No. 14-5019

IN THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,

Plaintiff-Appellee

v.

THE UNITED STATES,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE
UNITED STATES COURT OF FEDERAL CLAIMS
No. 07-648T; Judge Marian Blank Horn

REPLY BRIEF FOR THE UNITED STATES

TAMARA W. ASHFORD
Acting Assistant Attorney General

ROBERT W. METZLER (202) 514-3938
ARTHUR T. CATTERALL (202) 514-2937
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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INTRODUCTION

1. Mutual life insurance companies typically declare annual policyholder dividends toward the end of one year (Year 1) and, under the terms of the individual policies, pay them in the next year (Year 2) to policyholders whose policies are still in force on their respective policy "anniversary dates" falling in Year 2 (an "in-force" requirement). Such companies can, in Year 1, predict with a high degree of certainty the aggregate amount of declared annual dividends they will actually become obligated to pay in Year 2, and, prior to 1984, they could claim Year-1 tax deductions based on such estimates. In 1984, however, Congress amended the Internal Revenue Code to provide that policyholder dividends are deductible in the year in which they are paid or accrued, *see* I.R.C. § 808(c), which had the effect of delaying deductions until Year 2 in the situation described above. *See* MM Br. 6 ("Applying the accrual method to MassMutual's dividend declarations did not permit MassMutual to deduct dividends in the year it declared them.").

MassMutual is trying to avoid this result with respect to its post-1983 policies through a dividend "guarantee" strategy. Under this

strategy, MassMutual identifies a portion of the aggregate declared dividend that, based on historical "lapse" rates and the law of large numbers, it can predict with virtual certainty it will become obligated to pay to post-1983 policyholders in the following year. It then adopts a year-end board resolution proclaiming that it is "absolutely and irrevocably obligated to pay" that amount "in all events." (A215.)

2. Assuming, *arguendo*, that one can create an "obligation" by "guaranteeing" that a statistically-certain-to-be-incurred amount of future obligations will in fact be incurred, such an obligation will support a deduction in the year of the guarantee only if it is "fixed" – *i.e.*, only if "all events have occurred which determine the fact of liability" – at the close of that year. I.R.C. § 461(h)(4). MassMutual acknowledged below that, under the terms of its dividend guarantees, the fact of its liability thereunder did not become fixed until "at least one post-1983 policyholder became entitled to" the corresponding annual dividend under the in-force requirement contained in the individual policies. (A883-885.) According to MassMutual, this occurred with respect to each guarantee when "at least one post-1983 policyholder paid his or her premium through the policy's anniversary

date" falling in the succeeding year. (*Id.*) And the evidence showed that, in the case of each of the guarantees, "this event occurred in" the year in which the guarantee was adopted. (*Id.*)

In our opening brief (US Br. 37-54), we demonstrated that MassMutual's policyholders did not become "entitled to" declared annual dividends prior to the dividend payment date, *i.e.*, the policy anniversary date occurring in the following year, and that the alleged obligations under each corresponding dividend guarantee therefore did not become fixed until that succeeding year. Although MassMutual now disavows any reliance on its annual-dividend obligation to individual policyholders to establish the fact of its liability under the dividend guarantees, it cannot disavow the terms of those guarantees, which (as MassMutual acknowledged below) make clear that the alleged obligations thereunder were contingent on the corresponding annual-dividend obligations.

MassMutual's about-face is fatal to its case. There are, however, two other grounds for reversing the trial court's decision, *see* US Br. 55-71, and MassMutual's responses to our arguments on those points are equally infirm.

ARGUMENT

I. The All-Events Test

A. The alleged guarantee obligations were not fixed at year-end

1. MassMutual has abandoned the ground on which it persuaded the trial court to rule in its favor on this issue

In a pre-trial filing, MassMutual succinctly articulated the rationale underlying its claim that the alleged guarantee obligations were fixed at year-end (A884):

> Plaintiff became obligated to pay MassMutual's 1995 dividend guarantee as soon as at least one post-1983 policyholder became entitled to receive a dividend in 1996, *i.e.*, *as soon as at least one post-1983 policyholder paid his or her premium through the policy's anniversary date in 1996*. With respect to the post-1983 policies summarized in Exhibit 105, this event occurred in 1995, prior to the payment of policyholder dividends in 1996. [Emphasis added.[1]]

The trial court clearly relied on this "paid-up" argument in holding for MassMutual on this issue (A37):

> [At year-end,] [a]n identified group of plaintiff's policyholders were certain to receive the regular dividend [payable in the following year] and, therefore, qualify for the guaranteed dividend…. Therefore,…[at year-end,] [p]laintiff

[1] MassMutual made substantially identical statements with respect to each of the other dividend guarantees at issue. (A883, A885.)

> had an unconditional obligation to [these] post-1983 policyholders with paid-up policies to pay the guaranteed amounts of policyholder dividends…[in the following year].

