NO. 10-60988

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

ENTERGY CORPORATION & AFFILIATED SUBSIDIARIES,

Petitioners-Appellees,

- vs.-

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant.

APPELLEES' BRIEF

On Appeal from United States Tax Court

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May 11, 2011

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1 have an interest in the outcome of this case. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

1. Commissioner of Internal Revenue, Appellant.
2. Entergy Corporation & Affiliated Subsidiaries, Appellees.
3. Stephen D. Gardner, John P. Steines, Jr., and Benjamin P. Oklan (of Cooley LLP), attorneys for Entergy Corporation and Affiliated Subsidiaries.
4. Michael C. Prindible, Melissa D. Arnt, Gilbert S. Rothberg, Thomas J. Clark, and Francesca U. Tumami, attorneys for the Commissioner of Internal Revenue.

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STATEMENT REGARDING ORAL ARGUMENT

In view of the complexity of the case and the significant implications the case has for the administration of federal income tax laws, Entergy Corporation & Affiliated Subsidiaries ("Entergy") believe the Court will benefit from oral argument.

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STATEMENT OF FACTS[1]

None of the facts adduced at Entergy's trial or recited in *PPL Corp. v. Commissioner*, 135 T.C. 304 (2010), *appeal pending* (3d Cir.), are in dispute.[2] Entergy does not object to the Commissioner's statement of facts. The facts recited below are intended as a supplement to the Commissioner's statement of facts.[3]

A. History of the Windfall Tax.

Between 1984 and 1996, the United Kingdom privatized over 50 government-owned companies, many of which were monopolies subject to economic regulation. *PPL Corp.*, 135 T.C. at 306. The government privatized the companies by selling shares to public investors at a fixed offering price in a "flotation" (public offering). *Id.* Offering prices were set in consultation with investment advisors to maximize offering proceeds. Ex. 14-P at 1-2, 9-10. In

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1 Entergy does not disagree with the Commissioner's Jurisdictional Statement, Statement of the Issue, or Statement of the Case.

2 As discussed in the Commissioner's Statement of the Case, the Tax Court's memorandum opinion in *Entergy Corp.* v. *Commissioner*, T.C. Memo 2010-197 (2010), relied on its published opinion in *PPL Corp.*, which involved the identical issue and material facts and was issued on the same day. Both cases were tried before the same Judge. Appellant Br. at 3. Therefore, Entergy's Statement of Facts refers to both the *Entergy* record and the *PPL* opinion.

3 Citations to the trial transcript appear herein as "Tr. at __." Citations to Entergy's Record Excerpts appear as "R.E. __."

most cases, however, the shares immediately traded on the London Stock Exchange at a premium over the flotation price. *PPL Corp.*, 135 T.C. at 307.

Of the 32 privatized companies that would become subject to the Windfall Tax (the "Windfall Companies"), 12 were regional electric companies ("RECs"). First Stip. Facts and Exs. ¶ 23. London Electricity plc ("London Electricity"), a U.K. subsidiary of Entergy, was a REC. *Id.*

In the years after privatization, 29 of the 32 Windfall Companies operated under government price controls, which limited the price increases that the companies could charge. *PPL Corp.*, 135 T.C. at 308. Prices were not adjusted until the end of the five-year period after flotation, regardless of the company's performance. *Id.* at 309. Despite those controls, many of the companies became considerably more efficient and profitable than had been expected. *Id.* at 309. Notably, during the first four years after privatization, the RECs earned post-tax profits of over 80 percent of the flotation proceeds. *Id.* at 309 n.6. Substantial profits led to unexpectedly high dividends, executive compensation, and share price increases, which fueled public outcry that shareholders and executives of the privatized companies had profited unduly to the detriment of the U.K. fisc and consumers. *Id.* at 309-10.

Beginning in the early 1990's, the Labour Party stated publicly that, in order to finance social programs, it would impose a windfall tax on the excess

profits of the privatized companies. *Id.* at 310. By 1994, the idea of an excess profits tax had become a principal feature of the Labour Party's speeches and programs leading up to the 1997 Parliamentary election. *Id.* In 1996, the Labour Party retained Arthur Andersen to assist in drafting a tax on the excess profits of the privatized companies. *Id.* at 310. Gordon Brown, then the shadow Chancellor of the Labour Party, instructed Arthur Andersen to draft proposals for the imposition of a tax on the privatized companies' excess profits that would meet Parliamentary requirements, would be sustainable by the companies, and would not conflict with U.K. or European Union law. Tr. at 74-77, R.E. Tab A. In addition to the windfall tax approach that was eventually enacted, the Andersen team considered and rejected several alternatives. *PPL Corp.*, 135 T.C. at 311. A one-time windfall tax could achieve the desired revenue goal without encountering the problems associated with the other approaches. Tr. at 84-86, R.E. Tab A.

The Windfall Tax was enacted on July 31, 1997. First Stip. Facts and Exs. ¶ 31. Statements by various government officials and Parliamentary debate described the tax simultaneously as a tax on excess profits and as a means of recouping the perceived undervaluation of the companies reflected in cheap flotation prices. Ex. 15-P ¶ 190-192.

B. Description of the Windfall Tax.

The Windfall Tax Act (the "Act") identified the 32 Windfall Companies and set the tax rate at 23 percent. First Stip. Facts and Exs. ¶¶ 38-40. Schedule 1, an integral part of the Act, defined the "windfall" as the excess (if any) of:

> (a) "the value in profit-making terms of the disposal made on the occasion of the company's flotation" ("*value in profit-making terms*"), over
> (b) "the value which for privatisation purposes was put on that disposal" ("*flotation value*").

Id. ¶ 41.

Value in profit-making terms was defined in Schedule 1 of the Act as the "average annual profit" for the company's "initial period" multiplied by the "applicable price-to-earnings ratio." *Id.* ¶ 42. Average annual profit equaled 365 multiplied by a fraction the numerator of which was the company's profits during the initial period ("Initial Period Profits") and the denominator of which was the number of days in the initial period (generally, 1,461 days, or 4 years). *Id.* ¶ 51.

Initial Period Profits were equal to "profit on ordinary activities" net of regular U.K. corporate tax, as determined under U.K. financial accounting principles ("U.K. Financial Profits"). *Id.* ¶ 50. U.K. Financial Profits are in all material respects the same as net income determined under generally accepted accounting principles applicable in the United States. Ex. 69-P ¶ 28, R.E.

Tab B. U.K. Financial Profits are based on actual realized gross receipts with an allowance for the deduction of all related expenses and depreciation or amortization of wasting assets. Ex. 68-P ¶ 3.13, R.E. Tab C; Ex. 69-P ¶¶ 31-32, R.E. Tab B.

