No. 12-277

In the Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ENTERGY CORPORATION AND AFFILIATED SUBSIDIARIES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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TABLE OF AUTHORITIES

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Respondent does not appear to dispute that, if the Court grants review in *PPL Corp.* v. *Commissioner*, 665 F.3d 60 (3d Cir. 2011), petition for cert. pending, No. 12-43 (filed July 9, 2012), the petition in this case should be held pending the Court's disposition of *PPL*. Instead, respondent contends that the Court should deny both petitions because, in respondent's view, (1) although the Third and Fifth Circuits reached opposite conclusions on whether the United Kingdom (U.K.) windfall tax is an income tax for which a foreign tax credit is allowed under 26 U.S.C. 901, those courts "agree on the basic principles of law governing creditability of a foreign tax" (Br. in Opp. 15-18) (emphasis omitted); (2) the specific question presented is unlikely to affect a large number of taxpayers (*id.* at 18-25); and (3) the court of appeals' decision in this case is correct (*id.* at 25-29). Respond-

ent's arguments against granting review in *PPL* are unpersuasive.

1. Respondent concedes (Br. in Opp. 14) that the Third and Fifth Circuits have reached opposite conclusions on whether the U.K. windfall tax is an income tax for which a foreign tax credit is allowed under Section 901. Respondent contends, however (*id.* at 15-25), that review by this Court is not warranted because those courts "agree on the basic principles of law governing creditability of a foreign tax." *Id.* at 15 (emphasis omitted). The Third and Fifth Circuits both recognized that a foreign tax is creditable under Section 901 only if its predominant character "is that of an income tax in the U.S. sense," as the Treasury regulation requires, see 26 C.F.R. 1.901-2(a)(1)(ii), and that the predominant character of the foreign tax must be evaluated based on the realization, gross-receipts, and net-income tests set forth in 26 C.F.R. 1.901-2(b)(1). Contrary to respondent's suggestion, however, the courts applied substantially different analytical approaches within that regulatory framework.

In *PPL*, the Third Circuit analyzed the tax base specified in the U.K. statute in order to determine whether the windfall tax was imposed "[u]pon or subsequent to" a realization event, 26 C.F.R. 1.901-2(b)(2)(i)(A); whether it was imposed "on the basis of" gross receipts, 26 C.F.R. 1.901-2(b)(3)(i); and whether "the base of the tax" is net income, 26 C.F.R. 1.901-2(b)(4)(i). The windfall tax was a 23% tax imposed on a tax base equal to the difference between a company's profit-making value during its initial period and the price for which it was sold at flotation. See Pet. App. 104a. The Third Circuit correctly concluded that the windfall tax did not satisfy the regulatory requirements, and thus did not have the pre-

dominant character of an income tax, because the court could not arrive at initial-period profits as the tax base unless it rewrote the statute to apply a tax rate different from the 23% rate provided in the statute. *PPL*, 665 F.3d at 65.

The Fifth Circuit in this case, in contrast, began with the premise that Parliament's intent in enacting the U.K. windfall tax was to recover a portion of the utilities' "'excess profits' in light of their sale value." Pet. App. 7a-8a. The court concluded that, "[v]iewed in practical terms," but without regard for the statutory tax base, the windfall tax satisfied the regulatory tests. *Id.* at 7a. It based that determination on the facts that the tax was calculated with reference to profits that were made in the past (which the court concluded satisfied the realization test), was limited to companies that had made a profit during the initial period (which the court concluded satisfied the net-income test), and necessarily used gross receipts to calculate initial-period profits (which the court concluded satisfied the gross-receipts test). *Id.* at 7a-8a. The Fifth Circuit did not determine the predominant character of the tax by testing the tax base specified in the U.K. statute against each of the regulatory requirements. Instead, it concluded at the outset that the tax was designed to collect a portion of the utilities' excess profits following flotation, and based its determination that each regulatory test was satisfied on that initial conclusion.

Thus, although the Third and Fifth Circuits agree on the very general principle that a foreign tax is creditable only if its predominant character is that of an income tax in the U.S. sense, there is a clear circuit conflict on the proper analytical approach for evaluating whether a particular foreign tax is an income tax according to the

regulatory requirements. Petitioner's attempt to minimize the conflict fails.

2. As the Commissioner acknowledged in his brief in *PPL* (Br. for Resp't, *PPL*, No. 12-43, at 13 (filed Sept. 4, 2012)), the U.K. windfall tax is a one-time tax, and the government is aware of only three U.S. taxpayers that the U.K. tax has affected. Respondent is wrong, however, in contending (Br. in Opp. 18-25) that a decision by this Court on whether the U.K. windfall tax is a creditable income tax would have no prospective significance.

As the Commissioner explained in *PPL* (Br. for Resp't, *PPL*, No. 12-43, at 14), issues regarding the regulatory tests set forth in 26 C.F.R. 1.901-2(b) will necessarily arise in cases involving specific foreign tax laws that are unlikely to affect a significant number of American taxpayers. That is not a reason for this Court to leave in place a clear circuit conflict on a matter of federal tax law. The Fifth Circuit's approach, if allowed to stand, would enable future litigants to claim entitlement to a foreign tax credit for taxes that look nothing like an income tax, so long as one variable in the tax formula is the company's ability to generate income. That approach would largely eviscerate any distinction between a tax on income and a tax on the value of income-producing property. This Court's intervention is warranted to provide guidance on the proper analytical approach for evaluating foreign taxes under Section 901 and the Treasury regulation.

3. Finally, respondent contends (Br. in Opp. 25-29) that the Fifth Circuit's decision is correct. That argument, however, is irrelevant to whether the Court should grant certiorari to resolve a clear circuit conflict on a question of federal tax law. That is particularly so because the Court currently has before it *two* petitions

on that issue in cases where the courts of appeals reached irreconcilable decisions. Regardless of how the Court may later decide the merits, if certiorari is granted in *PPL*, the Court presumably will reverse or vacate the court of appeals' judgment in one of the two pending cases, and the petitioning party in that case can then be given effective relief. In any event, respondent's defense of the Fifth Circuit's decision is unpersuasive.

Respondent contends (Br. in Opp. 26) that the court of appeals correctly applied the realization test because the tax was calculated with reference to revenue earned by the utilities before the windfall tax was designed and assessed. But respondent ignores that, under the formula specified in the U.K. statute, the windfall amount of respondent's U.K. subsidiary subject to tax was £608.5 million, over £100 million more than the £503.4 million of profits that the U.K. subsidiary had actually realized during its initial period. 10-60988 C.A. R.E. Doc. 31, paras. 72, 76 (5th Cir. Apr. 13, 2011).

Moreover, the windfall tax does not satisfy the gross-receipts and net-income requirements merely because, as respondent contends (Br. in Opp. 26), it "operated to 'claw back' excess profits" or was imposed only on utilities that had made a profit during the initial period. That argument ignores the fundamental issue in this case. The windfall tax formula uses a company's profits during its four-year initial period as one variable to determine a company's windfall amount subject to tax. But that does not mean the windfall tax was "based on" those profits. The tax was based on each company's windfall amount, calculated as the difference between a company's profit-making value at flotation (which in turn is defined as nine times the company's average annual post-flotation profits during a four-year initial peri-

od) and the price at which the company was sold. That is a tax on value, not an income tax.

* * * * *

For the foregoing reasons and those stated in the petition for a writ of certiorari, the petition should be held pending this Court's final disposition of *PPL Corp.* v. *Commissioner*, No. 12-43, and disposed of as appropriate in light of that decision.

Respectfully submitted.

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