No. 15-5059

**IN THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT**

WELLS FARGO & COMPANY,

Plaintiff-Appellee

v.

UNITED STATES,

Defendant-Appellant

**ON APPEAL FROM THE ORDER OF THE
UNITED STATES COURT OF FEDERAL CLAIMS
No. 11-808-T, Judge Nancy Firestone**

REPLY BRIEF FOR THE APPELLANT

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GLOSSARY

Acronym	*Definition*
CCA	Chief Counsel Advice
CFC	Court of Federal Claims
FSA	Field Service Advice
I.R.C. or 'the Code"	The Internal Revenue Code (26 U.S.C.)
IRS	Internal Revenue Service
TIN	Taxpayer Identification Number

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REPLY BRIEF FOR THE APPELLANT

This appeal addresses test-case scenarios in which merged entities seek interest netting under Internal Revenue Code ("I.R.C." or "the Code") § 6621(d) (26 U.S.C.). In "Situation 1," the underpayment and overpayment were made *before* the merger. The entity with the overpayment (Old Wachovia) and the entity with the underpayment

(First Union) later merged, with First Union surviving. (A8.)[1] In "Situation 3,"[2] the acquired corporation, CoreStates, made the overpayment before its merger with First Union, and the surviving corporation, First Union, made the underpayment after the merger. (A9.) We submit that the Court of Federal Claims (CFC) erred in holding that interest netting was permissible in these situations.

A. Section 6621(d) does not permit interest netting in either test situation at issue here

Section 6621(d) conditions the availability of interest netting on the "same taxpayer" making both the overpayment and the underpayment. As explained in *Energy East Corp. v. United States,* 645 F.3d 1358, 1361 (Fed. Cir. 2011), for entities to qualify as the "same taxpayer," it is not enough that that the liability is "payable" by the same taxpayer. *Id.* at 1362 (rejecting argument that "the statute should

[1] "A" references are to the separately bound record appendix. "Op.Br." references are to our opening brief. "Br." references are to Wells Fargo's answering brief. We use herein the same shorthand names for entities involved in the mergers as in our opening brief. (*See* Op.Br. xiv, 4-10.)

[2] "Situation 2" was conceded below. (Op.Br. 11.)

be interpreted to read: '[t]o the extent that, for any period, interest is payable . . . by the same taxpayer,' interest netting is allowed on equivalent overpayments and underpayments"). Moreover, § 6621(d) "provides an *identified* point in time at which the taxpayer must be the same, *i.e.,* when the overpayments and underpayments are made." *Id.* at 1361.[3] Wells Fargo offers no viable reason for disregarding these principles established in *Energy East,* and with which the CFC's opinion cannot be reconciled.

Applying these statutory limitations, interest netting is not permissible in either Situation 1 or 3. Situation 1 is essentially indistinguishable from *Energy East.* Both involved the question whether two not-yet-related corporations can be considered the same taxpayer before their affiliation. The corporations in *Energy East* obviously were not the same taxpayer before they had any affiliation; the same result should follow here. *See Energy East*, 645 F.3d at 1361-

[3] As *Energy East* explains, underpayments and overpayments are made on particular dates. 645 F.3d at 1363 (citing I.R.C. §§ 6601(a), 6611(b)).

62 (it was unnecessary to reach whether subsequent acquisition made the consolidated group's members the same taxpayer, because they undisputedly were *not* the same pre-affiliation, when the overpayments and underpayments were made); *Magma Power Co. v. United States*, 101 Fed. Cl. 562, 570 (2011) (where "underpayments and the overpayments" of all entities "occurred *prior* to the merger" "it was abundantly clear that the . . . companies were not the same taxpayer").

Interest netting is also not permissible in Situation 3. Under *Energy East*, the Court must evaluate whether pre-merger CoreStates, which made its overpayment before the merger, is the "same taxpayer" as post-merger First Union, which made its underpayment after the merger. They plainly are not. They have different taxpayer identification numbers (TINs), which the Court of Federal Claims has identified as the key identifier of a taxpayer (*see Magma,* 101 Fed. Cl. at 576; Op.Br. 50-52) and their businesses and geographic scope differ substantially. (*See* Op.Br. 52-53.) While various tax attributes of pre-merger CoreStates carry over to post-merger First Union, the two corporation are hardly the "same taxpayer."

