.1118.)

December 1, 2002. (A.1112, 1116.) As of December 31, 2010, the total Delaware loan balance reported on Barnes's tax return was $127,202,495, or almost $60 million more than the original total amount of $67,605,000. (A.5239, 5244; *see* A.4786, 4368, 3942, 3509, 2870, 2438, 2191, 1964, 728; SA.344.)

D. PwC's opinion letter

PwC prepared an opinion letter for Barnes that addressed one aspect of the repatriation scheme: the "specific question" presented by Bermuda's investment in Delaware's preferred stock. (A.1405, 3031; *see* A.267-68.) In preparing the opinion letter, PwC claimed to rely on two documents that it had drafted: the business purpose document (A.259-60) and a letter of background facts and representations (A.205-06, 3028-33, 3039-40, 3111, 3126).

James Parent, the PwC engagement manager, commented on a draft of the opinion letter that he was "<u>not clear as to what a valid business purpose is for this transaction</u>" (A.3106 (emphasis in original).) Parent also raised concerns that the letter did not analyze why the transaction should not be recharacterized as a dividend under § 301 or why the step-transaction doctrine did not apply. (A.3106-07.) Parent

questioned why ASA would borrow money if it could not invest the cash that it currently had on hand. (A.3107.) Parent also asked whether the analysis should start with ASA (instead of with Bermuda) and observed that, if so, the most direct form of investment was from ASA to Barnes. (A.3107.) Another member of PwC's team agreed that technically the analysis could start with ASA. (A.3109.) Parent also expressed concern that a recent IRS determination (not mentioned in the opinion letter) dealt with cash repatriation and showed that the IRS looked very closely at business purpose, economic substance, and the step-transaction doctrine.[4] (A.3108.)

In its letter, PwC opined that Delaware's issuance of preferred stock to Bermuda qualified under § 351 of the Code, which provides for nonrecognition of gain or loss upon the transfer of property to a corporation solely in exchange for stock in the corporation, if immediately after the exchange the transferor is in control of the corporation. (A.3043-51.) *See* I.R.C. § 351(a). PwC stated that

[4] Parent referred to Field Service Advisory 200031023, 2000 WL 33120107 (Aug. 4, 2000), where the IRS recharacterized a repatriation transaction under economic substance and step transaction principles.

although Bermuda was investing in Delaware's preferred stock, which constituted "U.S. property" under § 956, Bermuda had a zero basis in those shares, and therefore Barnes had no Subpart F inclusion as a result of Bermuda's acquisition of that stock. (A.3040-41, 3051-52.) The letter included the limitation that it did not address any federal income tax consequences not directly expressed, and that it "only addresses the proposed transaction described above." (A.3057.) The letter also included the caveat that it was

> premised on all steps of the proposed transaction being implemented as described herein, including the proper execution of any and all applicable agreements and corporate documents needed to implement the proposed transaction. Failure to implement the proposed transaction as described above could adversely affect the conclusions reached in this opinion.

(A.3057.)

E. Tax reporting

Barnes filed consolidated corporate income tax returns for the years at issue. (A.566-802; SA.1-396.) DeForte signed the returns. (A.566; SA.1, 152.) Barnes reported no income attributable to the repatriation scheme in its returns for 2000 and 2001. (A.566-802; SA.152-396.) Barnes reported a taxable loss of $503,654 for 2000

(SA.152), which it claimed as a net operating loss carryback for 1998 (A.809). Barnes reported a taxable loss of $10,754,459 for 2001. (A.566.)

In a notice of deficiency, the Commissioner increased Barnes's taxable income for 2000 by $38,919,950, and its taxable income for 2001 by $19,378,596, to reflect ASA's cash that was transferred to Barnes under the repatriation scheme. (A.809-10.) The Commissioner also disallowed Barnes's net operating loss carryback to 1998. (A.809.) The Commissioner explained that the cash repatriated from ASA was dividend income. (A.810.) The Commissioner also determined that Barnes was liable for accuracy-related penalties under § 6662 of the Code for 1998, 2000, and 2001. (A.803, 809, 811.)

F. Tax Court proceedings

Barnes filed a petition in the Tax Court (A.4-28), and a trial was held in February 2012 (A.83-471). The Tax Court ruled for the Commissioner, holding that, under the step-transaction doctrine, Barnes was not entitled to repatriate ASA's funds without paying the federal income tax due. (A.472-537.) The court rejected Barnes's contention that Revenue Ruling 74-503, where the IRS had determined

on the facts presented that the basis of stock received by each corporation in a § 351 transaction was zero, precluded the Commissioner from challenging the repatriation scheme. (A.507-11.) The court explained that the ruling was inapposite because the substance of the repatriation scheme was a dividend from ASA to Barnes (A.509), and also because the Bermuda/Delaware exchanges were "part of a series of steps in an integrated transaction mandated by contractual agreement" and therefore should not be compared, in isolation, to the facts of the revenue ruling, as Barnes sought to do (A.510-11).

On the merits, the Tax Court pointed out that a transaction's substance, not its form, governs for tax purposes (A.517), and that particular scrutiny should be applied to (as here) transactions between related parties (A.522). The court explained that, under the step-transaction doctrine, intervening transactional steps may be disregarded if their purpose was to achieve tax consequences differing from those which a direct path would have produced. (A.518.) The court therefore held that the various interdependent steps of the repatriation scheme were "properly collapsed into a single transaction."

(A.527.) In making that determination, the court found that Barnes had failed to prove that Bermuda and Delaware were created for a legitimate nontax business purpose, and also found that Barnes had not shown that it respected the form of its own reinvestment plan. (A.522-27.) The court also found that Barnes's assertion that the repatriation scheme was intended to be temporary conflicted with the "objective facts." (A.527.) The court therefore held that the repatriation scheme was, in substance, dividend payments from ASA to Barnes, taxable under § 301. (A.527.)

The Tax Court also upheld the Commissioner's imposition of accuracy-related penalties under § 6662 for Barnes's substantial understatement of its income tax. (A.530-36.) The court rejected Barnes's contention that Revenue Ruling 74-503 provided substantial authority for its tax treatment of the reinvestment plan, in light of the "long history" of the substance-over-form doctrine, coupled with Barnes's inability to establish a business purpose for Bermuda or Delaware. (A.533-34.) The court also rejected Barnes's contention that it was excused from accuracy-related penalties because it acted with reasonable cause and in good faith in relying on PwC's opinion letter.

(A.534-36.) The court found that, although Barnes's employees were "highly knowledgeable people who knew what they were doing," they nevertheless "did not act in accordance with the specific requirements of the plan as stated in the PwC opinion letter." (A.536.) The court entered its decision (A.538-39), and this appeal by Barnes followed (A.540-41).

SUMMARY OF ARGUMENT

The Tax Court properly applied the well-established principle that substance prevails over form for federal tax purposes in determining that Barnes's repatriation scheme constituted the payment of a taxable dividend to Barnes by its controlled foreign corporation, ASA. Barnes wanted to make use of its foreign subsidiary's cash, but knew that doing so directly (through a dividend or loan) would create a U.S. tax liability. Barnes therefore purchased from PricewaterhouseCoopers (PwC) a tax scheme intended to permit it to repatriate $62 million of its subsidiary's foreign funds tax-free. The Tax Court held that the repatriation scheme used by Barnes was ineffective to accomplish its intended tax avoidance because, in substance, Barnes had received dividends of $62 million from its subsidiary. That holding is fully supported by the record.

