

**Nos. 18-3717 & 18-3718**

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

VHC, INC. AND CONSOLIDATED SUBSIDIARIES,

*Petitioner-Appellant*

v.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent-Appellee.*

On Appeal from the United States Tax Court  
Nos. 4756-15 & 21583-15, Judge Kathleen Kerrigan

**PETITIONER-APPELLANT’S REPLY TO BRIEF FOR THE APPELLEE**

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## ARGUMENT

### **I. Introduction**

The Tax Court, charged with applying the appropriate legal tests to the facts before it, failed in that task. The Tax Court did not address evidence in the record and it applied a needlessly complicated, muddled test that obscured the economic reality of the transactions at issue. It is not debatable whether the Tax Court failed to recognize what evidence was actually in the record; the court affirmatively ruled that certain types of evidence were not presented when they were. The Tax Court further made conclusory findings as to Appellant VHC's ("VHC's") business purpose for transactions, ignoring, without sufficient explanation, substantial first-and third-party record evidence directly contradictory to those findings. The Tax Court's findings are clearly erroneous and this Court should reverse and remand the case back to that court.

The Appellee, the Commissioner of Internal Revenue (the "government"), has filed a brief making numerous misstatements, attempting to spin the findings below and the record itself to make its case appear more favorable. These mischaracterizations begin in the government's statement of the case, which seems to suggest that Ron Van Den Heuvel ("Ron VDH") had significant influence over VHC beyond what the Tax Court found. *Compare* Brief for the Appellee and Supplemental Appendix ("Gov. Br.") 5, (discussing Ron VDH's voting power) with RA0022<sup>1</sup> (Tax Court opinion discussing number of shares owned but drawing no conclusions on voting power). The government similarly addresses the sections of the Tax Court's opinion in the order addressed by the Tax Court. But although the opinion as a whole contains numerous reversible errors, the most serious and egregious assignments of error by VHC relate to the second part of the opinion (related to ordinary and necessary expense deductions) not the first.

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<sup>1</sup> As in VHC's opening brief, citations to the VHC's Required Appendix are abbreviated herein as "RA." Citations to the Separate Appendix are abbreviated herein as "SA." Citations to the Record on Appeal in Tax Court case no. 4756-15 are abbreviated herein as "R" and cited to their internal page or exhibit numbers.

Nor does Appellee address the fact, discussed in the Brief and Required Short Appendix of Petitioner-Appellant VHC (“opening brief” or “VHC Br.”), that since the disposition of the Tax Court case, Ron VDH has been convicted of multiple crimes related to defrauding investors and lenders by making representations similar to those he made to VHC. VHC Br. 6, n. 5. The government does not argue that this reference is improper for this Court to consider; instead, the government simply presses forward as though it never happened, and states its case as though there is no reason to think anyone would have lent Ron VDH money. The taking of such an inconsistent position by the government is inappropriate.

VHC asks this Court to remand the case to the Tax Court for further proceedings. This is not a case where a lower court weighed evidence and rejected it; rather, the Tax Court flatly stated that certain kinds of evidence were not presented when they were, and it applied tests that provide little, if any, insight into the actual issues. These errors should be corrected.

**II. The Tax Court’s failure to allow business expense deductions for advances to or on behalf of Ron VDH’s companies is clearly erroneous**

In its opening brief, VHC argued first and foremost that the Tax Court erred in failing to accept what was its alternative argument below – that consistent with the rule of *Lohrke v. Commissioner*, 48 T.C. 679, 689 (1967), VHC should have been allowed to deduct advances to Ron VDH and his companies (and payments made to third parties in favor of Ron VDH and his companies), because, after 2002, those advances were ordinary and necessary business expenses made pursuant to guarantees to further VHC’s own access to credit. VHC Br. 13. The Tax Court clearly erred in finding that these advances had not been proven and that the ordinary and necessary nature of the advances was not shown. The government contests these arguments, and VHC addresses the government’s contentions in turn.

