No. 12-277

IN THE

Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

—v.—

ENTERGY CORPORATION & AFFILIATED SUBSIDIARIES,

Respondent.

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

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Pursuant to 26 C.F.R. 1.901-2(b), a foreign tax is creditable against U.S. tax if the foreign tax, judged on the basis of its predominant character, satisfies each of the realization, gross receipts, and net income requirements described in that regulation. The question presented is as follows:

Whether this Court should review the Fifth Circuit's findings regarding the predominant character of the U.K. Windfall Tax and the application of the three tests of 26 C.F.R. 1.901-2(b) to those findings.

RULE 29.6 STATEMENT

Entergy Corporation is the parent corporation of a group of affiliated subsidiaries. No publicly held corporation owns 10% or more of the stock of Entergy Corporation.

Because of the number of subsidiaries affiliated with Entergy Corporation, there is potentially a long list of parties who have an interest in this case. However, the Fifth Circuit and the Tax Court treated Entergy Corporation and Affiliated Subsidiaries as one party.

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STATEMENT OF THE CASE

In seeking review, the Government points principally to the disagreement between the Third and Fifth Circuits on the creditability under 26 U.S.C. 901 of the U.K. Windfall Tax (the "Windfall Tax" or "Tax"). But that narrow conflict does not warrant this Court's attention. As the Government itself candidly concedes, the Windfall Tax "was a one-time tax paid by a limited number of companies," and the "specific question presented in this case is therefore unlikely to recur or to have significance for a large number of U.S. taxpayers." No. 12-43, *PPL Corp. v. Commissioner*, U.S. Br. ("U.S. *PPL* Br.") 13. Even that equivocal statement overstates the importance of the question here. The specific issue presented by the Government in this case affects no more than *three* U.S. taxpayers and will *never* arise again. In just such circumstances, the Court has long been guided by Justice Harlan's dictum that certiorari may be denied "'where the impact of the conflict is narrowly confined and is not apt to have continuing future consequences.'" Eugene Gressman, *et al.*, SUPREME COURT PRACTICE 243 (9th ed. 2007) (quoting Justice Harlan, *Some Aspects of the Judicial Process in the Supreme Court of the United States*, 33 Austl. L.J. 108 (1959)).

In nevertheless urging the grant of certiorari, the Government and PPL Corp., petitioner in No. 12-43 (the companion case to this one), assert that questions "may also arise concerning the

creditability under Section 901 of taxes paid under other foreign tax statutes," and that "this Court's guidance on the correct analytical approach for evaluating foreign taxes under Section 901 and the [implementing] Treasury Regulation may have significant administrative importance beyond the specific foreign tax at issue here." U.S. Pet. 14. *See* PPL Corp. Pet. 33-34. But that is not so. It certainly is no reason to grant review in this case.

We are not aware of any foreign tax, anywhere, that has ever had the peculiar and extraordinary features of the Windfall Tax, which confused the Third Circuit in *PPL* (and led to the disagreement between the Third and Fifth Circuits over the operation of the Tax). Neither the Government nor PPL Corp. (nor, for that matter, any of PPL Corp.'s *amici*) has been able to identify *any* similar foreign levy. The fact of the matter is that everyone concerned—respondent here; PPL Corp.; the Third and Fifth Circuits; every other court ever to have addressed the issue; and, so far as we can tell from its briefs in this Court, even the Government—agrees on the principle that controls the determination of creditability: the substance rather than the form of the foreign tax is determinative.

In this setting, the Government and PPL Corp. are asking this Court to settle the creditability of a unique, defunct foreign tax; a complex and technical matter of undoubted interest to the parties in this litigation but of no wider or continuing public

significance. That sort of limited error correction manifestly is not this Court's role. The Government's petition for certiorari accordingly should be denied.

1. Section 901 of 26 U.S.C. provides a credit against federal income tax for the payment of any income, war profits, or excess profits taxes to a foreign country. The narrow issue in this case is whether the Windfall Tax is a creditable foreign tax under Section 901.

The foreign tax credit provisions were first enacted in Section 222(a)(1) of the Revenue Act of 1918 with operative language identical to that now codified in 26 U.S.C. 901. "The foreign tax credit provisions were enacted primarily to mitigate the heavy burden of double taxation for U.S. corporations operating abroad which were subject to taxation in both the United States and foreign countries." *Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256, 283 (1995).

A body of case law that developed over several decades fleshed out the criteria for creditability under Section 901 and its predecessors. *See, e.g., Biddle v. Commissioner*, 302 U.S. 573 (1938); *Bank of America Nat'l Trust & Savings Ass'n v. United States*, 459 F.2d 513 (Ct. Cl. 1972) *cert. denied*, 409 U.S. 949 (1972); *Inland Steel Co. v. United States*, 677 F.2d 72 (Ct. Cl. 1982); *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). Under those decisions, a foreign tax is creditable if it "reach[es] some net gain in the normal circumstances in which the tax applies ... The label and form of the foreign tax is not determinative." *Inland Steel,* 677 F.2d at 80.