Under the step-transaction doctrine, interrelated, intermediary steps in an integrated transaction are not given independent tax significance. The repatriation scheme consisted of a series of prearranged steps, including the creation of new foreign and domestic subsidiaries, that served no business purpose of Barnes but, instead, were intended to disguise the true nature of the transaction, *i.e.*, a repatriation by Barnes of ASA's excess cash. In refusing to let Barnes's labels dictate the taxation of the transaction's substance, the court correctly followed the fundamental principle that the minimization of a tax liability may not be accomplished through form alone. The Tax Court also correctly rejected Barnes's misguided contention that a revenue ruling precluded the Commissioner from challenging Barnes's return position in this case.

The Tax Court also correctly upheld the Commissioner's determination that Barnes is liable for penalties for its substantial understatement of its tax. Barnes's attempted reliance on the advice it received from PwC to establish reasonable cause for its tax underpayments is misplaced because (i) PwC designed and promoted the repatriation scheme to Barnes and financially benefitted from its

implementation, and (ii) the advice was not based on all pertinent facts and further was based on unreasonable assumptions.

The Tax Court's decision is correct and should be affirmed.

ARGUMENT

I

The Tax Court correctly determined that Barnes owed federal income tax on the $62 million it repatriated from its controlled foreign subsidiary

Standard of review

The propriety of a court's general characterization of a transaction for tax purposes is a question of law subject to *de novo* review. The court's findings of fact that inform the court's characterization of a transaction are reviewed for clear error. *Frank Lyon Co. v. United States*, 435 U.S. 561, 581 n.16 (1978).

A. The step-transaction doctrine

This case concerns an attempt by Barnes to repatriate funds from its Singapore subsidiary (ASA) without paying federal income tax. Rather than arrange a straightforward dividend or a loan from ASA—arrangements that would have resulted in the imposition of tax—Barnes attempted to achieve the same result while simultaneously

avoiding the imposition of tax by engaging in PwC's repatriation scheme. As the Tax Court held—and Barnes does not dispute—Barnes bore the burden of proving that the Commissioner's determination was incorrect. (A.505.) To satisfy that burden, Barnes must demonstrate that its repatriation scheme did not run afoul of the step-transaction doctrine. *See Del Commercial Properties, Inc. v. Commissioner*, 251 F.3d 210, 215 (D.C. Cir. 2001); *Stewart v. Commissioner*, 714 F.2d 977, 991-92 (9th Cir. 1983).

Because the Tax Court's application of the step-transaction doctrine rested on many particularized factual findings, Barnes devotes much of its opening brief to the contention that those findings are clearly erroneous. (Br.23-24, 26-44.) The "clearly erroneous" standard requires the appellate court to uphold any trial court determination "that falls within a broad range of permissible conclusions." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 400 (1990). If the trial court's "account of the evidence is plausible in light of the record viewed in its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. Where there are two permissible views of the

evidence, the factfinder's choice between them cannot be clearly erroneous." *Anderson v. Bessemer City*, 470 U.S. 564, 573-74 (1985).

The step-transaction doctrine is a manifestation of the more general, fundamental principle that the incidence of taxation depends upon the substance, rather than the form, of a transaction. *See Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945); *True v. Commissioner*, 190 F.3d 1165, 1174 (10th Cir. 1999); *Long Term Capital Holdings v. United States*, 330 F. Supp. 2d 122, 191 (D. Conn. 2004), *aff'd*, 150 Fed. Appx. 40 (2d Cir. 2005) (summary order). The Supreme Court has expressly sanctioned the step-transaction doctrine, noting that "interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction." *Commissioner v. Clark*, 489 U.S. 726, 738 (1989); *see also Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938) ("A given result at the end of a straight path is not made a different result because reached by following a devious path"); *Court Holding*, 324 U.S. at 334. The step-transaction doctrine "treats the 'steps' in a series of formally separate but related transactions involving the transfer of property as a single transaction, if all the steps are substantially linked.

Rather than viewing each step as an isolated incident, the steps are viewed together as components of an overall plan." *Greene v. United States*, 13 F.3d 577, 583 (2d Cir. 1994) (citation omitted); *Long Term Capital,* 330 F. Supp. 2d at 191.

Courts generally have identified three basic tests for determining whether to apply the step-transaction doctrine: the "interdependence," the "end result," and the "binding commitment" tests. *Associated Wholesale Grocers, Inc. v. United States*, 927 F.2d 1517, 1522 (10th Cir. 1991); *Long Term Capital*, 330 F. Supp. 2d at 191. The tests are not mutually exclusive, and the step-transaction doctrine will operate if the circumstances satisfy only one of the tests. *True*, 190 F.3d at 1175; *Long Term Capital*, 330 F. Supp. 2d at 191. Under the interdependence test, the court will disregard the tax effects of individual transactional steps "if it is unlikely that any one step would have been undertaken except in contemplation of the other integrating acts." *Kuper v. Commissioner*, 533 F.2d 152, 156 (5th Cir. 1976); *accord South Bay Corp. v. Commissioner*, 345 F.2d 698, 703-04 (2d Cir. 1965). Under the end-result test, the step-transaction doctrine applies if the parties have a "prearranged plan" and an "understanding" that they will achieve an

end result indirectly in order to avoid a tax liability attached to a direct route. *Greene*, 13 F.3d at 583; *accord Blake v. Commissioner*, 697 F.2d 473, 480 (2d Cir. 1982). The binding commitment test applies where, at the time of the first step, there is a binding commitment to take the later steps. *McDonald's Restaurants of Illinois, Inc. v. Commissioner*, 688 F.2d 520, 525 (7th Cir. 1982). As we will demonstrate, under any of the three tests, the transactions in Barnes's repatriation scheme are properly stepped together.

Because the repatriation scheme was executed among related parties, the Tax Court properly subjected it to extra scrutiny. (A.522, 527.) *See Merck & Co. v. United States*, 652 F.3d 475, 481 (3d Cir. 2011); *Kornfeld v. Commissioner*, 137 F.3d 1231, 1235 (10th Cir. 1998); *Kraft Food Co. v. Commissioner*, 232 F.2d 118, 123 (2d Cir. 1956). Neither the overall plan nor its component transfers were negotiated at arm's length. During 2000 and 2001, Barnes directly or indirectly owned 100 percent of the stock of Bermuda, Delaware, and ASA. (A.66-67.) Officers of Barnes signed the "plan of reinvestment" on behalf of all of the parties. (A.837.) *See Milbrew, Inc. v. Commissioner*, 710 F.2d 1302, 1305 (7th Cir. 1983) ("When persons who are not dealing with

each other at arm's length enter into a transaction that gives them tremendous tax savings, the Internal Revenue Service is entitled to be suspicious of the genuineness of the transaction.") Here, Barnes occupied "both sides of the bargaining table," and the form of the repatriation strategy did not correspond to its "intrinsic economic nature." *Merck*, 652 F.3d at 481 (citation omitted).

B. The Tax Court properly applied the step-transaction doctrine to the interdependent steps of the repatriation scheme

1. The Bermuda/Delaware exchanges were components of an integrated scheme to repatriate ASA's offshore funds without a U.S. tax cost

The Tax Court correctly applied the interdependence test to characterize the repatriation scheme as a dividend under the step-transaction doctrine. (A.521-27.) Because the Bermuda/Delaware exchanges were steps in a prearranged plan to "transfer cash from Singapore to the US without a tax liability" (A.958), it is "unlikely" that those exchanges "would have been undertaken except in contemplation of the other integrating acts." *Kuper*, 533 F.2d at 156. As the Tax Court found, the purported § 351 exchanges would have been "fruitless"

without the other steps necessary to accomplish Barnes's transfer-of-cash objective. (A.521.) *See True*, 190 F.3d at 1178; *South Bay*, 345 F.2d at 704. An integrated transaction carried out in accordance with a preconceived plan cannot be split up into its component parts for tax purposes. *Pickard v. Commissioner*, 113 F.2d 488, 488 (2d Cir. 1940) (exchange did not qualify under predecessor to § 351 where plan necessitated passing of control).

