No. 12-60533

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OSVALDO RODRIGUEZ AND ANA M. RODRIGUEZ,

Petitioners - Appellants

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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STATEMENT REGARDING ORAL ARGUMENT

Counsel for the appellee believe that oral argument may be helpful to the Court in light of the issue of statutory interpretation presented by this case.

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JURISDICTIONAL STATEMENT

On March 20, 2008, the Commissioner issued a notice of deficiency to Osvaldo Rodriguez and Ana M. Rodriguez (taxpayers), determining that they were liable for income tax deficiencies for 2003 and 2004 in the amounts of $316,950 and $295,530, respectively. (Doc. 19, Ex. 12-J.) [1] Taxpayers challenged the notice of deficiency by filing a petition in the Tax Court on June 9, 2008. (Doc. 1.) The petition was filed

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[1] "Doc." references are to the documents comprising the original record on appeal, as numbered by the Clerk of the Tax Court and transmitted to this Court.

within 90 days after the issuance of the notice of deficiency and was therefore timely under § 6213(a) of the Internal Revenue Code (26 U.S.C.) (I.R.C.). The Tax Court had jurisdiction pursuant to I.R.C. §§ 6213 and 7442.

Taxpayers' case was submitted to the court for decision on a set of stipulated facts. On December 7, 2011, the Tax Court issued an opinion, reported at 137 T.C. 174, determining that taxpayers were liable for the deficiencies determined by the Commissioner. (Doc. 40.) The court entered its final decision on December 9, 2011. (Doc. 41.)

On February 21, 2012, taxpayers submitted a motion for reconsideration or for consideration by the full Tax Court. (Doc. 42.) The Tax Court filed this motion as a motion to vacate or revise decision.[2] (Doc. 46 at 1.) The Tax Court denied taxpayers' motion to vacate on April 6, 2012. (Doc. 46.)

Fed. R. App. P. 13(a)(2) provides that, when a timely motion to vacate the Tax Court's decision is filed, the time for filing a notice of

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[2] Tax Court Rule 162 generally provides that a motion to vacate a decision of the Tax Court "must be filed within 30 days after the decision has been entered," but it also provides that the court may permit the filing of such a motion out of time. The Tax Court filed taxpayers' motion as if it were timely.

appeal runs from the date of the court's order disposing of the motion. Taxpayers filed a notice of appeal on June 27, 2012, which was timely because it was within 90 days after the Tax Court issued its order denying their motion to vacate. I.R.C. § 7483. Jurisdiction is conferred on this Court by I.R.C. § 7482.

STATEMENT OF THE ISSUE

Whether the Tax Court correctly held that amounts included in taxpayers' gross income pursuant to I.R.C. §§ 951 and 956 were not qualified dividend income under I.R.C. § 1(h)(11).

STATEMENT OF THE CASE

Taxpayers challenged in a Tax Court petition the Commissioner's determination of deficiencies in their income tax for 2003 and 2004. The Tax Court concluded, on a stipulated record, that the Commissioner's determination was correct.

STATEMENT OF FACTS

Taxpayers are citizens of Mexico and permanent residents of the United States. [3] (Doc. 19 at 2.) During the years at issue, they owned

[3] Ana Rodriguez became a naturalized citizen of the United States after the petition was filed in this case. (Doc. 19 at 2.)

100% of the stock of Editora Paso del Norte, S.A. de C.V. (Editora), a corporation that was incorporated in Mexico in 1976. (*Id.* at 4.) Editora is a controlled foreign corporation (CFC) within the meaning of I.R.C. § 957. [4] (Doc. 11 at 5.)

From 1976 until 2001, Editora's primary business was newspaper publishing and sales of newspaper advertising in Mexico. (Doc. 19 at 6.) In 2001, Editora established a branch in the United States to conduct U.S. operations. (*Id.*) The United States branch was called Editora Paso del Norte, S.A. de C.V., Inc., and had offices in El Paso, Texas. (*Id.* at 6-7.)

Editora ceased its newspaper business in 2001 and 2002, licensing the names of its various publications to related entities. (Doc. 19 at 7.) Editora thereafter engaged primarily in the development, construction, management, and leasing of real estate and printing

[4] A controlled foreign corporation (CFC) is any foreign corporation more than 50 percent of whose stock is owned directly, indirectly, or constructively by United States shareholders. I.R.C. § 957(a). CFC earnings are taxed to United States shareholders pursuant to I.R.C. § 951. A United States shareholder is a United States person who owns, directly, indirectly, or constructively, 10 percent or more of the voting stock of the foreign corporation. I.R.C. § 951(b). The term "United States person" includes "a citizen or resident of the United States." I.R.C. §§ 957(c), 7701(a)(30).

presses in Mexico and the United States. (*Id.* at 7-8.) Editora also received income in the form of interest from loans and royalties from the licensing of intellectual property. (*Id.*)

As explained above at n. 4, I.R.C. § 951 requires United States shareholders of a CFC to include certain corporate earnings in their income. Section 956 provides generally that the amount of United States property held by a CFC during the taxable year is an includible amount. On October 15, 2005, taxpayers filed an amended income tax return for 2003 in which they reported $1,585,527 as their share of Editora's increased investments in U.S. property during 2003. (Doc. 19, Ex. 6-J.) On the same date, they filed a 2004 income tax return in which they reported $1,478,202 as their share of Editora's increased U.S. investments during 2004. (*Id.*, Ex. 7-J.) They reported these amounts on their Forms 1040 as "qualified dividends," which, under I.R.C. § 1(h)(11), are taxed at a rate of 15% rather than at a taxpayer's regular rate of tax. [5] We refer to these amounts hereafter as "Section 951 inclusions."

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[5] Taxpayers filed their original 2003 tax return on or about October 4, 2004, but did not report any "qualified dividends" on that return. (Doc. 19, Ex. 5-J.)

The Commissioner issued a notice of deficiency to taxpayers, determining that they were liable for deficiencies in income tax for 2003 and 2004. (Doc. 11, Ex. 12-J.) The deficiencies resulted from the Commissioner's recharacterization of the Section 951 inclusions that taxpayers had reported as qualified dividends. (*Id.*) The Commissioner recharacterized the Section 951 inclusions as nondividend income that was subject to tax at taxpayers' regular tax rate, rather than at the 15% rate provided by I.R.C. § 1(h)(11).

Taxpayers challenged the Commissioner's determination in the Tax Court. (Doc. 1.) The parties submitted the case to the court for decision on a fully stipulated record. (Doc. 40 at 2.) The Tax Court concluded that the Commissioner was correct in his determination that the Section 951 inclusions did not constitute qualified dividends. (Doc. 44.)

