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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

THE UNITED STATES OF AMERICA, Plaintiff, v. KING MOUNTAIN TOBACCO CO., INC., Defendant.	Civil No. CV-12-3089-RMP **UNITED STATES' REPLY TO DEFENDANT'S OPPOSITION TO MOTION FOR SUMMARY JUDGMENT** **With Oral Argument** **July 30, 2014** **1:00 p.m., Yakima**

Introduction

On January 24, 2014, the Court granted the United States' motion for partial summary judgment in this suit to reduce federal tax assessments to judgment. The Court concluded that King Mountain Tobacco Co., Inc. ("King Mountain") is not exempt from federal tobacco manufacturers' excise taxes on its cigarettes and roll-

your-own tobacco. The United States then filed the pending motion for summary judgment on the sole remaining issue—how much King Mountain owes—so that a final money judgment can be entered.

In its response in opposition ("Opposition"), King Mountain argues that a trial is necessary because the government's computations do not include approximately $5 million earmarked for the Alcohol and Tobacco Tax and Trade Bureau ("TTB") from the federal asset forfeiture fund. But TTB has not yet received that payment. This is no reason to delay the entry of judgment for the amount due now.

In addition, King Mountain raises three new arguments that go back to the question the Court has already decided in favor of the United States, whether King Mountain is exempt from tax. These defenses come too late, causing prejudice. Also, they are meritless. No trial is required. Judgment should be entered for the total amount due as of February 25, 2014--$57,914,811.27, plus statutory interest.

Argument

I. No trial is necessary to determine the amount King Mountain owes.

Filed herewith is the Declaration of Tonya Geis. This Declaration, which was produced in discovery to King Mountain on February 26, 2014 (three binders of supporting computations were also produced on March 13, 2014, *see* Hankla Decl., Ex. C & D), shows that King Mountain owes $57,914,811.27 as of February 25, 2014, plus statutory interest accruing thereafter until payment.

King Mountain has not disputed the accuracy of Ms. Geis's computations. Instead, it argues that a trial is necessary because TTB does not account for a payment of between $5,000,000 to $8,995,259 to be received from forfeited funds held by the Justice Department's Criminal Division. *See* Hankla Decl., Ex. A (copy of Feb. 3, 2014 letter from Criminal Division to TTB, providing that TTB will receive up to $8,995,259, less expenses allowable to the United States); Ex. B (copy of Stipulated Consent Judgment and Final Order of Forfeiture, providing that the net payment to TTB will be no less than $5 million). TTB has not yet received this payment. Hankla Decl., ¶ 3.

This anticipated payment does not require a trial. King Mountain has raised no genuine issue of material fact about the accuracy of TTB's February 25, 2014 calculations. Judgment can be entered for the amount due as of that date, plus statutory interest. TTB will credit the forfeiture amount after receiving it.

II. **King Mountain's advice-of-counsel defense to penalties comes too late and lacks any factual or legal merit.**

The tax liabilities at issue include penalties assessed under 26 U.S.C. § 6651 and 6656 for failure to file timely tax returns and failure to timely pay and deposit taxes. Geis Decl., pp. 7-12. In its Opposition, King Mountain raises advice of counsel as a defense to these penalties. King Mountain did not, however, raise this issue previously, in its answer as required by Rule 8(c)(1) of the Federal Rules of Civil Procedure (the answer raises several affirmative defenses based on the Treaty

or other federal law, but not reasonable cause based on advice of counsel under sections 6651(a)(1) or 6656(a)), in its initial disclosures as required by Rule 26(a)(1)(A) (*see* Hankla Decl., Ex. F—the list of documents King Mountain disclosed that it might use in support of its defenses did not include the letter from counsel King Mountain now relies on), or otherwise. Until filing its Opposition, King Mountain's consistent position in this litigation was that it was exempt from tax, including penalties. It never conceded before that point that it might be liable for the tax but not the penalties.

