NO. 12-43

In the

Supreme Court of the United States

PPL CORPORATION AND SUBSIDIARIES,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR *AMICI CURIAE* ROSANNE ALTSHULER, RICHARD M. BIRD, MALCOM GILLIS, ARNOLD C. HARBERGER, GARY C. HUFBAUER, CHARLES E. McLURE, JR., JACK MINTZ, AND GEORGE R. ZODROW IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTEREST OF *AMICI CURIAE* 1

INTRODUCTION AND SUMMARY OF ARGUMENT 4

ARGUMENT 5

Tax Policy Considerations 5

The Economic Substance of the U.K. Windfall Tax 8

The Predominant Character of the Windfall Tax 12

The IRS Fixation on Form over Economic Substance 14

Failure of the Regulations to Track the Statute 18

Wider Relevance of the Issue 20

CONCLUSION 22

TABLE OF AUTHORITIES

Cases

Entergy Corp. & Affiliated Subsidiaries v. Comm'r, 683 F.3d 233 (5th Cir. 2012) 14

Estate of Weinert v. Comm'r, 294 F.2d 750 (5th Cir. 1961) 5

Statutes

26 U.S.C. § 901(b)(1) 4, 17, 18

Rules and Regulations

Treas. Reg. § 1.901-2 .... 8, 13

Treas. Reg. § 1.901-2(a)(1) 7, 13, 18

Treas. Reg. § 1.901-2(a)(3) 13

Treas. Reg. § 1.901-2(b)(3) 13

Treas. Reg. § 1.901-2(b)(4) 15

Other Authorities

Boris I. Bittker & Lawrence Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS (3rd ed. 1999) 15

Charles E. McLure, Jr. & George R. Zodrow, *A Hybrid Consumption-Based Direct Tax Proposed for Bolivia*, INTERNATIONAL TAX AND PUBLIC FINANCE (1996) 20

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INTEREST OF *AMICI CURIAE*[1]

Amici are distinguished academic economists with particular expertise in the economics of taxation. Their only interest in this case is their commitment to sound tax policy and a faithful execution of the law. They have not been compensated for preparing this brief. The identities of *amici* and brief statements of their qualifications are as follows:

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[1] Counsel for all parties have been given 10 days notice as required by Rule 37.2(a) and have consented to the filing of this brief. No person other than the named *amici* or their counsel authored this brief or provided financial support for it.

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Dr. Charles E. McLure, Jr. is a Senior Fellow (emeritus) at the Hoover Institute at Stanford University. As Deputy Assistant Secretary of the Treasury from October 1983 to August 1985, McLure had primary responsibility for preparation of the Treasury Department proposals to President Ronald Reagan that became the basis of the Tax Reform Act

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INTRODUCTION AND SUMMARY OF ARGUMENT

Under the Internal Revenue Code, U.S. taxpayers are allowed to take a credit against their U.S. tax liability for "income, war profits, and excess profits taxes" paid to foreign governments. 26 U.S.C. § 901(b)(1). In 1997 the United Kingdom (U.K.) imposed a Windfall Tax on recently privatized public utilities. The issue in this case is whether the Windfall Tax is a tax on excess profits, and thus eligible for the foreign tax credit.

The U.S. Tax Court, in a well-reasoned opinion, which was affirmed by the U.S. Court of Appeals for the Fifth Circuit, ruled that the Windfall Tax is a creditable tax on excess profits. In a conflicting ruling, however, the U.S. Court of Appeals for the Third Circuit held that the Windfall Tax is not a creditable tax on excess profits. *Amici* urge this Court to grant certiorari to resolve the irreconcilable conflict between the two circuit courts by reaffirming the sound economic analysis that underlies the Fifth Circuit's decision and repudiating the formalistic and economically irrational reasoning underlying the Third Circuit's ruling.

