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PPL, the Foreign Tax Credit, and the Gitlitz "Finger" Principle

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ARTICLES

PPL, the Foreign Tax Credit, and the *Gitlitz* "Finger" Principle

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I

In May 2013, the U.S. Supreme Court decided *PPL Corp. v. Commissioner*.[1] The decision upheld a foreign tax credit for the United Kingdom's so-called "windfall tax." The decision was unanimous, and represents an extraordinarily liberal reading of the statutory provisions and regulations governing the foreign tax credit.

The "windfall tax" was imposed on certain entities, mostly electric utilities, that had been "privatized" during the 1980s by the Conservative governments under Prime Ministers Margaret Thatcher and John Major. The Labour Party regained control of the United Kingdom government in 1997, after 18 years of Conservative rule. Parliament then enacted the windfall tax. The windfall tax was computed by first determining the average daily profits of the companies during a four-year testing period; multiplying that by nine; multiplying that figure by the number of days in the year (365), to determine the proper "capital value" of the company as of the date on which the company was privatized. From that amount was subtracted the "flotation value" of the company, that is, the price paid by shareholders at the time of privatization. The resulting number was the "tax base"; it was subject to taxation at a statutory rate of 23%.

Justice Thomas's opinion for the Court holds "that the predominant character of the windfall tax is that of an excess profits tax, a category of income tax in the U.S. sense."[2] The Court notes that the parties stipulated that the tax could be calculated according to the following formula:

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

where P is the aggregate profits over the four-year test period, D the number of days in the period, and FV the flotation value. If one assumes that for most companies, the D in this equation is 1,461, the number of days in a four-year period, then this formula can be re-expressed, eliminating the D and the number 365, as follows:

(2) $\text{Tax} = 23\%\ [(P / 4 \times 9) - FV]$

The Court noted that this equation can be rearranged by simple algebraic manipulation to read as follows:

(3) $\text{Tax} = 51.7\% \times \{P - [(FV / 9) \times 4.0027]\}$

The Court then stated that this presented the tax as a tax on actual (excess) profits earned — the tax base was essentially the profits during the four-year period in excess of "allowable" profits on the invested capital (flotation value):

> As noted, FV represents the value at which each company was privatized. FV is then divided by 9, the arbitrary 'price-to-earnings ratio' applied to every company. The economic effect is to convert flotation value into the profits a company *should* have earned given the assumed price-to-earnings ratio. See 135 T.C., at 327 ("'In effect, the way the tax works is to say that the amount of profits you're allowed in any year before you're subject to tax is equal to one-ninth of the flotation price. After that, profits are deemed excess, and there is a tax'" (quoting testimony from the treasurer of South Western Electricity plc)). The annual profits are then multiplied by 4.0027, giving the total 'acceptable' profits (as opposed to windfall profit) that each company's flotation value entitled it to earn during the initial period given the artificial price-to-earnings ratio of 9. This fictitious amount is finally subtracted from *actual* profits, yielding the excess profits, which were taxed at an effective rate of 51.71%.[3]

And Justice Thomas noted, unassailably but with two inevitable qualifications, that this expression represented the essence of a windfall profits tax:

[1] 133 S. Ct. 1897 (2013).

[2] *Id.* at 1897, 1903.

[3] *Id.* at 1897, 1904–05 (emphasis in original).

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> The rearranged tax formula demonstrates that the windfall tax is economically equivalent to the difference between the profits each company *actually* earned and the amount the Labour government believed it *should* have earned given its flotation value. *For the 27 companies that had 1,461-day initial periods*, the U.K. tax formula's substantive effect was to impose a 51.71 percent tax on all profits earned above a threshold. That is a *classic excess profits tax. See, e.g.,* Act of Mar. 3, 1917, ch. 159, Tit. II, §201, 39 Stat. 1000 (8% tax imposed on excess profits exceeding the sum of $5,000 plus 8% of invested capital).
>
> Of course, other algebraic reformulations of the windfall tax equation are possible.[4]