Wells Fargo's contention that *Energy East* is irrelevant, because that case involved a consolidated corporate group and this case involves statutory mergers, is misconceived. Because *Energy East*'s analysis was based on the statute's plain language, the applicability of this Court's explanation of the statutory limitations on interest netting is not restricted to the particular facts before the *Energy East* Court. *See* 645 F.3d at 1361-62. A merger – in which the surviving corporation inherits the acquired corporation's assets and liabilities (*see* Op.Br. 40-45, 54-67; pp. 16-30, *infra*) – does not change the analysis. As explained *infra* (§ B), inheriting liability is not enough to confer same-taxpayer status.[4] Moreover, as explained in our opening brief (Op.Br. 34-47, 59-66) and below (§ C), there is no merit to Wells Fargo's contention (Br. 23-24, 42)

[4] The fact that mergers differ from other acquisitions because assets and liabilities transfer by operation of law, whereas in other corporate acquisitions assumption of liability is voluntary and contractual (Br. 26), does not support the CFC's holding. That distinction means only that, upon execution of a "merger" agreement, certain things enumerated in the statute occur, whereas in other acquisitions the parties' contracts spell out such specifics.

that a merger's effect goes beyond transferring assets and liabilities and retroactively makes all parties to a merger the "same taxpayer."

B. Section 6621(d) does not allow interest netting based on inheriting tax liability

1. Section 6402 does not support Wells Fargo's expanded interpretation of § 6621(d)

Wells Fargo's assertion (Br. 3) that § 6621(d) must be read to allow interest netting in the disputed test situations because I.R.C § 6402(a) allows a person inheriting a tax liability to offset that liability with a tax overpayment, and because § 6621(d) was "designed to *expand* on the remedy" in § 6402, mischaracterizes the history and import of § 6402. Section 6402 illustrates that Congress knows how to draft a statute to permit a successor that inherits rights or obligations to use associated tax benefits. But instead of using such language in § 6621(d), Congress chose the more restrictive, "same taxpayer" language. As recognized in *Energy East,* § 6621(d)'s language cannot be stretched to permit interest netting in any instance where one taxpayer inherits the tax liability of another. *Id.* at 1362-63 (rejecting arguments that interest netting should be permitted if "interest is payable . . . by the same taxpayer"). Accordingly, the fact that liability for a tax

underpayment and the right to claim a tax overpayment may wind up in the same entity's hands is insufficient to allow interest netting under this Court's construction of § 6621(d)'s "plain" statutory language. *Id.* at 1362.

Nothing in the legislative history leading to § 6621(d)'s enactment indicates that Congress intended § 6621(d) to mirror § 6402's scope. Indeed, the Treasury Department's report to Congress on interest netting ("Treasury Report")[5] strongly points in the opposite direction. The Treasury Report explained that, before § 6621(d)'s enactment, interest netting could be achieved only (1) by an equalization method that applied interest to net liability on an annual basis, referred to as "annual netting" (*see* Treas. Rep. 12-13; Rev. Proc. 94-60, 1994-2 C.B. 775), and (2) under I.R.C. § 6402, which allowed offsetting credits against liabilities to the extent an overpayment and underpayment

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[5] Office of Tax Policy, Dep't of the Treasury, Report to the Congress on Netting of Interest on Tax Overpayments and Underpayments (Apr. 1997) (available at http://www.treasury.gov/resource-center/tax-policy/Pages/reports_congress.aspx, last visited July 18, 2015).

were simultaneously outstanding. Treas. Rep. 9, 13-15. But § 6621 differs substantially from § 6402, and there is no indication that Congress intended, in enacting § 6621(d), to incorporate the different standards applicable to § 6402.[6]

Section 6402 permits the IRS, in its discretion, to offset overpayments and underpayments only to the extent such debts are simultaneously outstanding. *See* Treas. Rep. 14-15, 29-30; Treas. Reg. § 301.6402-1; *Northern States Power Co. v. United States*, 73 F.3d 764 (8th Cir. 1996). But that provision does not require that the same taxpayer must have made the overpayment and underpayment. *See*