In its opinion, the Tax Court explained that I.R.C. §§ 951 and 956 subject U.S. shareholders of a CFC to tax "on the CFC's earnings that are invested in certain types of assets in the United States." (*Id.* at 4.) The parties agreed that, for 2003 and 2004, Editora was a CFC under I.R.C. § 957(a), and that taxpayers were United States shareholders

with respect to Editora. (*Id*. at 4-5.) The parties also agreed as to the amounts that taxpayers were required to include in income under I.R.C. §§ 951 and 956. (*Id*. at 5.) The only question presented for the Tax Court's decision was whether taxpayers' Section 951 inclusions constituted qualified dividends under I.R.C. § 1(h)(11). (*Id*.)

The Tax Court began its analysis with I.R.C. § 316, which defines the term "dividend" for purposes of subtitle A of the Code, including I.R.C. § 1. (Doc. 40 at 5.) The court pointed out that I.R.C. § 316(a) defines a dividend as a *distribution* of property by a corporation to its shareholders out of the corporation's current or accumulated earnings. (*Id*.) The court reasoned that the *sine qua non* of a dividend is a distribution of property, which requires a change in the form of the property's ownership. (*Id*.)

The Tax Court explained that the amount that is included in income under I.R.C. §§ 951 and 956 gives rise to no change in ownership, because the inclusion amount is based on the *undistributed* earnings of a CFC. (Doc. 40 at 6.) Given the absence of a distribution of property, the court reasoned that a Section 951 inclusion cannot be considered a dividend without some other

statutory provision that deems it to be a dividend. (*Id.*) The court found that there was no such special provision in the Internal Revenue Code or Treasury regulations for purposes of I.R.C. § 1(h)(11). (*Id.*)

The Tax Court noted, moreover, that Congress has enacted special provisions to treat Section 951 inclusions as if they were dividends in specified circumstances, and reasoned that these provisions would have been superfluous if Section 951 inclusions constituted dividends in the first place. (Doc. 40 at 6-7.) The court observed further that the Internal Revenue Code expressly characterizes certain types of items as distributions or dividends, but makes no such general provision for Section 951 inclusions. (*Id.* at 7-8.)

The Tax Court also found it noteworthy that I.R.C. § 951 was enacted at the same time that Congress enacted I.R.C. § 1248, which treats gain on the disposition of CFC stock as a dividend in certain specified circumstances. (Doc. 40 at 8.) The court viewed it as "purposeful" that Congress did not simultaneously make any similar provision for Section 951 inclusions. (*Id.*) And the court also found it

meaningful that Treasury Reg. § 1.902-1(a)(11) draws a distinction by referring to "deemed inclusions" under I.R.C. § 951, but referring to "deemed dividends" under I.R.C. § 1248 (and now-repealed I.R.C. § 551). (*Id.*)

The Tax Court took note of the fact that a 1962 committee report accompanying the enactment of Subpart F of the Code (which includes I.R.C. §§ 951 and 956) stated that tax was being imposed on CFC earnings because they were "substantially the equivalent" of a dividend to the United States shareholders. (Doc. 40 at 8.) The court stated that this language was "a far cry," however, from saying that these amounts actually constituted dividends. (*Id.* at 10.) In this regard, the Tax Court further noted that the original version of I.R.C. § 956(a) provided for a Section 951 inclusion that was defined by the amount of a CFC's year-end holding of United States property if that property "would have constituted a dividend . . . if it had been distributed." (Doc. 40 at 10.) The court found nothing in the legislative history of a subsequent deletion of this language to suggest

that the deletion was intended to eliminate the original distinction between Section 951 inclusions and dividends. (*Id.* at 10-11.)

The Tax Court recognized, moreover, that the Internal Revenue Code provides different "operating rules" for dividends and for Section 951 inclusions, pursuant to which dividends have a different effect on a corporation's earnings and profits and a shareholder's stock basis, than do Section 951 inclusions. (Doc. 40 at 12.)

The Tax Court also explained that the legislative history of I.R.C. § 1(h)(11) shows that it was enacted to remove a "perceived disincentive for corporations to pay out earnings as dividends instead of retaining and reinvesting them." (Doc. 40 at 13.) The court pointed out that Section 951 inclusions do not constitute paid-out amounts, but instead represent retained and reinvested earnings. (*Id.*) The court reasoned that Section 951 inclusions do not reflect the corporate conduct that I.R.C. § 1(h)(11) was enacted to encourage. (*Id.*) Further, the court noted that certain "technical rules" that apply to I.R.C. § 1(h)(11) do not work well with Section 951 inclusions. (*Id.*)

The Tax Court accordingly concluded that taxpayers' Section 951 inclusions did not constitute qualified dividend income under I.R.C. § 1(h)(11). (*Id.* at 16.)

SUMMARY OF ARGUMENT

Taxpayers are the controlling shareholders of Editora, a controlled foreign corporation (CFC). Section 951 of the Code required them to include certain amounts of Editora's undistributed earnings in income for 2003 and 2004. Specifically, they were required to include an amount that I.R.C. § 956 defined, generally, as the United States property held by Editora during the taxable year. Sections 951 and 956 are part of the Subpart F regime, which Congress enacted in 1962 to impose tax on United States shareholders who control foreign corporations but decline to repatriate the corporation's foreign earnings, and therefore would avoid current tax on the earnings absent Subpart F's provisions.

Taxpayers claimed on amended returns for 2003 and 2004 that their Section 951 inclusions constituted "qualified dividend income" under I.R.C. § 1(h)(11) and, as such, were taxable at the preferential

tax rate provided therein. The Commissioner determined in his notice of deficiency that the Section 951 inclusions were not qualified dividend income and taxpayers challenged that determination in the Tax Court. The Tax Court upheld the Commissioner's determination and taxpayers have demonstrated no error in its decision.

The term "qualified dividend income" is defined in I.R.C. § 1(h)(11) as dividends *received* during the taxable year from domestic corporations and qualified foreign corporations. The term "dividend" is defined, in turn, in I.R.C. § 316(a) as any *distribution* of property made by a corporation to its shareholders out of its earnings and profits. It is undisputed that taxpayers' CFC, Editora, made no *distribution* of its earnings to taxpayers during the years in issue. It therefore necessarily follows that taxpayers *received* no dividends during those years from Editora and, consequently, had no qualified dividend income with respect to that corporation. *See* I.R.C. §§ 1(h)(11) & 316(a). Although taxpayers were required under I.R.C. § 951 to include in their income the *undistributed* earnings of Editora, those Section 951 inclusions were not dividends as defined in I.R.C. § 316(a)

and, consequently, did not constitute "qualified dividend income" under I.R.C. § 1(h)(11), *i.e.*, dividends *received* during the taxable year. The Tax Court correctly so held.