In 1983, the Treasury Department issued a final regulation providing that a foreign tax is creditable under Section 901 if its predominant character is that of an income or excess profits tax in the U.S. sense. 26 C.F.R. 1.901-2(a)(3). The preamble to those regulations states that the "predominant character" standard explicitly adopts the judicial criteria established in *Bank of America Nat'l Trust & Savings* (Ct. Cl.); *Inland Steel*; and *Bank of America Nat'l Trust & Savings* (T.C.). T.D. 7918, 1983-2 C.B. 113, 114. Application of this standard requires examination of the design and operation of the foreign tax to determine whether it is "likely to reach net gain [in] the normal circumstances in which it applies." 26 C.F.R. 1.901-2(a)(3).

To be creditable under the regulations, the foreign tax, judged on the basis of its predominant character, must satisfy three tests: (1) the realization requirement,[1] (2) the gross receipts requirement,[2]

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[1] A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed subsequent to the occurrence of events that would result in the

and (3) the net income requirement.[3] 26 C.F.R. 1.901-2(b). A foreign tax on a subset of income, such as an excess profits tax, is creditable if it satisfies those tests, judged on the basis of its predominant character. On the other hand, a value-added tax, a sales tax, or a real estate tax would not be creditable because those types of taxes could not satisfy the regulatory tests.

2. An important aspect of 26 C.F.R. 1.901-2 is that it embraces the "substance-over-form" principle, which has been called the "cornerstone of sound taxation." BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES & GIFTS ¶4.3.3 (3d ed. 2012). This Court has long agreed with that principle. *See United States v. Phellis*, 257 U.S. 156, 168 (1921) (recognizing "the importance of regarding matters of substance and disregarding forms in applying the ... income tax laws."). The case law upon which 26 C.F.R. 1.901-2 is built judged

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realization of income under the Internal Revenue Code. 26 C.F.R. 1.901-2(b)(2).

[2] A foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of gross receipts or gross receipts computed under a method that does not exceed fair market value. 26 C.F.R. 1.901-2(b)(3).

[3] A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed to permit recovery of significant costs and expenses attributable to such gross receipts. 26 C.F.R. 1.901-2(b)(4).

creditability on the basis of the actual operation of the foreign tax, not its name or label. *See Bank of America Nat'l Trust & Savings*, 459 F.2d at 519 ("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."). Accordingly, 26 C.F.R. 1.901-2 mandates that creditability is to be judged on the basis of the ultimate substance of the foreign tax.

3. Respondent in this case, Entergy Corporation, is a Delaware corporation headquartered in New Orleans. It is the parent company of an affiliated group of corporations that produce and provide electricity. In 1997, one of its subsidiaries was London Electricity plc, a U.K. electric company.

4. The Windfall Tax was a one-time, retroactive tax imposed on only 32 British companies that had been privatized between 1984 and 1996 in public stock offerings (or "flotations"). Only three of the 32 companies were owned by U.S. taxpayers claiming a foreign tax credit. London Electricity was one of them. Another was a U.K. subsidiary of PPL Corp., whose petition regarding the creditability of the Windfall Tax is pending before this Court as No. 12-43.

The Windfall Tax was enacted by the U.K. Finance (No. 2) Act of 1997 (the "Windfall Tax Act" or "Act"), reprinted at Pet. App. 95a-116a. The Act is

convoluted and unique. It describes the Windfall Tax in Sections 1-5 and appended Schedules 1-2. The Windfall Tax Act itself identified the companies to which it applied and imposed a tax of 23 percent on each company's "windfall." Schedule 1 defined a company's "windfall" as the excess of:

a. "the value in profit-making terms of the disposal made on the occasion of the company's flotation," over

b. "the value which for privatisation purposes was put on that disposal."

Pet. App. 104a. "Value in profit-making terms" was defined in Schedule 1 as nine times average annual profit earned during a company's four financial years immediately following flotation.[4] Flotation value equaled the product of the per-share flotation price and the number of ordinary shares issued in the flotation. *Id.* at 104a-106a.

5. The Windfall Tax was described by Gordon Brown, then the Chancellor of the Exchequer, as a "one-off windfall tax on the excess profits of the

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[4] Schedule 1 provided that "value in profit-making terms" was based on "average annual profit" for the company's "initial period." Pet. App. 104a. For 27 of the 32 companies subject to the Windfall Tax, the initial period was four years. The remaining five companies' profits were annualized based on different periods because they were privatized at different times.

privatized utilities." C.A. R.E. Doc. 31, Ex. 15-P, para. 188 (5th Cir. Apr. 13, 2011) (Doc.). It was also described by the Board of Inland Revenue as a tax on excess profits. Doc. 31, Ex. 17-P, para. 41.