It is too late to raise the advice-of-counsel defense now. The United States would be prejudiced because the discovery period, after having been extended several times, has closed. *Compare* Healy Tibbits Const. Co. v. Ins. Co. of North Am., 679 F.2d 803, 804 (9th Cir. 1982) (defendant insurance company was permitted to raise policy exclusion defense in its summary judgment motion even though not specifically pleaded as an affirmative defense; plaintiff suffered no prejudice because it was aware of the policy terms). If King Mountain had raised the defense timely, the United States could have taken discovery as to whether King Mountain's reliance on advice of counsel was reasonable. An advice-of-counsel defense waives the attorney-client privilege, so the United States would have requested relevant documents and deposed King Mountain's former counsel at K&L Gates to find out exactly what the advice was, including all qualifications and litigation-risk assessments. That cannot be done now.

But even if King Mountain had timely raised advice of counsel as a defense, it would be insufficient as a matter of law. King Mountain knew at all relevant times that TTB categorically disagreed with the position that King Mountain was exempt from federal excise tax under the Treaty of 1855 or other federal law. King Mountain does not offer into evidence any formal opinion letter that K&L Gates may have prepared for King Mountain to rely on. Such an opinion necessarily would have discussed the facts and law and candidly assessed the litigation risks, including adverse precedent such as Ramsey v. United States, 302 F.3d 1074 (9th Cir. 2002) and other Ninth Circuit cases discussed in the United States' previous briefs. King Mountain's owner, Delbert Wheeler, was well aware of Ramsey because he was in the same business as Mr. Ramsey—hauling logs off the Yakama Reservation to market—and was directly affected by Ramsey's outcome. *Compare* Ramsey (Ramsey not exempt from federal excise tax under Treaty) with Cree v. Flores, 57 F.3d 762 (9th Cir. 1998) (Wheeler exempt from state excise tax under Treaty). To properly claim reliance on a professional as a defense to penalties, the taxpayer must not have been on notice that the legal position was erroneous at the time. *See* Betson v. Comm., 802 F.2d 365, 372 (9th Cir. 1986) (reliance on professional advice was good defense to penalties when deductibility of subject losses was "reasonably debatable"). King Mountain could not reasonably rely on legal advice contrary to Ninth Circuit precedent.

In short, the advice-of-counsel defense comes too late and would be ineffectual even if it had been timely raised.

III. King Mountain's equitable estoppel defense to a portion of the taxes and penalties comes too late and lacks any factual or legal merit.

As with the advice-of-counsel defense discussed above, King Mountain's equitable estoppel defense comes too late. "Estoppel" is one of the defenses specified in Rule 8(c)(1) that "must affirmatively" be stated. King Mountain did not mention it in its answer or allude to it in its initial disclosures. The United States would be prejudiced if King Mountain is allowed to maintain this defense now.

Additionally, King Mountain's proffered evidence is not strong enough to carry the burden of proving equitable estoppel against the federal government. "[E]quitable estoppel will not lie against the government as against private litigants." Office of Personnel Management v. Richmond, 496 U.S. 414, 419 (1990). The Supreme Court has "reversed every finding of estoppel" to come before it. Richmond, 496 at 422-23. "If equitable estoppel ever applies to prevent the government from enforcing its duly enacted laws, it would only apply in extremely rare circumstances." Volvo Trucks of North America, Inc. v. United States, 367 F.3d 204, 211 (4th Cir. 2004).

Not only must the traditional elements of equitable estoppel be established—ignorance of relevant facts by the claimant, knowledge of those facts by the

government, conduct by government on which the claimant could justifiably rely, and actual detrimental reliance on the government's conduct by the claimant—but three additional elements must be shown: "(1) the government engaged in affirmative misconduct going beyond mere negligence; (2) the government's wrongful acts will cause a serious injustice; and (3) the public's interest will not suffer undue damage by imposition of the estoppel." Baccei v. United States, 632 F.3d 1140, 1147 (9th Cir. 2011); Morgan v. Gonzales, 495 F.3d 1084, 1092 (9th Cir. 2007); Watkins v. U.S. Army, 875 F.2d 699, 709 (9th Cir. 1989).