The difficulty suggested by the first emphasized words in the quoted passage above was that there were 32 companies subject to the tax, and only 27 operated in privatized form for the full 1,461 days in the four-year period. For companies with short periods, the tax applied by taking their profits for such periods during their first four years that they were in operation as private companies, and projecting that the profits earned in that period would be earned over four years. The capital value derived based on those projected profits was then offset by the flotation value to arrive at the base which was subjected to tax at 23%. When two of the five ''outlier'' companies were analyzed, the statutory formula could still be ''rearranged'' as done by the Court opinion, but the tax rate on the ''tax base'' exposed by the rearrangement exceeded 100%, in one case substantially so. This presented difficulties under provisions of the regulations, the validity of which no one contested, which determine whether a tax qualifies as an income tax based on the ''predominant character'' of the tax. Peculiarly, although this is a critical question, the Court explicitly refrained from expressing any view as to its ''merits'':

> An *amici* brief argues that because two companies had initial periods substantially shorter than four years, the predominant character of the U.K. windfall tax was not a tax on income in the U.S. sense. See Alstott Brief 29 (discussing Railtrack Group plc and British Energy plc). The argument amounts to a claim that two outliers changed the predominant character of the U.K. tax. See 135 T.C. 304, 340, n. 33 (2010) (rejecting this view). The Commissioner admitted at oral argument that it did not preserve this argument, a fact reflected in its briefing before this Court and in the Third Circuit. See Tr. of Oral Arg. 35–36; Opening Brief for Appellant and Reply Brief for Appellant in No. 11-1069 (CA3). We therefore express no view on its merits.[5]

Justice Sotomayor concurred in the decision, but wrote a separate concurring opinion, in which she noted that taking the ''outliers'' into account changed the predominant character analysis, and changed the outcome. But, she said, because the government had taken the position at argument that the outliers should be disregarded, and the point was pressed only by amici, she would ''reserve consideration'' of the argument for ''another day'':

> The Court's conclusion that the windfall tax is a creditable excess profits tax under 26 U.S.C. §901(b)(1) depends on two interrelated analytic moves: first, restricting the 'predominant character' analysis to those companies that shared an 'initial period' of rate regulation of 1,461 days; and second, treating the tax's initial period variable as fixed. See *ante*, at 9–10. But there is a different way of looking at this case. If the predominant character inquiry is expanded to include the five companies that had different initial periods, especially those with much shorter initial periods, it becomes impossible to rewrite the windfall tax as an excess profits tax. Instead, it becomes clear that the windfall tax is functionally a tax on value. But because the Government took the position at oral argument that the predominant character inquiry should disregard such 'outlie[r]' companies, see Tr. of Oral Arg. 38–39, and this argument is therefore only pressed by *amici*, Brief for Anne Alstott et al. as *Amici Curiae* 28–30 (hereinafter Alstott Brief), I reserve consideration of this argument for another day and another context and join the Court's opinion.[6]

Justice Sotomayor's opinion accepted the Court's ''rearrangement'' as showing that for the 27 companies with 1,461-day periods, the tax was equivalent to a tax of 51.71% of windfall profits, subject to a credit equal to 44.47% of invested capital. But her opinion set forth details with respect to the five ''outliers.'' For

[4] *Id.* at 1897, 1905 (emphasis in original).

[5] *Id.* at 1897, 1905 n.6.

[6] *Id.* at 1897, 1905, 1907.

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three of these companies, the ''effective'' tax rate on excess profits, and the effective percentage of flotation value that constituted the ''credit'' did not differ substantially from the percentages generated by the 27 ''non-outlier'' companies. For a fourth, which had an initial period of 260 days, however, the tax rate would have been 290.60% and the threshold rate 7.91%, but Justice Sotomayor's opinion says that this company paid no tax, for reasons the opinion does not discuss. The fifth company, however, Railtrack Group, which Justice Sotomayor's opinion emphasized, had a tax rate of 239.10% and threshold rate of 9.62%.