The initial period was the company's four financial years immediately following flotation. For companies that did not have four full financial years after flotation and before April 1, 1997, the initial period was shorter (beginning at flotation and ending on the last day of the last financial year ending prior to April 1, 1997). First Stip. Facts and Exs. ¶¶ 44-45. The applicable price-to-earnings ratio was nine. *Id.* ¶¶ 42-43.

Flotation value equaled the product of the per-share flotation price and the number of ordinary shares issued in the flotation. *Id.* ¶ 52.

The following formula sets out the Windfall Tax calculation:

$$WT = 23\% \times [\{(365 \times (P/D)) \times 9\} - FV]$$

where

WT = Windfall Tax P = initial period profits

D = days in initial period FV = flotation value

Id. ¶ 54.

Twenty-seven of the 32 Windfall Companies had an initial period of 1,461 days, or 4 years. *Id.* ¶ 55. For those companies, the formula may be restated in the following steps:

WT =	23%	x	[{(365 x (P/1,461)) x 9}	–	FV]
WT =	23%	x	[{(P/4) x 9}	–	FV][4]
WT =	{23% x (9/4)}	x	[P	–	{(4/9) x FV }][5]
WT =	51.71%	x	[P	–	(44.47% x FV)]

Id. ¶¶ 55-58. Thus, 27 of the 32 Windfall Companies had a Windfall Tax liability of 51.71% of initial period profits in excess of a floor equal to 44.47% of flotation value.

Two other companies (National Power plc and PowerGen plc) had initial periods of four full financial years, but under U.K. accounting conventions the day counts were 1,456 and 1,463, respectively. *Id.* ¶ 48. As to those two companies, the algebraic restatement set forth above differed by miniscule fractions of one percent. *Id.* ¶¶ 63 n.5, 65 n.6.

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[4] For simplicity, the denominator of "4" in the restatement derives from the fraction 365/1461, which reduces to approximately 1/4. First Stip. Facts and Exs. ¶ 56.

[5] Step 3 in the restatement multiplies the 23% by 9/4 and the bracketed terms by 4/9. Because 9/4 x 4/9 = 1, this step does not change the Windfall Tax amount. *PPL Corp.*, 135 T.C. at 328 n.22.

Three companies (Northern Ireland Electricity plc, Railtrack Group plc, and British Energy plc), whose privatization occurred later than others, had initial periods of 1,380 days, 316 days, and 260 days, respectively. *Id.* ¶ 49. British Energy plc had no windfall tax liability. *Id.* ¶ 47. As to the other two companies, the algebraic restatement yields the following:

Northern Ireland: $WT = 54.75\% \times [P - (42.01\% \times FV)]$

Railtrack: $WT = 239.10\% \times [P - (9.62\% \times FV)]$

Id. ¶¶ 67, 69.

C. Effect of the Windfall Tax.

London Electricity had an initial period of 1,461 days, and its Initial Period Profits were £503.4 million. *Id.* ¶¶ 71-72. Thus, its value in profit-making terms was 9 x £503.4 x 365/1461, or £1,131,874,760. *Id.* ¶ 74. Its flotation value was £523,341,600. *Id.* ¶ 75. Therefore, its "windfall" was £1,131,874,760 minus £523,341,600, or £608,533,140. Its Windfall Tax was £139,962,622 (translated into $234,290,431). *Id.* ¶¶ 13, 77.

Subject to rounding differences caused solely by expressing percentages in hundredths (*i.e.*, by carrying only to two decimal places), the algebraically restated tax equals the actual tax calculated under the Windfall Tax statute.

Substituting actual values for the variables in the algebraic restatement give the following:

51.71% x [£503,400,000 – (44.47% x £523,341,600)] = £139,962,622[6]

Id. ¶¶ 58, 77.

Of the 32 Windfall Companies, 31 had a Windfall Tax liability. *PPL Corp.*, 135 T.C. at 317. The aggregate tax burden of the 31 companies equaled 20.27 percent of the aggregate Initial Period Profits. Ex. 68-P at Scheds. 4A-4B, R.E. Tab H. No Windfall Company had a Windfall Tax liability in excess of its Initial Period Profits. *PPL Corp.*, 135 T.C. at 317.

In the financial year that the tax accrued, all 31 of the companies with a Windfall Tax liability accounted for the tax within each company's "ordinary activities." Ex. 68-P ¶8.3. Thus, for financial accounting purposes, those companies treated the Windfall Tax as an ordinary charge against profits. *Id.* ¶10.3. Additionally, the companies treated the Windfall Tax as a charge against profits in the year the tax accrued, not in the year of flotation. Tr. at 116-117.

Witnesses for both parties agreed that (i) Windfall Tax liability could arise only if there was sufficient income during the initial period to cause the value in profit-making terms to exceed flotation value; (ii) once the flotation value threshold was exceeded, Windfall Tax liability increased in the same

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[6] For ease of presentation, the percentages have been rounded.

proportion as income increased; (iii) a company with no initial period income incurred no Windfall Tax liability regardless of how much its stock value increased; and (iv) a company with sufficient income would incur Windfall Tax liability regardless of how much its stock value deteriorated. Tr. at 219-222, R.E. Tab D; Tr. at 256-258, R.E. Tab E; Tr. at 265-266, R.E. Tab F.

SUMMARY OF THE ARGUMENT

The Tax Court's decision should be affirmed.

The U.K. Windfall Tax was a creditable excess profits tax under Treasury Regulation § 1.901-2. Under the regulation, a foreign tax is creditable if its predominant character is that of an income or excess profits tax in the U.S. sense. This in turn requires that the foreign tax satisfy the regulation's realization, gross receipts, and net income tests. The regulation is clear: in determining whether those tests are satisfied, the foreign tax is judged on the basis of its predominant character.

The regulation's predominant character standard requires a court to examine the intent and effect of the tax. This standard evolved out of the case law beginning with the Supreme Court's decision in *Biddle v. Commissioner*, 302 U.S. 573 (1938). Every foreign tax credit case since has examined the intent and the effect of the foreign tax to determine whether it is creditable. Evidence admitted in those cases has included testimony of the drafters of the

foreign tax, expert reports regarding how the tax operated in fact, and quantitative data relating to taxpayer and industry experience in calculating and paying the foreign tax. *See, e.g.*, *Exxon Corp. v. Commissioner*, 113 T.C. 338 (1999), *acq. in result*, I.R.B. 2001-31. The case law uniformly states that the literal language of the foreign statute is not determinative.