**A. VHC demonstrated, in its opening brief, several examples of specific deductible expenditures**

The government argues that below, VHC “never identified the specific expenditures it claims are deductible as business expenses.” Gov. Br. 39. The government criticizes VHC as having “chosen to rely on generalities, discussing the purported expenses almost exclusively in the aggregate and citing summary exhibits prepared by its bookkeeper and charts not in evidence purporting to summarize those summary exhibits.” *Id.* at 40.

But this is a distraction from the actual issue; the government’s explanations and criticisms shift between portions of its brief. Where VHC cited to specific expenses, the government argues that it “has chosen to rely on generalities.” Gov. Br. 40. Where VHC has cited to its internal books and records, the government points to cases decided under drastically different circumstances to argue that such internal books and records do not constitute substantiation. *Id.* at 41. And where VHC points to procedural defects, the government suggests that VHC is merely blaming others for its own strategic mistakes. *Id.* at 61. But these criticisms fail to address the key issue – that the Tax Court found that there was no evidence substantiating the relevant transactions when, by any metric, there was. Even if the Tax Court’s ruling that summaries or books and records were insufficient was well-founded in fact and law, the Tax Court still failed to address significant record evidence before it regarding numerous expenditures.

The Tax Court’s most egregious error was finding that VHC “did not introduce evidence of receipts, bank statements, contracts for services rendered, or documents establishing funds paid on guarantees...” RA0073-74. But VHC requested findings of fact related to every transaction at issue, and each finding was supported by citations to record evidence. Each of the

transactions identified as an example in the opening brief was the subject of requested findings with citations to the record.<sup>2</sup>

The government attempts to excuse the Tax Court's error by citation to *JPMorgan Chase & Co. v. Commissioner*, 530 F.3d 634, 640 (7th Cir. 2008), for the proposition that because VHC did not place into evidence a "list" of expenditures<sup>3</sup> which identified specific payments, the bank guarantee to which they were pursuant, and how they were ordinary and necessary, VHC "turned out the lights" on the Tax Court. Gov. Br. 41-42. But that case concerned reliance on a one-page chart where none of the underlying records were put into evidence, where months of transactions were missing, and where the taxpayer admitted that potentially large numbers of relevant transactions were not recorded. *JPMorgan Chase*, 530 F.3d at 640. None of those facts are at issue here.

Similarly, the government cites to *Buelow v. Commissioner*, 970 F.2d 412 (7th Cir. 1992) and *Pfluger v. Commissioner*, 840 F.2d 1379 (7th Cir. 1988) *cert. denied*, 487 U.S. 1237 (1988) for the proposition that the Tax Court is not required to guess as to a taxpayer's expenditures. But neither *Buelow* nor *Pfluger* has any bearing on this case. Those cases concerned the complete absence of records substantiating expenses. *See Buelow*, 970 F.2d at 413-14 (books and records not produced or brought to trial); *Pluger*, 840 F.2d at 1382-83 (taxpayers, lacking any records, argued for application of industry averages). They do not address the situation here,

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<sup>2</sup> The \$125,000 November 30, 2005 advance was the subject of proposed finding of fact number 1414, and cited exhibits including the check paid for that advance. R282, p. 259. The \$69,758.39 payments to Baylake Bank, aside from being the subject of proposed findings dealing with the business purpose of that guarantee specifically (R282, p. 103), were the subject of proposed findings citing to relevant checks. R282, p. 263, ¶ 1445 (citing journal entries plus check); p. 265, ¶ 1459 (citing journal entries plus check). The \$8,271,001.42 purchase of debt from Associated Bank was the subject of a proposed finding citing to the loan purchase agreement. R282, p. 97, ¶ 485.

<sup>3</sup> Such a list would presumably be a summary of the sort that much of the government's argument suggests may not be used. *Compare* Gov. Br. 41 ("[t]he record, however, contains no list... of individual expenditures that VHC contends are encompassed...") and Gov. Br. 58-59 (criticizing use of summary in evidence regarding guarantee lending).



where the Tax Court was presented with significant evidence of expenditures, for which specific findings of fact were requested, and the Tax Court simply failed to recognize what was before it.