But the fact that Justice Sotomayor was ''persuaded'' by the argument did not affect her final decision:

> At oral argument, the Government apparently rejected the notion that 'outliers' like Railtrack Group are relevant to creditability analysis. See Tr. of Oral Arg. 35–39. The Government also did not argue these outliers' relevance before the Court of Appeals, *ante*, at 14, n. 6, and so this argument, and the regulatory interpretation it depends upon, has only been presented to this Court by *amici*, see Alstott Brief 17–18, 28–30. We are not barred from considering statutory and regulatory interpretations raised in an *amicus* brief, but we should be 'reluctant to do so,' *Davis v. United States*, 512 U.S. 452, 457, n. (1994, 114 S. Ct. 2350, 129 L. Ed. 2d 362), when the issue is one of first impression and the Federal Government has staked out what appears to be a contrary position. Thus, while I find this argument persuasive, I do not base my analysis of this case on it and therefore concur in the Court's opinion.[7]

As this was only the second time the Supreme Court has decided a case involving the foreign tax credit, and the first in 75 years, and only the second Supreme Court decision of *any* international tax issue in those 75 years, it is not clear when Justice Sotomayor expects ''another day'' when her convictions can be brought to bear. Still cloudier was what she conceived could possibly constitute another ''context'' in which the question could be revisited.

It is submitted here that even the Court's ''rearrangement'' of the windfall tax statutory formula is impermissible under the regulations (and any other authority interpreting the statute). The statute and regulations condition the creditability of the tax exclusively upon the *foreign tax **base** as defined by the foreign tax law*, and, in particular, do not permit taking into account the *foreign tax **rate** as defined by the foreign tax law*. Considerations concerningthe latter matter are the province of the §904(a)[8] foreign tax credit limitation, not the ''creditability'' determination. This means that both algebraic reformulations of foreign statute prescriptions, and defense of foreign provisions by reference to the ''nonconfiscatory'' nature of their rates, are to be avoided.

And while algebraic reformulations of indefinite significance should be avoided, an algebraic analysis of the foreign tax structure is in order to determine if the base it reaches will in the ''predominant'' case be coextensive with, or at least intersect, the base subject to the United States tax. And such an analysis of the windfall tax demonstrates that the nominal base of that tax in the normal case extends beyond profits or income ''in a United States sense.'' And the proof is that the record in *PPL* demonstrated that many of the companies at issue — far more than the one, two, or five which may have constituted ''outliers'' — enjoyed profits during the four-year test period that were lower than the ''base'' which was subjected to the 23% tax.

Moreover, while the analysis of the ''outliers'' is not, in my judgment, the conclusive question, it would, as it apparently did for Justice Sotomayor, lead to the proper issues on the basis of which the windfall tax should have been found to be noncreditable. The Court's and Justice Sotomayor's reluctance to decide the case on the basis of issues not fully presented is understandable. But the Court was not forced to do that. If the issue is as serious as Justice Sotomayor held it to be, and as Justice Thomas's avoidance of it seemed to confirm, the Court could have ordered the matter rebriefed or reargued, or, at the extreme could have remanded, either to the Court of Appeals or the Tax Court, for consideration or reconsideration of the issue.

The Court's opinion will have unfortunate consequences for the tax system as a whole and for the administration of the foreign tax credit in particular. As to the latter, the decision is rife with opportunity for ''gaming'' by foreign legislators and administrators, at potentially heavy expense to noncorporate, and nonmultinational corporate, American taxpayers. As to the former, the decision — especially if read in connection with certain earlier but recent decisions of the Court, and particularly with earlier opinions of Justice Thomas — could signal the beginning of an era in which the Internal Revenue Service will bear an especially heavy burden in connection with virtually all tax controversies, a burden which tax advisors may

[7] *Id.* at 1897, 1905.

[8] All section (''§'') references are to the U.S. Internal Revenue Code of 1986, as amended, or the regulations thereunder, unless otherwise indicated.

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have the tricky task of taking into account in advising clients in respect of virtually all tax matters.