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[6] Wells Fargo's assertion (Br. 10-11, 18-19) that the IRS disregarded Congressional directives to implement interest netting is unfounded. The IRS obeyed Congress's direction to implement interest netting to the extent it could do so "consistent with sound administrative practices." Treas. Rep. 26-27, 29. It expanded annual netting, and implemented a policy under which it exercised its discretion to "maximize offsetting" under § 6402. Treas. Rep. 12-13. The IRS, however, reasonably concluded that then-existing law did not permit interest netting outside a single year if overpayment and underpayment liabilities were not simultaneously outstanding. *Id.* at 13-15, 30, 32 (discussing *Northern States Power Co. v. United States,* 73 F.3d 764 (8th Cir. 1996), and I.R.C. § 6601's mandatory language regarding imposition of interest).

I.R.C. § 6402 (allowing crediting of an overpayment and interest thereon against any liability of "such person").

The Treasury Report explained that, before the enactment of § 6621(d), statutory limits prevented so-called "global netting," *i.e.*, netting outside a single year if overpayment and underpayment amounts were not simultaneously outstanding. Treas. Rep. 14-15, 29-30. And it explained that one mechanism Congress could select, to allow global netting, was expansion of § 6402's offsetting provision. Congress could have chosen that approach and allowed netting rights to flow to "such person" as inherited the tax liability, while also expanding relief to provide that the underpayment and overpayment need not be simultaneously outstanding. *See id.* at 29.

Congress, however, did not choose that route. It instead implemented an "interest equalization approach" under which "no net interest is charged." *See* Treas. Rep. 28, 31-33. And Congress further departed from § 6402's approach by requiring that the "same taxpayer" must make the overpayment and the underpayment (I.R.C. § 6621(d)) –

rather than by focusing on the inheritance (from predecessor entities) of rights and liabilities.

As Wells Fargo points out (Br. 22), it is generally presumed that Congress is aware of existing law when enacting legislation, and the Treasury Report confirms Congress's awareness of existing law when it enacted § 6621(d). As this Court recognized in *Energy East*, the language Congress chose does not allow interest netting based on an entity's having inherited rights and liabilities; rather it must be "the same taxpayer." Wells Fargo's contention that § 6621(d) should be construed to have § 6402's breadth (Br. 17, 54) is thus misconceived in light of Congress's decision not to adopt wording in § 6621(d) similar to that of § 6402.[7]

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[7] That the IRS may have allowed some of Wells Fargo's claims that qualified under § 6402's different limitations (Br. 32) is of no relevance here. To the extent the IRS may have allowed claims under § 6621(d) similar to the disputed test situations (Br. 41), we believe it was before *Energy East* was decided. (*See* A1782-84.) But even if such claims were allowed thereafter, the fact that the IRS may have allowed – erroneously – similar claims furnishes no basis to allow additional claims that the statute does not authorize. *See, e.g., Harrah's Club v. United States*, 661 F.2d 203, 205 (Ct. Cl. 1981) ("the Commissioner may

(continued…)

Congress's choice in this regard is consistent with policy considerations. Congress has long been concerned with drafting tax laws to discourage manipulation by sophisticated taxpayers, who might engage in maneuvers lacking a genuine business purpose to gain a tax advantage. Indeed, the impetus behind the interest-rate differential (which made interest netting relevant) was concern that identical underpayment and overpayment interest rates could motivate sophisticated taxpayers to manipulate their underpayment or overpayment status "to maximize the differential with available returns in the rest of the economy." Treas. Rep. 18-19 (citing legislative history). Moreover, Congress has long been aware that provisions allowing tax attributes to pass from one corporate entity to another following a merger or other reorganization potentially create non-business incentives to combine entities, and it has balanced competing concerns of protecting against "trading in tax benefits" against

(…continued)
challenge in a succeeding year what he condoned or agreed to in a former year").

reasonable rules permitting successors' use of certain tax attributes. *See* Douglas A. Kahn, *Corporate Income Taxation*, at 564-65 (West 6th ed. 2009); Lewis T. Barr, *Net Operating Losses and Other Tax Attributes – Sections 381, 382, 383, 384, and 269,* 780-4th Tax Mgmt. at A-23 (BNA 2012).