**B. Guarantee payments were shown to be ordinary and necessary**

The government further misstates the concept of an ordinary and necessary business expense. Although the government is correct that the fact that an expense was forced on a taxpayer does not, by itself, make the expense ordinary and necessary, that statement does not tell the whole story. The government cites *Commissioner v. Lincoln Sav. & Loan Ass'n*, 403 U.S. 345 (1971) for that proposition. But that case concerns the fact that a necessary expense is not ordinary where it is in service of the creation of a capital asset. *Id.* at 353-54 (stating “principal function of the term ‘ordinary’ . . . is to clarify” distinction between currently deductible and capital expenses, and finding expenditure at issue capital). That is not the issue here, nor did the government argue that advances to or on behalf of Ron VDH and his companies were capital.

Similarly, the government cites to *United Draperies, Inc. v. Commissioner*, 340 F.2d 936, 938 (7th Cir. 1964) to suggest that a transaction must be “of common or frequent occurrence” to be ordinary. Gov. Br. 45. But that out-of-context quote from *United Draperies* does not accurately state the whole of the law. That case and the Supreme Court’s later-decided *Lincoln* case are at odds – *Lincoln* relates to the distinction between ordinary expenses as currently deductible as opposed to capital expenditures. *Lincoln*, 403 U.S. at 353-54. *United Draperies* dealt with payments of arguably unlawful kickbacks. *United Draperies*, 340 F.2d at 939 (“As a matter of common knowledge, we are convinced that the mores of the market place of this nation is not such that ‘kick-backs’ by vendor-suppliers . . . are an ordinary means of securing or promoting business.”). Its facts are *sui generis*. To the extent that courts after *Lincoln* have relied upon *United Draperies*, they have done so either in the context of arguably illegal kickback payments, or in the context of acknowledging that an expense may be ordinary and necessary

though incurred but once in a business's lifetime. *See Raymond Bertolini Trucking Co. v. Comm'r*, 736 F.2d 1120, 1125 (6th Cir. 1984) (There must be some "normal, logical connection between a taxpayer's particular business and the expenditure for it to be deductible"); *Butler v. Comm'r*, 84 T.C.M. (CCH) 681 (T.C. 2002) (citing *United Draperies* in relation to payments of illegal bribes for lower prices); *Podd v. Comm'r*, 75 T.C.M. (CCH) 2575 (T.C. 1998) (citing *United Draperies* in relation to kickbacks).

Here, the expenditures in question – payments of guarantees – are not bribes or kickbacks; they are guarantee payments made to preserve VHC's access to credit. The government suggests that VHC failed to show that making guarantees is common in the paper-making business. Gov. Br. 45.<sup>4</sup> But that focus is far too granular. Credit is necessary for virtually any company – in any industry – to function, and expenditures to preserve access to such credit are ordinary expenditures. This proposition is hardly revolutionary and requires only a basic understanding of business and the "common knowledge" cited in *United Draperies*. 340 F.2d at 939.

Here, the payments were ordinary and necessary. The government suggests that it has not been demonstrated how VHC's purchase, from Associated Bank, of loans it had guaranteed and this relates to the guarantees. Gov. Br. 54-55. But the record is clear that VHC made guarantees to Associated Bank and thus was liable for the value of these loans. *See VHC Br. 5-6*. The loan purchase document shows that VHC was in fact owed at least \$8 million by Ron VDH and his companies. VHC demonstrated below that the transaction was beneficial to VHC because it allowed it to reduce the amount it had guaranteed to Associated Bank in service of a strategy to collateralize any remaining guarantees with buildings VHC owned. R282, p. 97.

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<sup>4</sup> VHC is not, itself, a paper-making company. VHC is a contractor whose biggest client base is paper manufacturers.