Taxpayers' assertion that their Section 951 inclusions should be "deemed" to be dividends, *i.e.*, treated as if they were dividends, even though they are not, is unfounded and was correctly rejected by the Tax Court. Indeed, the adoption by this Court of taxpayers' anomalous position would contravene the Congressional intent underlying the enactment of the qualified dividend income provision. Congress enacted a preferential tax rate in I.R.C. § 1(h)(11) to stimulate the economy by providing an incentive for corporations to distribute their earnings to shareholders instead of retaining them. As is apparent, that Congressional purpose is not served where, as is the situation here, a CFC retains its earnings instead of distributing them. We would point out in this regard that taxpayers could have caused Editora to distribute its earnings to them as dividends, and had they done so, those dividends would have constituted qualified dividend income under I.R.C. § 1(h)(11). Having elected not to take that course

of action, taxpayers are in no position to contend that they should be taxed as if they had received Editora's income as dividends.

ARGUMENT

THE TAX COURT CORRECTLY HELD THAT TAXPAYERS' SECTION 951 INCLUSIONS DID NOT CONSTITUTE QUALIFIED DIVIDEND INCOME UNDER I.R.C. § 1(h)(11)

Standard of Review

This Court reviews *de novo* the Tax Court's interpretation of a provision of the Internal Revenue Code. *Bosamia v. Commissioner*, 661 F.3d 250, 253 (5th Cir. 2011); *Espinoza v. Commissioner*, 636 F.3d 747, 749 (5th Cir. 2011).

A. Introduction

In the Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960, Congress enacted provisions (codified in Subpart F of the Internal Revenue Code, I.R.C. §§ 951-964) requiring that, in certain circumstances, United States shareholders must include in gross income the earnings of "controlled foreign corporations" (CFCs). Congress intended thereby to address what it viewed as an inappropriate deferral of United States tax on income that was earned by CFCs. As explained by the legislative history (H.R. Rep. No. 87-

1447 at 57 (1962) (1962-3 C.B. 405, 461); S. Rep. No. 87-1881 at 78 (1962) (1962-3 C.B. 707, 784)):

> Under present law, foreign corporations, even though they may be American controlled, are not subject to U.S. tax laws on foreign source income. As a result no U.S. tax is imposed with respect to the foreign source earnings of these corporations where they are controlled by Americans until dividends are paid by the foreign corporations to their American parent corporations or to their other American shareholders. The tax at that time is imposed with respect to the dividend income received, and if this shareholder is a corporation it is eligible for a foreign tax credit with respect to the taxes paid by the foreign subsidiary. In the case of foreign subsidiaries, therefore, this means that foreign income taxes are paid currently, to the extent of the applicable foreign income tax, and not until distributions are made will an additional U.S. tax be imposed, to the extent the U.S. rate is above that applicable in the foreign country.

In order to provide for current taxation of such undistributed earnings, the Revenue Act of 1962 provided "that certain types of income of [CFCs], even though undistributed, are to be included in the income of U.S. shareholders in the year the income is earned by the foreign corporation." S. Rep. No. 87-1881 at 80 (1962) (1962-3 C.B. at 786). *See also* Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* (6th ed.) para. 15.61[3] ("the purpose of subpart F is to require the shareholder to report his share of the CFC's *undistributed* income") (emphasis in original).

Section 951(a), Appendix, *infra*, requires a U.S. shareholder of a CFC to "include [amounts] in his gross income" that include his pro rata share of amounts determined under I.R.C. § 956. Section 956 requires the inclusion of an amount that represents the lesser of (1) the excess of (a) the average of a CFC's end-of-quarter U.S. property holdings in a given year over (b) the CFC's earnings and profits that, generally speaking, were not previously included in income (*see* I.R.C. § 959(c)(1)(A)), or (2) the U.S. shareholder's pro rata share of "applicable earnings," which are, generally, the CFC's earnings and profits, reduced by distributions made during the year and by amounts that were previously taxed.

The effect of these provisions is to tax a United States shareholder on undistributed earnings of a CFC to the extent that there has been an increase in the amount of United States property held by the CFC in a taxable year. This effectuates Congress's intention "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. 87-1447 at 58 (1962-3 C.B. at 462). *See also* S. Rep. No. 94-938 at 226 (1976) (1976-3 C.B. (Vol. 3) 49, 264).

The issue here is the relationship between the income inclusions mandated by I..R.C. §§ 951 and 956, and the reduced tax rate applicable under I.R.C. § 1(h)(11) to "qualified dividend income." Section 1(h)(11), which was enacted in 2003, imposes tax at a preferential rate on "qualified dividend income," which is defined as dividends *received* during the taxable year from domestic corporations and "qualified foreign corporations." There is no dispute that Editora was a qualified foreign corporation or as to the amounts taxpayers were required to include in their income for 2003 and 2004 under I.R.C. §§ 951 and 956. The sole question is whether taxpayers' Section 951 inclusions constituted "qualified dividends" within the meaning of I.R.C. § 1(h)(11) so as to qualify for the preferential tax rate set forth in that provision. As demonstrated below, the Tax Court correctly answered that question in the negative.

B. The Tax Court correctly held that taxpayers' Section 951 inclusions were not dividends within the meaning of the Internal Revenue Code

As the Tax Court recognized, in order to be "qualified dividend income," an item of income must be a "dividend." (Doc. 40 at 5.) *See* I.R.C. § 1(h)(11). The term dividend is defined in the Internal Revenue Code as a distribution made by a corporation to its shareholders out of

its earnings and profits. (Doc. 40 at 5-6, citing I.R.C. § 316(a); Treas. Reg. § 1.316-1.) The court reasoned that, in the absence of a special rule in the Code, there can be no dividend without a distribution, and that a distribution cannot occur without a transfer of ownership. *See, e.g.*, *United States v. Davis*, 397 U.S. 301, 313 (1970) (the effect of a corporate distribution as a dividend is "to transfer the property from the company to its shareholders without a change in the relative economic interests or rights of the stockholders"); *Commissioner v. Gordon*, 391 U.S. 83, 90 n.5 (1968) (dividend involves a change in form of ownership "separating what a shareholder owns qua shareholder from what he owns as an individual"). Because no actual distribution of property occurs in the case of a Section 951 inclusion, the Tax Court correctly concluded that such an item is not a dividend for purposes of I.R.C. § 1(h)(11). (Doc. 40 at 5-6.)

The court's conclusion that a Section 951 inclusion is not a dividend for purposes of I.R.C. § 1(h)(11) is reinforced by the fact that Congress expressly has provided that Section 951 inclusions will be treated as dividends in certain specified circumstances that do not include I.R.C. § 1(h)(11). For example, I.R.C. § 851(b) provides that, in determining

qualification as a regulated investment company, an entity's Section 951 inclusions are "treated as dividends" to the extent that there is a distribution out of current-year earnings and profits (under I.R.C. § 959(a)(1)) that is attributable to amounts included in income by virtue of I.R.C. § 951. Another statute, I.R.C. § 904(d)(3)(G), provides that, for purposes of applying foreign tax credit limitation rules, the term "dividend" includes amounts that were included in income pursuant to I.R.C. § 951(a) (1) (B). And I.R.C. § 960(a)(1) provides that, for purposes of indirect foreign tax credits under I.R.C. § 902, Section 951 inclusions will be treated "as if the amount[s] so included were dividend[s] paid."