In addition to protecting against manipulative transactions, Congress's imposition of the same-taxpayer requirement limits the extent to which interest netting alters the annual accounting system, which is at the core of our tax system, and under which each unique taxpayer is required to file a return for each taxable year. (*See* Op.Br. 41-42.) Wells Fargo contends (Br. 50) that interest netting under § 6621(d) is one of several explicit statutory exceptions to the general principle that each taxpayer's liability is determined at the close of a taxable year. But Congress generally has allowed carryovers between tax years only in very limited circumstances, and has been even more restrictive in allowing passing of tax attributes from one entity to another. *See* I.R.C. § 381. Section 6621(d)'s temporal limitation and its same-taxpayer requirement align permissible interest netting with the

fundamental tax-law concept that each unique taxpayer is liable for tax on an annual basis. This Court thus should not discard § 6621(d)'s restrictions in favor of the broader, non-textual reading Wells Fargo urges. *See Duncan v. Walker*, 533 U.S. 167, 174 (2001) (statute should be construed to give all parts meaning); *Energy East*, 645 F.3d at 1362 (declining to engage in "phantom legislative action" to rewrite the statute).

Giving effect to § 6621(d)'s restrictions in this regard is not a "punishment" for corporate taxpayers, as Wells Fargo claims (Br. 35). If an entity had no overlapping underpayments and overpayments of its own before the merger, not being able to net its underpayment or overpayment interest amounts post-merger against another participant's does not cause a loss of any rights. Rather, to permit such post-merger netting creates windfall opportunities for taxpayers, which, as *Lisbon Shops, Inc. v. Koehler,* 353 U.S. 382, 389-90 (1957), explains, should not be a consequence of a merger.

2. Informal IRS advice that conflicts with *Energy East* should not be followed

Wells Fargo points for support (Br. 23, 39-40) to several informal written determinations by the IRS, including Field Service Advice (FSAs) and Chief Counsel Advice (CCAs). To the extent that those suggest that underpayments and overpayments belonging to separate taxpayers could be netted if the same entity later acquired both the right to the overpayment and the liability for the underpayment, they (i) conflict with § 6621(d)'s statutory language as construed in *Energy East*, (ii) are not authoritative, and (iii) should not be followed. As I.R.C. § 6110(k)(3) makes clear, informal "written determinations," including FSAs, "may not be used or cited as precedent." *See also* I.R.C. § 6110(b)(1)(A) (defining "written determination"). Courts have long viewed § 6110(k)(3) (originally codified as § 6110(j)(3)) as making reliance on these informal determinations inappropriate, and such determinations do not bind the Commissioner or the courts. *See United States v. Hill,* 506 U.S. 546, 564 n.12 (1993); *Stichting Pensioenfonds*

Voor de Gezondheid v. United States, 129 F.3d 195, 200 (D.C. Cir. 1997); (Op.Br. at 30 n.11).[8]

Wells Fargo's suggestion (Br. 39) that *Rowan v. United States*, 452 U.S. 247, 261 n.17 (1981), and *Xerox Corp. v. United States*, 656 F.2d 660 n.3 (Fed. Cir. 1981), support use of informal IRS determinations is overstated. Those cases merely mentioned informal determinations as indicating that the IRS had considered a subject, and *Rowan* expressly noted that the letters lacked "precedential force," and it eschewed any reliance on them for their substance. 452 U.S. at 261 n.17; *see also Vons*, 51 Fed. Cl. at 11 (discussing *Rowan*). In any event, the Supreme Court in *Hill* more recently rejected an attempt to rely on

[8] As explained in *Vons Cos. v. United States*, 51 Fed. Cl. 1, 12 (2001), § 6110(k)(3) reflects "a careful compromise struck by the Congress." The bar on citing informal IRS determinations as authority "recognizes the functional relationship between allowing the IRS to use a streamlined review process to issue such rulings and memoranda on a relatively expedited basis," and "assurances that those documents will have no precedential impact." *Id.* Accordingly, informal determinations "may not be used or cited in any precedential way" and "may not be used to support, in any fashion, an argument that one interpretation of the Code is more authoritative than another."

a similar informal determination, citing the statutory prohibition on use of such determinations as precedent. 506 U.S. at 564 n.12.