After the trial court issued its opinion in this case, the Second Circuit squarely rejected the notion that policyholders like MassMutual's – *i.e.*, those whose right to a declared annual dividend is subject to an in-force requirement contained in the policy – can become "entitled to" a declared dividend prior to the relevant policy anniversary date by satisfying their premium obligations through that date beforehand. *See New York Life Ins. Co. v. United States*, 724 F.3d 256 (2d Cir. 2013), *cert. denied*, 82 U.S.L.W. 3629 (U.S. Apr. 28, 2014) (No. 13-849); US Br. 47-54. Applying the holding of *New York Life* to this case, no post-1983 policyholder became "entitled to" the annual dividends declared in 1995, 1996, and 1997 prior to his or her policy anniversary date occurring in 1996, 1997, and 1998, respectively. And if that is so, then the alleged obligations under the dividend guarantees adopted in 1995, 1996, and 1997 likewise did not become fixed until 1996, 1997, and 1998, respectively, since (as MassMutual acknowledged below) those obligations were tied to the corresponding annual-dividend obligations.

MassMutual does not argue (or even suggest) that *New York Life* was wrongly decided; indeed, it apparently endorses the result:

> Because each of those individual [annual-dividend] liabilities depended on the individual policyholder's decision not to cash out the policy before its anniversary date [occurring in the following year], New York Life could not establish its liability to pay [declared annual] dividends was fixed until the relevant policy anniversary dates.

MM Br. 39-40. Instead, MassMutual denies that it ever relied on its annual-dividend obligation *vis-à-vis* pre-paying policyholders to establish the fact of its liability under the dividend guarantees, remarking (*id.* at 34 n.15) that it "advanced its legal arguments in its briefs, not in responses to proposed findings of fact." But its briefs contained the exact same argument. As the trial court observed:

> [P]laintiff argued that a defined group of post-1983 policyholders existed [at year-end] who had already paid their policies through their next anniversary and were already entitled to receive the annual dividend. The plaintiff contended there were no conditions precedent to these policyholders receiving their annual dividend…. Therefore, the plaintiff argued, the fact of liability…for the Dividend Guarantees…became fixed and, therefore, accruable in the year the Dividend Guarantee Resolutions were adopted. …

(A33 [internal quotation marks omitted].) The record confirms that MassMutual advanced this argument at every stage of the proceedings

below. *See* A107-108 (pre-trial memorandum); A1245 (opening statement); A652 (post-trial brief); A1667-1668 (closing argument).

Perhaps the clearest iteration of MassMutual's position below appears in its post-trial reply brief. After noting that the "key inquiry" is "when all events ha[d] occurred to fix Plaintiff's liability" under the dividend guarantees (A869-870), the brief states:

> In Plaintiff's case, all such events occurred in the years in which the dividend guarantees were adopted. This is because, at the end of each of the tax years at issue, a defined group of post-1983 policyholders who had already paid their premiums through their next (or later) anniversary had been formed. As a result of prepaying their premiums, this group of policyholders was already entitled – at the end of each of the tax years at issue – to receive policyholder dividends in the following year. … Exhibits 105 and 106 demonstrate that there were more than 100,000 such policyholders in each tax year at issue for which this contingency was satisfied. With respect to these policyholders, all preconditions had been met.

(A870.) Thus, when MassMutual takes issue with the assertion in our opening brief (US Br. 54) that it "concede[d] that the viability of its accrual argument with respect to the dividend guarantees is wholly dependent on the year-end status of the annual-dividend obligation *vis-à-vis* th[e] paid-up policies," *see* MM Br. 40 n.18, it is arguing with itself.

2. MassMutual's reliance on *Washington Post* is misplaced

Having abandoned its reliance on pre-paying policyholders, MassMutual argues that *Washington Post Co. v. United States*, 405 F.2d 1279 (Ct. Cl. 1969), establishes that the alleged guarantee obligations were fixed at year-end. But *Washington Post* merely stands for the proposition that a year-end payment obligation that is otherwise fixed as to both liability and amount can satisfy the traditional all-events test even if the obligation runs to a group whose number and composition may change over time. In other words, that the fact and the amount of the obligation as to any particular group member cannot be ascertained at year-end does not render the aggregate obligation ineligible for accrual under the all-events test. The Government has never argued otherwise in this litigation, even though the IRS did not formally withdraw its disagreement with *Washington Post* until 2011. *See* US Br. 36 n.10. Rather, the Government maintains that, unlike the group obligations in *Washington Post*, the alleged group obligations in this case were not otherwise fixed as to liability in the years in which the dividend guarantees were adopted (*i.e.*, for reasons that have nothing to do with the indeterminate membership of the group).

The group obligations at issue in *Washington Post* – *i.e.*, the Post's obligation to pay the non-vested portions of amounts it credited to its dealer profit-sharing plan – were fixed at the time of crediting because the Post's obligation to pay those amounts was not contingent on the occurrence of any other event. And that is because the plan specified not only that amounts that did not vest with respect to a particular dealer would be allocated among the remaining participants' accounts, but also that amounts that never vested with respect to *any* participant would nonetheless be distributed to the then-existing participants upon termination of the plan. Thus, the Post was obligated at the end of each year to pay (eventually) the entire non-vested portion of that year's credit, even if no vesting events ever occurred with respect to any of the dealers.