6. The current controversy originated in *Entergy Corp. & Affiliated Subsidiaries v. Comm'r*, 100 T.C.M. (CCH) 202 (2010), *aff'd* 683 F.3d 233 (5th Cir. 2012), a companion case to *PPL Corp. v. Comm'r*, 135 T.C. 304 (2010), *rev'd*, 665 F.3d 60 (3d Cir. 2011), pet'n for cert. pending (No. 12-43). The issue before the Tax Court in these cases was whether the Windfall Tax constituted a creditable foreign income tax under 26 U.S.C. 901. The records in *Entergy* and *PPL* were substantially identical. Both were tried before the same judge, and the Tax Court decision in *Entergy* was decided by reference to the decision in *PPL*.

In both cases, the taxpayers and the Commissioner of Internal Revenue agreed that 26 C.F.R. 1.901-2 is valid and controls the outcome. At trial, Entergy and PPL Corp. introduced extensive evidence of the design and effect of the Windfall Tax to demonstrate its predominant character. They argued that parliamentary history showed that the Windfall Tax was intended to function as an excess profits tax. They also argued that an algebraic reformulation of the Windfall Tax's statutory formula demonstrated that the Windfall Tax operated as an excess profits tax. The Tax Court described and addressed this evidence at some

length in its *PPL* decision. *See* Pet. App. 17a-36a, 47a-58a.

The following formula sets out the Windfall Tax calculation (*see* Pet. App. 51a-52a):

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

where

WT = Windfall Tax P = initial period profits
D = days in initial period FV = flotation value

Twenty-seven of the 32 companies subject to the Windfall Tax had initial periods of 1,461 days (4 years). For those 27 companies, the formula could be restated and simplified in the following steps:

$$WT = 23\% \times [\{(365 \times (P/1{,}461)) \times 9\} - FV]$$

$$WT = 23\% \times [\{(P/4) \times 9\} - FV]$$ [5]

$$WT = \{23\% \times (9/4)\} \times [P - \{(4/9) \times FV\}]$$ [6]

$$WT = 51.71\% \times [P - (44.47\% \times FV)]$$

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[5] For simplicity, the denominator of "4" in the restatement derives from the fraction 365/1461, which reduces to approximately 1/4. *See* Pet. App. 51a n.21.

[6] 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; it simply factors out the 9/4 multiple of profits. *See* Pet. App. 52a n.22.

Entergy and PPL Corp. argued that this reformulation demonstrated that the Windfall Tax was imposed, at the rate of 51.71 percent, on initial period profits in excess of 44.47 percent of flotation value, and therefore was a tax on excess profits.

In contrast, the Commissioner argued that the predominant character of the Windfall Tax was determined by the text of the Windfall Tax Act—that is, that the tax was levied on the difference between two values and, therefore, could not have been levied on income. Pet. App. 54a. The Commissioner, without citing authority, argued that the Tax Court was precluded from considering evidence beyond the text of the Act. *Id.* at 55a-56a.

The Tax Court rejected the Commissioner's arguments. It found that the extensive testimony relating to the enactment of the Windfall Tax and other parliamentary history, as well as the algebraic reformulation of the Tax, constituted relevant evidence of the Windfall Tax's predominant character. *Id.* at 59a-60a. In light of this evidence, it found that the design and effect of the Windfall Tax was to tax an amount that, under U.S. tax principles, would be considered excess profits. *Id.* at 70a. Therefore, the Tax Court held that the Windfall Tax constituted an excess profits tax that was creditable under 26 U.S.C. 901. *Id.* at 71a.

7. The Commissioner appealed the *PPL* decision to the U.S. Court of Appeals for the Third

Circuit and the *Entergy* decision to the U.S. Court of Appeals for the Fifth Circuit.

8. The Third Circuit issued its decision first, and it reversed the Tax Court. *PPL Corp. v. Comm'r*, 665 F.3d 60 (3d Cir. 2011). The Third Circuit agreed with the Tax Court that a foreign tax is judged on the basis of its predominant character and that the classification of a foreign tax "hinges on its economic substance, not its form." *Id.* at 64-65. However, the Third Circuit disagreed with the Tax Court's ultimate findings about the application of that principle to the Windfall Tax.

The Third Circuit was not persuaded that the algebraic reformulation demonstrated that the Windfall Tax was imposed on profits. *Id.* at 65. It reasoned that if the Windfall Tax were imposed on profits, the reformulation should express the tax simply as 23% x P, where P is profit. *Id.* Because the Third Circuit's oversimplified equation differed from the algebraic reformulation offered as evidence by PPL Corp., the court concluded that the tax base of the Windfall Tax could not be profits. *Id.* The court also rejected the formulation because it believed that 26 C.F.R. 1.901-2(b)(3)(ii), Ex. 3 makes it impermissible under the gross receipts requirement to reformulate the Tax at a higher effective rate.[7] *Id.* at 67. Finally, because PPL

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[7] Example 3 is part of a subsection in the regulation that addresses permissible means of imputing a taxpayer's gross receipts. *See* Pet. App. 10a-11a.