C. A merger does not make all participants the "same taxpayer"

Contrary to the CFC's determination, a merger does not make all participants the "same taxpayer" for interest-netting purposes. Before a merger, two distinct corporate entities exist. When they merge, the acquired corporation ceases to exist, and its assets and liabilities pass to the surviving corporation, which is a separate entity. *See* James Eustice and Thomas Brantley, *Federal Income Taxation of Corporations and Shareholders*, ¶12.04 (2015). In arguing that state law and Supreme Court precedent establish a general rule that a merged entity is the same taxpayer as each pre-merger participant, Wells Fargo ignores the context in which the cases on which it relies were decided. When considered in the proper context, and in light of subsequent statutory and judicial developments, it is clear that such a general rule does not exist.

1. Case law does not support the proposition that the participants in a later merger retroactively become the "same taxpayer" for purposes of determining their status before the merger

As this Court has recognized, I.R.C. § 6621(d) imposes a temporal requirement, under which a court must look to the time the overpayment and underpayment were made to evaluate whether they were made by the same taxpayer. *Energy East,* 645 F.3d at 1361. Rejecting the argument that Energy East and its subsidiaries met the same-taxpayer requirement because they later became part of the same consolidated group, this Court made it clear that all that mattered is that these entities were not the same when the overpayments and underpayments were made, which was before the merger took place. 645 F.3d at 1361. *Energy East* thus establishes that, for purposes of examining Situation 1, the pertinent question is whether pre-merger Old Wachovia and pre-merger First Union were the same taxpayer on the relevant dates *before* the merger, when the underpayments and overpayments undisputedly were made. (A8.)

They were not. As in *Energy East,* the pre-merger entities were entirely separate at that time; they were not affiliated at all. (A8, 671-

72.) The proposition Wells Fargo urges – that a later merger can "retroactively" make unrelated entities the same taxpayer – is wholly unfounded. Wells Fargo has not pointed to a single case holding that a merger can retroactively make such a fundamental change in the relationship (or, more accurately, the lack thereof) the entities had to each other before the merger took place. Rather, the cases Wells Fargo cites all address the different question whether, *after* a merger, certain tax attributes of the acquired corporation, such as deductions or credits, can be utilized by the successor corporation. *See, e.g., Helvering v. Metropolitan Edison*, 306 U.S. 522 (1939) (addressing whether amortized bond deduction that predecessor could have claimed before the merger could be used by the successor); *Koppers Co. v. United States*, 134 F. Supp. 290 (Ct. Cl. 1955) (addressing whether excess profits credit carryover could pass between predecessor and successor corporation after merger). They do not support the principle – necessary to the CFC's holding in Situation 1 (involving pre-merger

underpayments and overpayments) – that corporations that were separate before a merger retroactively become the "same taxpayer."[9]

2. There is no rule that a post-merger surviving corporation is the "same taxpayer" as the pre-merger acquired corporation

Wells Fargo fares no better in Situation 3, where the overpayment was made (pre-merger) by the acquired corporation (CoreStates) and the underpayment was made (post-merger) by the surviving corporation (First Union). Because the surviving corporation takes on the acquired corporation's assets and liabilities, it is often said that the acquired corporation is "absorbed by" the surviving corporation, or that the surviving corporation steps into the acquired corporation's shoes. But

[9] Wells Fargo's argument (Br. 24) that two different taxpayers could exist at the close of a taxable year, yet retroactively become the "same taxpayer" as a result of a later merger, goes well beyond other exceptions to annual accounting that allow one entity's tax attributes to transfer to another. Such a retroactive change in the identity or status of what were unique taxpayers at the close of each taxable year would constitute a marked departure from the fundamental principle that a taxpayer's liability is determined at the close of each taxable year. *See, e.g., Penn v. Robertson*, 115 F.2d 167, 175 (4th Cir. 1940) ("A cardinal principle of federal income taxation requires annual returns and accounting; and this principle requires the determination of income at the close of the taxable year without regard to the effect of subsequent events.").

such statements are merely "metaphorical expression[s]," reflecting the concept that attributes of the corporation that ceases to exist are transferred to another corporation. *Newmarket Mfg. Co. v. United States*, 233 F.2d 493, 499 (1st Cir. 1956) (describing concept that the "'corporate personality of the transferor is drowned in that of the transferee'" as a "metaphorical expression"); *see also E & J Gallo Winery v. Commissioner,* 227 F.2d 699, 705 (9th Cir. 1955) (acknowledging that the idea that pre-merger taxpayer was drowned in the merged corporation "is a fiction").