In contrast, the subject of the alleged group obligations in this case – "annual policyholder dividends with respect to post-1983 policies" (A215-216) – were also the subject of individual contractual obligations to each member of the group, obligations that the dividend guarantees expressly left undisturbed (A216):

> The Company's adoption of an Annual Dividend Guarantee for any year shall not affect any individual policyholder's right to receive, or the Company's obligation to pay or apply, the annual policyholder dividend otherwise due to that individual policyholder on the applicable anniversary date.

And those individual contractual obligations *were* subject to a "vesting" requirement: the requirement that the policy remain in force on the policy anniversary date occurring in the year after the year in which the annual dividend was declared. As the Second Circuit's decision in *New York Life* confirms (and MassMutual does not dispute on appeal), this in-force requirement could not be satisfied prior to the relevant policy anniversary date.[2]

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[2] The same factors that distinguish the alleged group obligations here from the group obligation in *Washington Post* on this point – *i.e.*, in terms of whether the obligation was fixed at year-end – also distinguish them from the group obligation described in Rev. Rul. 2011-29, 2011-49 I.R.B. 824, on which MassMutual likewise erroneously relies. Nothing in that ruling suggests that the subject of the group obligation there – employee bonuses – were also the subject of individual contractual obligations to the members of the group, much less that the group bonus plan specified that vesting requirements contained in the individual contracts remained undisturbed. Thus, the Government does not concede, as MassMutual would have it (MM Br. 29 & n.12), that a group obligor's liability to individual group members is *never* relevant to the issue of whether the group obligation is fixed.

In light of the foregoing, the language in each dividend guarantee to the effect that, upon adoption of the guarantee, the company "will be absolutely and irrevocably obligated to pay or apply[,]…in all events," "a specified amount of annual policyholder dividends with respect to post-1983 policies in the following year," (A215), is empty rhetoric. Giving effect to the entire document (and the individual contractual obligations that the document expressly leaves undisturbed and therefore necessarily incorporates by reference), the alleged group obligations under the dividend guarantees were contingent on the occurrence of another event that could not occur until the year following the year of adoption: satisfaction of the in-force requirement applicable to the corresponding annual-dividend obligation by at least one post-1983 policyholder. Because that event – *i.e.*, a post-1983 shareholder "deci[ding] to keep his or her policy in force through the policy's anniversary date," *New York Life*, 724 F.3d at 263 – was "'the last link in the chain of events creating liability'" to pay declared dividends under the terms of the individual policies (and, by extension, to make good on the dividend guarantees), *id*. (quoting *United States v. General Dynamics*, 481 U.S. 239, 245 (1987)), the fact that it was virtually

certain to occur on or shortly after the first day of the following year "cannot compensate for the fact that [it could not have occurred] as of the close of the old year." *Hallmark Cards, Inc., v. Commissioner*, 90 T.C. 26, 34 (1988) (citing *General Dynamics*, 481 U.S. at 243-244, for the proposition that "[t]he all events test is based on the existence or nonexistence of legal rights or obligations at the close of a particular accounting period, not on the probability – or even absolute certainty – that such right or obligation will arise at some point in the future.").

3. MassMutual's reliance on *Hughes Properties* is likewise misplaced

In *United States v. Hughes Properties, Inc.*, 476 U.S. 593 (1986), the Supreme Court addressed the year-end status of the taxpayer's liability arising from Nevada gaming regulations that prohibited casinos from reducing "progressive" slot-machine jackpot amounts except in the case of "actual[ ] pa[yment] to a winning player." *Id.* at 596 (internal quotation marks omitted). In essence, the Court found that, although the casino's "obligation to pay a particular progressive jackpot matures only upon a winning patron's pull of the handle in the future," *id.* at 597, it had an unconditional payment obligation at the end of each year (*i.e.*, in the aggregate amount of its progressive

jackpots at year-end) to a group consisting of the general gambling public, even though the identities of the particular group members who would ultimately receive payment could not be ascertained at year-end.

As is the case with *Washington Post*, the "group liability" aspect of *Hughes Properties* could be helpful to MassMutual only if the alleged group obligations under the dividend guarantees were otherwise fixed at year-end. As explained in the preceding section, the declaration of unconditional liability in the dividend guarantees cannot alter the fact that (1) the subject of the alleged group obligations was also the subject of individual contractual obligations to each member of the group, (2) the dividend guarantees expressly left those individual contractual obligations undisturbed, and (3) the individual contractual obligations were subject to a condition precedent – the in-force requirement – that could not be satisfied until the year following the year in which the corresponding dividend guarantee was adopted.

MassMutual nonetheless argues that this case is governed by *Hughes Properties* (rather than *General Dynamics*) because, according to MassMutual (MM Br. 32-33), the trial court *found as a fact* that the dividend guarantees "created an unconditional obligation" (A40) as of

year-end. MassMutual's characterization of the court's conclusion in that regard as a factual finding, in addition to being wrong, directly contradicts what it told the court below: "The determination of when Plaintiff became obligated to pay MassMutual's 1995 dividend guarantee is a legal one." (A884.)[3] To be clear, the trial court's statements that the dividend guarantees "created an unconditional obligation," *i.e.*, one that was "not subject to a condition precedent" and therefore was "fixed in the year in which plaintiff enacted the Dividend Guarantees," thereby "meeting the first requirement of the 'all events test,'" (A40), are legal conclusions that are subject to *de novo* review. *See* US Br. 34 (citing cases).