From the perspective of an economist, the Windfall Tax is indisputably a tax on excess profits, even though it may superficially appear to be a tax on the difference between two values. This proposition is easily demonstrated by a simple rearrangement of terms in the formula describing the tax base that is implicit in the U.K. statute. Indeed, the Internal Revenue Service (IRS) has stipulated that this rearrangement is

mathematically equivalent to the statutory description of the tax. Pet. App. at 62 & n.20. The U.S. Court of Appeals for the Third Circuit thus went astray in finding that the tax is not a creditable tax on excess profits.

Courts have often referred to the doctrine of "substance over form" as "the cornerstone of sound taxation." *See, e.g., Estate of Weinert v. Comm'r*, 294 F.2d 750, 755 (5th Cir. 1961). "Substance" is widely regarded as a matter of economic effects or reality. Yet, the Third Circuit ignored economic reality in deciding that the Windfall Tax is not a creditable excess profits tax. Instead, it focused entirely on the form of the U.K. statute in reaching its conclusion.

In determining that the U.K. Windfall Tax is not creditable, the Third Circuit rigidly applied the regulations interpreting the statute authorizing a foreign tax credit. But, as *amici* McLure and Zodrow observed in an article published in the *National Tax Journal* in 1998, the regulations do not deal adequately with excess profits taxation. Rather, they effectively define away the possibility of obtaining foreign tax credits for many forms of excess profits taxes. The Tax Court applied the regulations in a less rigid and more economically sensible manner and thus concluded correctly that the Windfall Tax should be creditable.

ARGUMENT

Tax Policy Considerations

Disallowance of a credit for taxes that should be creditable, such as the Windfall Tax, violates standard tax policy norms of equity, economic

neutrality, and international comity, and has undesirable effects on the international economic relations of the United States.

Unlike most foreign countries, the United States does not limit the tax on its residents (individual and corporate) to their domestic-source income; instead, it taxes their income from all sources, foreign as well as domestic. To prevent double taxation of its residents, the United States provides them a credit for income taxes, war profits taxes, and excess profits taxes paid to foreign governments on foreign-source income that is taxed in the United States.

The foreign tax credit is required to achieve equity among U.S. resident taxpayers. In the absence of the credit, resident taxpayers with foreign-source income that is taxed abroad would be taxed more heavily than resident taxpayers with only domestic-source income, thus creating inequity between resident taxpayers earning the same amount of income.

Equally important, the credit is required to achieve neutrality between foreign and domestic investment. In the absence of the credit, foreign investment that would otherwise be as attractive as domestic investment would be rendered less attractive. The resulting lack of neutrality between foreign and domestic investment would mean that U.S. capital would not be put to its most productive use. Seen from the perspective of the foreign country, the lack of a foreign tax credit in the United States would be tantamount to the imposition of an unwelcome exit tax on U.S. capital invested abroad.

In evaluating proposals for tax reform, foreign governments often consider whether the United States would grant a credit for the taxes being proposed. Fear that the United States might not grant such a credit can prevent adoption, or even consideration, of a tax that a foreign government might otherwise find optimal. Where the tax in question should not be creditable, as in the case of royalties disguised as taxes, there is nothing wrong with that result. However, from the standpoint of sound international policy, the IRS should not be allowed to discourage the adoption of foreign taxes that economic analysis clearly indicates should be creditable under U.S. law, simply because the foreign taxes do not take a particular form. Moreover, the unjustifiable denial of creditability is not simply a matter of comity. The fear that a credit would not be allowed for a tax that should be creditable may stifle foreign experimentation and innovation that would be beneficial to the foreign country and that the United States might find instructive.

The tax laws of foreign countries do not necessarily follow the same structure as the U.S. income tax. Yet, taxes that differ in form may have economic effects that are similar to those of the U.S. income tax. Indeed, the governing regulations recognize this fact by defining a creditable income tax as one whose "*predominant character*" is "an income tax in the U.S. sense." Treas. Reg. § 1.901-2(a)(1), (emphasis supplied). This means that the tax must ordinarily reach net gain, because, as a matter of substance, the levy has the characteristics of an income tax by fulfilling the realization, gross

receipts, and net income requirements specified in the regulations. *Id.* § 1.901-2. Economic effects cannot, of course, be determined by examining only the form of a tax, especially if only one feature of a tax is being considered in isolation. Instead, economic effects are inherently a matter of substance and must be considered within the context of the entire tax. Focusing solely on the form of a tax can result in denial of credit for taxes that economic analysis demonstrates should be creditable, resulting in double taxation and, consequently, inequity, non-neutrality, and the frustration of sound international tax policy.

