No. 10-60988

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

ENTERGY CORPORATION AND
AFFILIATED SUBSIDIARIES,

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ON APPEAL FROM THE DECISION OF THE
UNITED STATES TAX COURT

REPLY BRIEF FOR THE APPELLANT

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

THOMAS J. CLARK (202) 514-9084
FRANCESCA U. TAMAMI (202) 514-1882
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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This reply brief addresses only those points contained in the answering brief of Entergy Corporation and its affiliated subsidiaries (collectively "taxpayer") that we believe warrant a response. With respect to points not addressed, we rely on our opening brief.

In our opening brief, we argued that the Tax Court erred in ruling that the United Kingdom windfall tax was a creditable foreign tax

under I.R.C. § 901 (26 U.S.C.).[1] We pointed out that the applicable Treasury regulation, Treas. Reg. § 1.901-2 (26 C.F.R.), provides that a foreign levy is a creditable income tax if its predominant character is that of U.S. income tax, and that the regulation sets forth a mandatory three-part test for determining whether the predominant-character standard is met, *i.e.,* the realization test, gross-receipts test, and net-income test. We argued that the Tax Court failed to apply the three-part test in ruling that the predominant character of the windfall tax was that of an excess-profits tax and that, when the test is applied, it is apparent that the windfall tax was not a creditable foreign income tax. We also argued that the Tax Court erred because it improperly substituted consideration of Parliamentary intent and a mathematical reformulation of the windfall tax for an evaluation of the tax base as set forth in the U.K. statute.

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[1] Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended ("I.R.C."). "Doc." references are to the documents comprising the original record on appeal, as numbered by the clerk of the Tax Court and transmitted to this Court, and "Tr." references are to the trial transcript. "Br." refers to taxpayer's answering brief.

A. Taxpayer's discussion of the regulatory test is predicated on its incorrect assumption that the windfall tax was imposed on past profits

Taxpayer agrees that the three-part test of Treas. Reg. § 1.901-2(b) "controls the outcome of this case" by setting forth the governing standard for determining whether a foreign tax has the predominant character of a U.S. income tax and, thus, is creditable. (Br. 12.) Taxpayer disputes our claim that the Tax Court failed to apply the regulatory test, but taxpayer ultimately does not explain how the Tax Court purportedly applied the regulation. (Br. 16, 36-37.) It is clear from the Tax Court's opinion that there is no analysis of whether the windfall tax met any of the three regulatory subtests, all of which had to be met for the tax to be creditable. *See Mayo Foundation for Medical Education & Research v. United States*, 131 S. Ct. 704 (2011) (Treasury regulation provided the standard that governed the outcome of the case).[2]

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[2] Taxpayer contends that *Mayo* is "inapplicable to this case" because "there is no question that Treasury Regulation § 1.901-2 is a reasonable construction of a Congressional statute." (Br. 12, n.8.) But *Mayo* does apply because it reaffirms that a Treasury regulation that is a reasonable construction of a statute (such as Treas. Reg. § 1.901-2)

(continued...)

In our opening brief (at 25-31), we argued that the realization test was not met because the windfall tax was a tax on foregone company value, and not a tax on realized income. In response, taxpayer simply assumes its desired conclusion, *i.e.,* that "[t]he Windfall Tax was imposed on U.K. Financial Profits." (Br. 17.) In support of this conclusory assertion, taxpayer cites to paragraph 50 of the parties' stipulation of facts, but that citation does not support taxpayer. Paragraph 50 merely restates the windfall-tax statute's definition of profit for a company's initial period, which was merely one component in determining a company's profit-making value, which, in turn, was merely one element used to determine the tax base. (Doc. 31, ¶50.) Taxpayer further states, incorrectly, that "[t]he calculation of the Windfall Tax was based on Initial Period Profits" (Br. 17), but that plainly is not the case. The calculation of *profit-making value* was based, in part, on initial period profits. But, as the U.K. statute makes clear, the base upon which the windfall tax was imposed was the

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[2](...continued)
has the force of law. Here, the Tax Court was required to apply the three-part regulatory test, but it did not do so.

difference between two statutorily defined values, profit-making value and flotation value—*not* on initial period profits. (Doc. 31, Ex. 18-J (Part I, ¶1(1) & Sch. 1, ¶1)) (*available in* Appellant's Record Excerpts, Tab 7).