The government concedes that VHC's reasons for making guarantees were "not implausible." Gov. Br. 19. The government suggests that that does not matter, and cites to the Tax Court's conclusion that the transactions primarily benefited Ron VDH and the Tax Court's reference to prior guarantees as reasons the Tax Court's conclusions should not be disturbed. Gov. Br. 19-20. But the Tax Court, in reaching these conclusions, gives almost no consideration to significant record evidence – including, among other things, documentation from Associated Bank itself and the testimony of the consultant who crafted Associated Bank's strategy – that demonstrated that Associated deliberately leveraged VHC's line of credit to get it to guarantee Ron VDH's loans. The Tax Court passed on this evidence by stating only that VHC "entered into substantial guaranties with Associated Bank before 2002." *See* RA0074. This does not address the obvious record evidence that the 2002 Associated Bank guarantee was markedly different from prior ones. That failure is a glaring error. VHC is not asking this Court to re-weigh the evidence, but the Tax Court's opinion does not support the claim that the Tax Court actually did any weighing of the evidence before it. To put it another way, the record contained internal memoranda from a bank saying that it was going to threaten the business of VHC to get VHC to guarantee a third-party's debt. It also contained testimony of the consultant who crafted that strategy saying he proposed doing just that. Both are strong evidence that VHC had no choice, for its own business to survive, but to make the guarantee. A reader of the Tax Court's opinion would not know that such evidence had any connection to the Tax Court's conclusions on the 2002 guarantee. If the Tax Court weighed such significant evidence and found it unpersuasive, it needed to clearly state so.

That addresses the Associated Bank guarantee. The government further argues that VHC waived its argument concerning subsequent guarantees made to other banks because, it argues,

VHC made only a “skeletal argument” in its opening brief. Gov. Br. 49. But VHC argued in its opening brief that “when VHC later moved its obligations to other local banks...those banks demanded similar forced guarantees on existing loans.” VHC Br. 15. This is not a separate, skeletal, argument – it is an extension of the same argument that the Tax Court’s failure to address record evidence encompasses both Associated Bank and subsequent guarantees, which the government concedes is “thorough.” Br. 49. The law about what is or is not ordinary is the same, and there was no reason to belabor this point. If the Tax Court failed to properly address record evidence on Associated Bank, that error infects its analysis of subsequent guarantees.

Recognizing, perhaps, the weakness of the waiver argument, the government therefore argues in the alternative that “it is difficult to understand how VHC could have been ‘forced’ to guarantee Ron and his companies’ debts to other banks as a condition of moving VHC’s own debts to those banks.” Gov. Br. 50. But as stated, VHC’s guarantees to those banks were in relation to the movement of debt to those banks – they stemmed directly from the Associated guarantee. VHC could have lived with the guarantees at Associated, or moved the debt to other banks. *See* VHC Br. p. 7 (citing record evidence on this point). The point was argued extensively below, and was supported by the testimony of bank executives who confirmed that they imposed similar terms and made similar arguments to VHC as did Associated – but that, again, was not addressed by the Tax Court. *See* R282, pp. 100-101 (citing testimony of Nicolet Bank executive).

**C. The government’s argument that VHC “fails to show even a single guarantee-related expenditure” is misplaced**

The government next argues that VHC “failed to show even a single guarantee-related expenditure that was both substantiated and an ‘ordinary and necessary’ expense of its business. This argument is misplaced. The Tax Court affirmatively found that VHC did not provide the type of substantiation necessary for it to find that payments were made, and identified specific

categories including checks, receipts, and contracts. RA, p. 72. Yet VHC has cited to three examples – a \$125,000 check and loan document for one loan, three \$69,758.39 checks for payments to Baylake Bank on guarantees, and a \$8,271,001.42 transaction whereby VHC bought some of Ron VDH’s loans from Associated Bank – that demonstrate such documentation was provided as to significant dollar amounts of transactions.

When the Tax Court addressed ordinary and necessary nature of the payments, it did not address them transaction by transaction – nor could it, since it did not apparently understand what was in the record. Instead, the Tax Court addressed the payments in the aggregate and found that ordinary and necessary was not established in the aggregate. The Tax Court made no finding that sufficient linkages were not present for any individual transaction, even though those transactions were each the subject of proposed findings of fact. That individual transactions needed to be identified as ordinary and necessary, but were not, is not the basis for the Tax Court’s denial of the deduction. The Tax Court, not this Court, should be tasked with properly weighing the evidence actually before the Tax Court.