Barnes and PwC created a series of prearranged steps to disguise the intended tax-free repatriation of ASA's funds. *See Court Holding*, 324 U.S. at 334; *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). Barnes formed Bermuda and Delaware specifically for the purpose of the repatriation scheme (A.378-79, 3129), and those two new wholly owned subsidiaries had no paid employees, nominal amounts of cash, and boards that were controlled by officers of Barnes (A.670-71, 713-47, 856-60, 1709-10; SA.266-68, 329-49). Bermuda then transferred a small percentage of its common stock to Delaware, along with approximately $62 million in cash that it had received from ASA, in "exchange" for Delaware's preferred stock. (A.68-69 ¶¶23, 29.) In essence, Barnes contends that by forming Bermuda and Delaware, and by sprinkling a

small amount of Bermuda's common stock in with the $62 million in cash that Bermuda transferred to Delaware (in purported § 351 transactions), Barnes avoids being required under §§ 301, 951(a) and 956 to include the repatriated $62 million in its income.

The Tax Court correctly applied the step-transaction doctrine to look through the form of the repatriation scheme to its substance. (A.517-27.) The repatriation scheme was an integrated scheme that Barnes purchased from PwC in order to repatriate cash from ASA without a U.S. tax cost. (A.958, 3058-59.) Barnes does not dispute that it sought to repatriate ASA's cash for its own use, and that in short order, the cash in issue moved from ASA to Barnes. (A.156, 1111-18.) When the cash left Singapore, there was no doubt that Barnes would receive it, as Denninger, Barnes's CFO, conceded. (A.148.) The § 351 exchanges were "unnecessary to the achievement of the desired exchange of interests," the transfer of ASA's offshore cash Barnes. *Kuper*, 533 F.2d at 158. That offshore cash was "all along intended to come into [Barnes's] hands" and has not been repaid. *Minnesota Tea*, 302 U.S. at 613. Whether the reason for the repatriation of ASA's funds was Barnes's desire to fund "one or more international acquisitions"

later, or simply to pay off Barnes's high-interest debt (Br.5-7; *see* Br.8, 43, A.3034), is irrelevant. Once ASA's funds were effectively distributed to Barnes, tax was due. *See* I.R.C. § 301.

The record demonstrates that Barnes intended to accomplish through a series of interrelated steps the end result of placing ASA's cash in its own hands. The "most direct route" of investment—as Parent of PwC recognized—was from ASA to Barnes. (A.3107.) Paul Coneys, a PwC partner, acknowledged that a loan from ASA to Barnes would have involved one step, and a distribution from ASA to Barnes would have involved one or two steps, but the reinvestment plan involved substantially more than two steps. (A.271-73.) The Bermuda/Delaware exchanges did not "make[ ] any objective sense standing alone" without contemplation of the other steps. *True*, 190 F.3d at 1179. The Tax Court properly collapsed the interdependent steps of the repatriation scheme. (A.521-27.)

Although the step-transaction doctrine will operate if the circumstances satisfy only one of the tests, *True*, 190 F.3d at 1175; *Long Term Capital*, 330 F. Supp. 2d at 191, the other two tests are also met here. The end-result test applies because, from the initiation of the

transaction, Barnes had a pre-arranged plan that it would acquire ASA's cash, and an understanding and agreement that every step of that plan would be implemented. *See Greene*, 13 F.3d at 583; *accord Blake*, 697 F.2d at 480. It is undisputed that Barnes "intended from the outset" to place ASA's cash in its own hands. *True*, 190 F.3d at 1177. (*See* A.148, 958-63.) Barnes therefore cannot claim favorable tax treatment on the basis of the various intermediate transactions leading up to that intended result. The binding commitment test is also satisfied here, because Barnes had a fixed plan to repatriate ASA's funds by means of the Bermuda/Delaware transactions and "loans" from Delaware to Barnes. (A.831.) The Tax Court correctly applied the step-transaction doctrine in determining that, in substance, Barnes's repatriation scheme effected a dividend distribution from ASA to Barnes under I.R.C. § 301.

2. The absence of a valid business purpose for Bermuda or Delaware supports the Tax Court's dividend determination

The lack of independent justification for the individual steps of the repatriation scheme supports the Tax Court's decision to apply the step-transaction doctrine. Although the existence of a business purpose does

not preclude the application of the step-transaction doctrine, *see Associated Wholesale Grocers*, 927 F.2d at 1527, "the absence of a nontax business purpose is fatal." *Del Commercial Properties*, 251 F.3d at 214. The record makes clear that from the outset Barnes's objective was the "transfer of cash" from ASA to Barnes. (A.959.) The record similarly makes clear that Bermuda and Delaware were included in the repatriation scheme because "[b]y running the transaction through [Bermuda] and in turn through [Delaware], [ASA] will still have an investment but the Barnes Group US income pickup will be zero." (A.3129.) Denninger testified at trial that Barnes did the transaction because it was tax free, and that either a loan or a dividend was unacceptable to Barnes because of the tax consequences. (A.143-44, 149.) Because Barnes effectively admitted that the Bermuda/Delaware transactions were necessary steps in its overall tax-avoidance strategy, but wholly unnecessary for Barnes to obtain ASA's excess cash for use in Barnes's business, the Tax Court correctly determined that the Bermuda and Delaware aspects of Barnes's repatriation scheme should be disregarded under the step-transaction doctrine. (A.527.)

The evidence shows in this regard that Barnes and PwC went to great lengths to create out of whole cloth a business purpose for a tax-avoidance plan that originated in PwC's database. (A.3058-61, 3075-76, 3079, 3123.) That it was PwC that undertook the task of conjuring up purported business purposes for the repatriation scheme further supports the Tax Court's conclusion that in substance the repatriation transactions effected a dividend. (A.3075-76; *cf.* A.1135-36.) And despite having supplied the template for Barnes's business purpose, PwC itself was "<u>not clear as to what a valid business purpose is for this transaction.</u>" (A.3106 (emphasis in original).) The reason a nontax business purpose for the transaction was "not clear" to PwC was because, in fact, such a nontax business purpose did not exist.

The decision in *Merck*, 652 F.3d 475, is instructive here. The taxpayer there, like Barnes, sought to make use of its offshore subsidiaries' cash reserves, but the subsidiaries could not make a loan or pay dividends to the taxpayer without the proceeds being subject to taxation in full that year. *Id*. at 476-77. Applying a strategy proposed by its tax advisor, the taxpayer entered into an interest rate swap in an

effort to defer that taxation. *Id.* at 477. The taxpayer claimed to rely upon an IRS Notice for its position. *Id.* at 479-80.

The Third Circuit rejected the taxpayer's position in *Merck* and held that the transactions were, in substance, loans. *Id.* at 486. The court also held that a third-party bank could properly be considered as a "mere conduit" for the real transaction at issue. *Id.* at 484. The same conduit principle applies here. Bermuda and Delaware were "mere conduits" for placing ASA's cash into Barnes's hands. *See ibid.*; *Pickard*, 113 F.2d at 488-89 (conduit cannot be deemed a party to a tax-free reorganization). Indeed, the facts of this case are even more compelling than those of *Merck*, because the conduits in this case, Bermuda and Delaware, were newly formed, wholly owned subsidiaries of Barnes that were created and included in the repatriation scheme to mask the true nature of the transaction: a distribution from ASA to Barnes. *See Merck*, 652 F.3d at 484-85; *Court Holding*, 324 U.S. at 334; *Enbridge Energy Co. v. United States*, 553 F. Supp. 2d 716, 726 (S.D. Tex. 2008), *aff'd*, 354 Fed. Appx. 15 (5th Cir. 2009).