Taxpayer contends that it would be "factually impossible" for the windfall tax to be imposed prior to realization, observing that the U.K. government knew in advance how much revenue the tax would yield and arguing that that yield could not have been known if the profits had not been realized. (Br. 17-18.) Once again, however, taxpayer's argument proceeds from its faulty assumption that the windfall tax was imposed on past profits. In any event, to say that the windfall tax was a tax on past profits because the U.K. government knew how much revenue the tax would yield is a non sequitur. It is merely the unsurprising consequence of the fact that the windfall tax was a retrospective tax. Virtually every component of the tax had been established by historical events, *i.e.,* the length of each company's initial period, the reported profits during those initial periods, the number of shares offered at flotation, and the price of those shares. The tax rate and price-to-earnings ratio of 9 were established by

statute. Thus, the U.K. government knew in advance what each company's profit-making value and flotation value would be under the statutory formula. The fact that profit-making value was computed using historical data is not indicative of whether the windfall tax was a tax on past profits.[3]

In our opening brief (at 31-34), we also argued that the windfall tax failed to meet the gross-receipts and net-income tests because the base of the tax was not gross receipts less expenditures. This argument followed directly from the plain language of the Treasury regulation, which states that a foreign tax has the predominant character of a U.S. income tax *only if* "it is imposed on the basis of . . . gross receipts" (§ 1.901-2(b)(3)(i)(A)), and if "the base of the tax is computed by reducing gross receipts" by expenses attributable to those receipts

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[3] When valuing a company, it is, to be sure, not uncommon to estimate the company's *prospective* earnings, and to multiply those earnings by a price-to-earnings ratio. (Ex. 75-R at 11.) In this case, however, Parliament sought to determine a company's value at a specific time in the past, and it thus did not have to estimate earnings; it could rely, instead, on actual, historical earnings. That Parliament was able to rely upon this perfect knowledge (*i.e.,* historical earnings) in determining value at a point in the past does not transform what is, at bottom, a tax on the difference between two values into a tax on those past earnings.

(§ 1.901-2(b)(4)(i)). In its brief, taxpayer makes no serious effort to show that the windfall tax satisfied the gross-receipts or net-income tests. Instead, it argues only that "Initial Period Profits are derived from U.K. Financial Profits," which, in turn, are based upon actual gross receipts. (Br. 19.) Under the regulation, however, it does not matter that one of the several factors used to compute the tax base is "derived from" gross receipts. The regulation requires that "the base of the tax [be] computed by reducing gross receipts" by applicable expenses, and this regulation has the force of law. *See Mayo*, *supra*. Taxpayer has not even attempted to argue (because it cannot do so) that the base of the windfall tax was computed in this manner.[4]

Taxpayer criticizes our analysis of the regulatory test as elevating form over substance, and it describes our argument as hinging on "labels" and on the windfall-tax statute's failure to "use the correct buzz

[4] Elsewhere in its brief, taxpayer states that "the restated base upon which the tax was imposed" was "Initial Period Profits less 44.47% of flotation value." (Br. 34.) This should be rejected out of hand. A taxpayer should not be permitted to rewrite a foreign statute to secure for itself a foreign tax credit. The U.K. statute unambiguously expressed the tax base as profit-making value less flotation value.