Corp.'s windfall exceeded initial period profits, the Third Circuit, once again rejecting the parties' stipulated algebraic reformulation, concluded that the Windfall Tax also violated the realization requirement of the regulations. Id. at 67 n.3. Therefore, the Third Circuit found that the Windfall Tax was not creditable. *Id.* at 68.

9. The Fifth Circuit issued its decision in *Entergy* five months after the Third Circuit's decision. *Entergy Corp. & Affiliated Subsidiaries v. Comm'r*, 683 F.3d 233 (5th Cir. 2012) (Pet. App. 1a-13a). In contrast to the Third Circuit, the Fifth Circuit agreed with the Tax Court's findings regarding the predominant character of the Windfall Tax. Pet. App. 7a-8a. It observed that "[t]he tax rose in direct proportion to additional profits above a fixed (and carefully calculated) floor." *Id.* at 8a. Therefore, the Fifth Circuit found that the Windfall Tax was imposed on excess profits. *Id.* at 13a.

Additionally, the Fifth Circuit explained in detail that the Third Circuit was wrong in believing that 26 C.F.R. 1.901-2(b)(3)(ii), Ex. 3 applied in the circumstances of this case. Pet. App. 8a-12a. As the Fifth Circuit correctly noted, Example 3 "do[es] not illustrate the meaning of 'actual gross receipts.'" *Id.* at 10a. To be creditable, 26 C.F.R. 1.901-2 requires that a foreign tax be based on either actual gross receipts or an imputed value not intended to reach more than actual gross receipts. Pet. App. at 9a-10a. Example 3 is part of a subsection in the regulation

intended to distinguish impermissible methods of *imputing* gross receipts.[8] *Id.* at 10a. But as the Fifth Circuit explained, the Windfall Tax was not imposed on notional income; rather, it was imposed on average annual profit, which, in turn, was based on actual gross receipts. *Id.* at 11a. Therefore, "an example detailing an impermissible method for calculating *imputed* gross receipts (based on historical practices by OPEC countries) is facially irrelevant." *Id.*

10. On July 9, 2012, PPL Corp. petitioned for a writ of certiorari, challenging the Third Circuit's decision in its case. On September 4, 2012, the Government urged the Court to grant review in *PPL* and filed a petition for a writ of certiorari in this case, asking the Court to hold the Government's petition pending decision in *PPL*.

ARGUMENT

The Government asks the Court to resolve the disagreement between the Third and Fifth Circuits over the creditability of the Windfall Tax, as does PPL Corp. But even the most cursory review of the Third and Fifth Circuit decisions reveals no

[8] This subsection was directed at a common foreign practice of taxing artificially inflated income amounts rather than actual receipts. *Id.* This allowed the foreign country to increase domestic tax revenue at the expense of countries, such as the United States, that provided a dollar-for-dollar tax credit to the corporate taxpayer. *Id.*

disagreement between those courts on matters of fundamental principle. Instead, as the Fifth Circuit made clear in explaining why it rejected the Third Circuit's conclusion about creditability, those courts disagreed on their understanding of how the Windfall Tax operated, on the history and purpose of the Tax, and on the application of 26 C.F.R. 1.901-2's Example 3 in the specific circumstances of the Tax. There can be no denying that this is an exceedingly narrow and technical disagreement that affects only three U.S. taxpayers, will never again arise, and has no prospective significance.

To be sure, the Third and Fifth Circuits do disagree on this narrow, nonrecurring question. But in the circumstances here, that is no reason for this Court to grant review. In assessing petitions for certiorari, "[t]he Court as a whole now seems committed to giving the existence of a conflict [in the circuits] less than decisive weight"; "importance to a high degree may sometimes be necessary even where there is a conflict." SUPREME COURT PRACTICE 244-45. The question presented in this case does not satisfy that exacting standard. In addition, because the decision below is correct, the Government's petition should be denied.

I. THERE IS NO CONFLICT REGARDING THE LONG-SETTLED PRINCIPLES OF LAW GOVERNING CREDITABILITY OF A FOREIGN TAX

1. At the outset, the lower courts, including the Third Circuit in *PPL* and the Fifth Circuit in this case, *agree* on the basic principles of law governing creditability of a foreign tax. Those principles were forged by decades of case law beginning with *Biddle v. Comm'r*, 302 U.S. 573 (1938). In *Biddle*, this Court stated that whether a person has paid a foreign tax within the meaning of 26 U.S.C. 131 (1936) (one of the forerunners to current 26 U.S.C. 901) depends on the manner in which the foreign tax is laid and collected, what the taxpayer has done in conformity with the foreign law, and whether the taxpayer's act is the substantial equivalent of the payment of a tax as that term is used in U.S. law. 302 U.S. at 579.