The other salient point identified with *Hughes Properties – viz.*, "that a payment obligation…need not be free from all doubt as to its ultimate satisfaction…in order to be fixed for purposes of the all-events test," US Br. 39 – likewise could be of assistance to MassMutual only if the alleged guarantee obligations were fixed at year-end in the first place. For instance, the dividend guarantees provide that if the amount

[3] MassMutual made substantially identical statements with respect to each of the other dividend guarantees at issue. (A883-A885.)

of annual dividends actually paid in the following year (Year 2) fell short of the guaranteed amount, then the shortfall would be "apportioned among the post-1983 policies [that were] still in force" at the end of Year 2. (A217.) Had MassMutual drafted its dividend guarantees in a manner that otherwise fixed its alleged obligations thereunder as of the end of Year 1, then, under *Hughes Properties*, the "absurdly remote" (MM Br. 33) possibility that there might be no post-1983 policies still in force at the end of Year 2 to which any shortfall could be apportioned would not render the alleged obligation contingent as of the end of Year 1. In MassMutual's words, "remote possibilities that the class may not survive are disregarded." *Id*. at 30 (section heading). But there has to have been a fixed obligation to that class at the end of Year 1 in the first place, which, even assuming that the dividend guarantees gave rise to real "obligations," was not the case here.

B. MassMutual's critique of the Government's argument regarding the "fixed at year-end" requirement does not withstand scrutiny

1. The Government does not contend that a payment obligation to a group cannot be fixed unless at least one group member's right to share in the payment is fixed

As discussed *supra* at pp. 4-7, MassMutual acknowledged below that the alleged guarantee obligations did not become fixed until the corresponding annual-dividend obligations became fixed with respect to at least one post-1983 policyholder. Now it seeks to create the impression that the Government argues for a generally applicable *requirement* "that an[ ] individual liability be fixed for a group liability to be fixed." MM Br. 34 (heading). Thus, MassMutual accuses the Government (*id.*) of "simply retread[ing] the argument that *Washington Post* rejected forty-five years ago and that the IRS recently and formally abandoned in Revenue Ruling 2011-29." But the Government is not arguing that, as a rule of general application, a future payment obligation to a group cannot become fixed until at least one group member's right to share in the payment becomes fixed. Rather, the Government maintains that, based on the terms of *these* dividend guarantees (and as MassMutual acknowledged below), the alleged

group obligations thereunder did not become fixed until at least one group member's right to share in the payment became fixed.[4]

MassMutual also claims that the Government "want[s] to re-argue *Hughes Properties*," MM Br. 34, since the Government's argument allegedly "turn[s] on what it claims is the lack of an identifiable obligee," *id.* at 35. Again, however, the Government is not arguing that, as a rule of general application, a payment obligation to a group cannot be fixed without an identifiable obligee. Rather, the Government maintains that, based on the terms of *these* dividend guarantees (and as MassMutual acknowledged below), the alleged group obligations thereunder did not become fixed until there was at least one identifiable obligee with respect to the corresponding annual-dividend obligation.

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[4] MassMutual similarly argues (MM Br. 35) that "the Government demands, just as it did in *Washington Post*, identification of an obligation on a particular policy owned by an individual policyholder." Again, the Government is not "demand[ing]" such an identification on the basis of some generally applicable rule. Rather, the Government maintains that *the terms of the dividend guarantees* demand such an identification, as MassMutual seemed to recognize below.

2. The trial court recognized – as did MassMutual below – that satisfaction of the in-force requirement by at least one post-1983 policyholder was a condition precedent to the alleged group liability

It bears repeating that MassMutual (1) acknowledged below that the alleged guarantee obligations did not become fixed until at least one post-1983 policyholder became entitled to the corresponding annual dividend, and (2) argued that this condition was satisfied as soon as at least one post-1983 policyholder paid his premiums through the dividend payment date (*i.e.*, the policy anniversary date) occurring in the following year. In light of its own reliance on the annual-dividend obligation to individual policyholders, MassMutual's characterization of the Government's refutation of its "paid-up" argument as an "attempt to transmute the liability to a class into 'a series of unilateral offers to individual[s],'" MM Br. 35 (citing US Br. 40-46 and quoting *Washington Post*, 405 F.2d at 1283), is puzzling. Suffice it to say that, as MassMutual (and the court) recognized below, the general admonition in *Washington Post* against analyzing group obligations by reference to specific group members in the context of the all-events test has no

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application where (as is the case here) the alleged group obligation, by its terms, requires otherwise.

In failing to defend its "paid-up" argument, MassMutual concedes that what it recognized below as the condition precedent to the annual-dividend obligation – and, by extension, to the alleged guarantee obligations – could not be satisfied in the years in which the guarantees were adopted. Accordingly, it is forced to argue that the trial court applied its condition-precedent analysis "not to *individual* policyholders but to…'the *identifiable group* of post-1983 policyholders with paid-up policies'" at year-end. MM Br. 36-37 (quoting A35) (emphasis supplied by MassMutual). This is nonsense; the identifiable group comprised individual policyholders who, under the court's erroneous condition-precedent analysis, had purportedly become entitled to the corresponding annual dividend through advance payment of their premiums.