The government seeks to excuse the Tax Court’s error in part by suggesting, again, a waiver below with respect to a series of \$69,758.39 monthly payments to Baylake Bank. This is incorrect. VHC is well aware of the statement, quoted by the government, that “judges are not like pigs, hunting for truffles buried in [the record]. *Gross v. Town of Cicero, Ill.*, 619 F.3d 697, 702 (7th Cir. 2010). And VHC appreciates the difficulties associated with addressing specific facts in such a record – it spent considerable time organizing its proposed findings of fact below to attempt to assist the Court in that respect. But the simple fact is, as cited *supra*, VHC requested specific findings of fact on these payments and the guarantees in question. The government’s reliance on the size of the trial record – 12,000 pages – or the volume of briefing –

over 600 pages – could be used to excuse basically any error by the Tax Court. A six-page, 1,500-word argument would be only one percent of such briefing. The size of the record cannot excuse a court from reviewing evidence that is the subject of specific proposed findings of fact, especially when that evidence affects millions of dollars of tax.

The government’s argument as to the 2006 loan purchase agreement is similarly unavailing. The government argues that “VHC fails to cite any evidence substantiating that it actually paid the \$8.3 million purchase price recited in the agreement.” Gov. Br. 54. In other words, the government argues, the presence of a signed contract is not enough to prove that the transaction actually happened unless accompanied by a check. But the presence of a signed contract, consistent with VHC’s books, showing that it purchased the debt – is the sort of substantiation the Tax Court claimed was not in the record. And that the government can dream up other documents it would like to see on this point should not persuade this Court. One could always ask for more and better proof, no matter how much was offered. If the check had been produced, presumably the government would then insist on months of bank statements to prove the amount was not ultimately refunded. The Court should not indulge this speculation.

**D. The Tax Court improperly rejected VHC’s books and records**

Nor is the government’s argument against reliance on self-prepared books and records one that the Court should find persuasive. Like the Tax Court, the government cites cases that are materially different from this case. In fact, the government cites numerous cases that suggest that the presence of entries in the taxpayer’s books is not “conclusive,” not that they are not a significant matter. *See Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 187 (1918); *Kikalos v. United States*, 408 F.3d 900, 901 (7th Cir. 2005); *Glasgow Vill. Dev. Corp. v. Commissioner*, 36 T.C. 691, 703 (1961); *Gorokhovsky v. Commissioner*, 549 F. App’x 527, 530 (7th Cir. 2013). Those cases all concerned situations, much like those cases cited by the Tax Court, where there was

reason given to doubt the taxpayer's self-prepared books and records. And they clearly stand for the proposition that the records are "evidential." *Doyle*, 247 U.S. at 187.

A trial court rejecting record evidence absent contrary evidence is obliged to explain why it did so. *Imbesi v. Commissioner*, 361 F.2d 640, 643 (3d Cir. 1966) (taxpayer's testimony as to motive required consideration). Here, the Tax Court identified only that VHC's books were not audited, and that the records were "riddled with inconsistencies." But the Tax Court's findings were conclusory at best. As addressed in the opening brief, the Tax Court did not cite to any such inconsistencies, and this Court is left to guess what they were or whether they were material. VHC Br. 19.

The government attempts to supply its own view of supposed inconsistencies in place of the reasoning the Tax Court failed to give. Gov. Br. 58. The government argues that VHC's assertion before this Court that \$65 million in guarantee-related expenses are deductible is inconsistent with the Exhibit 1027-P below, which the government states shows a smaller number. *Id.* But assuming there was an unexplained discrepancy between the brief here and the finding below, that could not, of course, be the basis for the Tax Court's finding. But furthermore, the exact amount of a deduction to which VHC is entitled is a question for the Tax Court; the problem is that the Tax Court ignored record evidence in favor of VHC's position without justifying its decision. The government manufactures inconsistencies by citing, out of context, various pieces of evidence. But the Tax Court did not identify any such inconsistencies, that court just asserted, without support, that they existed. This Court should not do the Tax Court's job for it.

Further, although VHC's books were not audited, as pointed out by the government and the Tax Court, they were reviewed by its outside accounting firm, Schenck, every year. R282, p.