II

Let us take first, analysis of the correspondence of the ''base'' of the windfall tax to the profits actually earned by the companies during the four-year test period.

We can begin by noting that, in the Court's and taxpayer's ''rearrangement'' of the statutory formula, the tax rate is nonconfiscatory (51.7%) solely because the tax *rate* is 23%, *and* that rate is less than 44.44%. At a rate of 44.44% or greater, the theoretical tax rate under the ''reconstructed'' excess profits tax would be more than 100%. The opinions of the Supreme Court (as well as those of the lower courts) strongly suggest, though they do not hold, that this would *not* pass muster under the creditability rules, and one would certainly hope this would be so.

We can be a bit more formal by taking the generic case of a tax defined as was the windfall tax, which takes the aggregate profits (P) over a number of periods (we will assume this is years hereafter) (n), and capitalizes them at a capitalization rate (k), to determine a ''fair value'' (V). V is then reduced by an amount of invested capital (K), and subjected to a tax rate (r).

Equation (1) above then is expressed as:

(4) $r(\mathrm{V} - \mathrm{K}) = r[\, (\mathrm{P}/n) * k) - \mathrm{K}]$

And the ''rearrangement'' expressed in Equation (2) would look like this:

(5) $$r(\mathrm{V}-\mathrm{K}) = [(r*\left(\frac{k}{n}\right)] \times [\mathrm{P}-(n/k) \times \mathrm{K}]$$

In other words, what Justice Sotomayor calls the ''effective tax rate'' under the reconstructed windfall tax rate is the ratio of the capitalization rate to the period used (9⁄4 in the case of the windfall tax) multiplied by the nominal statutory tax rate (51.75% is 9⁄4 of 23%). What she calls the threshold rate is the reciprocal of the coefficient applied to the nominal rate to get the effective rate, i.e., 4⁄9 in the case of the windfall tax, times the invested capital (flotation value). It follows that if the ''nominal'' or statutory tax rate is greater than the ratio of the number of periods to the capitalization rate, i.e., greater than 4⁄9 (44.44%) in the case of the windfall tax, the ''effective rate'' will be greater than one (100%), i.e., the tax will be confiscatory. This would be true generally with respect to any capitalization rate and period used.

In an article[9] published after the argument in *PPL* but before the decision, I took this analysis further to ask the question which I believe the current regulations, the statute, and *all prior authority under §901 and its predecessors ask*, viz., the correspondence between the nominal tax base of a tax structured in this manner (V − K) and actual profits during the tested period (P). The abiding assumption, which there is no reason to question in the case of the windfall tax, is that P represents ''net gain,'' income or profits as conceived by the United States law, ''in a United States sense,'' or under the regulations, there being no difference for these purposes in these varying formulations. The question is whether the foreign tax is ''aimed'' only at net gain, or at something else, or, more particularly, something more.

The algebra is simple, as presented in my earlier article, but is worth repeating briefly here.

We introduce a variable, which we will call r, as the *average annual pre-WFT profit rate* during the four-year testing period, meaning the percentage that the average profit earned (P/4) during the four years is of the original flotation value (FV). We can show that, so long as the average annual *profit rate* during the four-year period was below 20%, the *base* of the WFT (not the tax liability) would be less than or equal to the aggregate profits for the four-year period. The equations are simplified by getting rid of the ''dailiness'' computation, we determine the threshold at which the base of the windfall tax is equal to the aggregate profit. Let P be the aggregate profit; PMV, the profit making value; FV, the flotation value; and r the annual profit rate. The equation we wish to solve is as follows, and denote the tax base as *TB*:

(6) $TB = PMV - FV = P$

Representing that the aggregate profit for the four-year period is four times the average annual profit:

(7) $P = 4 \times (\mathrm{r} \times \mathrm{FV})$

and the ''profit-making'' value is nine times the average annual profit during the four-year period ($r \times$ FV), or:

(8) $PMV = 9 \times (\mathrm{r} \times \mathrm{FV})$

So, plugging equations (7) and (8) into equation (6), we get:

(9) $(9r \times FV) - FV = 4r \times FV$

which resolves to:

(10) $9r - 1 = 4r$

This means that r is equal to 1⁄5, or 20%. If this is set up as an inequality, it means that for an r greater than one-fifth, the base of the WFT (excess of ''profit-making'' value over flotation value) will be greater than the aggregate profits for the four-year period. Beyond this, the method of the tax — capitalizing profits over a period of years at a fixed rate, and deduct-

[9] Langbein, ''Doing the Math (and the English) in the Windfall Tax Cases,'' 42 *Tax Mgmt. Int'l J.* 134 (Mar. 2013).