Congress, in § 381, and the IRS, in revenue rulings (*see* Br. 8, 36-38), have permitted the carryover of specifically described tax attributes when associated rights and liabilities are inherited in a merger, thus permitting a surviving corporation to be "treated" as if it were the continuation of the acquired corporation in limited contexts. (*See* Br. 8, 36-38.) But no provision allows such treatment for interest-netting purposes. Rather, Congress explicitly limited the benefits of interest netting to the "same taxpayer." I.RC. § 6621(d). Moreover, although Congress has provided that certain tax attributes can pass from one

corporation to "another" in the event of a statutory merger, interest netting is not among them. I.R.C. §§ 381, 368(a)(1)(A).

a. State law (even if relevant) does not support the CFC's holding

To the extent state law could play any role in ascertaining whether two entities are the "same taxpayer" for purposes of § 6621(d) (and we do not think it does),[10] it does not support Wells Fargo's arguments. Delaware law, which Wells Fargo acknowledges is representative of all state merger law relevant here (A1566), illustrates that what occurs in a merger does not make the acquired corporation and surviving corporation the "same taxpayer" after the merger, much less make them – retroactively – the same taxpayer prior thereto. Although one early case that Wells Fargo cites (Br. 5) describes a merger in terms of the "the old corporations hav[ing] their identity absorbed into . . . the one into which they were merged," *Argenbright v. Phoenix Fin. Co.*, 187 A. 124, 126 (Del. Ch. 1936), statutory provisions

[10] *See PPL Corp. v. Commissioner*, 133 S. Ct. 1897, 1902 (2013) ("state-law definitions [are] generally not controlling in [the] federal tax context") (citing *Heiner v. Mellon*, 304 U.S. 271, 279 (1938)).

and later cases clarify that this is a "metaphorical expression" (*Newmarket,* 233 F.2d at 499), reflecting the fact that rights and obligations are transferred; it is not a determination that the surviving and acquired corporations are the same entity for all purposes, and certainly not for the purpose of the interest-netting provisions of the Internal Revenue Code. *See, e.g., Beals v. Washington Int'l, Inc.*, 386 A.2d 1156, 1161 (Del. Ch. 1978) (confirming that a merger effects a transfer of rights and liabilities from one particular entity to another); *Braasch v. Goldschmidt*, 199 A.2d 760, 767 (Del. Ch. 1964) (same).[11]

After a merger, the surviving corporation does not become, retroactively or prospectively, the same entity as the acquired (or

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[11] Under Delaware law, a merger occurs when "2 or more corporations . . . merge into a single corporation." Del. Code Ann. tit. 8, § 251(a) (2015). That remaining "single corporation" is "any 1 of the constituent corporations" that merged – not a wholly new entity. *Id.* In a merger of two corporations, one entity is the "surviving corporation" that continues to exist post-merger, while the other entity is the "disappearing corporation . . . that ceases to exist as a result of its merger into the surviving corporation." 1 R. Franklin Balotti & Jesse A. Finkelstein, *Delaware Law of Corporations and Business Organizations* § 9.2 (West 2014).

disappearing) corporation. Rather, "[w]hen companies merge under Delaware General Corporation Law, the surviving corporation succeeds to both the rights and obligations of the [disappearing] constituent corporation." *Halliburton Co. Benefits Comm. v. Graves*, 463 F.3d 360, 370 (5th Cir. 2006), *decision clarified on denial of reh'g*, 479 F.3d 360 (5th Cir. 2007); *see also Beals*, 386 A.2d at 1161 ("'the survivor must assume the obligations of the constituent'") (quoting *Fitzsimmons v. W. Airlines, Inc.,* 290 A.2d 682, 685 (Del. Ch. 1972)). Indeed, that the acquired and surviving corporation remain separate entities, even though assets and liabilities are transferred from one to the other, is readily apparent from the language used to describe the parties to a merger. There would be no need to distinguish between the "surviving" and "disappearing" (or acquired) corporations if all of those entities were one and the same. Balotti & Finkelstein, *supra*, at § 9.2; *see also Halliburton*, 463 F.3d at 370. After the merger, the acquired corporation "cease[s]" to exist. Del. Code Ann. tit. 8, § 259 (2015); *see also Beals*, 386 A.2d at 1161; *Damon Alarm Corp. v. Am. Dist. Tel. Co.*, 304 F. Supp. 83, 84 (S.D.N.Y. 1969).