The Economic Substance of the U.K. Windfall Tax

As a matter of economic substance, the Windfall Tax is clearly a tax on excess profits and thus should be creditable.

Beginning in 1997, the U.K. imposed an excess profits tax, the Windfall Tax, because it was thought that privatized public utilities had earned excessive profits during the initial four-year regulatory period following privatization. Tax liability was 23% of the difference between "value in profits terms" during the first four years after privatization and the amount the U.K. government realized through privatization, termed "flotation value" in U.K. parlance. "Value in profits terms" was calculated by multiplying average net income in the four years by 9, an arbitrarily chosen price-earnings ratio.

Although described in legislative terms as a tax on excess value, the tax had the economic effects of a tax on excess profits. This follows inexorably from

the fact that the calculation of "value in profits terms" was based on average net income over the four-year period, rather than on an actual measure of value (which could have easily been established from market data). Indeed, the IRS stipulated that "... the tax formula can be restated as a 51.75% tax on profits in excess of 4/9 of flotation value ...." PPL Pet. at 11 (citing Pet. App. at 62). *From an economic point of view, that statement alone is enough to demonstrate that the Windfall Tax was a tax on excess profits*. Moreover, as Professor Stewart Myers says (3d Cir. JA at 1065) and Professor Edward Maydew confirms (3d Cir. JA at 1012-14), "the U.K. Windfall Tax ... has basically the same structure as the U.S. excess profits taxes." The unavoidable conclusion is that the Windfall Tax should be creditable.

A review of the empirical evidence reinforces what the mathematics shows, namely, that the Windfall Tax was, in effect, levied on profits. First, Myers documented the close empirical relationship of tax liability to profits. Pet. App. at 59-60 & n.17. Even more compelling is the fact that, when a PPL Corporation's subsidiary's request for an increase in a deduction was granted, its tax liability dropped by exactly 51.75% of the increase in the deductible amount, confirming what Professor Maydew's numerical example shows (PPL Pet. at 7-9; Pet. App. at 44, 61-62 & n.19; 3d Cir. JA at 1009-11), to wit, that when income changes by £100, the tax changes by £51.75. This was inevitable because the effective tax rate was 51.75% and, as Myers says, "the *only moving part in the Windfall Tax machinery is net income*." 3d Cir. JA at 1061 (emphasis in original).

The U.S. Court of Appeals for the Third Circuit stated: "If profit is in essence the only variable in the tax base, we would first need to explain away the other two variables that the U.K. statute puts there." Pet. App. at 10. This statement is disingenuous, at best; it appears to reflect a predetermination that the Windfall Tax is not a creditable tax. Although the court does not identify the "two variables" at issue, it appears that they are the flotation value and 9, the assumed price-earnings ratio. These terms are included in the description of the base of the Windfall Tax for the same reason that conventionally formulated excess profits taxes include a measure of the capital stock, for which flotation value serves as a proxy, and a rate of return above which returns are deemed to be excessive, for which 1/9 (or 11.1%) serves as a proxy, as recognized in the statement by Peter Lilley quoted in the next paragraph.

Nor is it accidental that the Windfall Tax had the economic effects of a conventional excess profits tax. That is precisely what was intended, as reflected in statements by members of both the ruling Labour Party and the opposing Conservative Party. Particularly telling is the description of the tax by Conservative Party Shadow Chancellor of the Exchequer Peter Lilley, MP, who understood perfectly the nature of the tax. He said, "They [the government] have taken average *profits* over four years after flotation. If those *profits* exceed one ninth of the flotation value, the company will pay windfall tax on the excess." Pet. App. at 42 (emphasis supplied). He advisedly spoke of the excess of *profits* over one-ninth of the flotation value, not the excess

of actual value over flotation value. Of course, his description corresponds exactly to the way conventional excess profits taxes operate.