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ing invested capital — will generate a ''break even'' point with respect to *any* capitalization rate, and *any* period over which profits were calculated. The ''break even'' point will simply be the reciprocal (1 divided by the number) of the difference between the capitalization multiplier and the number of years in the period. Thus, suppose you wanted the rate of return to be 5% (a capitalization rate of 20), and you used only one year in the period. The profit rate at which you taxed an amount in excess of profits would be 1⁄19, or 5.263%. In other words, suppose the FV were 100, and the profits in the one year were 10, the tax base (100: 20 times 10 (200) minus 100) would greatly exceed actual profits (10). If the profits were 5.263, the tax base would be 20 times 5.263 times (105.26) over 100, or 5.26, exactly equal to profits for the year (or close enough for government work).

But as it turns out, the nominal base of the foreign tax will be less than or equal to profits at the point at which the annual profit rate (P/*n*) is less than or equal to the reciprocal of the arithmetic excess of the capitalization rate over the number of periods used in determining a ''fair'' capital value. Thus, in the general case the ''breakeven profit rate'' is $[1/(k - n)]$. In the case of the windfall tax, that point is 1/(9 – 4), or 1⁄5, or 20%.

The regulations provide that a foreign tax satisfies the realization requirement of the regulations if it is imposed ''[u]pon or subsequent to the occurrence of events ('realization events') that would result in the realization of income under the income tax provisions of the Internal Revenue Code.''[10] For 23 of the 31 companies involved, this was not the case: they were subject to tax on something other than events that would have resulted in the realization of income under the Code prior to the time the tax was imposed.

What the Supreme Court's decision amounts to saying, in terms of an analysis of the foreign ''base,'' is that if one can identify a tax rate, less than 100%, but greater than the nominal statutory foreign rate, such that the foreign base, when multiplied by the ratio of the nominal rate to the rate so identified, is less than or reasonably congruent with the United States base, then the foreign tax is creditable, notwithstanding that the base as defined by the foreign law is generally, characteristically, and substantially in excess of the United States base. In terms of the windfall tax, the identified rate is 51.75%, and ratio of the statutory rate to that rate is 4⁄9. Thus, so long as *4⁄9 of the base* defined for foreign tax purposes is reasonably congruent with the United States base, the tax qualifies. This mode of analysis is radically different from any in previous reported cases and from anything the regulations appear to contemplate.

[10] Regs. §1.901-2(b)(2)(i)(A). There are exceptions to this that do not apply in the context of the windfall tax. Regs. §1.901-2(b)(2)(i)(B)–(C).

III

We begin with the fundamentals: the objective of the foreign tax credit is to avoid double taxation *in fact* of the same income. This conditions the §904(a) limitation of the credit by the tax rate: what is credited is no more than the United States rate as applied to the foreign income. But there is also the problem of ensuring that the ''base'' to which the foreign tax applies is the same as the base to which the United States tax applies. The statutory limitation does not ensure this; hence the question of the ''creditability'' of the foreign tax.

It is useful to compare the statutory foreign *income* tax limitation with the parallel limitation governing estate taxes. Section 2014(a) provides a credit against the estate tax for ''any estate, inheritance, legacy or succession taxes actually paid to any foreign country.'' Section 2014(b) provides a dual limitation on this estate tax foreign tax credit. Section 2014(b)(2) provides that the credit, with respect to *all* foreign taxes, is limited to an amount which bears the same ratio to the pre-credit tax as the foreign property bears to the value of the entire gross estate. The foreign property for these purposes must meet three criteria:

- It must be included in the gross estate (for U.S. purposes);
- It must be situated in the foreign country (as defined under U.S. ''situs'' rules);
- It must actually be subject to the foreign tax.