The Tax Court properly applied the predominant character standard in holding that the Windfall Tax was creditable. It heard testimony and reviewed documents confirming that the purpose of the Windfall Tax was to tax the excess profits of the privatized companies. Tr. at 63-64, R.E. Tab A; Ex. 15-P ¶ 188. It heard testimony and admitted the algebraic restatement of the Windfall Tax formula confirming that the Windfall Tax was, in effect, a tax on profits above a floor. Ex. 68-P; Tr. at 161-163, R.E. Tab G. It admitted quantitative data confirming that the Windfall Tax operated as an excess profits tax with respect to each individual taxpayer and all of the taxpayers subject to the tax. Ex. 68-P at Scheds. 4A-4B, R.E. Tab H.

Faced with this evidence, the Commissioner argues that the creditability of a foreign tax can be determined only by the literal text of the foreign tax statute, and that the consideration of any other evidence is legal error. However, the Commissioner cannot escape the overwhelming authority that the predominant character of a foreign tax is measured by its intent and effect. Indeed, the

Commissioner cites no relevant authority for his contention that creditability is determined solely by the text of the foreign statute. At no point in the history of the foreign tax credit has a court articulated such a test. Instead, the Commissioner's strategy is to suppress the facts and marshal inapplicable case law in the hope that, if this Court ignores the evidence, it won't notice the true character of the Windfall Tax.

The Commissioner's refrain is that the literal text of the foreign statute is determinative. Every other court that has adjudicated this issue has held otherwise. The Commissioner's plain text arguments are erroneous.

ARGUMENT

I. Standard of Review.

The Tax Court's legal conclusions are reviewed *de novo*. *Whitehouse Hotel L.P. v. Commissioner*, 615 F.3d 321, 333 (5th Cir. 2010). Additionally, questions regarding foreign law are reviewed *de novo*. In considering the meaning of foreign law, the Circuit Court may rely on any factual material. *Karim v. Finch Shipping Co.*, 265 F.3d 258, 271 (5th Cir. 2001). Factual findings are reviewed for clear error. *Texasgulf, Inc. v. Commissioner*, 172 F.3d 209, 214 (2d Cir. 1999).

II. The Tax Court Correctly Held That the U.K. Windfall Tax Qualified as a Creditable Excess Profits Tax Under the Code, Applicable Case Law, and Treasury Regulation § 1.901-2(a).

This Court should affirm the Tax Court's decision that the U.K. Windfall Tax was a creditable tax within the meaning of section 901 of the Internal Revenue Code.[7]

Section 1.901-2 of the Treasury Regulations, promulgated in 1983, controls the outcome of this case.[8] Under the regulation, a foreign levy is an income, war profits, or excess profits tax if (i) it is a tax and (ii) its predominant character is that of an income or excess profits tax in the U.S. sense. Treas. Reg. § 1.901-2(a). It is not disputed that the U.K. Windfall Tax was a tax. The sole

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[7] Unless otherwise indicated, all "section or "§" references are to the Internal Revenue Code of 1986 (26 U.S.C.) (the "Code"). All references to Treasury Regulations are to current provisions.

[8] Because there is no question that Treasury Regulation § 1.901-2 is a reasonable construction of a Congressional statute, *Mayo Foundation v. United States*, 131 S. Ct. 704 (2011), is inapplicable to this case. If the Commissioner's argument is that his interpretation of § 1.901-2 deserves deference, his interpretation is governed by *Christensen v. Harris County*, 529 U.S. 576 (2000). Under *Christensen*, deference to an administrative agency's interpretation of its own regulation is warranted only when the language of the regulation is ambiguous. *Id.* at 588. Under *Auer v. Robbins*, 519 U.S. 452 (1997), the agency's interpretation is not given deference when it is plainly erroneous or inconsistent with the regulation. *Id* at. 461. As discussed in this brief, Treasury Regulation § 1.901-2 is unambiguous, and the Commissioner's interpretation of § 1.901-2 in this case is both erroneous and inconsistent with the regulation.

issue in this case is whether the predominant character of the Windfall Tax was that of an income or excess profits tax in the U.S. sense.

Since the adoption of the forerunner of section 901 in the Revenue Act of 1918, every case deciding whether a foreign tax is creditable under the predominant character standard, including those governed by the regulation at issue in this case, has examined how the foreign tax operated in fact. No case has looked exclusively at the words of the foreign tax act. The established approach, requiring a factual analysis of how the foreign tax operates, is based on the Supreme Court's decision in *Biddle v. Commissioner*, 302 U.S. 573 (1938), in which the creditability of a British tax was determined by an analysis of how the tax operated. This factual inquiry was embraced by the predominant character standard in the Commissioner's own regulation. It was expounded upon by the case law, including two cases that were decided after the promulgation of the current regulation: *Texasgulf, Inc. v. Commissioner*, 172 F.3d 209 (2d Cir. 1999), and *Exxon Corp.*, 113 T.C. 338, *acq. in result*, I.R.B. 2001-31.

Against that authority, the Commissioner makes essentially one argument, packaged as two, that the Windfall Tax fails the tests for creditability under the regulation. First, he argues that, regardless of whether the foreign tax operated as an income tax or excess profits tax in the U.S. sense, the text of the foreign

statute must slavishly track the literal words of the section 1.901-2 regulation. Second, he argues that the regulation prohibits consideration of evidence of foreign legislative intent or direct evidence of how the foreign tax actually operated. In short, the Commissioner insists that the particular words of the foreign statute that he emphasizes, and those words alone, determine creditability.

The administrative history, jurisprudence, and actual wording of the regulation itself refute the Commissioner's first argument. As a matter of simple logic, a regulation that bases creditability on the predominant character of a tax cannot ignore evidence of excess profits tax equivalence. As to the Commissioner's second argument, ample case law, without dissent, embraces inquiry into foreign legislative intent and how a foreign tax actually operates in order to determine creditability.

A. The Tax Court Correctly Held That the "Predominant Character" of the U.K. Windfall Tax Was That of an Income Tax in the U.S. Sense Under Treasury Regulation § 1.901-2(a)(3).

Under Treasury Regulation § 1.901-2, the "predominant character" of a foreign tax is that of an income, war profits, or excess profits tax in the U.S. sense if "the foreign tax is likely to reach net gain in the normal circumstances in which it applies." Treas. Reg. §§ 1.901-2(a)(1)(ii) and 1.901-2(a)(3).

The predominant character standard was incorporated into Treasury Regulation § 1.901-2 in 1983. The preamble to the regulation states that the predominant character language is an adoption of the judicial criteria established in *Bank of America Nat'l Trust & Savings Ass'n v. United States*, 459 F.2d 513 (Ct. Cl. 1972); *Inland Steel Co. v. United States*, 677 F.2d 72 (Ct. Cl. 1982); and *Bank of America Nat'l Trust & Savings Ass'n v. Commissioner,* 61 T.C. 752 (1974), *aff'd*, 538 F.2d 334 (9th Cir. 1976). T.D. 7918, 1983-2 C.B. 113; Addenda A. Thus, the predominant character of the Windfall Tax was that of an income tax if it was "reasonably intended, always to reach some net gain," and "the key is the effect of the foreign tax on net gain." *Bank of America v. United States*, 459 F.2d at 519-520, 521. And, in determining the predominant character of the Windfall Tax, "... it is important, for the foreign tax credit, ... to see whether taxation of net gain is the ultimate objective or effect of that tax." *Inland Steel*, 677 F.2d at 80.