3. Barnes's attempts to manufacture a nontax business purpose for Bermuda and Delaware are beside the point and do not withstand scrutiny in any event

Barnes has failed to show any error in the Tax Court's application of the step-transaction doctrine to tax the repatriation scheme as a dividend in accordance with its substance. Barnes's contention that Bermuda and Delaware had a legitimate nontax business purpose (Br.7, 30-37) is misconceived because, even if such a business purpose existed, it would not preclude application of the step-transaction doctrine, as the Tax Court correctly held (A.521). *See Aeroquip-Vickers, Inc. v. Commisisoner*, 347 F.3d 173, 183 (6th Cir. 2003); *Associated Wholesale Grocers*, 927 F.2d at 1527; *South Bay*, 345 F.2d at 704. Even if the interrelated steps of a transaction have legitimate business reasons, the transaction must be treated as a single unit and judged by its end result. "To ratify a step transaction that exalts form over substance merely because the taxpayer can either (1) articulate some business purpose allegedly motivating the indirect nature of the transaction or (2) point to an economic effect resulting from the series of

steps, would frequently defeat the purpose of the substance over form principle." *True*, 190 F.3d at 1177.

At all events, the Tax Court correctly found that Bermuda and Delaware lacked a legitimate nontax business purpose. (A.523-25.) Barnes's reliance on Coneys's testimony to support a contrary contention (Br.30-36) is misplaced. Far from "unimpeached and uncontradicted" (Br.31, 34), Coneys's trial testimony is contradicted by Barnes's candid statements that the entities and the transactions were tax-motivated. (A.962, 3129.) Barnes's contemporaneous statements should be taken at face value. The Tax Court's findings regarding the parties' intentions involved determinations of credibility, which are uniquely within the province of the trial court and are afforded broad deference on appeal. *See Anderson*, 470 U.S. at 575; *Merck*, 652 F.3d at 482; *United States v. Gaines*, 295 F.3d 293, 298 (2d Cir. 2002); *N.L.R.B. v. Katz's Delicatessen of Houston Street, Inc.,* 80 F.3d 755, 765 (2d Cir. 1996). Barnes's argument that the Tax Court should have weighed the evidence differently (Br.28-44) misapprehends this Court's function in reviewing the Tax Court's findings.

Although Barnes contends that Bermuda had a business purpose related to "Singapore corporate law" (Br.31-34), Barnes points to no evidence that PwC believed, or advised Barnes, that Singapore corporate law prevented ASA from distributing or loaning its cash to Barnes. Barnes's confused contentions regarding whether ASA could have held shares of a Singapore parent (Br.33) have no bearing on that question. The Tax Court did not "misconstrue[ ] the issue" (Br.34), but instead properly declined to "make [Barnes's] argument" for it in this regard (A.523). At all events, Coneys admitted at trial that Barnes did not provide PwC with a nontax business purpose for Bermuda. (A.264.)

Barnes's argument that Delaware was formed to reduce state taxes (Br.34-36) is equally unpersuasive. In the Tax Court, Barnes claimed that Delaware was included in the repatriation transaction to obtain a "state tax benefit." As the Tax Court noted, however (A.524), Barnes provided no explanation of the benefit it was referring to. The court, accordingly, gave no weight to Barnes's claim in this regard. On appeal (Br.35), Barnes now seeks to offer the explanation it failed to

provide to the Tax Court.[5] Needless to say, Barnes is poorly positioned to criticize the Tax Court for refusing to attach any weight to its cryptic assertion of a purported "state tax benefit" – that it never even attempted to explain to the Tax Court.

In any event, the record makes clear that Barnes's newly explained "state tax benefit" was not the motivation for including Delaware in its repatriation scheme. As we have explained, and the Tax Court found, the inclusion of Delaware, as well as Bermuda, in the repatriation scheme was to create a smoke screen that would obscure the fact that the substance of the transaction was a repatriation by Barnes of ASA's funds. (A.527.) The record shows in this regard that Barnes contacted PwC for advice as to how it could repatriate ASA's funds without incurring any federal tax liability. (A.321-22, 3132.) PwC pulled from its database a repatriation scheme that it had developed for another client. (A.255, 449, 3058-61, 3078.) Nowhere did PwC advise Barnes that the purpose for creating Delaware was to

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[5] According to Barnes (Br.35), interest paid by it to Delaware would be deductible by it for Connecticut tax purposes but would not be subject to Delaware tax.

create a state tax benefit. Indeed, in May 2000, PwC provided Barnes with a draft "business purpose" for the scheme which indicated that international cash management should be advanced as the business purpose for the scheme. (A.3075.) In response, Barnes, in July 2000, provided its "business purpose" document to PwC. That document reiterated essentially the same business purposes as the draft originally sent by PwC. No mention was made of any "state tax benefit." (A.1134-36.)

Moreover, Barnes's claimed state tax benefit was dependent upon its payment to Delaware of the interest due it under the loan agreements. As discussed below, however, Barns failed to prove that it paid any of the interest and the record demonstrates that, at a minimum, it failed to pay $60 million of the interest purportedly owed to Delaware. Its actions in this regard confirm that the "state tax benefit" touted by Barnes as the reason for Delaware is nothing but an afterthought. Nor has Barnes offered any evidence to show how Delaware performed a "corporate governance" function. (Br.36.) The Tax Court correctly concluded that Barnes's "vague assertions" were

"insufficient to support a finding that Bermuda and Delaware were created for legitimate nontax business purposes." (A.527.)

As the Tax Court also correctly found, Barnes's failure to show that it respected the form of the reinvestment plan "further undermines any legitimate nontax business purpose for including Bermuda and Delaware in the plan." (A.525.) In particular, the Tax Court correctly found that the Delaware loans "were not bonafide loans."[6] (A.525.) Barnes did not sign contemporaneous notes or loan agreements, but instead signed (and backdated) those documents only after it received the loan proceeds. (A.80 ¶¶3-4, A.1111-18.) It therefore is apparent that the parties did not follow normal business practices, but instead attempted to create a paper trail after the fact.

[6] The loan agreements (A.1111-13, 1115-17) contained no fixed repayment schedule; on the contrary the loan balance was payable only upon the demand of Delaware. Since Barnes controlled Delaware, repayment of the "loans" would occur only if Barnes made a demand for payment on itself. It appears that Barnes chose not to do so and that consequently, as far as the record shows (which covers the period when the "loans" originated, 2000 and 2001, until the end of 2010) Barnes never paid any of the loan balance, including at least $60 million in accrued but unpaid interest that had been added to the loan balance. (A.5239, 5244.)

The Tax Court also correctly found that Barnes failed to show that it complied with the terms of the Delaware loan agreements. (A.497, 525-26.) The loan agreements provided that interest "shall be paid annually" at a fixed rate of 7.5 percent on December 1 of each year commencing in 2002. (A.1112 ¶3, A.1116 ¶3.) The term "shall" as used in contracts is mandatory. *Conoco, Inc. v. Norwest Bank*, 767 F.2d 470, 471 (8th Cir. 1985). But, as of December 31, 2010, the total Delaware loan balance reported on Barnes's tax return had nearly doubled, from $67,605,000 to $127,202,495, an increase that represents accrued but unpaid interest. (A.1114, 1118, 5239, 5244.) Barnes asserts, without citing to the record, that, if no interest had been paid, the "hypothetical loan balance" would have been even higher (Br.38) and that $8.7 million in interest necessarily "was paid" (Br.39). But Barnes did not substantiate its claim in this regard by presenting any contemporaneous records of interest payments.[7] (A.525.) Moreover,

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[7] It is entirely conceivable that at some point in time Barnes simply stopped adding the unpaid interest to the loan balance because it knew full well that it never was going to pay the loan balance. Thus, even assuming, as Barnes asserts (Br.38), that the loan balance would have been $137,451,753, rather than $127,202,495, if all the interest
(continued…)

Barnes's own tax return indicates that Barnes failed to pay approximately $60 million in interest that was due Delaware under the terms of its purported loans. (A.5239, 5244.) In these circumstances, the Tax Court hardly erred in finding that Barnes largely ignored the terms of the "loans" made to it by Delaware. Contrary to Barnes's contention (Br.39), paragraph two of the loan agreements did not excuse it from paying interest, but instead permitted Delaware to demand repayment of the principal in full at any time (which it never did) along with any interest that had accrued since the last payment. (A.1112 ¶2, A.1116 ¶2.)