Moreover, at least two elements of Delaware law are incompatible with the view that the acquired and surviving corporation after a merger are the same entity, and clarify that what happens in a Delaware merger is simply a transfer of rights and obligations. First, that state's treatment of shareholder derivative actions is incompatible with Wells Fargo's view. A shareholder derivative suit is "an action brought by a shareholder in the name . . . of a corporation to redress an injury sustained by, or to enforce a duty owed to, the corporation." W. Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 5939 (West 2014). Since a derivative action is brought in the corporation's name, the entity is "an indispensible party." *Arnstein v. Bethlehem Steel Corp.*, 18 F. Supp. 916, 918 (E.D.N.Y. 1937).

If a corporation's shareholders attempt a derivative action on behalf of a corporation that is acquired in a merger consummated during the course of that action, a problem arises at the time the acquired corporation ceases to exist. The law addressing what becomes of the derivative claim makes clear that the correct categorization of a merger is a transfer of rights and obligations. As the court explained in

Arnstein, addressing a merger of a New Jersey corporation into a Delaware corporation:

> Since whatever right of action the [disappearing] New Jersey corporation had against its directors *passed* to the [surviving] Delaware corporation, the [disappearing] New Jersey corporation after the merger could not have instituted this action. Then it follows that if the [disappearing] corporation itself was barred because its right of action was *transferred* to *another* corporation, the stockholders of the New Jersey corporation were without derivative status.

18 F. Supp. at 918 (emphasis added). Delaware courts have likewise so held, citing *Arnstein* and other cases that follow it. *See Arkansas Teacher Ret. Sys. v. Countrywide Fin. Corp.*, 75 A.3d 888, 891, 896 (Del. 2013); *Lewis v. Anderson*, 477 A.2d 1040, 1044 (Del. 1984); *Braasch*, 199 A.2d at 767. These opinions describe how the right to the derivative action is transferred via the merger, finding that the corporate right of action "transfer[s]" from one distinct entity to "another." *Arnstein*, 18 F. Supp. at 918. And they hold that the corporation to which the corporate right of action was transferred (the surviving corporation) is not the same entity as the acquired corporation, whose shareholders had exercised derivative rights in bringing suit. Thus, the derivative action that was result of the exercise of derivative rights by the shareholders

of the acquired corporation, which, post-merger, ceased to exist, had to be dismissed. *See id.* The theory (advanced by Wells Fargo) that a merger makes the acquired and surviving entities the same taxpayer is incompatible with this body of case law. And, as we have explained, interest netting is not a right or attribute that transfers after a merger; rather it can only be claimed if the "same taxpayer," at the relevant time, has an overlapping underpayment and overpayment.

The notion that the acquired and surviving corporations are the same entity also conflicts with Delaware law permitting mergers between different types of entities. In Delaware, corporations can merge with limited liability companies, Del. Code Ann. tit. 8, § 264 (2015), with non-stock (generally nonprofit) corporations, *id.* § 257, with general or limited partnerships, *id.* § 263, and with joint stock associations, *id.* § 254. This allowance for disparate-entity mergers refutes the proposition that the disappearing entity and the surviving entity are the same, and further confirms that the correct understanding of what happens in a merger is simply the transfer of rights and obligations from one entity to another.

b. I.R.C. § 381 clarifies that the acquired and surviving corporations are separate, and cases decided before that statute was enacted furnish no basis for interest netting in the circumstances presented here

As explained below, older cases decided before the enactment (in 1954) of § 381 that address transfers of attributes in mergers cannot reasonably be read as enunciating a general rule that parties to a merger become the same taxpayer following the combination. But in any event, those cases provide no relevant guidance here. None addressed a statute comparable to § 6621(d), which requires entities to be the "same taxpayer" at "an *identified* point in time," *Energy East,* 645 F.3d at 1361. Cases addressing whether the surviving corporation can use certain tax attributes of an acquired corporation in the context of less restrictive statutory language hardly should be treated as controlling here.