The IRS claims that the Windfall Tax should not be creditable, because it was levied on the difference between two values. But, as both Stewart Myers (Pet. App. at 60 n.17) and Chris Osborne (Pet. App. at 78 n.29) note, "value in profits terms" is not a measure of real value or a term that is recognized in financial literature or practice; it is an artificial construct that has no economic meaning. It was calculated by multiplying *past* income by an arbitrarily chosen price-earnings ratio. But, as Myers notes (3d Cir. JA at 1045, 1055), value is related to *prospective* earnings, not past income. Moreover the price-earnings ratio utilized was not the result of a study of the earnings of the affected companies relative to their price. Rather, as Osborne (Pet. App. at 78 n.29; 3d Cir. JA at 908) states, it was an arbitrary figure chosen to reconcile the competing needs for revenue and the desire not to impose a tax that was so high that it would impede the companies' investment efforts or drive them into insolvency.

Both Osborne and Dr. Chris Wales, who were responsible for designing the tax, have stated that the Windfall Tax was structured the way it was, as the difference in two values, entirely for "'presentational' reasons," Pet. App. at 58 & n.16, that is, for presentation to the British public. The enacting legislation could just as easily, and more transparently, have described the Windfall Tax as it was described above: as 51.75% of profits in excess of 4/9 of flotation value. The choice to structure and

describe the tax differently — the form of the tax — should not affect its creditability, as it does not affect its economic effects — its substance.

That the Windfall Tax was not a tax on excess value in any meaningful economic sense also can be seen from its structure. The total profits in the first four years after privatization were divided by 4 (to convert to average annual profits) and multiplied by the arbitrarily chosen price-earnings ratio of 9 to derive "value in profits terms," which was compared with value at privatization. It makes no sense to impose a tax on value in this way. If the intent were really to tax excess value, the logical comparison would have been between the market value of stock, which was readily available, and the value at flotation. The artificial construct, "value in profits terms," would not have been used. Beyond that, even if "value in profits terms" were a meaningful term, it would make no sense to compare its average value over four years with flotation value; the tax would more logically have been levied on the difference between flotation value and market value four years after privatization. By comparison, it would be quite reasonable under an excess profits tax to compare average income over four years with an imputed return on flotation value, which is what the Windfall Tax did.

The Predominant Character of the Windfall Tax

The Windfall Tax has the predominant character of an income tax in the U.S. sense and thus should be creditable. To be creditable, a foreign tax must have the predominant character of an

income tax in the U.S. sense. Treas. Reg. § 1.901-2(a)(1)(ii). To satisfy that requirement, the tax must be "likely to reach net gain in the normal circumstances in which it applies." *Id.* § 1.901-2(a)(3). The criteria used to determine whether a tax reaches net income are realization, gross receipts, and net income. *Id.* § 1.901-2.

On its face, the Windfall Tax reaches net income. Moreover, it satisfies the realization, gross receipts, and net income criteria. The calculation of "value in profits terms" is based on *net income* during the first four years after privatization. It is clear that the income had been *realized*, as it had been reported on financial statements. Because the calculation of net income is based on *gross receipts*, the gross receipts criterion is satisfied. Because deductions are allowed for expenses, the *net income* criterion is satisfied.