Barnes contends (Br.29) that the substance of the repatriation scheme was an investment by Bermuda in Delaware's preferred stock. Delaware, however, was essentially a shell corporation that was not

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(…continued)
had been accrued and added to the loan principal, it does not follow that the difference between those two figures represents interest actually paid by Barnes to Delaware. Indeed, since it would have been a simple matter for Barnes to provide direct proof of the interest payments, if any, it made to Delaware, but it failed to do so, the Tax Court was amply justified in refusing to infer from Barnes's "hypothetical loan balance" chart (Br.38) that Barnes had actually paid any interest to Delaware.

engaged in any business. (A.1709.) Its only source of funds from which to pay dividends on the preferred stock Barnes caused it to issue to Bermuda was the interest due on the "loans" that Barnes caused it to make to Barnes. But, as indicated above, Barnes failed to pay most, if not all, of the interest that was due under the purported loan agreements between Barnes and Delaware. Moreover, the entire repatriation scheme consists of essentially nothing more than a circular flow of funds among Barnes and its wholly owned subsidiaries, the pre-planned result of which was that ASA's excess funds to the tune of $62 million wound up in Barnes's coffers.

The Tax Court also correctly found (A.526) that Barnes failed to prove that Delaware paid preferred dividends to Bermuda. As we explained above, and as the Tax Court found (A.526), Delaware was financially incapable of making the dividend payments because its only source of funds was the interest purportedly owed to it by Barnes, and Barnes failed to prove that it paid any interest to Delaware.[8] Barnes's

[8] As indicated above, Barnes's own tax return indicates that it failed to pay at least $60 million of the interest that Barnes was obligated to pay Delaware under the terms of the loan agreements.

wholly unsubstantiated assertion (Br.42) that it paid some interest on the Delaware "loans" hardly is sufficient to establish that the Tax Court's contrary finding is clearly erroneous. Barnes's contention that the periodic payment of the dividends was not required and that the dividends could be accrued and paid when the stock was redeemed (Br.40) is unsubstantiated as well as inconsistent with its further claim that all the required preferred dividends were, in fact, "declared and paid" (Br.10).

Conspicuously absent from the "proof" of payment of dividends by Delaware to Bermuda are any bank records of those companies showing that funds in the amount of the preferred dividends were withdrawn from Delaware's bank account and deposited into Bermuda's bank account. Nor did Barnes submit any ledgers or other books of the two corporations that substantiate Barnes's claim that the preferred dividends owed by Delaware to Bermuda were actually paid. The withholding tax returns (Forms 1042) proffered by Barnes as proof that the dividends were paid are not self-substantiating and hence do not establish the truth of the representations therein. (A.1389-1404.) And the unsubstantiated testimony of DeForte, who directed their

preparation, that dividends were made (A.348, 387) was properly regarded by the Tax Court as insufficient to establish actual payment given the failure of Barnes to introduce any corroborating bank records and its further failure to prove that Delaware had any funds from which it could have paid dividends. *See Lawinger v. Commissioner*, 103 T.C. 428, 438 (1994); *Halle v. Commissioner*, 7 T.C. 245 (1946), *aff'd*, 175 F.2d 500 (2d Cir. 1949). Barnes's contention that the Commissioner did not "offer[ ] any evidence at trial to establish that no such preferred dividends were paid" (Br.41) is a misguided attempt to shift its burden of proof to the Commissioner.

At all events, even if Barnes had shown (and it did not) that it paid some interest to Delaware and that Delaware paid some dividends to Bermuda, any such showing would not demonstrate any error in the Tax Court's conclusion that there was no business purpose for the steps in the repatriation scheme involving Delaware and Bermuda. The inclusion of Delaware and Bermuda did not generate any pre-tax profit for the Barnes Group, as those shell corporations were not engaged in any business. The form of the repatriation scheme, even if it had been fully respected by Barnes, involved nothing more than a circular flow of

funds among Barnes and its controlled entities that had no purpose other than to disguise the fact that, in substance, Barnes had repatriated ASA's funds by means of a dividend payment. *See Clark*, 489 U.S. at 738; *Minnesota Tea*, 302 U.S. at 613; *Court Holding*, 324 U.S. at 334.

4. The repatriation scheme was, in substance, the payment of dividends from ASA to Barnes in 2000 and 2001

The Tax Court correctly determined that the substance of the repatriation scheme was two dividend payments from ASA to Barnes, taxable under § 301 in 2000 and 2001. *See* pp.4-5, *supra*. That determination reflects the economic substance of the repatriation scheme, a distribution of cash by a second-tier subsidiary, ASA, to its parent, Barnes. Barnes therefore should have reported dividend income on its 2000 and 2001 federal income tax returns equal to the amount of money received from ASA each year. *See Gregory v. Helvering*, 293 U.S. 465, 470 (1935) (treating as a single taxable transaction a series of transfers that satisfied the literal language of the reorganization provisions but yielded the same economic result as a dividend); *Tollefsen v. Commissioner*, 431 F.2d 511, 514 (2d Cir. 1970)

(withdrawals were dividends under substance-over-form principles); *Wolf v. Commissioner*, 357 F.2d 483, 485 (9th Cir. 1966) (substance of transaction was a dividend, despite "literal compliance" with § 351); *Oyster Shell Products Corp. v. Commissioner*, 313 F.2d 449, 451-52 (2d Cir. 1963) ("loan" by corporation to shareholder treated as dividend).

Barnes fails to cast any doubt upon the Tax Court's holding by relying upon the form of the repatriation scheme. (Br. 26-30.) Whether the entities that engaged in the repatriation scheme were "legally separate corporate entities" (Br.28) is beside the point. The question whether a corporation passes muster as a separate legal entity under *Moline Properties, Inc., v. Commissioner*, 319 U.S. 436 (1943), is entirely distinct from the question whether the step-transaction doctrine applies to particular transactions in which a legitimate corporation is engaged. *See Gregory v. Helvering*, 293 U.S. at 469.

Likewise, Barnes's reliance on the fact that the entities hold shares of each other's stock (Br.29) is misplaced because the repatriation scheme was intended to, and did, transfer ASA's cash to Barnes. The stock transfers were merely an effort to "escape . . . a tax upon a dividend." *Wolf*, 357 F.2d at 486. It does not matter whether an

unnecessary "equity structure" could have been implemented only by means of unnecessary "steps of transactions." (Br.29-30.) The Tax Court did not "invent[ ] a new step" (Br.28), but instead disregarded the steps that were unnecessary to achieve Barnes's intended result in its "transfer of cash plan" (A.959).