Furthermore, the words of the foreign taxing statute are not determinative. As stated by the Court of Federal Claims in the *Bank of America* case:

> We do not, however, consider it all-decisive whether the foreign income tax is labeled a gross income or a net income tax .... The important thing is whether the other country is attempting to reach some net gain, not the form in which it shapes the income tax or the name it gives.

459 F.2d at 519; *see also Inland Steel*, 677 F.2d at 80 (stating that to determine whether a foreign tax is creditable, "[t]he label and form of the foreign tax is not determinative.").

The 901 regulations establish three requirements to determine whether the predominant character of a foreign levy is that of an income tax in the U.S. sense. Under Treasury Regulations §§ 1.901-2(b)(2), (3), and (4), a foreign levy is likely to reach net gain if, judged on the basis of its predominant character, it satisfies (i) the realization requirement, (ii) the gross receipts requirement, and (iii) the net income requirement.

On appeal, the Commissioner argues that the Tax Court "invented" its own test for creditability. The Commissioner is wrong. The Tax Court heard evidence of the intent and effect of the Windfall Tax in order to judge the Windfall Tax based on its predominant character. The Tax Court then applied the regulation to the undisputed evidence. By ignoring the predominant character standard in his argument on appeal, it is the Commissioner, not the Tax Court, who is inventing a new test for creditability.

The Windfall Tax, judged on the basis of its predominant character, satisfied each of the three tests for creditability under Treasury Regulation § 1.901-2(b).

1. The Tax Court Correctly Held That the Windfall Tax Was Imposed on Realized Income.

A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, the tax is imposed on income subsequent to events that would result in the realization of income under the Code. Treas. Reg. § 1.901-2(b)(2)(i)(A). The Windfall Tax was imposed on U.K. Financial Profits (that is, profit on ordinary activities determined under U.K. financial accounting principles), which are equivalent to realized profits as determined under U.S. generally accepted accounting principles. First Stip. Facts and Exs. ¶ 50, Ex. 69-P ¶ 28, R.E. Tab B.

The calculation of the Windfall Tax was based on Initial Period Profits, which were equal to U.K. Financial Profits. First Stip. Facts and Exs. ¶¶ 50-51. In both the U.K. and U.S. accounting systems, the calculation of profits and losses is based on fundamental principles of revenue realization. Thus, in calculating U.K. Financial Profits, revenue is taken into account only when realized. Ex. 69-P ¶ 31, R.E. Tab B.

Moreover, it was factually impossible for the tax to be imposed prior to realization. In all cases, the Windfall Tax taxed profits earned before its enactment. First Stip. Facts and Exs. ¶¶ 31, 44. Initial Period Profits were earned between 1986 and, at the latest, a Windfall Company's last full financial

year ending before April 1, 1997. *Id.* ¶ 45. The Windfall Tax was enacted on July 31, 1997, after each Windfall Company's Initial Period Profits had been publicly reported. *PPL Corp.*, 135 T.C. at 332. Those profits could not have been known if they hadn't been realized. All the companies subject to the Windfall Tax charged the tax against profits in the year the tax was enacted. Ex. 68-P ¶8.3. They could not have known how much Windfall Tax to accrue unless the Initial Period Profits on which the tax was based had been realized. Furthermore, Gordon Brown's July 2, 1997 budget speech,[9] Inland Revenue's July 2, 1997 announcement of the Windfall Tax,[10] and the U.K. Treasury's July 1997 publication "Explanatory Notes: Summer Finance Bill 1997"[11] each stated that the Windfall Tax would yield around £5.2 billion. Gordon Brown, Inland Revenue, and Her Majesty's Treasury could not have known the Windfall Tax's yield if Initial Period Profits had not been realized. The Tax Court recognized that the architects of the Windfall Tax knew (1) exactly which companies the tax would target, (2) the publicly reported after-tax financial profits of those companies, and (3) the target amount of revenue the tax would raise. *PPL Corp.*, 135 T.C. at 332. Based in part on those undisputed facts, the court found that the Windfall Tax purposefully operated on excess profits. *Id.* Thus, the

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9 Ex. 15-P ¶ 194; *PPL Corp.*, 135 T.C. at 314.

10 *PPL Corp.*, 135 T.C. at 314-15.

11 *Id.* at 315.

Windfall Tax was imposed after realization within the meaning of Treasury Regulation § 1.901-2(b)(3)(i)(A).

2. The Tax Court Correctly Held That the Windfall Tax Satisfied the Gross Receipts Requirement.

The Windfall Tax was imposed on gross receipts. Initial Period Profits began with "turnover," which is analogous to gross revenue in the U.S. sense. Ex. 69-P ¶¶ 32, 39, R.E. Tab B. As is the case with the realization requirement of the regulation, it was factually impossible for the tax to be imposed prior to a Windfall Company's accrual of the gross receipts upon which the Windfall Tax was ultimately imposed.

Initial Period Profits are derived from U.K. Financial Profits. First Stip. Facts and Exs. ¶ 50. U.K. Financial Profits are based upon actual gross receipts less deductions for all related expenses and depreciation or amortization of wasting assets. Ex. 68-P ¶ 3.13, R.E. Tab C; Ex. 69-P ¶¶ 31-32, R.E. Tab B. Since the Initial Period Profits were earned before the enactment of the Windfall Tax, all of the gross receipts from which the Initial Period Profits were derived had also accrued and existed before enactment. Thus, judged on the basis of its predominant character, the Windfall Tax was imposed on the basis of gross receipts within the meaning of Treasury Regulation § 1.901-2(b)(3)(i)(A).

3. The Tax Court Correctly Held That the Windfall Tax Satisfied the Net Income Requirement.

The Windfall Tax was imposed on net income. A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by deducting from gross receipts the significant costs and expenses attributable to such gross receipts. Treas. Reg. § 1.901-2(b)(4)(i)(A).

As in the U.S., U.K. Financial Profits are also determined by deducting all related costs and expenses from realized gross revenue. Ex. 68-P ¶ 3.13, R.E. Tab C. Thus, U.K. Financial Profits are of the same nature as net income calculated under U.S. generally accepted accounting principles. Ex. 69-P ¶ 28, R.E. Tab B. Because Initial Period Profits were equal to U.K. Financial Profits, the base of the Windfall Tax was calculated in the same manner as net income in the U.S. sense. First Stip. Facts and Exs. ¶ 50, Ex. 69-P ¶¶ 32, 41, R.E. Tab B. Therefore, judged on the basis of its predominant character, the Windfall Tax satisfied the net income requirement.