Two maxims of statutory construction inform the reading of these special provisions treating Section 951 inclusions as if they were dividends. As the Tax Court properly recognized, Congress' enactment of statutory provisions treating Section 951 inclusions *as if* they were dividends would have been unnecessary if those amounts were dividends at all events. To read the special provisions as unnecessary, however, would violate the rule of statutory construction that Congress should not be deemed to have enacted a superfluous

provision. *See, e.g., Weinberger v. Hynson, Westcott & Dunning, Inc.*, 412 U.S. 609, 633-634 (1973); *Duke v. Univ. of Texas at El Paso*, 663 F.2d 522, 526 (5th Cir. 1981).

Moreover, the existence of special provisions that treat Section 951 inclusions as if they were dividends in certain circumstances indicates that Congress did not intend such inclusions to be otherwise characterized as dividends. A well established rule of statutory construction is instructive here. *Duke*, 663 F.2d at 526 (maxim "expressio unius est exclusio alterus" "expresses the learning of common experience that generally when people say one thing they do not mean something else," quoting 2A C. Sands, Statutes and Statutory Construction s 47.24 (4th ed. 1973)). Accordingly, that Congress enacted several special provisions providing, in specified circumstances, not including for purposes of I.R.C. § 1(h)(11), that Section 951 inclusions are to be treated as if they were dividends gives rise to a strong inference that Congress did not intend for Section 951 inclusions to be treated as dividends for purposes of I.R.C. § 1(h)(11) or for any other purposes not specified in the Internal Revenue Code.

It is telling, moreover, that the same Congress that enacted I.R.C. § 951 also enacted I.R.C. § 1248, which treats gain from the disposition of CFC stock "as a dividend, to the extent of the earning and profits of the foreign corporation." It is wholly illogical to suggest that the same Congress that expressly provided for dividend treatment of CFC stock sale gains under I.R.C. § 1248 intended the same dividend treatment to apply to I.R.C. § 951 inclusions yet failed to make any provision therefor.

It is also significant that Congress has expressly provided, outside of the context of Subpart F, for the treatment of certain nondividend amounts as dividends or distributions. Thus, I.R.C. § 54A(g), for example, treats "as a distribution" any credit that is allocated to an S corporation shareholder, while I.R.C. § 302(a) provides that certain redemptions "shall be treated as a distribution." *See also* I.R.C. §§ 304(a), 305(c). Section 551(b) (now repealed) provided that undistributed foreign personal holding company income was includible "as a dividend" in the company's shareholder's income. That Congress has not singled out Section 951 inclusions for such special dividend

treatment can hardly be regarded as insignificant, as the Tax Court correctly recognized.

It is also significant that Section 951 inclusions have never been considered to be dividends for purposes of I.R.C. § 245, which grants a deduction to corporations with respect to dividends received from certain foreign corporations. "Eligible dividends" are amounts that "are paid out of the earnings and profits of a foreign corporation" in certain circumstances. I.R.C. § 245(b)(2). In 1998, both the House and the Senate considered proposals that would have amended I.R.C. § 245(a) to provide that "[f]or purposes of this subsection, the term 'dividend' shall include any amount the taxpayer is required to include in gross income for the taxable year under section 951(a)." S. 2231, § 301(b), 105th Cong. (1998); H.R. 4173, § 301(b), 105th Cong. (1998). Although the proposals were never reported out of committee, the drafting of the proposals is a clear indication that Congress understood that it would be necessary to take some action if Section 951 inclusions were to be treated as dividends for purposes of I.R.C. § 245.

Moreover, treating Section 951 inclusions as dividends does not square with other statutory provisions pertaining to actual dividends.

For instance, Section 951 inclusions do not reduce the CFC's earnings and profits, *see* I.R.C. §§ 956(a)(2), (b)(1) and Treas. Reg. § 1.952-1(c)(1), while dividend distributions under I.R.C. § 316 do reduce the distributing corporation's earnings and profits. I.R.C. § 312. Further, a Section 951 inclusion increases the stock basis of any United States shareholder who must include that amount in income. *See* I.R.C. § 961(a); Treas. Reg. § 1.961-1; Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, at para. 15.61[3] (to the extent that undistributed income is taxed to the shareholder, his basis for his stock is increased by § 951, and subsequent distributions of these previously taxed amounts are tax-free to the shareholders, but reduce the basis in their stock). In the case of actual dividends under § 316, however, there is no adjustment to the basis of the shareholder's stock. I.R.C. § 301.

The treatment of Section 951 inclusions as qualified dividends for purposes of I.R.C. § 1(h)(11) would also be inconsistent with the purpose of that statute. Section 1(h)(11) was added to the Internal Revenue Code by the Jobs and Growth Tax Relief Reconciliation Act of 2003, P. L. No. 108-27, § 302(a), 117 Stat. 752, and provides for a

favorable rate of tax to be applied to "qualified dividends." Congress intended that this measure would have a stimulative effect on the United States economy by encouraging corporations to distribute their earnings to shareholders. *See Staff of Joint Comm. on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress*, JCS-5-05 NO 4, 2005 WL 5783608 (May 2005). [6] To treat Section 951 inclusions as qualified dividends eligible for a preferential tax rate, even though they are, by definition, *un*distributed amounts of corporate earnings, would contravene the intent of Congress in enacting § 1(h)(11), which was to stimulate the economy by providing an incentive for corporations to distribute their earnings as dividends, instead of retaining those earnings. Needless to say, the stimulus of the economy intended by Congress is not achieved where, as is the case

[6] This Court has recognized that the Joint Committee Staff's explanation of legislation, *i.e.*, the "Blue Book," does not directly represent the views of legislators, but that "[t]he Joint Committee's views . . . are entitled to great respect." *McDonald v. Commissioner*, 764 F.2d 322, 336 n. 25 (5th Cir. 1985).

here, a CFC retains its earnings rather than distributing them to its shareholders. [7]

Finally, treating Section 951 inclusions as dividends for purposes of I.R.C. § 1(h)(11) runs afoul of the rules the statute provides for identifying "qualified dividends." One of the requirements for a qualified dividend is that the shareholder must have owned the stock giving rise to the dividend for a minimum holding period prior to the payment of the dividend. Section 1(h)(11)(B)(iii) defines this holding period by reference to I.R.C. § 246, which measures a shareholder's holding period by reference to the ex-dividend date, *i.e.*, the date on which the corporation identifies the owners of record for purposes of distributing a dividend. *See* I.R.C. § 246(c). There is no comparable way to measure a holding period in the case of Section 951 inclusions,

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[7] Taxpayers could have caused their CFC, Editora, to distribute its earnings to them as dividends. Had they done so, the distributed amounts would have constituted qualified dividends under § 1(h)(11), would have reduced, *pro tanto*, Editora's earnings and profits, and, thus, would have reduced, or eliminated, the amount of taxpayers' Section 951 inclusions. I.R.C. §§ 312, 951, 956(b)(1). Taxpayers' attempt to be treated as if they had caused their CFC to distribute its earnings to them, even though they caused their corporation to retain those earnings, is unfounded and was properly rejected by the Tax Court.

because they are determined at the end of a CFC's tax year and reported as income to the shareholder for the taxable year in which or with which the CFC's tax year ends. Section 1(h)(11) thus defines the term "qualified dividend" in part by applying a holding-period test that cannot be applied in the case of a Section 951 inclusion.