Barnes's primary complaint with the Tax Court's dividend treatment appears to be its contention that the distributions were not "permanent." (Br.22, 27-29; *see* Br.8, 42-43.) That contention, even if accepted at face value, is wholly irrelevant. First, Barnes was calling all the shots and was under no obligation to later return any of ASA's funds to it. Even if it had been Barnes's intention to use the repatriated funds at some point in the future to fund foreign acquisitions (Br.43), that hardly shows any error in the Tax Court's determination that, in substance, Barnes received ASA's funds as a dividend. Moreover, the Tax Court properly credited the "objective facts" to reject Barnes's claim that its repatriation of ASA's funds was not "permanent." (A.527.) *See Herzog Miniature Lamp Works, Inc. v. Commissioner*, 481 F.2d 857, 863 (2d Cir. 1973) ("the Tax Court could properly conclude that the intention claimed by taxpayer had not been manifested by a convincing

course of conduct on taxpayer's part"). Barnes exercised dominion and control over ASA's cash and, upon receiving it, used it to reduce its own high-interest indebtedness. (A.148.) As the Tax Court correctly found, Barnes has not returned any of ASA's funds. (A.527.) Nor has Barnes explained how ASA, its controlled subsidiary, could have compelled it to do so. Barnes's assertions that it intended to repay the Delaware loans and to cause Delaware to redeem the preferred stock (Br.29) prove nothing; neither event occurred and it would not matter if it had.[9] A discretionary and unenforceable plan on the part of Barnes to return ASA's funds to it at some point in the future has no bearing on the correctness of the Tax Court's determination that the substance of the repatriation scheme was the payment of a dividend by ASA to Barnes. *See Crellin's Estate v. Commissioner*, 203 F.2d 812 (9th Cir. 1953) (taxpayers who received dividends under claim of right could not exclude them from income even though they later repaid them).

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[9] Barnes does not explain the "potential for double taxation" that it asserts caused it to not "unwind" the repatriation scheme in 2006. (Br.19, 44.) That vague justification is irrelevant in any event. Once Barnes received ASA's cash dividend for its own use, it does not matter what it may have originally intended to do with the cash in the future.

Moreover, if Barnes had a legally enforceable obligation to return ASA's funds to it, the substance of the transaction would be a loan directly from ASA to Barnes, taxable under §§ 951(a)(1)(B) and 956. Because the Tax Court held that the distributions were dividends, the court did not reach this alternative argument by the Commissioner. (A.515-16 & n.41.) This Court may affirm on any ground supported by the record. *Steginsky v. Xcelera Inc.*, 741 F.3d 365, 369 (2d Cir. 2014).

As Barnes recognized (A.127, 962, 3129), a loan from ASA to Barnes is subject to United States tax. *See* § 956(c)(1)(C); pp.5-6, *supra*. When an intermediary in a financing transaction (such as Delaware) functions solely as a conduit, it is disregarded and the transaction is treated as a direct loan from the "real lender." *Del Commercial Properties*, 251 F.3d at 214-15. Consequently, even if the transfers to Barnes constituted loans rather than dividends, ASA, rather than Delaware, was the true lender of the $62 million in cash. The repatriated amounts are therefore taxable to Barnes under

§§ 951(a)(1)(B) and 956. Viewing the repatriation strategy either as dividends or as loans, the Tax Court's decision is correct.[10]

C. An IRS Revenue Ruling does not insulate Barnes's repatriation scheme from challenge

The Tax Court correctly rejected Barnes's erroneous contention that Revenue Ruling 74-503, 1974-2 C.B. 117, prohibits the Commissioner from challenging Barnes's position in this case. (A.505-11; *see* Br.44-53.) Revenue Ruling 74-503 addressed a situation where a parent corporation exchanged its treasury stock for the previously unissued stock of a subsidiary corporation in a transaction to which § 351 applied. The ruling concluded that the basis of the stock received by each corporation was zero.

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[10] The Commissioner also raised two additional alternative arguments in the Tax Court: (1) that Barnes acquired control of Bermuda and Delaware with the principal purpose of evasion and avoidance of income tax, and therefore that the IRS may disallow any claimed deduction, credit, or other allowance under I.R.C. § 269, and (2) that ASA was considered to hold the Delaware preferred stock under the anti-abuse rule of Treas. Reg. § 1.956-1T(b)(4). The Tax Court did not reach either of these two alternative arguments (A.516 & n.41), which require factual determinations that would have to be made by the trial court in the first instance. Therefore, if this Court were to reverse the decision of the Tax Court, it should remand the case to the Tax Court to consider these alternative arguments.

The IRS later revoked Revenue Ruling 74-503 and stated that the conclusion that the transferor received a zero basis in the transferee's stock was "incorrect." Rev. Rul. 2006-2, 2006-1 C.B. 261 (Dec. 20, 2005). The IRS invoked its authority to decide that it would not challenge a position taken previously with respect to a prior transaction "by a taxpayer that *reasonably relied* on the conclusions in Rev. Rul. 74-503." *Id*. (emphasis added); *see* I.R.C. § 7805(b)(8); Treas. Reg. § 601.601(d)(2)(v)(c).

Barnes did not reasonably rely on the conclusions in Revenue Ruling 74-503. As the Tax Court explained, the revenue ruling does not apply to the repatriation scheme because the Bermuda/Delaware transfers were not bona fide § 351 exchanges. (A.509.) Instead, the Bermuda/Delaware transfers were intermediary steps in an integrated scheme that was intended to, and did, transfer ASA's offshore cash to Barnes in a transaction that was, in substance, a dividend. *See* Argument I.B, *supra*. Because the tax effect of the Bermuda/Delaware exchanges viewed in isolation is irrelevant under the step-transaction doctrine properly applied by the Tax Court, so is Revenue Ruling 74-503. The Tax Court correctly held that Barnes's position "distorts the

scope" of what the IRS chose not to challenge in Revenue Ruling 2006-2. (A.509.)

Because the Commissioner does not seek to "disavow" (Br.24, 45) or "argue against" (Br.50) Revenue Ruling 74-503 in this case,[11] the Tax Court's decisions in *Rauenhorst v. Commissioner*, 119 T.C. 157 (2002), and *Dover v. Commissioner*, 122 T.C. 324 (2004), lend no support to Barnes's argument. (Br.46, 50-53.) Revenue Ruling 74-503, and the basis computation rules of § 351 in general (Br.49), do not insulate Barnes's repatriation scheme from challenge because the overall substance of the scheme was not a § 351 exchange between Bermuda and Delaware, but, instead, a dividend from a controlled foreign corporation (CFC). The IRS long has concluded in revenue rulings that a transaction must be viewed as a whole, and that the substance of a transaction, rather than its form, governs its tax consequences.[12]

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[11] As noted, the Commissioner later revoked Rev. Rul. 74-503.

[12] *See, e.g.*, Rev. Rul. 89-73, 1989-1 C.B. 258; Rev. Rul. 87-89, 1987-2 C.B. 195 (situation 3); Rev. Rul. 76-429, 1976-2 C.B. 97; Rev. Rul. 76-192, 1976-1 C.B. 205; Rev. Rul. 70-296, 1970-1 C.B. 62; Rev. Rul. 70-140, 1970-1 C.B. 73; Rev. Rul. 54-96, 1954-1 C.B. 111, *modified*

(continued…)

Barnes's argument, if adopted, would lead to the absurd result of permitting a U.S. parent corporation to make large cash repatriations from a CFC disappear for tax purposes by including nominal amounts of stock from a controlled subsidiary. The Tax Court correctly rejected Barnes's attempt to shoehorn its repatriation scheme into the confines of Revenue Ruling 74-503.

II

The Tax Court correctly sustained the Commissioner's imposition of underpayment penalties under I.R.C. § 6662

Standard of review

The Tax Court's determination that penalties were properly imposed by the Commissioner is reviewed for clear error. *Nicole Rose Corp. v. Commissioner*, 320 F.3d 282, 285 (2d Cir. 2003); *Goldman v. Commissioner*, 39 F.3d 402, 406 (2d Cir. 1994).

(…continued)
by Rev. Rul. 56-100, 1956-1 C.B. 624; Rev. Rul. 231, 1953-2 C.B. 9. These rulings reflect established case law. *See* Argument I.A, *supra*.