words." (Br. 34, 35.) Our argument, however, does not rest on labels or on the absence of "buzz words," but on the plain language of the Treasury regulation, which the Tax Court was required to apply. *See Mayo, supra.* Under the regulatory standard, the essential substance and structure of the windfall tax, as set forth in the U.K. statute, is not that of a U.S. income tax. In other words, in this case, the statute's form reflects its substance. As explained in our brief (at 22), the base of the U.S. income tax is gross income less allowable deductions, and the tax rate is then applied to the resulting amount of taxable income. The base of the windfall tax, in contrast, is the difference between two *values*, and the tax rate is then applied to that difference. Each value in the formula accords with a recognized method of computing company value, *i.e.,* price-to-earnings ratio multiplied by company profits, on one side, and share price at flotation multiplied by the number of shares, on the other. Neither side of the equation seeks to approximate gross receipts or allowable expenditures, while using alternate labels or buzz words. The windfall tax is thus qualitatively different from a U.S. income tax.

B. The windfall tax was a tax on the difference between two values, and taxpayer's arguments recharacterizing it as a tax on income are not persuasive

In our opening brief (at 26-29), we argued that the plain language of the U.K. statute shows the windfall tax to be a tax on the difference between two values, and we pointed out that the Supreme Court long ago recognized that a tax on value is fundamentally different from a tax on income. Taxpayer has not disputed our argument that a tax on value is fundamentally different from a tax on income, nor can it. Rather, taxpayer sidesteps this point by arguing that "one of those two 'values' was driven exclusively by realized net profits" and contending that the Commissioner's U.K. law expert, Philip Baker, so testified. (Br. 30.) Taxpayer is wrong on both counts.

First, profit-making value was not driven "exclusively" by profits. Nor was value "derived solely from realized net profits," as taxpayer contends. (Br. 31.) Rather, profit-making value depended on additional factors that were selected by Parliament: the price-to-earnings ratio of 9 and the number of days in each company's initial period. (Doc. 31, Ex. 18-J (Sch. 1, ¶2)) (*available in* Appellant's Record

Excerpts, Tab 7). The presence of the price-to-earnings ratio, in particular, confirms that profit-making value was a value concept, not an income concept. Taxpayer contends that the "intent" of the profit-making-value formulation was to tax excess profits (Br. 32), but the materials it cites in support of that contention confirm that profit-making value was intended to capture company value. (*See* Doc. 31, Ex. 16-P, ¶3 & Ex. 17-P, ¶9.)

Second, with respect to Baker's testimony, nowhere did he testify that realized net profits were the "driving force" behind the windfall tax, as taxpayer twice asserts (Br. 30, 38). Although Baker did agree, on cross-examination, with the four bullet points listed on pages 30-31 of taxpayer's brief, those points do not establish that the windfall tax was, in substance, a tax on net profits. As to the first bullet point (that "Windfall Tax liability could arise only if there were sufficient Initial Period Profits to cause the value in profit-making terms to exceed flotation value" (Br. 30)), this is hardly a smoking gun. Clearly there would be no tax if there had been no windfall. As to the second bullet point (that "[o]nce the flotation value threshold was exceeded, Windfall Tax liability increased in the same proportion as profits increased" (Br.

31)), this is merely the mathematical consequence of basing profit-making value, in part, on profits. As to the third and fourth bullet points (regarding the effect of increases or decreases in a company's stock price (Br. 31)), they are irrelevant. The windfall-tax computation did not take into account increases or decreases in stock price, so those fluctuations obviously would not affect windfall tax liability.

Moreover, when questioned further, Baker clearly stated his opinion that "[t]he formula is more than just looking at the profits shown in the accounts. There are other elements, as His Honor, the Judge, pointed out. There are other elements that go into computing the tax." (Tr. 230; *see* Tr. 227-30.) Baker also testified that if two companies had the same profits, but they had different flotation values, they would not have paid the same amount of windfall tax "because the difference between the two values would have been different for the two companies." (Tr. 231.) The fact that two companies with identical profits could have different windfall tax liabilities absolutely refutes the notion that the tax was imposed on net profits.