The U.S. Court of Appeals for the Third Circuit concluded erroneously that the gross receipts criterion was not satisfied. Pet. App. at 14-15. To support this view, the court referred to an example in the regulations, Treas. Reg. § 1.901-2(b)(3)(ii), Ex. 3, that describes a situation in which gross receipts are deemed to be 105% of the market value of petroleum sold, suggesting that the Windfall Tax does not meet the realization test, because it is based on 225% of gross receipts. Pet. App. at 12-14. This analysis fails on several counts. First, as is well known, the example in the regulations was intended to prevent inflation of gross receipts from the sale of petroleum, in order to maximize credits. It is totally irrelevant in the present case, where the gross receipts involved were from the actual sale of utility services. *See Entergy Corp. & Affiliated Subsidiaries*

v. Comm'r, 683 F.3d 233, 237-238 (5th Cir. 2012) (discussing example and its intent). Second, as demonstrated below, the Windfall Tax was not based on 225% of profits; because of the way the tax was structured, the effective tax rate was 225% of the 23% statutory rate, or 51.75%.

The Third Circuit seems to think that the Windfall Tax should not be creditable merely because it is, in effect, levied on only *excess* profits. *See* Pet. App. at 10-11 & n.2. This assertion is absurd. The purpose of the regulations is to prevent crediting of taxes that are based on a figure *greater* than net income, calculated in the U.S. sense. They are not intended to prevent crediting of taxes that reach *less* than net income, as all excess profits taxes (including the Windfall Tax) do by taxing only excess profits. To argue otherwise is to read excess profits taxes out of the statute, even though it provides explicitly that they are creditable.

The IRS Fixation on Form over Economic Substance

The IRS's focus on form over economic substance in determining whether a tax is creditable — a position embraced by the court below — flies in the face of fundamental principles of tax policy that economic "substance" rather than "form" should be the cornerstone of sound taxation. The IRS even goes so far as to say, "[t]he words of the U.K. statute *are* the 'substance' of this tax." Pet. App. at 67 (emphasis in original). In other words, in the view of the IRS and the court below, form trumps economic substance when creditability is at stake.

That the IRS would invoke — and that an appeals court would condone — form rather than economic substance as the touchtone of creditability is truly astonishing. *That substance, which is rooted in economic reality, and not form should control sound tax analysis is the cornerstone of jurisprudence in the tax area.* As Boris I. Bittker and Lawrence Lokken write in the chapter on "Pervasive Judicial Doctrines" in their classic treatise *Federal Taxation of Income, Estates and Gifts*:

> In 1921, when today's federal income tax was still in its swaddling clothes, the Supreme Court recognized "the importance of regarding matters of substance and disregarding forms in applying the ... income tax laws." More recently, the substance-over-form principle has been called "the cornerstone of sound taxation."

Boris I. Bittker & Lawrence Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS § 4.3.3 at 4-34 (3rd ed. 1999) (citations omitted).

The Third Circuit's and IRS's preoccupation with form over substance purportedly provides a basis for ignoring evidence of economic substance in determining creditability. This also strains credulity. The potential need to consider evidence in determining creditability under the statute is demonstrated by the fact that the regulations provide explicitly that foreign tax credits are available for a tax that fails to allow a deduction that is found in the U.S. income tax, as long as another provision compensates for that lack of deductibility. Treas. Reg. § 1.901-2(b)(4)(i). Whether

such compensation exists and is adequate is inherently a question of substance, that is, of economic effects. It would be impossible ever to meet this test if evidence extrinsic to the statute, namely economic analysis, could not be considered.

In focusing entirely on form and ignoring economic substance in their denial of the creditability of the Windfall Tax, the IRS and the Third Circuit necessarily reject the relevance of the algebraic reformulation of the Windfall Tax described above (*see* pp. 8-12 *supra*), which demonstrates that the Windfall Tax is, in economic substance, a creditable tax on income. The assertion seems to be that mathematical manipulation of the formula depends on extrinsic evidence. This also strains credulity. It is equivalent to arguing that if a statute says "2 + 3 = 5," it is illegitimate to say "5 – 3 = 2," because the arithmetic manipulation involved requires extrinsic evidence.

Despite its refusal to recognize the mathematical identity of the Windfall Tax and a plainly creditable excees profits tax, the Third Circuit engaged in some mathematical manipulation of its own. The court's mathematical analysis proceeded from the false premise that the taxpayer had claimed that tax liability was based only on first period profits, to the neglect of flotation value. Pet. App. at 9 ("Were this a tax on initial-period profit, as PPL contends that it is in substance, …."). Based on this misinterpretation of what the taxpayer had said, the court derived several formulas for tax liability that omit flotation value. Pet. App. at 11-12. Of course, these produce the wrong result.