A. Penalties for substantial understatement of tax and negligence under I.R.C. § 6662

Section 6662 of the Code imposes a mandatory accuracy-related penalty for certain tax underpayments. For Barnes's 1998, 2000, and 2001 tax years, the IRS determined that 20-percent accuracy-related penalties applied because Barnes substantially understated its tax, *see* I.R.C. § 6662(b)(2) and (d), and, in the alternative, because Barnes was negligent or disregarded rules or regulations, *see* I.R.C. § 6662(b)(1) and (c).[13] (A.811.) The Tax Court correctly held that Barnes was liable for an accuracy-related penalty for each year in issue. (A.532-36.)

B. The Tax Court correctly determined that the penalty for substantial understatement of tax was applicable

Section 6662(b)(2) and (d) of the Code impose a penalty for a substantial understatement of tax. The term "understatement" means the excess of the amount of the tax required to be shown on the taxpayer's return for the taxable year over the amount of tax shown on

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[13] Because these penalties may not be stacked, *see* Treas. Reg. § 1.6662-2(c), even if both are applicable, only one may be assessed and collected. For this reason, the Tax Court, having determined that Barnes was liable for the substantial understatement penalty, did not address the applicability of the negligence penalty.

the return. I.R.C. § 6662(d)(2). In the case of a corporation, there is a substantial understatement of tax for the years in issue if the amount of the understatement for the taxable year exceeds the greater of 10 percent of the tax required to be shown on the taxpayer's return or $10,000. I.R.C. § 6662(d)(1). As relevant here, the amount of the taxpayer's understatement of tax (for purposes of computing the penalty) is reduced by that portion of the understatement which is attributable to the tax treatment of any item by the taxpayer if there is "substantial authority" for such treatment. I.R.C. § 6662(d)(2)(B)(i). During the years at issue, that reduction was not permitted in the case of any item attributable to a corporate "tax shelter." I.R.C. § 6662(d)(2)(C)(ii). A tax shelter included any entity, plan, or arrangement whose "significant purpose . . . is the avoidance or evasion of Federal income tax." I.R.C. § 6662(d)(2)(C)(iii).

Because a significant purpose, indeed the sole purpose, of the repatriation scheme was the avoidance of federal income tax, *see* Argument I, *supra*, the repatriation scheme was a tax shelter under I.R.C. § 6662. Barnes therefore may not avail itself of the "substantial authority" reduction.

In any event, even if the repatriation scheme was not considered a tax shelter, Barnes lacked substantial authority for its claimed exclusion from its income of the $62 million that it repatriated from ASA because the weight of authorities supported a contrary treatment. *See TIFD III-E, Inc. v. United States*, 666 F.3d 836, 848-50 (2d Cir. 2012). There is substantial authority for the tax treatment of an item only if the weight of authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. Treas. Reg. § 1.6662-4(d)(3)(i). The authorities that may be relied upon include the Code, regulations, revenue rulings and procedures, judicial decisions, and certain IRS written determinations. Treas. Reg. § 1.6662-4(d)(3)(iii). Conclusions reached in legal opinions or opinions rendered by tax professionals are not "authority," although the authorities cited in support of the conclusions may constitute substantial authority. *Id.*

The Tax Court correctly rejected Barnes's contention that Revenue Ruling 74-503 provided substantial authority for its position. (A.532-34; *see* Br.56-57.) As we have explained, the repatriation scheme was an integrated scheme to repatriate ASA's cash tax-free. *See* Argument

I, *supra*. Far from having "no choice" but to apply the revenue ruling (Br.57), Barnes and PwC concocted a convoluted scheme involving multiple unnecessary steps in an effort to shoehorn a foreign cash repatriation into the terms of the ruling, which addresses a transaction between a domestic parent corporation and its domestic subsidiary. Contrary to Barnes's contention (Br.57), there was ample reason for it to doubt that the revenue ruling would immunize it from application of the step-transaction doctrine—a doctrine that has been applied by the courts on numerous occasions to disregard steps in a transaction that are intended to disguise the transaction's true nature and to thereby obtain a tax benefit never intended by Congress.[14] *See* Argument I.A, *supra*.

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[14] Barnes's contention that General Counsel Memorandum 34998, 1972 WL 32278 (Aug. 23, 1972), provides substantial authority is fundamentally misconceived. (Br.57 n.8; *see* Br.49 n.7.) Under the regulations, a general counsel memorandum that is "more than 10 years old generally is accorded very little weight." Treas. Reg. § 1.6662-4(d)(3)(ii). (*See* A.533 n.45.) To the extent that IRS determinations may be considered, PwC was aware that in a Field Service Advisory issued during the planning stages of the repatriation scheme, the IRS applied the step-transaction doctrine to a repatriation transaction. *See* FSA 200031023, 2000 WL 33120107 (Aug. 4, 2000); A.3108; *supra* n.4.

In short, because Barnes did not have substantial authority for its tax treatment of the repatriation scheme in any event, the Tax Court correctly held that the substantial-understatement penalty was applicable. (A.532-34.)

C. Barnes did not prove that it acted with reasonable cause and in good faith under I.R.C. § 6664(c)

Section 6664(c)(1) provides a narrow defense to § 6662 penalties if the taxpayer proves that it had (1) reasonable cause for the underpayment and (2) acted in good faith. *See Gustashaw v. Commissioner*, 696 F.3d 1124, 1139 (11th Cir. 2012); *Higbee v. Commissioner*, 116 T.C. 438, 446-47 (2001). The determination whether a taxpayer acted with reasonable cause and in good faith is made on a "case-by-case basis, taking into account all pertinent facts and circumstances." Treas. Reg. § 1.6664-4(b)(1). The most important factor is the extent of the taxpayer's effort to assess its proper tax liability. *Id*. That effort is judged in light of the taxpayer's "experience, knowledge, and education." *Id*.

The Tax Court correctly held that Barnes failed to act with reasonable cause and in good faith in excluding the $62 million in cash

that it repatriated from ASA. (A.534-36.) In certain circumstances, reliance upon the advice of a professional tax advisor may constitute reasonable cause for a taxpayer's underpayment of tax. Taxpayers cannot, however, abdicate their duty to file complete and accurate tax returns, and, therefore, the reasonable-cause regulations emphasize that reliance "on the advice of a professional tax advisor . . . does not necessarily demonstrate reasonable cause and good faith." Treas. Reg. § 1.6664-4(b)(1).

Here, the Tax Court correctly held that Barnes failed to prove that it was reasonable to rely on PwC's opinion letter. (A.536; *see* Br.58-61.) As Barnes concedes (Br.61), its sophistication regarding the tax laws is relevant in deciding whether it acted with reasonable cause. Reasonable cause for Barnes's reporting position is judged in light of the sophistication of its employees, in particular DeForte, whom the Tax Court correctly found to be "highly knowledgeable people who knew what they were doing[.]" (A.536.) *See* Treas. Reg. § 1.6664-4(b)(1). DeForte had thirty years of tax and accounting experience at increasing levels of responsibility before he joined Barnes in 1999. (A.311-17.) DeForte was familiar with substance-over-form principles, including the

step-transaction doctrine (A.377, 380-81), and acknowledged that it had crossed his mind that a court might view Bermuda and Delaware as conduits to move money from ASA to Barnes (A.380-81). He had "[s]ound knowledge" of domestic and international tax matters (A.1124) and knew that direct methods of repatriating ASA's cash would be subject to U.S. tax (A.960-62). DeForte reviewed the authorities cited in PwC's opinion. (A.339, 1431-1655.) The "improbable tax advantages" offered by the repatriation scheme should have alerted a person with DeForte's knowledge and experience to its illegitimacy. *See 106 Ltd. v. Commissioner*, 684 F.3d 84, 93 (D.C. Cir. 2012); *Stobie Creek Investments LLC v. United States*, 608 F.3d 1366, 1383 (Fed. Cir. 2010); *Neonatology Associates, P.A. v. Commissioner*, 299 F.3d 221, 234 (3d Cir. 2002).