Taxpayer does not seriously dispute that the windfall tax was expressed in the statute as a tax on the difference between two values,

although it attempts to undermine that fact in footnote 29 of its brief. In that footnote, taxpayer suggests that profit-making value was not a true reflection of company value, stating that "a single price multiple is rarely used by itself without numerous other factors being considered." (Br. 33, n.29.) Taxpayer cites to Raymond Ball's expert report and the testimony of two experts from the *PPL* case as excerpted in the Tax Court's opinion in *PPL*.[5] But whether profit-making value was an economically perfect formula for ascertaining company value is not the point. This is not a valuation case in which the court had to determine the "best" valuation method. And there were bona fide governmental reasons for enacting a simple formula. (*See* Commissioner's Br. 47-48.) Indeed, the Tax Court apparently recognized that whether profit-

[5] The testimony of the *PPL* experts, Stewart Myers and Christopher Osborne, is not part of the record in this case. Other portions of Myers's testimony and expert report, which were not reproduced in the Tax Court's opinion, acknowledge that multiplying earnings by a price-to-earnings ratio is a recognized method for estimating the economic value of a company. Osborne, a member of the Andersen team, was not an economics or accounting expert, and his opinion as to whether profit-making value was a "real value" is entitled to no weight. Moreover, other testimony in the *PPL* case established that it was Parliamentary counsel, and not the Andersen team, that devised the statutory term "value in profit-making terms." Thus, the Andersen team's view of the term is entirely irrelevant.

making value yielded a precise economic value was irrelevant, as it declined to decide the question. (PPL Op. 54.) Rather, the issue in this case is simply understanding the statutory term. The statute used the term "value"; the U.K. government's explanations of the term unequivocally state that it approximated "company value" (Doc. 31, Ex. 16-P, ¶3 & Ex. 17-P, ¶¶8-9); and members of Parliament recognized during the debate of the windfall tax that it was expressed as a tax on company value, *see* Debate of Finance Bill, U.K. House of Commons, Standing Committee A, 2d Sitting, Part II (July 17, 1997, 11pm) ("Because of the way in which schedule 1 is drafted, the windfall tax taxes the increase in value of the company during those four years. It is effectively a capital gains tax on a company's increase in value.") (Statement of Nick Gibb).[6]

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[6] The debate transcript is available at http://www.publications.parliament.uk/pa/cm199798/cmstand/a/cmfinb.htm. During the July 17, 1997 debate, there was extensive discussion of the rationale for the profit-making-value formula and the selection of the price-to-earnings ratio. The profit-making-value formula was criticized by some members of Parliament for being too simplistic and unfair, but Geoffrey Robinson defended the formula, stating that "simplicity has great merits," including reducing the opportunities for tax avoidance. He also explained that a more tailored formula (*e.g.,* that used a different

(continued...)

Finally, taxpayer argues that the form and structure of the windfall tax simply do not matter, stating that "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 44.7% of flotation value . . . does not lead to the conclusion that one is creditable and the other is not." (Br. 34.) As an initial matter, there is no evidence that Parliament ever considered enacting a tax of "51.71% of Initial Period Profits less 44.7% of flotation value." That formulation comes entirely from taxpayer. In any event, as argued in our opening brief (at 38-43), both this Court and the Supreme Court have held that in determining federal tax consequences, the form chosen by the legislature does matter. *See AT&T, Inc. v. United States*, 629 F.3d 505, 514 & 520 (5th Cir. 2011); *United States v. Miss. Chemical Corp.*, 405 U.S. 298, 311-12 (1972). Taxpayer offers no response to our discussion of those cases.

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[6](...continued)
price-to-earnings ratio for each sector) would have increased the windfall tax burden from a projected £5 billion to £17 billion.