169, ¶ 812. Although a lower standard than an audit, a review is not insignificant, and helps credit the accuracy of VHC's books. It includes inquiry into the business's accounting practices. *See* ICPA - SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services* – 2016, p. 2568, § 12 (accountant should understand accounting principles and practices used by client, including in recording significant accounts). In addition, the IRS audited VHC for every year at issue and never imposed a single penalty, even though failure to keep adequate books and records is the basis for imposing accuracy-related penalties. *See* Treas. Reg. § 1.6662-3(b)(1).

VHC further argued, in its opening brief, that the Tax Court's approach was erroneous because it did not apply the rule of *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930), allowing it to estimate where it was not fully satisfied with substantiation. VHC Br. 19-20. The government argues that VHC waived this argument by not making it below. Gov. Br. 60. This is incorrect. VHC cited, in its Answering Brief below, *Cohan*, pointing out the Tax Court's exact power to do what VHC now asserts it should have done if it was not satisfied with the level of substantiation. R286, p. 141. That this power was first cited in an answering brief does not mean it was waived—the government argued that VHC did not properly substantiate; arguing in response that even if the government's argument had any merit, VHC was entitled to relief is not the kind of argument that needs to be made in an opening brief. The law is not that VHC must assume that it will lose and argue in its opening brief what the logical conclusion of a position asserted by the government in its opening brief is.

**E. The Tax Court's errors in docket management compounded any difficulties it had with the record**

The government next argues that VHC "tries to shift the blame for its overreliance on summaries and account books" to the government or the Tax Court. Gov. Br. 62. But the



government misstates the issue. As described in VHC's opening brief, nothing in the Notice of Deficiency gives any indication that any transaction was not substantiated. VHC Br. 23. It is true the IRS, as the government argues, denied the assertion in the Petition that amounts were substantiated. But, if an issue is not the basis of a Notice of Deficiency, the IRS cannot claim a presumption of correctness by later raising the matter in litigation. *See Shea v. Commissioner*, 112 T.C. 183 (1999). Assuming, *arguendo*, that the Commissioner's denial put the matter at issue, at best, the IRS would have been free to make a showing that transactions were *not* substantiated, but it would not have been entitled to a presumption of correctness on this matter.

Then, in its issues Memorandum, the government asserted that VHC bore the burden of substantiation. The Tax Court, through the mismanagement described in VHC's opening brief, failed to rule on this issue until the eve of trial. It then rebuffed VHC's efforts to introduce substantiating evidence for hundreds of transactions. The Tax Court is certainly entitled to control its record; but taxpayers are harmed where the Tax Court fails to timely tell the parties what is properly at issue, then refuses to admit records due to their volume and rules against the taxpayer for failing to provide sufficient documentation. An orderly trial process is part of the process due to a taxpayer, and that was denied here.

### **III. The Tax Court improperly ruled that the transactions at issue were not bona fide debt**

The government argues that the Tax Court properly determined that transactions at issue were bona fide debt, and begins its argument on this point with a citation that the burden of proving that a transaction is bona fide debt is a "'difficult one to meet,' especially when the 'transaction is cast in sufficiently ambiguous terms to permit an argument either way depending on which is subsequently advantageous from a tax point of view.'" Gov. Br. 24 *citing Ellinger v. United States*, 470 F.3d 1325 (11th Cir. 2006). Preventing that type of harm is a worthy goal, but

this case in no way implicates that harm. VHC consistently characterized – and was so found to have done so by the Tax Court – transactions with Ron VDH and his companies as debt.

RA0054. It reported interest income that was accrued – not received – from these transactions, consistent with that characterization.<sup>5</sup> They were evidenced by promissory notes and held out to third-parties as debt. The entire premise of the government’s argument in defense of the Tax Court’s reasoning on this issue is similarly faulty.

**A. The Tax Court’s findings based on the multi-factor test it applied are incorrect**

The Tax Court’s finding using “ten objective factors”, *see Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476 (1980) is flawed, as discussed in VHC’s opening brief, because the Tax Court has allowed a complex multifactor test to obscure the very object of that test. The key question is “whether there was a genuine intention to create a debt with a reasonable expectation of repayment, and did that intention comport with the economic reality of creating a debtor-creditor relationship.” *Id.* at 494. The test applied by the Tax Court is intended to be a guide to get to that answer; it is not intended to substitute for arriving at a reasonable answer to that question based on the record. Facts like subordination and timely repayments are indicia, but they do not answer the question.