C. Taxpayers show no error in the Tax Court's conclusion that Section 951 inclusions are not qualified dividends within the meaning of I.R.C. § 1(h)(11)

1. Taxpayers claim that the Tax Court's decision in this case improperly exalted form over substance by denying dividend characterization to their Section 951 inclusions "merely because the Appellants have not first declared a dividend." (Br. 8.) They assert (Br. 11-13) that the amounts includible in their income under I.R.C. § 951 were "deemed dividends" even though they were not declared as such. Taxpayers' substance-over-form argument is entirely misconceived.

As indicated above, the term dividend is defined in I.R.C. § 316(a) as a *distribution* of property made by a corporation to its shareholders out of its earnings and profits. And the term "qualified dividend income" is defined in I.R.C. § 1(h)(11) as dividends *received* during the

taxable year from domestic and qualified foreign corporations. Taxpayers' Section 951 inclusions reflect the *undistributed* earnings of their controlled foreign corporation. [8] Thus, in neither form nor substance do taxpayers' Section 951 inclusions constitute dividends "received during the taxable year." Indeed, in asserting (Br. 11) that their Section 951 inclusions should be "deemed" to be dividends, taxpayers are seeking to have the inclusions treated *as if* they were dividends, even though they are not. The judicially-created substance-over-form doctrine provides no support for taxpayers' attempt to have their Section 951 inclusions recast as something they are not, *i.e.*, a distribution to shareholders by a corporation of property out of its earnings.

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[8] Nor does the Internal Revenue Code otherwise treat Section 951 inclusions as dividends. On the contrary, as explained above, *supra*, at pp. 22-23, Section 951 inclusions are treated far differently than dividends. Thus, while the payment of a dividend effects a *pro tanto* reduction in the corporation's earnings and profits, Section 951 inclusions have no effect on a CFC's earnings and profits. Conversely, although the payment of a dividend has no effect on a stockholder's basis in his corporation, Section 951 inclusions serve to increase, *pro tanto*, a shareholder's basis in a CFC. *See* I.R.C. § 961(a). On the other hand, when a CFC distributes its earnings as a dividend, the distributed earnings are treated as qualified dividend income. *See* I.R.C. § 1(h)(11).

In cases implicating the substance-over-form doctrine, the courts examine a transaction's formal steps and determine whether the transaction's form reflects its true substance, and whether the form effectuates - or thwarts - Congressional intent. *Frank Lyon v. United States*, 435 U.S. 561, 573 (1978). Where the form and substance of a transaction are in conflict, the substance is controlling. Here, however, neither party seeks to recast a transaction. The parties agree that taxpayers were required to include certain amounts in income in 2003 and 2004 based on a calculation of the amounts of Editora's investment in United States property in those years. No "transaction" gave rise to this imputed income, and no application of a substance-over-form doctrine could recharacterize a nonexistent transaction to achieve the result that taxpayers seek, *i.e.*, the treatment of their Section 951 inclusions as dividends.

Moreover, although taxpayers refer to their Section 951 inclusions as "deemed dividends," even they do not claim that there is any statutory provision that deems those nondividend amounts to be dividends for tax purposes. What they appear to be asserting, however, is that their Section 951 inclusions are so-called "constructive

dividends," which result "[w]hen a corporation confers an economic benefit upon a shareholder, in his capacity as such, without an expectation of reimbursement." *Loftin & Woodard v. United States*, 577 F.2d 1206, 1214 (5th Cir. 1978). In these circumstances, "that economic benefit becomes a constructive dividend, taxable to the respective shareholder." *Id.*; *see also United States v. Mews*, 923 F.2d 67, 68-69 (7th Cir. 1991); *Estate of DeNiro v. Commissioner*, 746 F.2d 327, 330 (6th Cir. 1984).

The common thread of cases finding a constructive dividend in the absence of a formal declaration of a dividend, however, is a corporate distribution of property, either directly to a shareholder or to another for the shareholder's benefit. This Court has explained that the first question to be answered in testing for "dividend equivalence" is: "did the *transfer* cause funds or other property to leave the control of the transferor corporation and did it allow the stockholder to exercise control over such funds or property either directly or indirectly through some instrumentality other than the transferor corporation" (emphasis added). *Sammons v. United States*, 472 F.2d 449, 451 (5th Cir. 1972).

In the case of the Section 951 inclusions at issue here the answer to this question is plainly no. Taxpayers' Section 951 inclusions entail no *transfer* of property from their CFC, Editora, to themselves or to any third party. There can be no constructive dividend where there is no distribution of corporate property nor any corporate expenditure on behalf of a shareholder.

As discussed above, taxpayers were free to cause Editora to declare and pay a dividend to them. Had they done so, the distributed amounts would have constituted qualified dividends under I.R.C. § 1(h)(11). Taxpayers, however, chose not to cause Editora to pay out its earnings to them as dividends and, accordingly, are in no position to contend they nevertheless should received the same tax benefits as if they had caused Editora to pay them dividends. *See National Alfalfa Hydrating Co. v. Commissioner*, 417 U.S. 134, 149 (1974); *Cornelius v. Commissioner*, 494 F.2d 465, 471 (5th Cir. 1974).