But the taxpayer never claimed that liability depended *only* on first-period profits. Rather it depends on the excess of first-period profits over 4/9 of flotation value. That is what makes it an *excess* profits tax, instead of merely a profits tax. Incredibly, the court explicitly recognized that "[i]n PPL's view, looking through the form of the tax to its substance reveals that 'the [t]ax [i]s, in substance, a tax on profits, specifically on excess profits.'" Pet. App. at 8-9. Moreover, this is precisely what the statute recognizes as creditable, 26 U.S.C. § 901(b)(1), the Third Circuit's decision to the contrary notwithstanding.

Ignoring flotation value, as the court did without justification, transforms the operative part of the above description of the tax — a 51.75% tax on profits in excess of 4/9 of flotation value — into "a 51.75% tax on profit ...." Pet. App. at 12. Then, arguing that the regulations do not allow restatement of the tax rate, the court deduces that the unchanged tax rate of 23% is levied on 225% of profits, in violation of U.S. law, which provides that no more than 100% of profits can be taxed. *Id.* From this misguided view, the court concludes that the gross receipts and realization criteria are not met. *Id.* This interpretation confuses statutory tax rates and effective tax rates. Although the *statutory tax rate* is only 23%, the *effective tax rate*, which is applied to exactly 100% of excess profits, is 51.75%. The Third Circuit insists on stating the tax as "Tax = 23% x [2.25 x *P*]." Pet. App. at 11. It is equally valid — and more sensible from an economic point of view — to state it as "Tax = [23% x 2.25] x *P*."

In short, by focusing narrowly on the form of a tax, to the exclusion of its substance, the IRS and the Third Circuit come to an economically irrational conclusion that the Windfall Tax is not creditable. Following this approach is likely to produce double taxation, and, as a consequence, inequity, non-neutrality, and the frustration of international tax policy objectives.

Failure of the Regulations to Track the Statute

Insofar as the regulations fail to recognize that an excess profits tax is creditable, they are not faithful to the statute.

Section 901(b)(1) of the Internal Revenue Code provides a credit for "the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country." 26 U.S.C. § 901(b)(1). Before describing the characteristics of an income tax, the governing Treasury regulations state:

> (a) *Definition of income, war profits, or excess profits tax* — (1) *In general.* 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* ...) paid to any foreign country. ... A foreign levy is an income tax if and only if —
>
> (i) It is a tax; and
>
> (ii) The predominant character of that tax is that of an income tax in the U.S. sense.

Treas. Reg. § 1.901-2(a)(1) (emphasis added). These regulations are not faithful to the statute, insofar as

they define away the distinction between income taxes and excess profits taxes (and war profits taxes), which the statute provides explicitly are creditable. In essence, the regulations define "income, war profits, and excess profits taxes" to be "income taxes" and then say implicitly that, to be creditable, excess profits taxes must be "an income tax in the U.S. sense" regardless of whether they constitute a war profits or an excess profits tax. Based on this illogical regulatory interpretation of the statute, the IRS finds the Windfall Tax not to be an income tax and thus not creditable.

This regulatory misinterpretation of section 901(b)(1) is analogous to the following. Suppose that (a) a statute provides a tax benefit for the raising of "chickens, ducks, and geese," (b) the regulations refer to "chickens, ducks, and geese" as "chickens," and (c) the IRS, following these regulations, rules that no tax benefit is allowed for the raising of ducks and geese, because ducks and geese are not chickens. The violence done to the statutory language of section 901(b)(1) by the regulations in section 1.901-2 is only slightly less obvious than that done in this hypothetical example. To prevent this type of travesty, the regulations misinterpreting section 901(b)(1) must be disregarded.