Here, VHC documented the transactions as debt. It held them out to third-parties as debt. It accepted negative tax consequences (in the form of accrued income) in treating them as debt. And, especially early on, it received substantial repayments. Neither the Tax Court or the government has ever offered any satisfactory answer to why transactions meeting these criteria would not evidence an intention to create bona fide debt. Indeed, why would VHC pay income

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<sup>5</sup> Below, the government actually argued that VHC was not entitled to the reversal of this accrued interest income if the government prevailed on its bona fide debt arguments. R285, p. 218. The Tax Court rejected this argument.

tax on interest payments it never received if it did not believe it was owed and would eventually receive that interest?

Nor is the government's assertion that VHC does not contest the Tax Court's findings with respect to certain of the debt-equity factors availing. The government ignores that the premise of VHC's argument is that the mechanical application of these factors hindered the Tax Court's mission of identifying the truth. That repayment was "contingent on several events..." (namely Ron VDH having money to repay), and that Ron and his companies "failed to comply with the terms of promissory notes" is not wholly irrelevant, and the test employed by the Tax Court is reasonable insofar as it lists these as factors for consideration. But the test employed by the Tax Court appears to put these factors on equal footing with facts concerning the basic economic reality that VHC in no way made any sort of capital investment and that it consistently bore the tax consequences of treating these advances as debt.

The government's citation, at Gov. Br. 13, to the making of "advances without reasonable expectation of repayment throughout the years at issue," raises another problem with its – and the Tax Court's – reasoning. The Tax Court, again, did not adequately address the effect of the Associated Bank guarantees. The record is clear – Associated Bank forced VHC to guarantee loans in 2002. Once that guarantee was made, VHC was obligated to continue making advances. Advances after 2002 were not made willingly, but compulsorily. *See* VHC Br. p. 7. The test applied by the Tax Court does not require inquiry into the reasons for making further advances, just whether they were made. The Tax Court's mechanical application of this test and its failure to analyze transactions in their appropriate temporal context, as discussed in VHC's opening brief, obscured the true facts. For example, arguments about Ron VDH's inability to pay back loans dealt with the entire time period at issue in the aggregate and ignored significant

events suggesting he could pay them back, such as pending deals with Enron – when guarantees were signed, VHC had a reasonable basis for believing it would not have to make payments on those guarantees, but this fact was not addressed properly by the Tax Court.

The government further disputes the significance of this Court’s decision in *J&W Fence Supply Co. v. United States*, 230 F.3d 896 (7th Cir. 2000), solely on the basis that the cited portion, concerning the economic reality of the transactions and the significance of putting money behind a characterization, is dicta. But dicta or not, it is a persuasive point. If a taxpayer endures negative tax consequences for a position taken, that factor is obviously significant. And this Court has clearly stated that multifactor tests without weights assigned are problematic; its guidance on what is significant should not be ignored. The Tax Court did not properly address this guidance, instead relying on a host of factors that effectively collapse in on each other in an analysis unmoored from the timing or context of specific facts.

Further, the government argues that VHC waived its argument under Treas. Reg. § 1.166-1(c) that amounts arising out of receivables of an accrual method taxpayer are *per se* enforceable obligations. Gov. Br. 33. The government argues that the argument was “skeletal” given the size of the briefs below. *Id.* But VHC clearly cited the applicable governing law, R282, p. 359, and there was no dispute – and the government does not now dispute – that the record established that advances were recorded as income. That the standard was simple and could be stated clearly (in opposition to the multifactor test applicable to other amounts, which required voluminous argument to address) should not be held against VHC. Further, in VHC’s reply brief below, specific arguments about the appropriateness of substantiation on this issue were addressed. R286, p. 184. Further, VHC requested findings, and cited to record evidence, as to what portion of the writeoffs were due to such receivables. *See, e.g.*, R282, p. 133, ¶ 643. The Tax Court’s

failure to address the appropriate standard as to such amounts is reversible error. *See Culbertson v. Commissioner*, 337 U.S. 733, 747 (1949) (remanding case to Tax Court for further proceedings where Tax Court applied wrong legal standard).