2. Taxpayers place heavy reliance on certain statements in the legislative history of the Subpart F provisions in asserting that Congress intended for Section 951 inclusions to be treated as dividends. (Br. 9, 11-13.) That reliance is misplaced. Courts,

including this one, have traditionally declined to resort to legislative history when the language of the governing statutes is unambiguous. *See, e.g.*, *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992); *Dunn-McCampbell Royalty Interest, Inc. v. National Park Service*, 630 F.3d 431, 439 n.15 (5th Cir. 2011); *Carrieri v. Jobs.com Inc.*, 393 F.3d 508, 518-519 (5th Cir. 2004). Taxpayers do not claim that I.R.C. §§ 1(h)(11) and 951 are ambiguous, nor would such a claim be correct. Nothing in the actual language of either statute provides any support for taxpayers' claim that Section 951 inclusions constitute qualified dividends under I.R.C. § 1(h)(11). In the circumstances, there is no reason for this Court to examine the legislative history of Subpart F. [9]

[9] Taxpayers argue, in the alternative, that resort to legislative history is appropriate if a "plain reading" of I.R.C. § 951 produces "an absurd result." (Br. 10.) They assert that reading I.R.C. § 951 to mean that Section 951 inclusions are not dividends for purposes of I.R.C. § 1(h)(11) would result in such an absurdity. (*Id.*) Taxpayers' claim is itself absurd. Even taxpayers do not claim that Section 951 inclusions are *actually* dividends; instead they argue that they should be deemed to be dividends. There is nothing absurd about a reading of I.R.C. § 951 that does not make the same leap that taxpayers make, particularly where the treatment of Section 951 inclusions as qualified dividends under I.R.C. § 1(h)(11) would undermine the Congressional purpose for taxing qualified dividends at a preferential tax rate. *See* pp. 23-25.

In any event, however, taxpayers' reliance on legislative history does not help them. As we pointed out above, Subpart F was enacted as a reflection of Congress's concern that the foreign source income of foreign corporations controlled by Americans was not being taxed currently, *i.e.*, not until the corporations chose to pay out dividends. Section 951 addressed this perceived problem by imputing income to United States shareholders even though no earnings had been distributed to them. Taxpayers point to a few statements appearing in Subpart F's legislative history in which various committees or individuals explained that CFC income would be taxed to United States shareholders *as if* the CFC had distributed a dividend. (Br. 12-13.) From these remarks, taxpayers leap to the unfounded conclusion that Congress intended for Section 951 inclusions to be treated as dividends entitled to the favorable treatment of I.R.C. § 1(h)(11).

In 1962, however, dividends were subject to tax at the same rate that applied to any other item of ordinary income that a taxpayer received. There was no significance, from a tax perspective, to any comment that compared dividends and imputed income under Subpart F. It is only wishful thinking for taxpayers to claim (Br. 11) that the

legislative history of the Revenue Act of 1962 "supports the view that subpart F inclusions are deemed dividends *for purposes of Section 1(h)(11)*" (emphasis added).

Significantly, there is nothing in the 2003 enactment of I.R.C. § 1(h)(11) to support taxpayers' claim that Congress intended Section 951 inclusions to benefit from the statute's favorable treatment of qualified dividends. As the Tax Court noted (Doc. 44 at 13), the goal of I.R.C. § 1(h)(11), in part, was to eliminate what Congress perceived as a disincentive to the distribution of corporate earnings, *i.e.*, the "double taxation" that resulted when corporate earnings were taxed to the corporation and again to individuals upon the distribution of dividends. When the measure that became I.R.C. § 1(h)(11) was proposed, the House bill (H.R. 2) favored dividend income by taxing dividends at capital gains rates rather than at ordinary income rates. *See* H. R. Rep. No. 108-094 at 31 (2004) ("dividends received by an individual shareholder from domestic corporations are taxed at the same rates that apply to net capital gain"). The Senate bill, S. 1054, dealt with the double taxation issue by excluding some amount of dividends from a shareholder's income, and, unlike the House bill, provided that both domestic corporation and certain foreign

corporation dividends were eligible for this treatment. S. Prt. 108-26 at 12 (2003).

In final form, the Jobs and Growth Tax Act of 2003, P.L. 108-27, followed the House approach of reducing the rate of tax on dividends, and adopted the Senate's inclusion of foreign corporation dividends in the scope of this favorable tax treatment. Even though Congress expressly allowed foreign corporation dividends to be taxed at the new lower rate, there is nothing I.R.C. § 1(h)(11)'s legislative history indicating that Congress intended to extend that benefit to Section 951 inclusions.

The significance of this omission is reinforced, moreover, by the fact that, in both the House and Senate versions of tax relief for dividend income, favorable treatment was expressly provided for the gain from dispositions of so-called "section 306 stock," which is taxed as ordinary income rather than as capital gain. *See* I.R.C. § 306(a)(1)(A); H.R. 2, § 302(e)(3); S. 1054 § 301(e)(2). Congress made it clear that this section 306 stock gain would be treated as a dividend for purposes of I.R.C. § 1(h)(11), even though it is not, in reality, a dividend. *See* I.R.C. § 306(a)(1)(D) ("For purposes of section 1(h)(11) and such other provisions as the Secretary may specify, any amount treated as

ordinary income under this paragraph shall be treated as a dividend received from the corporation."). It is telling that Congress made no such effort to offer deemed dividend status to Section 951 inclusions when it enacted I.R.C. § 1(h)(11).

It is also telling that a year after enacting I.R.C. § 1(h)(11), Congress enacted I.R.C. § 965 to provide a temporary dividends received deduction, but stated that the deduction would not apply to "items that are not included in gross income as dividends, such as subpart F inclusions or deemed repatriations under section 956." H.R. Conf. Rep. No. 108-755 at 300, 302 (2003).

In short, there is simply no indication in the legislative history of either I.R.C. § 951 or I.R.C. § 1(h)(11) that Congress intended to provide favorable tax treatment to income that is imputed to United States shareholders of CFCs when the CFCs fail to declare dividends.

3. In Notice 2004-70, 2004-2 C.B. 724, the IRS "provide[d] guidance regarding the treatment as qualified dividend income, for purposes of section 1(h)(11) of the Code, of distributions, inclusions, and other amounts from foreign corporations subject to certain anti-deferral regimes." In Section 4.02 of the Notice, the IRS stated that

"section 951(a)(1) inclusions are not dividends and therefore cannot constitute qualified dividend income."

Taxpayers' extensive attack (Br. 20-26) on Notice 2004-70 is pointless. Notice 2004-70 is nothing more than an announcement of the IRS's official position that Section 951 inclusions are not dividends and therefore cannot constitute qualified dividend income under I.R.C. § 1(h)(11). IRS's notices are not regulations, and, consequently, are not entitled to *Chevron* deference. *Cf. Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984); *see also Mayo Found. for Med. Educ. and Research v. United States*, 131 S. Ct. 704, 712-14 (2011). Notice 2004-70 would have relevance in this case only if the Commissioner's litigating position were contrary to the position announced in that notice. Since the Commissioner's litigating position is entirely consistent with Notice 2004-70, the notice is of no consequence. We point out in this regard that, although the Tax Court stated in its opinion (Doc. 40 at 14-15) that it agreed with the conclusion in Notice 2004-70, it did not purport to accord any deference to the notice. Rather, the court decided this case on the basis of its own analysis of the relevant statutory provisions. Taxpayers have

demonstrated no error in the Tax Court's *de novo* statutory analysis and their entire argument concerning Notice 2004-70 is nothing but a red herring.