Amici McLure and Zodrow made this point nearly fifteen years ago in an article published in the *National Tax Journal*:

> [B]y initially referring to income, war profits, and excess profits taxes collectively as "income taxes," and then requiring that, to be creditable, the foreign tax must be "an

> income tax in the U.S. sense" ..., the regulations are not faithful to the wording of the statute. (Fn. ref. omitted) Since the structures of income and excess profits taxes are inherently different, these differences should be taken into account explicitly in the regulations; specifically, there should be separate criteria defining what is creditable as an income tax and what is creditable as an excess profits tax.

Charles E. McLure, Jr. & George R. Zodrow, *The Economic Case for Foreign Tax Credits for Cash Flow Taxes*, 51 NATIONAL TAX JOURNAL 1, 8-9 (Mar. 1998). Once it is recognized that the regulations do not deal with war profits and excess profits taxes, it is clear that taxes not structured like the U.S. income tax may nevertheless qualify for foreign tax credits.

Wider Relevance of the Issue

The importance of creditability of taxes that do not look exactly like the U.S. income tax goes far beyond the creditability of the U.K. Windfall Tax. The wider relevance of this issue can be seen from the following episode, which is documented in the *National Tax Journal* article cited above as well as in Charles E. McLure, Jr. & George R. Zodrow, *A Hybrid Consumption-Based Direct Tax Proposed for Bolivia*, 1 INTERNATIONAL TAX AND PUBLIC FINANCE 97 (1996).

In the mid 1990s the President of Bolivia, Gonzalo Sanchez de Lozado, expressed strong interest in proposing a business cash flow tax (of which the flat tax is an example). Acting as

consultants to the government of Bolivia, *amici* McLure and Zodrow examined the creditability issue carefully and concluded:

a) that the regulations do not accurately reflect the wording of the statute they are intended to interpret;

b) that the business cash flow tax could be interpreted as a tax on excess profits, and thus should be creditable under section 901(b) (1);

c) that the business cash flow tax should be creditable under strict application of the regulations, because, as a simple matter of economics, the first-year write-off of all investment would more than compensate for the lack of a deduction for interest;

d) that in the particular circumstances of Bolivia the business cash flow tax would have had the "predominant characteristics of an income tax," as defined under U.S. law, even if the benefit of first-year write-off were ignored; and

e) that credit for the business cash flow tax would reduce U.S. revenue less than credit for a conventional income tax levied at the same rate.

President Sanchez de Lozado and *amici* McLure and Zodrow met with a representative of the IRS. The President explained that he was considering proposing a business cash flow tax solely because of its domestic advantages, and *amici* McLure and Zodrow made the foregoing arguments for the creditability of such a tax. The IRS representative replied that none of the arguments mattered, because, "we look at form, not substance." Faced with this intransigence and the risk that the

business cash flow tax might not be creditable, the President had no alternative but to succumb and propose a conventional income tax.

As *amici* McLure and Zodrow observed in their *National Tax Journal* article, by emphasizing form over substance, in direct contradiction of both statutory and regulatory authority, the IRS is unduly influencing the forms of taxation foreign governments can consider. The IRS is thereby violating both the best economic interests of the United States and international comity by discouraging the adoption by foreign governments of taxes that many economists in the U.S. and elsewhere have argued are superior to the traditional income tax.

CONCLUSION

For all of the reasons stated above, this Court should grant certiorari in this case to resolve the conflict between the decisions of the Fifth Circuit Court of Appeals, which decided correctly that credit should be allowed for the U.K. Windfall Tax, and that of the Third Circuit, which erred seriously in deciding that the Windfall Tax is not creditable. Failure to resolve the split would perpetuate undesirable uncertainty regarding creditability for many U.S. corporations considering foreign investments. Worse, affirming the decision of the Third Circuit would create the specter that foreign taxes that meet both the statutory and regulatory criteria for creditability might not be found creditable, merely because they do not follow a form dictated by the IRS, acting with no statutory or

regulatory basis. *Economic substance, not formalism, should govern the eligibility for the foreign tax credit.*

Respectfully submitted,

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