B. A Simple Mathematical Exercise and Taxpayer Data Confirm That the Predominant Character of the Windfall Tax Was a Tax on Realized Net Profits.

"Quantitative and empirical evidence relating to taxpayer and to industry experience in calculating and paying foreign taxes is appropriate and relevant

in analyzing the net income requirement." *Exxon Corp.*, 113 T.C. at 358-59 (citing *Texasgulf, Inc.*, 172 F.3d at 216). Thus, the Tax Court properly considered mathematical analysis in determining how the tax operated with respect to the 29 Windfall Companies with four-year initial periods,[12] since they represented over 90 percent of all of the taxpayers subject to the Windfall Tax.[13]

The parties stipulated that for the 27 Windfall Companies with 1,461-day initial periods, the Windfall Tax statutory formula could be algebraically restated as a tax imposed, at the rate of 51.71 percent, on Initial Period Profits in excess of 44.47 percent of flotation value. The algebraic restatement results in exactly the same Windfall Tax liability as the statutory formula for the 27 Windfall Companies that had 1,461-day initial periods.[14] The restatement

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[12] For 27 of the 29 companies with four full financial years, the Initial Period consisted of 1,461 days. The two remaining companies had initial periods consisting of 1,463 and 1,456 days. First Stip. Facts and Exs. ¶ 48.

[13] Of the three remaining Windfall Companies that had initial periods of less than four years, one had no Windfall Tax liability, and the Windfall Tax liability of the other two did not exceed Initial Period Profits. *Id.* ¶ 49.

[14] Empirical data is admissible to demonstrate how a tax operates with respect to the entire field of taxpayers if the data represents the majority of taxpayers. *Texasgulf, Inc.*, 172 F.3d at 215-216. In *Texasgulf*, the data represented 84% of taxpayers. *Id.* at 215. In *Exxon*, the data represented 76 and 87 percent of taxpayers (depending on whether one or both of the two allowances were considered). 113 T.C. at 359. Thus, the algebraic restatement in the instant case is comfortably within the zone of predominance established by those cases.

differed minimally for the two other companies with slightly different four-year initial periods. First Stip. Facts and Exs. ¶¶ 58, 63, 65.

Consistent with the analysis in the *Exxon* and *Texasgulf* cases, the Tax Court also properly considered aggregate data in determining whether the Windfall Tax reached net gain. The aggregate Windfall Tax paid by all 32 Windfall Companies was £5,233,000,000. Ex. 68-P at Scheds. 4A-4B, R.E. Tab H. The aggregate Initial Period Profits for all of the companies that had Windfall Tax liability was £25,813,300,000. *Id.* Thus, the aggregate effective rate of Windfall Tax was approximately 20 percent of the aggregate Initial Period Profits. *Id.*

C. The Tax Court Correctly Held That the Windfall Tax Qualified as an Excess Profits Tax in the U.S. Sense Under Section 901 of the Code and Its Statutory Predecessors.

The foreign tax credit for "any income, war profits, or excess profits tax" dates from 1918. All subsequent reenactments have specifically referred to "excess profits taxes" in addition to "income taxes."[15]

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[15] Revenue Act of 1918, § 238; Revenue Act of 1921, § 238; Revenue Act of 1924, § 238; Revenue Act of 1925, § 238; Revenue Act of 1928, § 131; Revenue Act of 1932, § 131; Revenue Act of 1934, § 131; Revenue Act of 1936, § 131; Revenue Act of 1938, § 131; Internal Revenue Code of 1939, § 131; Internal Revenue Code of 1954, § 901; Internal Revenue Code of 1986, § 901.

An excess profits tax was first added to the U.S. tax law by the Excess Profits Tax Act, 39 Stat. 1000 (1917), which was shortly superseded by The War Revenue Act, 40 Stat. 302 (1917) and the Revenue Act of 1918, 40 Stat. 1057 (1919). The early taxes established the basic framework for U.S. excess profits taxes. A U.S. excess profits tax was a tax imposed on income in excess of a floor, which varied in amount from taxpayer to taxpayer. Ex. 69-P ¶ 21. Historically, U.S. excess profits taxes defined the excess profits subject to tax as either (or the lesser of) the income exceeding an allowed rate of return on invested capital or the income exceeding an allowed average of pretax income over a specified period. Ex. 69-P ¶ 20.

Several cases and revenue rulings either assumed or concluded that foreign excess profits taxes similar to the Windfall Tax were creditable. U.K. excess profits taxes were conceded or assumed to be creditable in three cases: *H.H. Robertson Co. v. Commissioner*, 176 F.2d 704, 707 (3d Cir. 1949) (conceding that the U.K. World War II Excess Profits Tax was creditable); *Ethyl Corp. v. United States*, 75 F. Supp. 461, 465 (Ct. Cl. 1948) (assuming that the U.K. World War II Excess Profits Tax was creditable); *Columbian Carbon Co. v. Commissioner*, 25 BTA 456, 474 (1932) (conceding that the U.K. World War I Excess Profits Tax was creditable), *acq.*, 1932-1 C.B. 2.

Additionally, IRS administrative practice has recognized foreign excess profits taxes as eligible for the U.S. foreign tax credit. Rev. Rul. 68-318, 1968-1 C.B. 342 (Italian tax on profits in excess of a percentage of capital); Rev. Rul. 56-51, 1956-1 C.B. 320 (Cuban tax on profits in excess of a percentage of capital). Another ruling concluded that a tax imposed at variable rates was creditable. Rev. Rul. 74-435, 1974-2 C.B. 204 (Swiss Cantonal tax imposed at variable rates on multi-year profits was creditable).

The U.K. Windfall Tax bore the hallmarks of previous excess profits taxes enacted in both the U.S. and the U.K. As applied to over 90 percent of the Windfall Companies, the 51.71 percent tax was imposed on profits in excess of a floor equal to 44.47 percent of flotation value. First Stip. Facts and Exs. ¶ 58. Therefore, the Tax Court correctly held that the U.K. Windfall Tax was a creditable excess profits tax under section 901 of the Code.

III. The Commissioner's Arguments Regarding the Plain Text of the Windfall Tax Act and His Opposition to Extrinsic Evidence Are Contrary to Applicable Case Law and the Rules of Judicial Procedure.