Moreover, by providing in § 381 that only certain specific attributes – not including interest netting – are transferred from one taxpayer to another after a merger, Congress confirmed its understanding that a merger does not make its participants the same

taxpayer. *See* I.R.C. §§ 368(a)(1)(A), 381. If a merger had that effect, there would have been no need to include mergers in the types of reorganizations for which Congress specified particular attributes could be used by a successor.

But even if cases decided before I.R.C. § 381 was enacted are relevant here (and we submit they are not), they do not support Wells Fargo's contentions. Neither *Metropolitan Edison*, 306 U.S. 522, nor cases purporting to follow it, establish the rule Wells Fargo urges, *viz.*, that a merger makes its participants the "same taxpayer." Indeed, if that were true, all tax attributes of each participant unquestionably would belong to the surviving corporation, and there would have been no reason for the Supreme Court, eighteen years later in *Libson Shops, Inc. v. Koehler*, 353 U.S. 382 (1957), to focus on whether the surviving corporation was a substantial continuation of the business that had, pre-merger, incurred the loss, in deciding whether the surviving corporation could use carryover losses. And there would have been no reason for Congress to have made § 381 applicable to statutory mergers. *See* I.R.C. §§ 368(a)(1)(A), 381. We explained in more detail in our

opening brief (at pp. 56-63) why these pre-§ 381 cases do not supply the answer to the question posed in this case, and there is no need to repeat that discussion here.

Wells Fargo's continued heavy reliance (Br. 24-30) on these old cases – which are now irrelevant in light of Congress's enactment of I.R.C. § 381 – is grasping at straws. None of the cases stands for the proposition that interest netting is allowed in the situation involved here; the cases have nothing to do with interest netting at all. What they addressed was simply whether successor corporations could utilize pre-merger tax attributes of acquired corporations, whether by a statutory merger or some other *de facto* merger arrangement, and until Congress enacted § 381, there was inconsistency in the decided cases. While it is true that, in the course of making determinations of this sort, some courts,[12] as a kind of shorthand, described the question before them as whether the successor corporation could be viewed – for purposes of claiming the tax attributes of the acquired corporation – as

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[12] *E.g., Stanton Brewery, Inc. v. Commissioner*, 176 F.2d 573 (2d Cir. 1949); *Gallo,* 227 F.2d at 704-05;

the same entity, that articulation does not establish that a successor corporation is the "same taxpayer" for all tax purposes, much less for purposes of a statute Congress enacted years later. This case law, in short, cannot carry the heavy weight Wells Fargo places on it.

At all events, and as we explained in our opening brief (at pp. 62-63), any notion that *Metropolitan Edison* stands for the proposition that all parties in a merger become the same taxpayer was dispelled by the Supreme Court's subsequent decision in *Lisbon Shops,* which confirms that *Metropolitan Edison* cannot be read for the broad proposition urged by Wells Fargo. In *Lisbon Shops,* the Court rejected the argument that, where the successor sought to carry over losses of three acquired corporations in a statutory merger, *Metropolitan Edison* required allowing the carryovers because the successor was the same taxpayer as the merged constituents. Instead, the Court determined that the deduction of the carryover losses should be disallowed because the businesses seeking to benefit from the loss were not the same businesses that had incurred the loss. *Lisbon Shops,* 353 U.S. at 389-90.

Libson Shops' holding, that a comparison of the businesses was required to ascertain whether the same taxpayer incurred the loss and the offsetting gains, cannot be squared with the CFC's analysis here, which assumed that a merger makes all its participants one and the same. Indeed, this Court's predecessor, the Court of Claims, stated in *Wisconsin Central* that *Libson Shops* makes "clear" that "merger alone is not a sufficient basis for allowing the resultant corporation to succeed to its predecessors tax attributes." 296 F.2d at 754; *see also Westinghouse Air Brake Co. v. United States,* 342 F.2d 68, 73-74 (Ct. Cl. 1965). The CFC thus erred in concluding that a merger makes all parties thereto the "same taxpayer" for purposes of interest netting.

CONCLUSION

The CFC's decision should be reversed, and partial summary judgment should be entered for the Government.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing reply brief was electronically filed with the Clerk of the Court for the United States Court of Appeals for the Federal Circuit by using the appellate CM/ECF system on July 27, 2015, and that all counsel for the appellee are CM/ECF users and will be served by the CM/ECF system.

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