Since the decision in *Biddle*, lower courts have been uniform in their approach to determining creditability. Every case applying Section 901 has examined not merely the words of the foreign tax act, but how the foreign tax operated in fact.[9]

[9] *See Texasgulf Inc. v. Comm'r*, 172 F.3d 209, 215 (2d Cir. 1999) ("[W]e focus our attention on how the [Ontario Mining Tax] operates with respect to the entire industry ..."); *Inland Steel Co. v. United States*, 677 F.2d 72, 80 (Ct. Cl. 1982) ("To qualify as an income tax in the United States sense, the foreign country must have made an attempt always to reach some net gain ... The label and form of the foreign tax is not determinative.");

Respondent is not aware of a single decision that ended its inquiry with the text of the foreign statute or disavowed reliance on the actual practical operation of the foreign tax. Accordingly, there is no confusion about the essential meaning of Section 901 and no question of principle dividing the lower courts.

2. In light of this unanimity, it is not surprising that the Third and Fifth Circuits *agreed* on the central inquiry, and that both courts were faithful to the legacy of *Biddle* and the foreign tax credit cases that followed. The Third Circuit thus declared expressly that "[o]ur classification of a foreign tax hinges on its economic substance, not its form" (*PPL*,

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Bank of America Nat'l Trust & Savings Ass'n v. United States, 459 F.2d 513, 519 (Ct. Cl. 1972) ("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.") *cert. denied*, 409 U.S. 949 (1972); *Exxon Corp. v. Comm'r*, 113 T.C. 338 (1999) (finding that the Petroleum Revenue Tax operated as an excess profits tax even though the text of the tax act disallowed certain expenses), *acq. in result*, I.R.B. 2001-31; *Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256 (1995) (finding that the Norwegian municipal and national taxes on petroleum operated as income taxes, and the special tax on petroleum operated as an excess profits tax); *Bank of America Nat'l Trust & Savings Ass'n v. Comm'r*, 61 T.C. 752, 760 (1974) ("[T]he term 'income tax' in § 901(b)(1) covers all foreign income taxes designed to fall on some net gain or profit, and includes a gross income tax if, but only if, that impost is almost sure, or very likely, to reach some net gain because costs or expenses will not be so high as to offset the net profit."), *aff'd*, 538 F.2d 334 (9th Cir. 1976).

665 F.3d at 65); the Fifth Circuit agreed, in similar terms, that "[t]he case law from which 26 C.F.R. § 1.901-2 is derived refutes" the suggestion "that we should rely exclusively, or even chiefly, on the text of the Windfall Tax in determining the tax's 'predominant character.'" Pet. App. 6a. As we explain below, the Third Circuit simply misapplied that principle to the facts here.

Additionally, the analyses of the Third and Fifth Circuits conformed to 26 C.F.R. 1.901-2. Both courts sought to determine the predominant character of the Windfall Tax. To that end, both courts applied the three tests of 26 C.F.R. 1.901-2(b). Neither court enunciated a new test of creditability. Neither court analyzed the Windfall Tax in a manner affecting how future cases will be decided. Under these decisions, future foreign tax credit cases will still be governed by the principles espoused in the prior case law and the requirements of 26 C.F.R. 1.901-2.

The only point on which the Third and Fifth Circuits disagreed was their ultimate holding regarding the creditability of the Windfall Tax. That difference was driven by the two courts' conflicting applications of 26 C.F.R. 1.901-2(b) to the peculiar features of the Windfall Tax. In the Fifth Circuit's view, the Windfall Tax was imposed on excess profits because the Tax "rose in direct proportion to additional profits above a fixed (and carefully calculated) floor." Pet. App. 8a. Conversely, the Third Circuit found that "the tax base [of the

Windfall Tax] cannot be initial-period profit alone unless we rewrite the tax rate. Under the Treasury Department's regulation, we cannot do that." *PPL,* 665 F.3d at 65. The Third Circuit's conclusion that the Windfall Tax was not creditable derives from its mistaken perception that the multiplier irreparably tainted the tax and could not, despite basic algebra, be factored away. This is a disagreement over permissible inferences to be drawn from the multiplier contained in the Windfall Tax Act, not over how to apply Section 901.

3. There is no need for the Court to resolve this technical disagreement. The Windfall Tax was a one-time, retroactive tax imposed on a fixed set of 32 British companies. It has no application after 1997. Only three of the U.K. companies were owned by U.S. taxpayers claiming a foreign tax credit: PPL Corp., Entergy Corp., and American Electric Power Company.[10] No other taxpayer would be affected by a decision of this Court regarding creditability of the Windfall Tax.