Barnes's reliance on PwC's opinion letter was unreasonable for the additional reason that Barnes knew that PwC was burdened with an inherent conflict of interest. *See Goldman*, 39 F.3d at 408 (taxpayers "cannot reasonably rely for professional advice on someone they know to be burdened with an inherent conflict of interest"). PwC developed the repatriation scheme for another client and retrieved the scheme from its

database for use by Barnes after Barnes sought its advice as to how it could repatriate ASA's funds without incurring a federal income tax liability. The fee paid by Barnes to PwC compensated PwC for designing and implementing the repatriation scheme. (A.1683, 3058-61, 3132-42.) PwC even had a financial stake in the outcome: a portion of its fee was based on the "value added" to Barnes by PwC, which in this context, meant the tax savings realized by Barnes from the scheme. (A.1684.) Moreover, if the scheme worked for Barnes, PwC could market it to other corporations seeking to repatriate funds from a controlled foreign corporation. As is apparent, if PwC had opined that it was more likely than not that its repatriation scheme would not survive a challenge by the IRS, neither Barnes nor any other client would agree to implement the scheme. *See Stobie Creek*, 608 F.3d at 1382 (taxpayer's reliance was not objectively reasonable where advisor had financial stake in outcome, regardless of longstanding relationship). Further, the self-serving testimony proffered by Barnes and PwC that PwC's fees were not calculated by reference to any tax benefit (Br.13) conflicts with the "value added" language of the engagement letter (A.1684). In light of PwC's conflict of interest, Barnes's reliance on the

opinion letter for objective advice regarding the legality of the repatriation strategy was unreasonable. *See 106 Ltd.*, 684 F.3d at 90-91 (advisors who implemented and profited from transaction had inherent conflict of interest); *Pasternak v. Commissioner*, 990 F.2d 893, 903 (6th Cir. 1993) (no reasonable cause where advice was not from an independent tax advisor, but was from law firm that designed and implemented tax shelter); *Paschall v. Commissioner*, 137 T.C. 8, 22 (2011) (alleged reliance on advisors who coordinated deal did not establish reasonable cause and good faith).

At all events, even if the tax advice Barnes received from PwC were treated as having been provided by a disinterested advisor (which it was not), that advice still would be insufficient to establish that there was reasonable cause for Barnes's underpayment of tax, because Barnes failed to demonstrate that the PwC opinion satisfies the threshold regulatory requirements. To provide reasonable cause for a tax underpayment, legal advice: (i) must be based on all of the pertinent facts, and must take into account "the taxpayer's purposes (and the relative weight of such purposes) for entering into a transaction and for structuring a transaction in a particular manner," and (ii) must not be

based on "unreasonable factual or legal" assumptions, including any "which the taxpayer knows, or has reason to know, is unlikely to be true." Treas. Reg. § 1.6664-4(c)(1); *see Long Term Capital*, 330 F. Supp. 2d at 206. If a tax shelter is involved, the legal advice received by a corporate taxpayer may be taken into account only if there was substantial authority for its position and it concluded, based upon either its own analysis or that of an independent professional tax advisor, that there was a greater than 50 percent likelihood that the tax treatment would be upheld if challenged by the IRS. Treas. Reg. § 1.6664-4(f).[15]

Applying the Regulation to the facts here confirms that the Tax Court correctly rejected Barnes's reasonable-cause defense. PwC's opinion letter was not based on "all pertinent facts," Treas. Reg. § 1.6664-4(c)(1)(i), because it was expressly restricted to one limited part of the repatriation scheme: the "specific question" presented by Bermuda's investment in Delaware. (A.1405, 3031.) Coneys confirmed

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[15] Treas. Reg. § 1.6664-4(e) was redesignated as Treas. Reg. § 1.6664-4(f) by T.D. 9109, 68 Fed. Reg. 75126 (Dec. 30, 2003).

that, although it was ASA's cash that was circulated among Bermuda, Delaware, and Barnes, PwC's opinion letter analyzed only Bermuda's "investment" in Delaware's preferred stock, and that the specific question considered was the validity for tax purposes of the transaction between Bermuda and Delaware. (A.267-68.) PwC did not opine on the integrated repatriation scheme as a whole wherein ASA's excess funds wound up in the hands of Barnes. (A.3031-57.) Barnes ignored that fundamental infirmity in PwC's advice. *See Nicole Rose*, 320 F.3d at 285 (scheme was "sufficiently blatant that the participation of experts cannot convert [taxpayer's] actions" into a reasonable attempt to comply with the Code).

PwC's opinion letter was also based on the unreasonable factual assumption that there were valid nontax business purposes for the transaction. (A.3033-36.) That assumption was unreasonable because Barnes knew that the sole purpose of the repatriation scheme was the repatriation of ASA's cash without a U.S. tax cost. (A.958-63, 3129, 3132.) PwC's opinion letter was also based on unreasonable legal assumptions. The letter mentioned § 301 in only one conclusory sentence and offered no legal analysis of why the funds repatriated by

Barnes from ASA would not be taxed as a dividend under that section. (A.3032, 3106-07.) *See Long Term Capital*, 330 F. Supp. 2d at 209-11) (no reasonable good faith reliance on opinion letter containing superficial pronouncements). PwC's treatment of the step-transaction doctrine is similarly conclusory. (A.3032.) Although PwC stated in its discussion of § 269 that "no other form of investment is more direct than the proposed investment by [Bermuda] in the [Delaware] shares," that statement is premised on ignoring the rest of the repatriation scheme, *i.e.*, the part where Barnes winds up with ASA's cash. (A.3055.) The opinion letter did not discuss the three tests for the step-transaction doctrine or the relevant case law in that regard. (A.3031-57.) PwC's letter was an "advocacy piece" to justify a preconceived tax-avoidance scheme that PwC previously had marketed to other clients, not a balanced, reasoned opinion intended to guide Barnes's decision-making. *Long Term Capital*, 330 F. Supp. 2d at 210 n.110.

Barnes's contention that the Tax Court should have ignored its failure to respect the form of its own transaction (Br.60-61) is contrary to the advice it received from PwC. PwC's opinion letter was expressly premised on "all steps of the proposed transaction being implemented

as described herein, including the proper execution of any and all applicable agreements and corporate documents needed to implement" it. (A.3057.) PwC also warned that a "[f]ailure to implement the proposed transaction as described above could adversely affect the conclusions reached in this opinion." (A.3057.) Yet Barnes immediately failed to implement the transaction properly when it failed to sign contemporaneous documentation for the Delaware loans in December 2000 and July 2001. (A.80 ¶4, A.1111-18.) *See Schulman v. Commissioner*, 93 T.C. 623, 642-43 (1989). Barnes also failed to prove that any interest or dividends were paid, even though, as the Tax Court observed, this is a "complex and technical area of law in which precision is required" (A.536) and PwC's opinion letter expressly warned that strict compliance with the formalities of the transaction was critical (A.3057). *See Intertan, Inc. v. Commissioner*, 87 T.C.M. (CCH) 767, 776-77 (no reasonable cause where taxpayer failed to follow advice), *aff'd*, 117 Fed. Appx. 348 (5th Cir. 2004). The Tax Court correctly determined that Barnes "forfeited any defense of reliance on the opinion letter issued by PwC" (A.536) and thus correctly concluded that Barnes did not reasonably and in good faith rely on PwC's advice (A.535-36).

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

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/s/ Deborah K. Snyder
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Attorney

May 15, 2014

CERTIFICATE OF SERVICE

It is hereby certified that, on this 15th day of May, 2014, (1) six paper copies of this brief were mailed to the Court, and (2) I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Second Circuit using the CM/ECF system. Counsel for the appellant are registered CM/ECF users and will be served by the CM/ECF system.

/s/ Deborah K. Snyder
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