C. Taxpayer would have this Court accord no weight to the text of the windfall-tax statute

Unable to escape the fact that the windfall tax is, on its face, a tax on the difference between two values—and, thus, not an income tax in the U.S. sense—taxpayer resorts to arguing that the text of the foreign statute is not determinative of whether it is a creditable tax under I.R.C. § 901. Instead, taxpayer relies almost exclusively on extrinsic evidence of the design and operation of the windfall tax to make the case that it was a tax on excess profits.[7]

In discussing the appropriate role of extrinsic evidence in the foreign-tax-credit context, taxpayer misunderstands the Commissioner's argument on appeal. (*See* Br. 14, 29.) The Commissioner does not contend (as he did below) that extrinsic evidence has no relevance in determining creditability under Treas. Reg. § 1.901-2(b). Rather, our argument is that it was improper for the Tax Court to *supplant* an analysis of the windfall-tax statute with an analysis of extrinsic evidence. (*See* Commissioner's Br. 36.) Even if

[7] The only portion of the windfall-tax statute that appears to matter to taxpayer is the reference to initial period profits which, as previously explained, taxpayer isolates out of context.

extrinsic evidence is relevant, it cannot entirely displace consideration of the plain language of the windfall-tax statute, as the Tax Court and taxpayer would have it. Moreover, we argued that the *type* of extrinsic evidence relied on by the Tax Court here (*i.e.,* the mathematical reformulation created by taxpayer's expert and the post-enactment testimony of Geoffrey Robinson and members of the Andersen team) lacks probative value.[8] (*See* Commissioner's Br. 50.)

[8] Thus, taxpayer's reliance (Br. 28) on Tax Ct. R. 146 is misplaced. Rule 146 states that "[t]he Court, in determining foreign law, may consider any relevant material or source, including testimony, whether or not submitted by a party or otherwise admissible." The rule "was intended to provide flexible procedures for presenting and utilizing material on issues of foreign law." *Owens-Illinois, Inc. v. Commissioner*, 76 T.C. 493, 496 (1981) (internal quotations omitted). But we are not arguing that the extrinsic evidence supplied by taxpayer was inadmissible. Instead, our argument is that the Tax Court erred in focusing exclusively on extrinsic evidence—to the exclusion of the windfall-tax statute itself—in determining the predominant character of the windfall tax. And we dispute the probative value of the particular type of extrinsic evidence offered here. Rule 146 does not speak to either of these points.

1. Contrary to taxpayer's arguments, the creditability analysis required by the Treasury regulation and case law begins with the tax base as set forth in the foreign statute

Taxpayer argues that our focus on the base of the windfall tax as set forth in the U.K. statute is "inconsistent" with Treas. Reg. § 1.901-2 (Br. 12, n.8) because the regulation instructs that the analysis is to be based on the "predominant character" of the tax (Br. 9, 14). But taxpayer overlooks the fact that the regulation sets forth a three-part "if and only if" test for determining whether the predominant character is that of a U.S. income tax. Treas. Reg. § 1.901-2(a)(3)(i) & (b)(1). *See Texasgulf, Inc. v. Commissioner*, 172 F.3d 209, 216 (2d Cir. 1999) ("Although § 1.901-2's preamble reaffirms *Inland Steel's* general focus upon the extent to which a tax reaches net gain, both the preamble and § 1.901-2 introduce three detailed tests for conducting the net gain inquiry."). And the regulation makes clear that the inquiry is directed to the tax base as set forth in the foreign statute: "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 reducing gross receipts . . . to permit recovery of the significant costs and

expenses . . . attributable, under reasonable principles, to such gross receipts." Treas. Reg. § 1.901-2(b)(4)(i) (emphasis added). Because the regulation explicitly requires an inquiry into how the tax base is computed, it is hard to imagine where the analysis would begin if not with the text of the foreign statute.

Regarding the proper role of extrinsic evidence, taxpayer's discussion of the case law (Br. 20-22, 25-28) both understates the extent to which the text of the foreign statute was determinative and overstates the extent to which extrinsic evidence was determinative. In none of the cases did the foreign statute purport to tax the difference between two values, as the windfall tax does. In *Texasgulf* and *Exxon Corp. v. Commissioner*, 113 T.C. 338 (1999), in particular, the base of the tax as set forth in the foreign statute was gross receipts less certain expenses, just as the Treasury regulation requires. The question in those cases was whether the expense allowance was sufficient to meet the net-income test. In none of the cases did extrinsic evidence actually *supplant* the text of the foreign statute, as in this case.