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[10] American Electric Power Company is currently disputing the disallowance of foreign tax credits for its subsidiaries' payments of the Windfall Tax via an administrative proceeding with the IRS. *See* Brief of *Amicus Curiae* American Electric Power Co., *PPL Corp. v. Comm'r*, 665 F.3d 60 (3d Cir. 2011) (No. 11-1069). An appeal of a lower court's decision regarding American Electric Power Company's entitlement to foreign tax credits for the Windfall Tax would be filed in either the Sixth or the Federal Circuit, depending on which lower court initially hears the dispute.

Moreover, never before and, in all likelihood, never again will a court encounter a foreign levy resembling the Windfall Tax that functions like an income tax but is draped in such strange terms. Respondent is not aware of any foreign tax, the text or legislative history of which evinces such complex and subtle design objectives. Neither the Government nor PPL Corp. has cited any other foreign tax that is written in similar terms or whose creditability would be affected by the Court's decision in this case. Likewise, conspicuously absent from the *amicus* briefs supporting certiorari in *PPL* is any mention of another foreign tax, the creditability of which might be affected by the Third Circuit's decision.

This is the sort of limited disagreement that the Court need not resolve. "The important and recurring nature of the issue in conflict often plays a decisive role in the grant or denial of certiorari." SUPREME COURT PRACTICE 245. Accordingly, "[a] conflict will not necessarily result in the grant of certiorari if the issue is no longer a live one"; where, as here, the limited prospective effect of the provision at issue "will prevent the problem from arising in the future, certiorari may be denied despite a square conflict." *Id.* at 247. Indeed, the Government itself frequently urges the Court to deny review despite an acknowledged conflict in the circuits when "the specific issues presented in th[e] case … lack meaningful prospective importance," have "relevance only for [a] few taxpayers," or "lack recurring

importance." No. 01-1209, *The Boeing Co. v. United States*, U.S. Br. 17. *See also*, *e.g.*, No. 11-1119, *Yang v. Holder*, U.S. Br. 9 ("[w]hile there is disagreement in the courts of appeals," review should be denied because the question "is one of diminishing importance"); *id.* at 17 (review should be denied notwithstanding circuit conflict because disagreement in the circuits affects only "older cases" that "is a diminishing set."). That is this case.

As a consequence, the "important federal interest in uniform enforcement of the federal tax laws" formulaically invoked by the Government does not militate in favor of review here. U.S. *PPL* Br. 14. In fact, insistence on such uniformity is not the Government's consistent position. The Government argues against review even in tax cases where the courts of appeals are in conflict but denial of certiorari is thought to be in the Government's immediate interest. We have just pointed to one such case in which the Government acknowledged that the circuits were in conflict but urged denial because (1) the issue presented "ha[d] relevance only for [a] few taxpayers," (2) the statutory provisions involved had been modified or repealed, and (3) the issue was of "no recurring importance." No. 01-1209, *The Boeing Co. v. United States*, U.S. Br. 17, 18. Additionally, SUPREME COURT PRACTICE (at 246 n.25) notes that the Court "denied certiorari in two cases … which the Solicitor General admitted were in conflict" on a question of federal tax procedure "but in which he argued 'that the issue lacks sufficient

general importance to merit review by this Court.'" The same result, for the same reason, is appropriate here.

4. Nor would the grant of review in these cases provide any necessary or useful guidance on the broader application of Section 901 and its implementing regulation. The Third Circuit's decision does not "threaten[ ] the creditability of every foreign tax that does not precisely mirror a U.S. income tax," as PPL Corp. contends. PPL Corp. Pet. 33. The principles governing creditability have been uniformly applied for decades to many different tax regimes throughout the world. That the Third Circuit decided *PPL* under those same principles refutes PPL Corp.'s contention that the Third Circuit's holding fundamentally changed the law.

As PPL Corp. points out, domestic corporations annually claim tens of billions of dollars in foreign tax credits and have done so for many years. PPL Corp. Pet. 4, 33 (citing Scott Luttrell, IRS SOI Bull., *Corporate Foreign Tax Credit, 2007*, p. 140 fig. B (2011) (total foreign tax credits claimed from 2003 to 2007 ranged between $50 billion and $86 billion a year)). But the vast majority of these credits were derived from undisputed foreign income taxes. In fact, since the decision in *Bank of America Nat'l Trust & Savings Ass'n v. United States* in 1972, the earliest case upon which 26 C.F.R. 1.901-2 is built, Respondent is aware of only six other cases—over a period of forty years—in which the status of a foreign

levy as an income tax has been litigated.[11] The reality is that determining the creditability of an income or excess-profits tax almost always is a routine inquiry, seldom requiring judicial intervention. In such a setting, it is difficult to see how the grant of review in this narrow foreign tax credit case would satisfy the Court's usual certiorari criteria.