Thus, while the end result is the same, the trial court's "conclusion here" is not, as MassMutual claims (MM Br. 37), "nearly identical to the holding[s] in *Washington Post* and Revenue Ruling 2011-29," in which the Court of Claims and the IRS, respectively, held that the group

obligations there were not subject to conditions precedent.[5] Rather, the court concluded (correctly) that the alleged group obligations *were* subject to a condition precedent (at least one post-1983 policyholder becoming entitled to the corresponding annual dividend), but it also concluded (incorrectly) that the condition was satisfied in the years in which the dividend guarantees were adopted.

3. Because the alleged group liability was tied to the corresponding annual-dividend obligation, *New York Life* is directly relevant to this case

Given that MassMutual made the exact same argument below regarding its annual-dividend obligation that it now ascribes to the taxpayer in *New York Life* (MM Br. 38),[6] and given its acknowledgment that the Second Circuit squarely rejected that argument (*id*. at 38-39),

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[5] Nor does the Government argue that "additional conditions had to be satisfied for individual beneficiaries *to remain in the group*." MM Br. 37 (emphasis added). Rather, the Government maintains (as MassMutual acknowledged below) that a condition had to be satisfied in order for the group to come into existence in the first place: satisfaction of the in-force requirement applicable to the corresponding annual-dividend obligation by at least one post-1983 policyholder.

[6] *Compare* MM Br. 38 ("New York Life argued that its liability for a dividend payment became fixed at the moment the policyholder made the final payment necessary to keep the policy in force through its anniversary date.") *with* A870 (post-trial reply brief), *supra* p. 7.

MassMutual's cavalier dismissal of *New York Life* as inapposite defies reason. More importantly, although MassMutual now argues (*id.* at 37) that the alleged guarantee obligations became fixed "[o]nce the Board adopted [the] guarantees," the terms of the guarantees establish that, as MassMutual acknowledged below (A883-A885), it did not "bec[o]me obligated" thereunder until "at least one post-1983 policyholder became entitled to" the corresponding annual dividend. *New York Life* confirms (and MassMutual now concedes) that no MassMutual policyholder became entitled to a declared annual dividend until the policy anniversary date occurring in the year following the year of declaration.[7] Thus, in asserting that "if any particular policyholder… cashed out a MassMutual policy, MassMutual *remained obligated* to pay a fixed aggregate amount to any *remaining members of the class*," MM Br. 40 (emphasis added), MassMutual erroneously assumes the year-end existence of "the class" in the first place.

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[7] Inasmuch as MassMutual has never claimed that the in-force requirement in its policies differed from the in-force requirement in New York Life's policies, its reference to the Second Circuit's mistaken belief to the contrary (MM Br. 39 n.17) can only be meant to confuse. *See* US Br. 51 n.18.

C. The dividend guarantees did not give rise to "obligations"

MassMutual's response to our alternative argument that the guarantee obligations were illusory (US Br. 55-61) is unpersuasive. First, as discussed *supra* at pp. 13-14, the trial court's conclusion (A40) that the dividend guarantees "created an unconditional obligation" is not, as MassMutual claims (MM Br. 41), a "factual finding" that is subject to "clearly erroneous" review. It is the "obligation" aspect of the court's "unconditional obligation" holding – *i.e.*, whether the dividend guarantees "impose[d] any obligation on the plaintiff" (A37) – that is the subject of the Government's alternative argument. As is the case with the "unconditional" aspect of that holding (*i.e.*, whether any such obligation was subject to a condition precedent at year-end), and as MassMutual itself recognizes (MM Br. 41-43), the court decided the "obligation" issue by analyzing the relevant case law, not by resolving any disputed factual issues. Regarding the relevant case law, in asserting (*id*. at 43) that "no relevant precedent gives any indication that it turned on a board's public announcement of its obligations," MassMutual completely ignores *New York Life* and its reading of the cases relied upon by the trial court on this point. *See* US Br. 56-58.

Moreover, in attempting to refute the additional basis cited by the Government for concluding that the guarantee obligations were illusory, *viz.*, that their "stated objective…was already virtually certain to occur in the ordinary course of the companies' business operations, independent of any 'guarantee' to that effect," US Br. 59-60, MassMutual unwittingly bolsters the Government's argument. According to MassMutual, "[t]he fact that MassMutual was virtually certain to *pay the guaranteed amounts* reinforces [its] claim that its liability to pay *them* accrued in the year of the guarantees." MM Br. 44 (emphasis added). In other words, MassMutual is arguing that, because it was virtually certain at the end of Year 1 that at least 85% of its maximum potential obligation to post-1983 policyholders with regard to the just-declared annual dividend would in fact be incurred in Year 2, it follows that such annual-dividend obligation should be deemed to have accrued in Year 1 to that extent. But that is precisely the result that *General Dynamics* prohibits in general and that Congress, in 1984, specifically prohibited in the context of policyholder dividends. For that reason, this Court should hold that the alleged guarantee obligations were illusory even if it also agrees with the

Government that the dividend guarantees, as drafted, did not fix the alleged obligations thereunder as of year-end. Such a holding would disabuse MassMutual and other mutual insurers of the notion that they might be able to draft their way around *General Dynamics* and congressional intent.