For example, in *Texasgulf*, the issue was whether the Ontario Mining Tax was creditable. As the Second Circuit observed, the foreign

statute expressly imposed tax on a mine's "profit" to the extent it exceeded a statutory exemption. 172 F.3d at 211. "Profit" was defined in the statute as the difference between gross receipts from mine output and certain mine expenses. *Id.* at 211-12. The parties stipulated that the mining tax met the realization and gross-receipts tests of the regulation. *Id.* at 215.

The only question was whether the net-income test was met in light of the fact that the mining-tax statute did not allow certain significant expenses to be deducted in computing the tax base. *Id.* at 212 & 215. The Second Circuit applied an alternative net-income test set forth in the regulation (that is not at issue in this case), which looks at whether any allowances "effectively compensate for [the] nonrecovery of [ ] significant costs or expenses." Treas. Reg. § 1.901-2(b)(4)(i). The court stated that "the language of § 1.901-2—specifically, 'effectively compensate' and 'approximates, or is greater than'—suggests that quantitative empirical evidence may be just as appropriate as qualitative analytical evidence in determining whether a foreign tax meets the net income requirement." 172 F.3d at 216. The court concluded that the alternative net-income test was met based on

industry data showing that a processing allowance effectively compensated for the nonrecoverable expenses. *Id.* at 215-16. That conclusion hardly supports taxpayer's view here that the court may rely upon extrinsic evidence to rewrite the text of a foreign statute—in which the tax base is the difference between two statutorily defined values—to make it comply with the Treasury regulation.

Similarly, in *Exxon*, the issue was whether the U.K. petroleum revenue tax was a creditable foreign tax. The Tax Court observed that the petroleum tax "replaced the U.K. corporation income tax as it otherwise would have applied to activities of oil and gas companies" and was "structured as" a corporate income tax. 113 T.C. at 344. The court also observed that the express statutory provisions of the tax "include in the tax base, with limited exceptions, income earned from North Sea-related activity and permit allowances, reliefs, and exemptions." *Id.* at 356. Thus, the parties had stipulated that the tax met the realization and gross-receipts tests, and the only remaining question was whether the net-income test was met in light of the statute's disallowance of certain expense deductions. *Id.* at 352-53. As in *Texasgulf*, extrinsic evidence showed that certain allowances

effectively compensated for the nonrecoverable expenses, such that the alternative net-income test was met. *Id.* at 357-59. Extrinsic evidence was not used to fundamentally transform a non-creditable tax on foregone company value into a tax on net income, as it was here.[9]

In *Phillips Petroleum Co. v. Commissioner,* 104 T.C. 256 (1995), the issue was whether Norwegian "special charges" on petroleum exploitation constituted taxes and, if so, whether they were creditable. Notably, in ruling that the charges were taxes (and not royalties), the Tax Court stated that "the distinction between a royalty interest and a tax can only be determined by an examination of the particularities involved in the imposition of the charges. While labels should not be determinative in the question of creditability, *the declaration of the*

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[9] *Texasgulf* and *Exxon* thus lend no support whatsoever to taxpayer's "aggregate data" argument. (Br. 22.) Taxpayer observes that the total windfall tax paid by the 32 affected companies was £5 billion and that the companies' aggregate initial period profits was £25 billion, and taxpayer thus deduces that "the aggregate effective rate of Windfall Tax was approximately 20 percent of the aggregate Initial Period Profits." (Br. 22.) Neither case supports this grossly oversimplified manner of examining the windfall tax. Any tax can be mathematically expressed as a percentage of the taxpayer's income. Taxpayer's illustration provides no insight into whether the windfall tax satisfies the three-part test of the regulation.

lawmaking power is entitled to much weight. We cannot close our eyes to the fact that the legislation Norway enacted was entitled the P[etroleum] T[ax] A[ct]." *Id.* at 295-96 (emphasis added).