A. The Commissioner's Arguments Have No Basis in the Applicable Case Law.

Two themes permeate the Commissioner's argument on appeal: (i) creditability of a foreign tax can be determined only by his selected text of the foreign statute, and (ii) the Tax Court erred in considering extrinsic evidence

of the intent and effect of the Windfall Tax. The case law unanimously rejects the Commissioner's arguments. The test for creditability has never been whether the plain text of a foreign statute describes the foreign tax as an income tax in the U.S. sense. In an early foreign tax credit case, *Biddle v. Commissioner*, the Supreme Court stated:

> [Creditability] must ultimately be determined by ascertaining from an examination of the manner in which the British tax is laid and collected what the stockholder has done in conformity to British law and whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute.

302 U.S. at 579.

In *Phillips Petroleum Co. v. Commissioner*, 104 T.C. 256 (1995), the Tax Court evaluated the creditability of a Norwegian petroleum tax under the temporary Section 901 regulation preceding the current regulation. The Tax Court received evidence of Norway's purpose in designing the tax and how the petroleum tax operated in fact. *Id.* at 291-292, 301-302. Indeed, the Commissioner himself offered evidence about the intent of the tax[16] and expert

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[16] "Respondent's allegations that Norway sought a desired or prescribed level of compensation through enactment of the PTA was drawn from comments made by a group in committee recommendations before the [Norwegian Legislature]... ." *Phillips Petroleum*, 104 T.C. at 292.

testimony that the tax base did not approximate gross receipts.[17] Although the text of the petroleum tax statute did not satisfy the gross receipts test, the court analyzed quantitative data and found that the base of the tax, in effect, approximated gross receipts. *Id.* at 312. Therefore, the court found the petroleum tax creditable as an excess profits tax under section 901. *Id.* at 316.

In *Texasgulf*, the Tax Court and the Second Circuit evaluated the creditability of the Ontario Mining Tax ("OMT") under the current Section 901 regulation. *Texasgulf Inc. v. Commissioner*, 172 F.3d 209, 211 (2d Cir. 1999). The text of the OMT statute did not satisfy the net income requirement because it did not provide for the recovery of all significant costs and expenses. The OMT excluded deductions for investment interest, cost depletion, and royalties paid. Instead, the OMT allowed a deduction for a fixed "processing allowance." *Id.* at 212. However, the court admitted empirical evidence to determine how the OMT operated with respect to the entire industry. *Id.* at 215. Because the processing allowance exceeded nonrecoverable expenses for nearly 85 percent of taxpayers, the court found that the processing allowance effectively compensated for nonrecoverable expenses. *Id.* at 215-16. Therefore, the court

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[17] "In the case at bar, we received testimony and expert reports from three expert witnesses: petitioners put forth two experts ... respondent one expert, Peter R. Odell." *Id.* at 302.

held that the OMT reached net gain and was creditable under section 901. *Id.* at 217.

In *Exxon Corp. v. Commissioner*, 113 T.C. 338 (1999), *acq. in result*, I.R.B. 2001-31, the Tax Court evaluated the credibility under the current Section 901 regulation of taxes imposed pursuant to the United Kingdom Petroleum Revenue Act ("PRT"). The PRT did not provide for the deduction of all significant costs and expenses because interest expense deductions were disallowed. *Id* at 346. Both the Commissioner and Exxon offered testimony from United Kingdom government officials regarding the purpose of the PRT, expert testimony as to how the PRT operated, and data showing how the PRT affected taxpayers. *Id.* at 341, 342, 348, 354, 357.[18] After evaluating the evidence, the court found that the PRT provided several allowances that effectively compensated the oil companies for the disallowed interest expense.

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[18] Additionally, in *Exxon*, the Commissioner argued that it was appropriate to use quantitative data to analyze the creditability of the PRT. 113 T.C. at 359. Although it has no precedential value, the Commissioner's Action on Decision in the *Exxon* case is diametrically opposite to his current argument. In the AOD, the Commissioner stated, "While we generally believe that quantitative data should not be used exclusively to establish whether the net income requirement is satisfied, we agree that the exclusive use of such data may be appropriate in situations involving specialized taxes that apply to a limited number of taxpayers, such as the PRT." AOD CC-2001-04 (Jul. 30, 2001); Addenda B. The Windfall Tax, in the instant case, was a specialized tax that applied to a limited number of taxpayers.

Id. at 357. Thus, the court held the PRT to be creditable as an excess profits tax under Section 901. *Id.* at 359-60.

The case law is uniform. The Tax Court properly considered extrinsic evidence of intent and effect to judge the Windfall Tax on the basis of its predominant character. The Commissioner's arguments do not withstand scrutiny.

B. The Commissioner's Arguments Contravene the Rules of Judicial Procedure.

Under Tax Court Rule 146 and its identical counterpart, Federal Rule of Civil Procedure 44.1, in determining foreign law, a court may consider any relevant material or source, including testimony, whether or not submitted by a party or otherwise admissible. According to former Fifth Circuit Judge John Brown, "Rule 44.1 gives the judges in American federal courts almost *carte blanche* discretion over admissibility of such evidence." John R. Brown, *44.1 Ways to Prove Foreign Law*, 9 Tul. Mar. L.J. 179, 188 (1984).

Rule 44.1 and Rule 146 were enacted to lessen the burden of proving the content of statutes of foreign countries that attach different meanings to words than Americans do. The United Kingdom's laws are no exception. Defined statutory terms such as "windfall," "flotation," and "value in profit-making terms" have different meanings, or no meaning, in American parlance. The Tax

Court properly considered testimony regarding the intent of the drafters of the Windfall Tax, the ultimate impact of the Windfall Tax, and an algebraic restatement of the Windfall Tax to determine the meaning of the words in the Act.

Based on the cases he cites regarding legislative intent, the Commissioner would have this Court believe that the question before it involves the construction of a U.S. statute.[19] It does not. Rather, it involves whether a foreign statute satisfies the criteria established by the United States statute, regulations, and case law. None of the cases cited by the Commissioner concerning statutory construction are relevant to that inquiry.[20]

The Commissioner's argument against extrinsic evidence should not be sustained. Doing so would allow the Commissioner's argument concerning the interpretation of a treasury regulation to override the Federal Rules of Civil Procedure and the Tax Court Rules of Practice and Procedure. Thus, acceptance

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19 Appellant Br. at 38-43.

20 Furthermore, the statutory construction cases cited by the Commissioner are predicated on unambiguous statutes. However, when determining foreign law, Rule 146 and Rule 44.1 do not require ambiguity before a court can consider any evidence it deems relevant. According to the Tax Court in *Exxon Corp. v. Commissioner*, T.C. Memo 1992-92, 63 T.C.M. (CCH) 2067, 2072 (1992), "There is no ambiguity requirement in that Rule [146], and we see no reason to limit the expansive scope of its language and that of its counterpart in the Federal Rules in order to read one in." This Court affirmed the Tax Court and held that its findings of fact fully supported its conclusions. *Texaco v. Commissioner*, 98 F.3d 825, 828 (5th Cir. 1996).

of his argument would permit the Commissioner to regulate the practice of federal courts. The Commissioner does not have that power.