In the same vein, we note that this case, no less than *General Dynamics*, "involve[s] a statistical *estimate* of liabilities to numerous individuals." MM Br. 31 (emphasis in original). Under MassMutual's reasoning, the taxpayer in *General Dynamics* could avoid the result in that case by means of a year-end board resolution that (1) identifies the group of future obligees (*i.e.*, employees who incurred reimbursable medical expenses in the past year (Year 1) but did not file claims by the end of the year), (2) irrevocably guarantees that, at a minimum, the company will make total reimbursements to that group in the following year (Year 2) in an amount that it can predict with statistical near-certainty will, in fact, be claimed in that year (say, 85% of its reserve for such reimbursements), and (3) provides that any (purely hypothetical) shortfall will be allocated among the group members who in fact file

claims in Year 2. Surely such a substantively meaningless gesture would not dictate a different tax result.

II. The Economic-Performance Requirement

A. The IRS's interpretation of Treas. Reg. § 1.461-4(g)(3) prevails under general principles of statutory (and regulatory) interpretation

Based on the ordinary meaning of "rebate" and "refund" (as evidenced by contemporaneous lay dictionary definitions (A61)),[8] the term "rebate, refund, or similar payment" in Treas. Reg. § 1.461-4(g)(3) does not plainly and unambiguously include policyholder dividends paid by mutual life insurance companies.[9] Nor does the regulatory language

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[8] Even the insurance-specific entry included in the definition of "rebate" in the cited edition of Black's Law Dictionary – "[a] deduction from a stipulated premium on a policy of insurance" (MM Br. 46-47) – does not necessarily connote a policyholder dividend. *See* International Risk Management Institute, Inc., *Glossary of Insurance and Risk Management Terms*, http://www.irmi.com/online/insurance-glossary/terms/r/rebate.aspx (last visited May 23, 2014) (defining "rebate" as "[t]he sharing of the agent's or broker's commission with the insured").

[9] MassMutual's own policies – which indicate (A139) that dividends "are based on…divisible surplus" and "reflect our mortality experience and investment experience," but do not refer to them as rebates or refunds of previously paid premiums – similarly refute the notion that the term "policyholder dividend" ordinarily (*i.e.*, in a non-technical sense) connotes a rebate or refund.

plainly and unambiguously exclude such dividends. If the Court accepts that dual premise, then the next step is to resolve the ambiguity using the traditional tools of statutory (and regulatory) construction.

One such tool that has no application to this case – but which the trial court relied on extensively – is consideration of industry usage. As the cases cited by the court in support of such an approach (A61-62) make clear, resort to industry usage is appropriate when the statute (or regulation) at issue pertains to a specific industry. *See Star-Glo Assocs., LP v. United States*, 414 F.3d 1349, 1356 (Fed. Cir. 2005) (construing the term "trees per acre" in statute compensating owners of destroyed citrus groves); *see also La. Pub. Serv. Comm'n v. F.C.C.,* 476 U.S. 355, 372 (1986) (construing terms in the Communications Act of 1934); *Corning Glass Works v. Brennan*, 417 U.S. 188, 201-202 (1974) (noting that resort to industry usage "is particularly salutary" where "Congress incorporated words having a special meaning within *the field regulated by the statute*") (emphasis added). Since the recurring-item exception to the economic-performance requirement is not specific to the insurance industry, the trial court's reliance on an insurance-specific connotation of the word "rebate" – including its reliance on Federal

Circuit cases involving insurance-specific provisions of the Internal Revenue Code – was erroneous.

Once the insurance-specific usage of the word "rebate" is stripped away, MassMutual's regulatory construction analysis reduces to the following (MM Br. 50): "The language in [Treas. Reg. §] 1.461-4(g)(3) is expansive, and policyholder dividends fit well within it."[10] But since the recurring-item exception "relax[es]…the general economic performance rule of section 461(h)" by "giving the taxpayer a greater entitlement to accelerate deductions," it should be narrowly construed. *Caltex Oil Venture v. Commissioner*, 138 T.C. 18, 33 (2012) (applying narrow-construction principle to the taxpayer-favorable "3-½ month" rule of

[10] We note that, in arguing that its alleged guarantee obligations were fixed at year-end under the all-events test, MassMutual views those year-end obligations as "unitary class liabilit[ies]" rather than "the sum of thousands of individual liabilities." MM Br. 39. Since it could not be known at year-end how much of the guaranteed amount would be paid to any given policyholder, it cannot be said (without the benefit of hindsight) that the year-end, unitary class liability – which is the liability that must qualify for the recurring-item exception, *see* Treas. Reg. § 1.461-5(b)(1)(i) – pertained solely to what MassMutual asserts were, in the hands of each recipient, refunds of premiums previously paid by the recipient.