The government also characterizes as a “quibble” VHC’s argument, VHC Br. 32-33, that the Tax Court incorrectly found that there was “no evidence” it had a right to enforce payments and that it had “not introduced objective evidence establishing the advances as loans.” The government suggests these errors do not matter and that really, the Tax Court meant that there was some evidence and it was “found...wanting.” Gov. Br. 35. But that is not what the Tax Court said; the Tax Court, rather, affirmatively found it was not presented with evidence that was, in fact, presented. RA0072 (finding VHC “did not introduce evidence of receipts, bank statements, contracts for services rendered, or documents establishing funds paid on guaranties.”) Further, given the Tax Court’s application of a multifactor test with no clear weights ascribed to any factor, it is unclear how the government can argue that the failure to understand what was even contained in the record is not error; if two of the factors changed, would that tip the scales? The Tax Court should have weighed the record before it in reaching that decision. It did not.

**B. The Government’s substantiation argument regarding bona fide debt should similarly be rejected**

The government next argues that the disallowance of bad debt deductions may also be affirmed on the alternative ground that VHC failed to substantiate the amounts of its claimed advances. Gov. Br. 36. This is not so, and this argument should be rejected.

The Tax Court found that VHC failed to substantiate its entitlement to deduct amounts as business expenses, but did not make that same finding in rejecting VHC’s bona fide indebtedness argument or even hint that this was a consideration. And here, the government relies on its argument with respect to the ordinary business expense section of its brief to show a lack of

substantiation. Gov. Br. 36-37. But the government, in the section of the brief it references, argues that 1) these expenses were not ordinary and necessary, and 2) these expenses were not shown to be related to guaranties. At the very least, the examples provided by VHC demonstrate significant amounts owed by Ron VDH to VHC (including an over \$8,000,000 loan purchased from Associated Bank). The fact of these advances, at least, was substantiated. This argument is without merit and should therefore be rejected.

**IV. The Tax Court failed to reverse all interest income that should have been reversed as a consequence of its bona fide debt ruling**

VHC's opening brief argues that the Tax Court erred by not reversing all interest income in all years at issue. The Tax Court's ruling misunderstood the functioning of accruals, and, furthermore, it misunderstood VHC's argument. *See* VHC Br. 34-35.

The government's primary argument is that this argument was waived because VHC used the phrase "excess amounts" when citing to examples on its brief below and that it was therefore only seeking reversal of those excess amounts. Gov. Br. 66. This is not so – while the argument could have been clearer, in context in its brief below and given the evidence it is sufficiently clear that VHC was addressing all accrued amounts in Exhibit 40-J, not just the years cited as examples. *See* R282, p. 155 (identifying accrual amounts in all years).

Further, although the government argues that testimony regarding the decision to stop accruing *some* amounts related to Ron VDH and his companies applies to all accruals, this is not true. The Tax Court, for purposes of these accruals, credited VHC's books and records – otherwise no interest income would have been reversed. If the Tax Court credited that there were accruals in 2005, 2006, and 2007 but not in other years, when accruals were proven by reference to the same exhibits, it should have identified a reason for the distinction. It did not.

**V. Conclusion**

The Tax Court's opinion contains numerous instances where the court failed to address evidence in the record. In some cases, it affirmatively found that kinds of evidence that were in the record and cited on brief were not in evidence at all. In other cases, it affirmatively found that there was no evidence in the record on specific points, when again, there was. Still in other cases, the Tax Court cites facts that arguably support its conclusions but offers no explanation whatsoever for rejecting especially compelling record evidence. Further, the Tax Court committed clear errors in its choice and application of tests. This Court should conclude that the Tax Court has committed errors and should remand with instructions to rectify said errors.

Respectfully submitted,

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Dated: February 6, 2020

/s/ Robert M. Romashko

Robert M. Romashko



**Certificate of Service**

I hereby certify that on February 6, 2020, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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