King Mountain has not shown conduct by the government that would meet the traditional elements of estoppel, much less the additional elements required of a claim against the government. King Mountain identifies no representations by the government upon which it relied to its detriment; its dealings were with Fred Brackett, a cigarette wholesaler who was cooperating with the government but did not know about the government's interest in King Mountain until after he had already purchased the contraband cigarettes from King Mountain. Brackett Affid., ECF No. 75-4, ¶ 6 ("My cooperation [with federal law enforcement authorities investigating cigarette diversion activities nationwide] did not involve King Mountain in any way."). There is no proof that King Mountain would have used the funds seized from Brackett to voluntarily pay the taxes it failed to report on its returns. And King Mountain shows no "affirmative misconduct," which "requires an affirmative misrepresentation or affirmative concealment of a material fact,

Watkins, 875 F.2d at 707, such as a deliberate lie or pattern of false promises." Baccei, 632 F.3d at 1147. King Mountain does nothing more than provide evidence of a federal undercover investigation of cigarette trafficking. Additionally, King Mountain fails to show that the public's interest would not suffer undue damage from an estoppel, which here would result in a loss to the Treasury of over $57 million in cigarette tax liabilities legally due and owing.

Further, King Mountain has unclean hands. This alone disqualifies it from equitable relief. *E.g.,* Irving v. Gray, 479 F.2d 20 (2d Cir. 1973) ("because they do not come before us with clean hands, we would not be able to grant them injunctive relief even if we believed that they had been assessed too much by the IRS"); *see generally* Keystone Driller Co. v. Gen. Excavating Co., 290 U.S. 240 (1933). King Mountain engaged in unlawful activity, as demonstrated by the affidavit of FBI agent Matthew Bullwinkel, attached as Exhibit A to the Leftwich Declaration. (The Leftwich Declaration was produced to King Mountain on February 26, 2014 along with the Geis Declaration discussed above. Hankla Decl., Ex. C, D & E.) Among other things, King Mountain failed to report the removal from its bonded warehouse of, and failed to prepay the tax on, over 175 million cigarettes—22 tractor-trailer loads—that it shipped to a South Carolina wholesaler as part of a scheme to evade federal and state cigarette taxes. Leftwich Decl., ¶ 12; Ex. A. King Mountain should have raised in the forfeiture proceeding any

complaints it had about the way the criminal investigation was conducted instead of stipulating to judgment. *See* Hankla Decl., Ex. B (stipulation to judgment).

IV. King Mountain's potential-forfeiture-of-allotted-land defense to all of the taxes and penalties comes too late and lacks any factual or legal merit.

In addition to being raised too late, not being mentioned in the answer, initial disclosures, or otherwise prior to the Opposition, King Mountain's defense under 26 U.S.C. § 5763(c) simply misreads the law. King Mountain's argument, analogous to its rejected General Allotment Act argument, is that since, in its view, a failure to pay tax may result in a forfeiture under section 5763(c) of the trust land on which King Mountain's facilities are located, then King Mountain should be exempt from tax. Section 5763 does not imply this, though. Forfeitures of real estate under section 5763(c) do not result from the mere failure to pay tax. They result when "illicit" manufacturers of tobacco products operate on such land without required permits or bonds. King Mountain is not such a manufacturer. It properly obtained a permit from TTB and posted a surety bond approved by TTB before commencing business. *See* Wheeler Decl., ¶ 6. King Mountain's failure to pay tax, standing alone, could not result in a forfeiture of real property held in trust by the Bureau of Indian Affairs for Mr. Wheeler. So long as King Mountain continues to maintain its permit and bond, Mr. Wheeler's trust land is safe from forfeiture under section 5763(c). The premise of King Mountain's argument for an exemption from tax is thus false.

Conclusion

No trial is necessary. Based on the foregoing and on the United States' Motion, there is no genuine issue of material fact and the United States is entitled as a matter of law to summary judgment as to King Mountain's liability for the subject taxes, in the amount of $57,914,811.27 as of February 25, 2014, plus statutory interest to the date of payment.

DATED this 18th day of June, 2014.

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CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of June, 2014, I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF System, which will send notification of such filing to the following:

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