5. Taxpayers make much of various IRS General Counsel Memoranda, private letter rulings and IRS manual provisions, which they claim show that, prior to the enactment of I.R.C. § 1(h)(11), the IRS treated Section 951 inclusions as dividends. (Br. 14-17.) None of the cited documents are authoritative and may not be used or cited as precedent. *See* I.R.C. § 6110(k)(3). Moreover, none of the materials cited by taxpayers addressed the question of whether Section 951 inclusions are eligible for the special treatment of qualified dividends under I.R.C. § 1(h)(11). [10]

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[10] The Supreme Court has held that the Commissioner cannot be bound by prior administrative interpretations or practices, and that he may change an erroneous administrative interpretation if he determines that such a position is incorrect. *Dixon v. United States*, 381 U.S. 68, 72-3 (1965) ("Congress, not the Commissioner, prescribes the tax laws. . . Consequently it would appear that the Commissioner's acquiescence in an erroneous decision, published as a ruling, cannot in and of itself bar the United States from collecting a tax otherwise lawfully due"); *see also Dickman v. Commissioner*, 465 U.S. 330, 343 (1984). Accordingly, even if the statements on which taxpayers rely could be construed as indicating that the IRS once viewed Section 951 inclusions as dividends for purposes of I.R.C. § 1(h)(11) (and they cannot), those statements would not bar the Commissioner from now

(continued...)

Taxpayers rely on General Counsel Memorandum (GCM) 39153 and GCM 36965, but neither memorandum addressed the treatment of Section 951 inclusions for purposes of I.R.C. § 1(h)(11). (Br. 15.) In fact, they were issued in 1984 and 1976, respectively, and thus could not have considered whether income imputed to taxpayers under I.R.C. § 951 was a dividend that was subject to taxation at the favorable rate applicable under I.R.C. § 1(h)(11), which was enacted in 2003.

Moreover, the courts have recognized that GCMs are not authoritative because they are not reviewed at the highest levels of the IRS or by the Department of Treasury and are not otherwise subject to the notice and comment procedure followed in the promulgation of treasury regulations. GCMs reflect only "informal, unpublished opinions of attorneys within the IRS." *Disabled American Veterans v. Commissioner*, 942 F. 2d 309, 315 n.5 (6th Cir. 1991); *see also Tupper v. United States*, 134 F.3d 444, 448 (1st Cir. 1998); *Stichting Pensioenfonds Voor De Gezondheid v. United States*, 129 F.3d 195, 200

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[10](...continued)
correctly interpreting I.R.C. § 951 and barring taxpayers' claim that their Section 951 inclusions are subject to tax at the lower rate provided by I.R.C. § 1(h)(11).

(D.C. Cir. 1997); *Hernandez v. Commissioner*, 490 U.S. 680, 702-703 and n.13 (1989); *American Ass'n of Christian Schools v. United States*, 850 F. 2d 1510, 1515 n. 6 (11th Cir. 1988). [11]

Taxpayers cite the decisions in *Morganbesser v. United States*, 984 F. 2d 560, 563 (2nd Cir. 1993), and *Hermann* v. *E.W. Wylie Corp.*, 766 F. Supp. 800, 802-03 (D.N.D. 1991), to claim that GCMs should be given weight in ascertaining the IRS's position on an issue. (Br. 14-15.) These decisions do not help them. The force of the *Morganbesser*

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[11] In this regard, the decision in *Rauenhorst v. Commissioner*, 119 T.C. 157 (2002), is readily distinguishable. Taxpayers rely on *Rauenhorst* to claim that GCMs 39153 and 36965 constitute a "concession" and estop the Commissioner from denying that Section 951 inclusions result in income that is taxable under I.R.C. § 1(h)(11). The Tax Court in *Rauenhorst* concluded that the Commissioner had conceded an issue by virtue of having issued a revenue ruling that took a position contrary to the one he advanced in the Tax Court. A revenue ruling is "an official interpretation by the Service that has been published in the Internal Revenue Bulletin." Treas. Reg. § 601.601(d)(2)(i). Taxpayers are generally permitted to rely on revenue rulings as authoritative in determining a tax treatment that arises out of the same facts addressed in the ruling. Treas. Reg. § 601.601(d)(2)(v)(e); *see also Silco, Inc. v. United States*, 779 F.2d 282, 286 (5th Cir. 1986) ("Commissioner will be held to his published rulings in areas where the law is unclear, and may not depart from them in individual cases," quoting *Estate of McLendon v. Commissioner*, 135 F.3d 1017, 1024 (5th Cir. 1998)). Giving preclusive effect to a published revenue ruling, as the Tax Court did in *Rauenhorst*, does not in any way suggest that any such weight should be afforded to a General Counsel Memorandum.

decision was undercut by the Second Circuit in *Nathel v. Commissioner*, 615 F.3d 83, 93 n.9 (2d Cir. 2010), where the court of appeals noted the decision in *Morganbesser,* but concluded that the GCM on which the taxpayers relied in *Nathel* was limited in its persuasive power because it did not address the issue before the Court. 615 F.3d at 93. The same is true here. And in the *Hermann* decision, the District Court found a GCM's interpretation "helpful" even though it acknowledged that this Court, in *Penn v. Howe-Baker Engineers, Inc.*, 898 F.2d 1096, 1105 (1990), held that a GCM has no binding effect because "it is an internal document reviewing a proposed ruling in a specific case." 766 F. Supp. 802-803. The court's conclusion in *Hermann* thus conflicts with this Court's view of the impact of a General Counsel Memorandum.

Private letter rulings likewise have no precedential value except in the case of the taxpayers to whom they were issued. *See, e.g.*, *Campbell v. Cen-Tex, Inc.*, 377 F.2d 688, 691 (5th Cir. 1967) ("[t]he Commissioner is not bound by his unpublished rulings, except to the taxpayers for whom they were made"); *Phi Delta Theta Fraternity v.*

Commissioner, 887 F.2d 1302, 1308 (6th Cir. 1989); *David R. Webb Co. v. Commissioner*, 708 F.2d 1254, 1257 n.1 (7th Cir. 1983).

As taxpayers point out, this Court relied in part on a private letter ruling in *Transco Exploration Co. v. Commissioner*, 949 F.2d 837 (5th Cir. 1992), to support its conclusion in that case. The Commissioner had originally issued a private letter ruling adopting the the same position that Transco urged, but he had reversed the position and asserted a tax deficiency against Transco. 949 F.2d at 840. This Court noted that private letter rulings have no precedential value, but reasoned that "[i]t does not follow that they are not relevant here." *Id.* The Court concluded that the Commissioner's position in *Transco* lacked any statutory support and found support for this conclusion in the fact that the Commissioner had at one time read the statute differently. The same was true in *Hanover Bank v. Commissioner*, 369 U.S. 672 (1962), *i.e.*, the Commissioner had issued several private letter rulings but later reversed the position that was reflected in the rulings. In finding that the statutory interpretation set out in the original rulings was correct, the Supreme Court attributed significance to the original rulings as "an interpretation put upon the [governing]

statute by the agency charged with administering the revenue laws." 369 U.S. at 686.