IV. None of the Commissioner's Arguments Withstand Scrutiny.

A. The Windfall Tax Satisfied the Three Subtests of Treasury Regulation § 1.901-2(b) Because It Was Imposed, in Substance, on Realized Profits in Excess of a Floor.

1. The Commissioner's Arguments That the Windfall Tax Was Not Imposed on Realized Income Do Not Evaluate the Intent and Effect of the Windfall Tax.

The Commissioner argues that the Windfall Tax did not satisfy the realization test because, according to its text, the tax was imposed on the difference between two values.[21] His textual argument ignores the fact that Schedule 1 of the Windfall Tax Act emphasizes that one of those two "values" was driven exclusively by realized net profits. The Commissioner's own expert testified that realized net profits were the driving force behind the Windfall Tax. During the trial, Philip Baker, the Commissioner's expert on U.K. taxation, testified as follows:

1. Windfall Tax liability could arise only if there were sufficient Initial Period Profits to cause value in profit-making terms to exceed flotation value.

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[21] Appellant Br. at 26-28.

2. Once the flotation value threshold was exceeded, Windfall Tax liability increased in the same proportion as profits increased.
3. If a company had no Initial Period Profits but its stock price tripled during the initial period, it would have incurred no Windfall Tax liability.
4. If a company had Initial Period Profits in excess of flotation value but its stock price fell during the initial period, the company would still have had a Windfall Tax liability.

Tr. at 219-222, R.E. Tab D. That testimony was confirmed by the testimony of both Professor Ball and Mr. Taub. Tr. at 256-258, R.E. Tab E; Tr. at 265-266, R.E. Tab F. Indeed, the Tax Court fully understood that the algebraic restatement demonstrated that the Windfall Tax was, in substance, a tax imposed on profits in excess of a floor. Tr. at 162-163, R.E. Tab G.

The Commissioner seizes upon the fact that all of the Windfall Tax variables were fixed at the time the tax was enacted and concludes that the tax was imposed on a company's "statutorily foregone value."[22] However, that argument ignores the manner in which the tax operated and that the "value" was derived solely from realized net profits. The Commissioner's citation to *F.W. Woolworth v. United States*, 91 F.2d 973 (2d Cir. 1937) is wholly misplaced.[23]

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22 Appellant Br. at 26.
23 Appellant Br. at 27.

The *Woolworth* court stated that a foreign levy does not become an income tax just because the foreign taxing statute labels it as such. *Id.* at 977. For the same reason, a tax on excess profits does not lose its character as an income tax or excess profits tax simply because it uses the words "value in profit-making terms."

The Commissioner's argument that profits were only a component in determining Windfall Tax Liability and not the object of the tax is simply not correct.[24] Once again, he refuses to come to grips with the intent and effect of the tax. The Windfall Tax was directed at the excess profits of the privatized companies. *PPL Corp.*, 135 T.C. at 309-310. That intent was stated in the Budget Speech by Chancellor of the Exchequer Gordon Brown on July 2, 1997;[25] the U.K. Inland Revenue announcement dated July 2, 1997, concerning the proposed U.K. Windfall Tax;[26] and the publication titled "Explanatory Notes Summer Finance Bill 1997 – HM Treasury – July 1997."[27] That intent was corroborated by the testimony of Geoffrey Robinson, a senior Labour member of Parliament and a member of the shadow Treasury team tasked with drafting the Windfall Tax, who testified, "The whole thing [i.e., the purpose of the

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24 Appellant Br. at 26-28.
25 *PPL Corp.*, 135 T.C. at 314.
26 *Id.*
27 *Id.* at 315.

Windfall Tax] is about the profits. Had there been no excess profits, there would be no tax." Tr. at 107. That intent was further corroborated by Christopher Osborne and Christopher Wales, members of the Arthur Andersen team who were hired by Mr. Robinson to assist in the development of the Windfall Tax. *PPL Corp.*, 135 T.C. at 325. Finally, the algebraic restatement confirms that the Windfall Tax was imposed on excess profits.

The Commissioner offered Peter Ashton,[28] who testified that price-to-earnings ratios such as a market multiples method are used to determine company value.[29] The Commissioner cites cases in which a company was valued based on a multiple of net earnings to demonstrate that the Windfall Tax could only have been imposed on value. However, the mere mention of a valuation term does not disqualify a levy from being an income tax. Simply put, Mr. Ashton's testimony and the valuation cases the Commissioner cites fail to

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[28] Appellant Br. at 27-28.

[29] Mr. Ashton's testimony was refuted by Professor Ball, who testified that a single price multiple is rarely used by itself without numerous other factors being considered. Ex. 69-P ¶ 51. In *PPL*, Professor Stewart Myers rejected Mr. Ashton's testimony, stating, "9 is not an accurate P/E multiple, and it is not applied to current or expected future earnings ... [Therefore,] 'value-in-profit-making terms' cannot measure the economic value that companies could, would, or should have had." *PPL Corp.*, 135 T.C. at 326 n.17. Also, Christopher Osborne, a member of the Andersen team involved in designing the tax, testified that value in profit making terms "is not a real value: it is rather a construct based on realised profits that would not have been known at the date of privatisation, and a mechanism by which additional taxes on profits could be levied." *Id.* at 338 n.29.

recognize how the Windfall Tax was intended to operate and how it operated in fact.

Finally, the Commissioner argues that because London Electricity's Windfall Tax base exceeded its Initial Period Profits, the Windfall Tax must have been imposed on something other than profits, which just repackages his assertion that a tax based on a multiple of net income cannot be an income tax.[30] Such an argument elevates form over substance. Parliament's decision to enact a tax equal to 23% of nine times average Initial Period Profits less flotation value instead of 51.71% of Initial Period Profits less 44.47% of flotation value, where each formulation produces the same tax,[31] does not lead to the conclusion that one is creditable and the other is not. Such a conclusion would represent precisely the kind of reliance on form and labels that the courts in *Bank of America* and *Inland Steel*, *supra*, rejected.

The facts are that London Electricity's Windfall Tax liability was £139,962,622. Its Initial Period Profits were £503,400,000, and the restated base upon which the tax was imposed (Initial Period Profits less 44.47% of flotation value) was £270,644,421. Those facts demonstrate that both the Windfall Tax and the base on which it was imposed were far less than the profits

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30 Appellant Br. at 29-30.