Treas. Reg. § 1.461-4(d)(6)(ii)).[11] This principle refutes MassMutual's contention (MM Br. 49-51) that the negative inference supporting the IRS's interpretation – an inference based on the surrounding language of § 1.461-4(g)(3), surrounding provisions and examples contained in §§ 1.461-1(e), 1.461-4(g), and 1.461-5(e), and legislative and regulatory history, *see* US Br. 66-69 – is somehow unfounded.

B. The IRS's interpretation of its own regulation is entitled to deference

1. The Government is entitled to respond to the trial court's erroneous deference analysis

The doctrine of waiver – insofar as it relates to preserving an issue for appeal – stems from the "general rule…that a federal appellate court does not consider an issue not *passed upon* below." *Singleton v. Wulff*, 428 U.S. 106, 120 (1976) (emphasis added); *see, e.g.*, *Digital-*

[11] The court in *Caltex* also noted that, as evidenced by the preamble to the final regulations, "[t]he Secretary showed an intention to limit the relaxation of the economic performance rule" in rejecting certain commentators' suggestions regarding the "3-½ month" rule as initially proposed. 138 T.C. at 33 n.18. The same is true of the recurring-item exception. *See* T.D. 8408, 1992-1 C.B. 155, 161-162 (rejecting commentators' "argu[ment] that no liabilities other than those specified by section 461(h)(3)(C) may be excluded from the recurring item exception").

Vending Servs. Int'l, LLC v. Univ. of Phoenix, Inc., 672 F.3d 1270, 1278 (Fed. Cir. 2012); *see also Hormel v. Helvering*, 312 U.S. 552, 557 (1941) (referring to "questions of law which were neither pressed *nor passed upon*…below") (emphasis added). It follows, then, that the doctrine of waiver is inapplicable where the lower court addressed the subject issue of its own accord. *See Lebron v. Nat'l Railroad Passenger Corp.*, 513 U.S. 374, 379 (1995) (addressing an alternative argument raised for the first time in the petitioner's merits brief "since it was addressed by the court below," and noting that "'[o]ur practice permit[s] review of an issue not pressed so long as it has been passed upon….'") (quoting *United States v. Williams*, 504 U.S. 36, 41 (1992)) (first alteration added); *see also Citizens United v. Federal Election Comm'n*, 558 U.S. 310, 323 (2010) (addressing an issue "raise[d]…for the first time before us…because 'it was addressed by the court below'") (quoting *Lebron*, 513 U.S. at 379); *Hollmer v. Harari*, 681 F.3d 1351, 1356 n.3 (Fed. Cir. 2012) (rejecting waiver argument on authority of *Lebron*).

Here, the trial court devoted almost five pages of its opinion (A51-A56) to the issue of deference, even though neither party briefed that issue. But the court applied the wrong analysis; instead of determining

whether the IRS's interpretation of the term "rebate, refund, or similar payment" in Treas. Reg. § 1.461-4(g)(3) is entitled to deference, *see generally Auer v. Robbins*, 519 U.S. 452 (1997), the court analyzed whether the regulations implementing the recurring-item exception of I.R.C. § 461(h)(3) – in particular, Treas. Reg. § 1.461-5(b)(5)(ii), which provides that rebates and refunds are deemed to satisfy the matching requirement of I.R.C. § 461(h)(3)(A)(iv)(II) – are entitled to deference as a reasonable interpretation of the statute, *see generally Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). The Government is entitled to correct this mistake on appeal; "[o]therwise, the more surprising a [trial] court decision in terms of resolving unbriefed and unargued points, the more insulated from review that decision would be." *United States v. Clariot*, 655 F.3d 550, 556 (6th Cir. 2011); *see Hollmer*, 681 F.3d at 1356 n.3 (holding that when a tribunal *sua sponte* "applies a legal standard that governs its holding, the propriety of that standard is properly before us on appeal").[12]

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[12] We note that this Court applied *Auer* deference in *Abbott Labs. v. United States*, 573 F.3d 1327 (Fed. Cir. 2009), even though the Government did not argue for it in the Court of Federal Claims. Thus,

(continued…)

2. The IRS's interpretation of the regulation reflects its fair and considered judgment

MassMutual's substantive arguments against deference are wholly unconvincing. First, the quoted passages (MM Br. 55) from *Bowen v. Georgetown Univ. Hosp*., 488 U.S. 204, 212, 213 (1988), stand for the proposition that an agency's interpretation of a *statute* (not its own regulation) expressed for the first time in litigation is not entitled to deference. In contrast, and notwithstanding the suggestion to the contrary contained in the passage quoted by MassMutual (MM Br. 56) from *Adair v. United States*, 497 F.3d 1244 (Fed. Cir. 2007), the fact that an agency's interpretation of its own regulation is "found solely in [a] government[ ] brief," *id*. at 1252, does not preclude deference to that interpretation. *See Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 171 (2007); *Auer*, 519 U.S. at 462; *Abbott Labs. v. United States*, 573 F.3d 1327, 1331 (Fed. Cir. 2009); *Cathedral Candle Co. v. U.S. Int'l Trade Comm'n*, 400 F.3d 1352, 1364 (Fed. Cir. 2005); US Br. 63-64. Nor

(…continued)
MassMutual's assertion that "[t]his case…contrasts with the *Abbott Laboratories* litigation," MM Br. 54 n.26, "where the Government invoked deference at all stages of the litigation," *id*. at 58, is wrong.