Nor, contrary to the Government's assertion (U.S. *PPL* Br. 11), will the algebraic reformulation of the Windfall Tax relied upon by the Tax Court and the Fifth Circuit threaten to turn every tax based on value into an income or excess-profits tax.[12]

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[11] *See Texasgulf, Inc. v. Comm'r*, 172 F.3d 209 (2d Cir. 1999) (holding the Ontario Mining Tax creditable under the current version of 26 C.F.R. 1.901-2); *Inland Steel Co. v. United States*, 677 F.2d 72 (Ct. Cl. 1982) (holding that the Ontario Mining Tax was not creditable under an earlier version of 26 C.F.R. 1.901-2); *Exxon Corp. v. Comm'r*, 113 T.C. 338 (1999) (holding U.K. petroleum taxes creditable); *Phillips Petroleum Co. v. Comm'r*, 104 T.C. 256 (1995) (holding Norwegian municipal, national, and special taxes on petroleum creditable); *Schering Corp. v. Comm'r*, 69 T.C. 579 (1978) (holding the Swiss Federal Withholding Tax creditable); *Bank of America Nat'l Trust & Savings Ass'n v. Commissioner*, 61 T.C. 752 (1974) (holding that a Thailand business tax, Philippines tax on banks, Buenos Aires tax on profit-making activities, and a Taiwan business tax were not creditable), *aff'd*, 538 F.2d 334 (9th Cir. 1976).

[12] The Government's assertion (U.S. *PPL* Br. 10) that the Windfall Tax must be a value tax because it resembles the "income capitalization" method is similarly meritless. The Government's cited authorities state that the income capitalization method values a property's stream of *future*

Reformulation of a tax imposed at a higher rate or greater multiplier than those employed in the Windfall Tax could easily result in a tax in excess of income. That would clearly violate the rule that a creditable tax may reach, but may not exceed, net income.[13] The Windfall Tax did not do that.

Similarly, contrary to the implication of No. 12-43, *PPL v. Comm'r*, *Amici* N. Jerold Cohen *et al.* Br. 5, the disagreement between the Third and Fifth Circuits does not create an opportunity for litigants to forum shop. Even if the Third And Fifth Circuits disagreed on a recurring matter of principle (which, as we have explained, they do not), it is hardly likely that multinational corporations would move their headquarters from one federal circuit to another simply to seek a different interpretation of 26 C.F.R. 1.901-2.

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income. John A. Bogdanski, *Federal Tax Valuation* para. 3.05[1] (2012) and 2 *Bender's State Taxation: Principles and Practice* § 24.05[3] (Charles W. Swenson ed. 2012). A tax on projected future income would not be creditable because it would fail the realization test. That, however, does not describe the Windfall Tax. It was based on profits known and realized at the time of enactment.

[13] *See, e.g., Bank of America Nat'l Trust & Savings Ass'n v. Comm'r*, 61 T.C. at 760 ("[T]he term 'income tax' in § 901(b)(1) covers all foreign income taxes designed to fall on some net gain or profit, and includes a gross income tax if, but only if, that impost is almost sure, or very likely, to reach some net gain because costs or expenses will not be so high as to offset the net profit."), *aff'd*, 538 F.2d 334 (9th Cir. 1976).

5. Of course, in our view the Third Circuit erred in its understanding of the Windfall Tax. It failed to see how basic algebra demonstrated that the Tax operated as an excess profits tax.[14] It also erroneously thought that 26 C.F.R. 1.901-2(b)(3)(ii), Ex. 3 prevented it from entertaining an algebraic simplification of a statutory formula that was expressed as a multiple of profits. As the Fifth Circuit noted in rejecting the Third Circuit's holding, "the Third Circuit opinion seems to overlook that a tax based on actual financial profits in the U.K. sense necessarily begins with gross receipts." Pet. App. 11a. The Third Circuit likewise failed to recognize that "an examination of the origins of the 2.25 multiplier … illustrates that it had nothing to do with inflating the utilities' profits into notional amounts." *Id.* at 12a. On the face of it, those errors involved simple oversights or miscalculations by the Third Circuit that are peculiar to an excess profits tax nominally imposed on a value derived from profits.

A determination of whether the Third or Fifth Circuits is correct on these points would require this Court to analyze volumes of testimony regarding enactment of the Windfall Tax and other relevant parliamentary history, as well as the algebraic

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[14] *See PPL*, 665 F.3d at 65 ("Were this a tax on initial-period profit, as PPL Corp. contends that it is in substance, the tax base would be simply P, so that we could express the tax thus: Tax = 23% x P.").

reformulation of the Tax, in order to gauge the Tax's predominant character. It is axiomatic that this Court does not grant certiorari to review factual findings or correct the misapplication of a properly stated rule by a lower court. *See* Sup. Ct. R. 10. The Court should not do so here.