On the issue of creditability, the Commissioner had conceded that the realization test was met. The court went on to conclude that the gross-receipts test was met under an alternative provision of the regulation (also not at issue in the present case) that looked at whether gross receipts were "computed under a method that is designed to produce an amount that is not greater than fair market value and that, in fact, produces an amount that approximates, or is less than, fair market value." *Id.* at 297-98 (quoting temporary Treasury regulation then in effect). The court also determined that the net-income test was met because—in contrast to the windfall tax—the Norwegian taxes were "computed, without substantial deviation, by reducing a taxpayer's gross receipts with the expenses and capital expenditures attributable thereto." *Id.* at 315.

Finally, taxpayer's reliance on *Biddle v. Commissioner*, 302 U.S. 573 (1938), is entirely misplaced. (Br. 9, 13, 25.) The issue in that case was whether the stockholders of British corporations could be

considered the payors of the corporations' British tax. The Supreme Court held that that determination had to be made by applying U.S. law, not British law. The Supreme Court went on to hold that the stockholders could not be considered the payors of the tax and, thus, it did not reach any further questions of creditability. *Id.* at 583.

In sum, the case law does not support the approach taken by the Tax Court here. In *Texasgulf, Exxon,* and *Phillips Petroleum*, the courts expressly found that the foreign tax satisfied the gross-receipts and net-income tests of the regulation. The Tax Court made no such finding in this case. The court's holding that a tax that a foreign statute imposes on the difference between two values is a creditable income tax is unprecedented, and is contrary to I.R.C. § 901.

2. The extrinsic evidence relied on by taxpayer here lacks probative value and should not have been accorded determinative weight

In our opening brief (at 43-55), we also argued that the Tax Court erred in according probative weight to the mathematical reformulation of the windfall tax submitted by taxpayer's expert and to the post-enactment testimony of legislative intent offered by Geoffrey Robinson and the Andersen team. We argued that under well-established U.S.

case law, neither type of evidence is a reliable indication of Parliament's intent in enacting the windfall tax.

In response, taxpayer dismisses our entire argument on the basis that U.S. principles of statutory construction purportedly do not apply in this case. (Br. 29.) According to taxpayer, because this case does not involve construction of a U.S. statute, the case law relied on by the Commissioner is irrelevant. Taxpayer's position is untenable. First, in *Biddle*, the Supreme Court made clear that the determination whether a foreign tax meets the criteria for creditability under the Internal Revenue Code turns on "our own revenue laws." 302 U.S. at 578-79. *See also Bank of America Nat'l Trust & Sav. Ass'n v. United States*, 459 F.2d 513, 515 (Ct. Cl. 1972) ("It is now settled that the question of whether a foreign tax is an 'income tax' within § 901(b)(1) must be decided under criteria established by our revenue laws and court decisions[.]"). Thus, it is entirely appropriate to utilize U.S. principles of statutory interpretation to interpret the U.K. windfall tax for federal tax purposes.

Second, taxpayer misunderstands our reliance on the case law. We did not cite to the case law to provide the framework for

interpreting the windfall-tax statute; rather, we cited to that case law to emphasize the elementary points that Parliament's intent is best reflected in the language of its statute, and that the post-enactment testimony of legislators and expert witnesses regarding legislative intent is "of scant or no value." *Graham Co. Soil & Water Conservation District v. United States*, 130 S. Ct. 1396, 1409 (2010).

Finally, taxpayer argues that the fundamental rules of statutory construction should not apply to the windfall-tax statute because the statutory terms "windfall," "flotation," and "value in profit-making terms" have "different meanings" than they do in "American parlance." (Br. 28.) It does not matter, however, whether these terms have different meanings, or any meaning at all, in "American parlance." The critical point is that Parliament clearly defined each of these terms in the windfall-tax statute, and there is no reason to look elsewhere to discern their meaning.