Taxpayers here can take no comfort from the treatment of private letter rulings in those cases, because the private letter rulings on which they seek to rely were issued long before I.R.C. § 1(h)(11) offered favorable tax treatment to dividends, and therefore did not address the question presented here.

To the extent that taxpayers rely on statements found in the Internal Revenue Manual to support their position, moreover, they stray even further from recognized authority. It is well established that the Internal Revenue Manual has no legal effect. *Keado v. United States*, 853 F.2d 1209, 1214 (5th Cir. 1988) ("Procedures or rules adopted by the IRS [in the Internal Revenue Manual] are not law"); *United States v. Horne*, 714 F.2d 206, 207 (1st Cir. 1983); *United States v. Will*, 671 F.2d 963, 967 (6th Cir. 1982). Moreover, the Internal Revenue Manual provisions that taxpayers cite instruct IRS personnel only about rules that relate to foreign tax credits, but say nothing about allowing Section 951 inclusions to be taxed at a lower rate as qualified dividends.

Taxpayers also point to a 2004 IRS form, Form 5471, as evidence that the IRS once viewed Section 951 inclusions as dividends that should be eligible for the tax treatment of I.R.C. § 1(h)(11). (Br. 26-27.) They make much of the fact that instructions to Form 5471 advised individual taxpayers to report Section 951 inclusions on their Forms 1040 as dividend income, but "the authoritative sources of tax law . . . are statutes, regulations, and judicial decisions, and not instructions published by the Internal Revenue Service." *Norman v. United States*, 2006 WL 2038264, *6 (N.D. Cal. 2006) (quoting *Crop Care Applicators, Inc. v. Commissioner*, 2001 WL 1922019), *aff'd*, 287 F. 3d. Appx. 614 (9th Cir. 2008). *See Casa de la Jolla Park, Inc. v. Commissioner*, 94 T.C. 384, 396 (1990) (even if form instructions are misleading, the sources of authoritative tax law are statutes and regulations, not government publications). "It is settled law that taxpayers cannot rely on [IRS] instructions to justify a reporting position otherwise inconsistent with controlling statutory provisions." *Montgomery v. Commissioner*, 127 T.C. 43, 65 (2006), *relying on Johnson v. Commissioner*, 620 F.2d 153, 155 (7th Cir. 1980).

Moreover, the 2004 instructions for Form 5471 actually cut against taxpayers' position, because, while they instructed individuals to report Section 951 inclusions as dividends, they also instructed corporate taxpayers to report Section 951 inclusions as "other income." Prior to the 2003 enactment of I.R.C. § 1(h)(11), a Section 951 inclusion and a dividend were taxed at the same rate of tax as any other item of ordinary income. For a corporate taxpayer, however, characterization of Section 951 inclusions always mattered, because such amounts were not eligible for the dividends received deduction allowed by I.R.C. § 245(a). The 2004 Form 5471 instructions thus required that corporate taxpayers report Section 951 inclusions as other income, not as dividends.

6. Taxpayers also rely on a district court decision and a Tax Court decision to advance their claim that Section 951 inclusions are deemed dividends. (Br. 13-14.) Neither authority has any precedential value here, but, in any event, the courts in those cases did not hold that Section 951 inclusions are dividends at all, let alone that they are dividends for purposes of I.R.C. § 1(h)(11). The court in *Koehring v. United States*, 433 F. Supp. 929, 934 (E.D. Wis. 1977), *aff'd*, 583 F.2d

313 (7th Cir. 1978), explained the Subpart F taxing scheme by stating, among other things, that a "United States shareholder's pro rata share of the Subpart F income of [a CFC] is to be included in the income of that United States shareholder as a dividend deemed paid in money on the last day of the taxable year of the [CFC]." But the only issue presented in that case was "whether or not Koehring Overseas Corporation was a Controlled Foreign Corporation within the meaning of § 957 of the Internal Revenue Code during the fiscal year of Koehring ending November 30, 1964." 433 F. Supp. at 934. Thus, the court had no occasion to address the question presented here.

Equally unavailing is taxpayers' reliance on *Stamm Int'l Corp. v. Commissioner*, 90 T.C. 315 (1988). The issue in that case was whether the Commissioner was entitled to be relieved of the terms of a settlement agreement that he had mistakenly agreed to without taking account of a relevant statute. The Tax Court concluded that no relief was available to the Commissioner, and, in reaching this conclusion, described one of the terms of the settlement agreement, to wit, the taxpayer's concession "that it has realized a dividend under Subpart F, I.R.C. (*i.e.*, sec. 951, *et seq*.)." The Tax Court's repetition of

a settlement term that was drafted by the parties is hardly tantamount to the court's having reached the conclusion that Section 951 inclusions are dividends.

CONCLUSION

Based on the foregoing, the decision of the Tax Court is correct and should be affirmed.

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NOVEMBER 2012

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/s/ Teresa T. Milton
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Dated: November 20, 2012

APPENDIX

SECTION 956. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

(a) **Amounts included.--**

(1) **In general.--**If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder * * * of such corporation and who owns * * * stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends--

* * * * *

(B) the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2).

SECTION 956. INVESTMENT OF EARNINGS IN UNITED STATES PROPERTY.

(a) **General Rule**.–In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of --

(1) the excess (if any) of –

(A) such shareholder's pro rata share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close each quarter of such taxable year, over

(B) the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder, or

(2) such shareholder's pro rata share of the applicable earnings of such controlled foreign corporation.

* * * * *

(c) **United States property defined.–**

(1) **In general.**–For purposes of subsection (a), the term "United States property" means any property acquired after December 31, 1962, which is --

(A) tangible property located in the United States;

* * * * *

(C) an obligation of a United States person; or

* * * * *

(2) **Exceptions.**– For purposes of subsection (a), the term "United States property" does not include---

* * * * *

(F) the stock or obligation of a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation, nor a domestic corporation, 25 percent or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the controlled foreign corporation, is owned, or is

considered as being owned, by such United States shareholders in the aggregate;

* * * * *

(L) an obligation of a United States person which-

-

(i) is not a domestic corporation, and

(ii)is not--

(I) a United States shareholder (as defined in section 951(b) of the controlled foreign corporation, or

(II)a partnership, estate, or trust in which the controlled foreign corporation, or any related person (as defined in section 954(d)(3)), is a partner, beneficiary, or trustee immediately after the acquisition of any obligation of such partnership, estate, or trust by the controlled foreign corporation.

* * * * *