II. THE FIFTH CIRCUIT'S DECISION IS CORRECT

1. The issue presented here by the Government does not warrant this Court's attention. Review of this case is particularly unwarranted because the Fifth Circuit's decision is correct. The Fifth Circuit properly examined the design and operation of the Windfall Tax to determine its predominant character. Pet. App. 7a-8a. After doing so, the court was "persuaded by the Tax Court's astute observations as to the Windfall Tax's predominant character: the tax's history and practical operation were to 'claw back' a substantial portion of privatized utilities' 'excess profits' in light of their sale value."[15] *Id.*

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[15] During the trial, Philip Baker, the Commissioner's expert on U.K. taxation, testified that (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; (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

The Fifth Circuit then correctly applied the three tests in 26 C.F.R. 1.901-2 to the predominant character of the Windfall Tax. First, the Fifth Circuit found that the Windfall Tax satisfied the realization requirement because the tax was based on revenues from the operation of the utilities that were earned "long before the design and implementation of the tax." Pet. App. 7a. The court observed that "[r]evenues from earlier ordinary operation are clearly 'realized;' indeed, the Labour Party accurately estimated the amount the Windfall Tax would raise, as the earnings of each of the utilities were publicly available when the Labour Party drafted the tax." *Id.* Second, the Fifth Circuit observed that the Windfall Tax "*only* reached—and only *could* reach—utilities that realized a profit in the relevant period, calculating profit in the ordinary sense (e.g. by subtracting operating expenses associated with generating the utilities' income)." *Id.* Therefore, it found that the Windfall tax satisfied the net income requirement. *Id.* Finally, the Fifth Circuit found that the Windfall Tax satisfied the gross receipts test because the tax operated to "claw back" excess profits. *Id.* at 7a-8a. The court reasoned that "a tax based on actual financial profits in the U.K. sense necessarily begins with gross receipts, as, again, the record here indicates." *Id.* at 11a.

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initial period, the company would still have had a Windfall Tax liability. 4/8/08 Tr. 219-222, 100 T.C.M. (CCH) 202 (2010).

The Fifth Circuit also explained why the contrary holding of the Third Circuit was based on a misunderstanding of the application of 26 C.F.R. 1.901-2(b)(3)(ii), Ex. 3 to the factual circumstances of this case. The Third Circuit found that the Windfall Tax failed at least the gross receipts requirement based on an application of that example. Pet. App. 8a-10a. But as the Fifth Circuit recognized, Example 3 does not illustrate the meaning of "actual gross receipts." *Id.* at 10-11a. Instead, Example 3 is part of a subsection of the regulations distinguishing permissible imputed gross receipts from impermissible notional amounts. *Id.* As the Fifth Circuit explained:

> The Windfall Tax relies on no Example 3-type imputed amount … There was no need to calculate imputed gross receipts; gross receipts were actually known. And thus, an example detailing an impermissible method for calculating *imputed* gross receipts (based on historical practices by OPEC countries) is facially irrelevant. *Id.* at 11a.

Therefore, the Fifth Circuit disagreed with the Third Circuit's flawed conclusions. *Id.* at 12a.

2. The Government's insinuation (Pet. 8-9) that the Tax Court and the Fifth Circuit erroneously declined to analyze the text of the statute in

determining the predominant character of the Windfall Tax is meritless. The courts below considered the words of the Windfall Tax; they simply declined to limit their analysis to the words alone. As the Fifth Circuit stated, "[t]he tax rose in direct proportion to additional profits above a fixed (and carefully calculated) floor. That Parliament termed this aggregated but entirely profit-driven figure a 'profit-making value' must not obscure the history and actual effect of the tax, that is, its predominant character." Pet. App. 8a. Every case examining creditability of a foreign tax has determined creditability based on how the foreign tax operates. There is not a single relevant authority that supports the Government's contention that creditability is determined exclusively, or even chiefly, by the text of the foreign statute.

Before the lower courts, the Government nevertheless focused on the labels used in the Windfall Tax, relying on those labels in an attempt to obscure the Tax's practical operation.[16] Before this Court, the Government seems to have retreated somewhat from that position. However, the Government's theory continues to rest on a healthy serving of double-talk and does not deny that the

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[16] *See*, *e.g.*, No. 10-60988 (5th Cir.), U.S. Opening Br. 32 ("the basis of the windfall tax was the difference between a company's profit-making value and its flotation value," and "[t]he windfall-tax statute makes no mention at all of gross receipts or gross income").

practical operation of the foreign tax controls. *See* U.S. *PPL* Br. 9-12. In any event, the Government does not even attempt to explain why the Fifth Circuit was wrong in its thorough and persuasive analysis, which demonstrates beyond any doubt that the Windfall Tax falls squarely on a specific portion of taxpayer profits. The Government's submission on the merits makes one other thing clear: this case does not involve disagreement over any recurring question of principle that extends beyond the expired Windfall Tax. The narrow and technical question presented does not warrant the Court's attention.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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