does anything in the Supreme Court's jurisprudence – or in this Court's cases (other than *Adair*) – on this subject suggest that deference in that situation is dependent on whether the brief was "signed by any [agency] official." *Adair*, 497 F.3d at 1252.[13]

Because an agency's interpretation of its own regulation can command deference even if it is "found only in [a] brief," *Cathedral Candle*, 400 F.3d at 1363, MassMutual's suggestion that the Government must identify a separate "statement from the IRS or Treasury" – be it "a regulation, an administrative ruling, or an informal letter" – that "agree[s] with" the IRS interpretation advanced here, MM Br. 56, 57, is simply wrong.[14] Thus, there is nothing "mysterious[ ]" (*id.*

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[13] We note that the Government's briefs in *Abbott Laboratories* and *Am. Express Co. v. United States*, 262 F.3d 1376 (Fed. Cir. 2001) – two leading cases in this Circuit applying *Auer* deference in the tax context – were not signed by any IRS or Treasury official. *See* Brief for the Appellee, *Abbott Labs. v. United States*, No. 2009-5014 (Fed. Cir. Mar. 5, 2009), 2009 WL 870168; Brief for the Appellee, *Am. Express Co. v. United States*, No. 00-5111 (Fed. Cir. Nov. 9, 2000), 2000 WL 34251380.

[14] Because the Government need not point to any such corroborating agency statement, "[t]he lack of evidence about whether Treasury and the IRS previously adopted" the interpretation advanced by the IRS here (MM Br. 56 n.27) is of no moment. And MassMutual's suggestion that it would be unfair to afford deference to the IRS's (continued…)

at 57) about the Government's citation of two IRS Field Service Advisories (FSAs) that do not "actually take[ ] the position" (*id.*) for which the Government now seeks deference. As our opening brief makes clear (US Br. 65-66), the Government does not cite those FSAs for "the position advanced here" (MM Br. 58).[15] Rather, the Government maintains that the FSAs – which recognize that the term "rebate, refund, or similar payment" in Treas. Reg. § 1.461-4(g)(3) is ambiguous as to whether it includes policyholder dividends – support a finding that the IRS's resolution of that ambiguity (as manifested in its position in this case) "reflect[s] the agency's fair and considered judgment on the matter in question" and is therefore entitled to deference. *Auer*, 519 U.S. at 462; *see Long Island Care*, 551 U.S. at 171 (noting that the agency "has clearly struggled with" the interpretive

(…continued)
interpretation without "development of the record" in that regard (*id.* at 54 n.26) likewise rings hollow; indeed, a unanimous Supreme Court in *Auer* had no qualms about deferring to an agency interpretation of its own regulation raised for the first time in a Supreme Court brief.

[15] Accordingly, MassMutual's criticism of the Government for "fail[ing] to inform the Court" that FSAs may not be cited as precedent, MM Br. 57, is entirely gratuitous.

issue and that this "indicates that [its] interpretation of [the] regulation reflects its considered views").

MassMutual's attempt to portray *Abbott Laboratories* and *Cathedral Candle* as unhelpful to the Government is likewise unavailing. According to MassMutual (MM Br. 58), *Abbott Laboratories* is inapposite because, unlike the FSAs referenced by the Court there, the FSAs cited in our opening brief "do not suggest the interpretation" of the regulation advanced by the IRS. To the contrary, each of the cited FSAs recognizes that Treas. Reg. § 1.461-4(g)(3) can be read as excluding policyholder dividends, which is the interpretation advanced by the IRS in this case. *See* US Br. 65-66. As for *Cathedral Candle*, it is hardly surprising that the Government in the instant case "does not identify any administrative authority from an agency outside of Treasury" (MM Br. 58-59) that supports the IRS's interpretation of its own regulation, given that the administration of the Internal Revenue Code is the sole province of the IRS and the Treasury Department. MassMutual's suggestion that *Cathedral Candle* somehow turned on that circumstance – *i.e.*, the existence of a corroborating regulation promulgated by a separate agency – is baseless. *See* 400 F.3d at 1364

(upholding the agency's interpretation of its regulation and *then* observing that such interpretation was consistent with the other agency's regulation).

Finally, while MassMutual's policy arguments against *Auer* deference (MM Br. 59-60) have no bearing on this Court's deliberations, we note that there *is* another side to the argument. *See* Jason Marisam, *Constitutional Self-Interpretation*, 75 Ohio St. L.J. 293 (2014) (arguing in favor of *Auer* deference).

CONCLUSION

The judgment of the Court of Federal Claims should be reversed.

Respectfully submitted,

TAMARA W. ASHFORD
Acting Assistant Attorney General

/s/ Arthur T. Catterall

ROBERT W. METZLER (202) 514-3938
ARTHUR T. CATTERALL (202) 514-2937
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

JUNE 2014

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the Federal Circuit by using the appellate CM/ECF system on June 9, 2014. Counsel for the appellee are registered ECF users and will be served by the ECF system.

/s/ Arthur T. Catterall
ARTHUR T. CATTERALL
Attorney

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/s/ Arthur T. Catterall
Attorney for the Appellant
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