D. Taxpayer's remaining arguments lack merit

Taxpayer argues that the Tax Court correctly held that the windfall tax was an excess-profits tax, arguing that the windfall tax is structurally similar to historical U.S. and U.K. excess-profits taxes. (Br. 22-24.) The Treasury regulation provides, however, that to be a creditable excess-profits tax, the tax nevertheless must have the predominant character of a U.S. income tax, and that a tax has this character only if it meets the three-part test that governs this case. *See* Treas. Reg. § 1.901-2(a)(1) ("Section 901 allows a credit for the amount of income, war profits or excess profits tax (referred to as 'income tax' for purposes of this section and §§ 1.901-2A and 1.903-1) paid to any foreign country."). The cases and revenue rulings cited by taxpayer (Br. 24) are not to the contrary, as all of the cited rulings predate the 1983 Treasury regulation. In short, structural similarity to historical excess-profits taxes is insufficient to establish creditability. The foreign tax must meet the realization, gross-receipts, and net-income tests of Treas. Reg. § 1.901-2(b). *See Mayo, supra.*

In any event, it is only taxpayer's post-hoc mathematical reformulation of the windfall tax—and not the enacted windfall tax

itself—that appears structurally similar to an excess-profits tax. The enacted windfall tax does not "define[ ] 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," as taxpayer suggests. (Br. 23.) Rather, the windfall-tax statute defines the taxable windfall amount as the difference between profit-making value and flotation value. That taxpayer's argument relies on a complete rewrite of the statute is apparent from taxpayer's statement that "[a]s applied to over 90 percent of the Windfall Companies, the 51.75 percent tax was imposed on profits in excess of a floor equal to 44.47 percent of flotation value." (Br. 24.) There was no "51.75 percent tax" on anything. Rather, the statute imposed a 23% tax on the windfall amount. (*See* Doc. 31, Ex. 18-J (Part I, ¶1 & Sch. 1, ¶1)) (*available in* Appellant's Record Excerpts, Tab 7).

Moreover, to the extent it is relevant, Geoffrey Robinson testified that the Andersen team considered structuring its proposed windfall tax as an excess-profits tax but ultimately rejected the idea because "it could have impacted quite variously on the different companies

involved and could have impacted very severely on perhaps even the very survivability of some of them." (Tr. 84.) If that was the case, then it cannot be true that the windfall tax was in substance an excess-profits tax, as taxpayer contends. If so, the windfall tax presumably would have posed the same difficulties.

Finally, taxpayer takes issue with our argument that the effect of the Tax Court's opinion was to treat the windfall tax as "reaching" net gain merely because it was not confiscatory of net gain (*i.e.,* no company had a windfall-tax liability in excess of book income). (*See* Commissioner's Br. 34-36.) Taxpayer calls this a "mischaracterization" (Br. 37), but in the very next section of its brief, it goes on to make our very point by arguing that the Tax Court's opinion did not "render creditable any value-based tax" (Br. 38). In explaining why a hypothetical value tax would not be creditable, taxpayer states that it is because the tax "would not reach net gain, it would eliminate it." (*Id.*) And taxpayer states that the windfall tax was a "traditional income or excess profits tax" because it "took only a portion of net gain." (Br. 39.) Taxpayer's own brief demonstrates the danger underlying the Tax Court's opinion, *i.e.,* it opens the door for taxpayers to argue that a

foreign tax is creditable merely because it is not confiscatory of net gain.

CONCLUSION

Based on the foregoing, the Tax Court's decision is wrong and should be reversed.

Respectfully submitted,

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

/s/ Francesca U. Tamami

THOMAS J. CLARK (202) 514-9084
FRANCESCA U. TAMAMI (202) 514-1882
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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CERTIFICATE OF SERVICE

I hereby certify that on May 31, 2011, I electronically filed the foregoing reply 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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/s/ Francesca U. Tamami
FRANCESCA U. TAMAMI
Attorney

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