31 First Stip. Facts and Exs. ¶¶ 54-58.

earned during the four-year initial period. The fact that the form of the statute recited a tax base in excess of profits did not change the fact that the substance of the Windfall Tax was a tax on excess profits. Nothing in the history or text of the section 901 regulations evinces abandonment of substance-over-form principles.

2. The Commissioner's Arguments That the Windfall Tax Did Not Satisfy the Gross Receipts Test or the Net Income Test Further Elevate Form Over Substance.

According to the Commissioner, the Windfall Tax failed the gross receipts and net income tests because "the Windfall Tax statute makes no mention at all of gross receipts or gross income."[32] However, he does not argue that the measurement of Initial Period Profits failed those tests. Rather, he argues that the Windfall Tax was not creditable because the Act did not use the correct buzz words.

Next, the Commissioner argues that the gross receipts test was not satisfied because the tax was imposed on the *difference* between two values, and thus, the tax base was "divorced from any traditional concept of gross receipts."[33] The Commissioner's use of italics to emphasize the word "difference" seems to imply that any time a tax is imposed on the difference

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32 Appellant Br. at 32.

33 Appellant Br. at 33.

between two values, it does not reach gross receipts. What he fails to acknowledge is that one of those two "values" – "value in profit-making terms" – was derived from the taxpayer's U.K. Financial Profits, which was in turn derived from "turnover" less expenses. Ex. 68-P ¶¶ 3.13, 9.14, R.E. Tab C. "Turnover" in the U.K. system is equivalent to the U.S. concept of gross revenue. Ex. 69-P ¶39. And Financial Profit in the U.K. system is equivalent to the U.S. concept of net income. *Id.* ¶28, R.E. Tab B. Thus, there can be no reasonable doubt that the Windfall Tax passed both the gross receipts and net income tests of the regulation. Its failure to use those terms is irrelevant.

B. The Commissioner's Characterization of the Tax Court's Analysis of the Windfall Tax Is Inaccurate.

The Commissioner mischaracterizes the Tax Court's analysis by arguing that the court failed to consider the realization, gross receipts, and net income tests under Treasury Regulation § 1.901-2(b).[34] In essence, the Commissioner argues that the Tax Court committed legal error because it failed to recite the three subtests in Treasury Regulation § 1.901-2 verbatim and then mechanically apply the words of the Windfall Tax to those subtests. As discussed above, the Tax Court evaluated the predominant character of the Windfall Tax at length. The Tax Court found that because both the design and effect of the Windfall Tax

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[34] Appellant Br. at 17, 19, 24, 34.

were to tax what would be considered excess profits under U.S. tax principles, the Windfall Tax reached net gain in the normal circumstances in which it applied. *PPL Corp.*, 135 T.C. at 341. By definition, an excess profits tax under U.S. principles satisfies the realization, gross receipts, and net income tests. Thus, the Commissioner's argument merely applies his form-over-substance mantra in this case to the Tax Court's analysis. In the Commissioner's view, just as a foreign tax is not creditable unless it recites the literal language of the regulation verbatim, the Tax Court's opinion is invalid for the same reason.

Additionally, the Commissioner argues that the Tax Court disregarded how the Windfall Tax liability was calculated and instead simply declared that the tax reached net gain because book income exceeded the tax liability.[35] That mischaracterization completely ignores the expert reports and testimony of Michael Taub and Professor Raymond Ball. Exs. 68-P, 69-P. Each submitted a report stating that U.K. Financial Profits are calculated by deducting costs and expenses from realized gross revenue to reach net profits. Ex. 68-P ¶ 3.13, R.E. Tab C; Ex. 69-P ¶ 32, R.E. Tab B. The Commissioner offered no testimony to refute that conclusion.

Professor Ball testified that the algebraic restatement of the Windfall Tax formula demonstrates that the Windfall tax was, in substance, imposed on

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[35] Appellant Br. at 35.

profits. Tr. at 161-163, R.E. Tab G. The Commissioner's own U.K. tax expert testified that the driving force behind the Windfall Tax was profits, not value. Tr. at 219-222, R.E. Tab D. Indeed, the Tax Court fully understood that the algebraic restatement demonstrated that the Windfall Tax was, in substance, a tax imposed on profits in excess of a floor. Tr. at 162-163, R.E. Tab G. In sum, the Tax Court considered evidence of intent and effect to determine whether the Windfall Tax operated on excess profits. To argue, as the Commissioner now does, that the Tax Court declared the tax creditable merely because book income exceeded the tax liability ignores the record in both this case and *PPL Corp.*

C. Treating the Windfall Tax as an Excess Profits Tax Does Not Create the Potential to Convert Any Foreign Tax Into a Creditable Income Tax.

The Commissioner attempts to alarm the court by suggesting that a holding for Entergy would render creditable any value-based tax simply by expressing value as a function of income.[36] The Commissioner's argument is a gross overstatement. For example, a 23 percent tax on the value of property, with value measured at nine times annual earnings, would be the equivalent of an income tax imposed at a 207 percent rate. Obviously such a tax would not be creditable because the amount of the levy would be more than twice the income on which it was imposed — it would not reach net gain, it would eliminate it.

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[36] Appellant Br. at 43.

What distinguishes the Windfall Tax from the hypothetical tax just described is that the base was not nine times earnings; rather, it was nine times average earnings over a four-year period less flotation value. As has been demonstrated, those important features made the Windfall Tax the equivalent of a 51.7 percent tax on profits in excess of 44.47 percent of flotation value — a tax that took only a portion of net gain, as any traditional income or excess profits tax does. That such a tax is creditable, despite any unusual wording it might employ, is precisely the teaching of *Biddle*, *Bank of America*, *Exxon*, and *Texasgulf*. Thus, the Court should not take the Commissioner's bait unless it intends to overrule an unbroken line of cases that form the very bedrock of foreign tax credit jurisprudence.

The Commissioner's argument reflects his fundamental misunderstanding of the algebraic restatement. An algebraic restatement does not by itself make a foreign tax creditable. The algebraic restatement neither eliminates key terms, nor is it offered as a representation of Parliament's intent as the Commissioner argues.[37] The restatement is offered only as evidence of the effect of the Windfall Tax. The Windfall Tax is creditable because the totality of the evidence proves that the intent and effect were to tax the excess profits of the Windfall Companies.

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[37] Appellant Br. at 45-46, 48.

CONCLUSION

For the foregoing reasons, Appellees respectfully request that this Court affirm the Tax Court's ruling and hold that the U.K. Windfall Tax imposed on London Electricity in 1997 was a creditable tax for purposes of section 901 of the Code.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 11, 2011, I electronically filed the foregoing brief with the Clerk of the Court using the CM/ECF System, which will send notice of such filing to the following registered CM/ECF user:

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