Section 2014(b)(1) provides that the credit, with respect to *any particular* foreign tax, is limited to the same ratio which property meeting these three criteria (and the third with respect to the particular tax) bears to all property subject to that tax.

The first limitation is a *rate limitation*, parallel to the §904(a) limitation on the income tax credit, except with the proviso that the base of the estate tax credit is limited to property *actually taxed* by the foreign country, while the income tax limit is determined exclusively by whether United States law recognizes income as ''foreign source.'' The second limitation in §2014 is a *base limitation*. It necessarily applies not only on a per-country, but also on a per-tax basis: one can credit only that portion of any given tax payment that the *intersecting base* — the amount actually subject to tax by *both* countries — constitutes of the *entire* tax base subjected to tax in the foreign country.

This is not to suggest, much less to advocate, the importation of a limitation parallel to the estate tax

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limitation into the income tax foreign tax credit. Estate taxes are imposed only once with respect to any given person, and the base of any inheritance or estate tax is ordinarily far simpler to determine than the base of the income tax of any person, much more so in the case of a complex transnational corporation. The administration of such a credit in the income tax credit would probably be impossible, as it would require a sophisticated understanding by the tax authorities of the provisions and application of the tax laws of an enormous number of countries, with respect to an enormous number of issues.

But the contrast between the income and estate tax foreign tax credits does illumine a theoretical problem with the income tax foreign tax credit and its attendant limitation. And that theoretical problem has given rise to the general issue in the windfall tax cases: the question when a foreign tax may be claimed as a credit.

IV

When the question first presented itself, the Board of Tax Appeals took a lenient view, allowing a credit for a tax on whatever the foreign government ''determines to be income.''[11] In *Keen v. Commissioner*,[12] France imposed a tax on income, but computed income as seven times the rental value of the residence, which was occupied by a taxpayer not domiciled in France. The Board held:

> Whatever may be the nature of the tax, it is imposed upon what the *French Government determines to be income*. . . . The fact that under the law the taxable income is determined in a manner different from the taxable income under the Revenue Act of 1921 does not change the nature of the tax. The fact that the net income of the petitioner as computed under the Revenue Act of 1921 was much in excess of the income of the petitioner determined for the purposes of the French tax does not change the character of the tax paid.[13]

The Board thus explicitly rejected the significance of two circumstances: first, the status of the tax ''in the U.S. sense''; and second, the fact that the taxable income so computed was substantially less than the taxpayer's taxable income for United States purposes, computed under applicable United States law. In *Havana Electric Railway, Light & Power Co. v. Commissioner*,[14] the Board reversed an earlier ruling based on a clarification of the nature of the tax made in a Cuban Supreme Court ruling subsequent to the Board's earlier ruling. In both decisions, the Board gave near conclusive weight to the characterization of the tax by the foreign authority imposing it.

This approach changed after (not with) the 1938 decision of the Supreme Court in *Biddle v. Commissioner*.[15] *Biddle* is a much misunderstood case, frequently hailed as the classic statement and ultimately source of authority for the principle now enshrined in the regulations, that to be creditable a tax must be an income tax in a ''United States sense.'' But *Biddle* does not stand for this proposition. Moreover, the case was a result driven more by the ideology of its day than by any fair or logical reading of the statute. As such, it is probably wrongly decided and its holding has had little practical application historically, and has virtually none today.[16]

Biddle involved the United Kingdom's garden-variety imputation credit system. The United Kingdom, upon distributions by a corporation that had paid corporate income tax, charged the distributee shareholders with a portion of that tax attributable to the amount distributed, which was included in income, and then allowed a credit for the tax ''deemed paid.'' A United States shareholder of a British corporation who received an amount so distributed sought to credit the amount so allowed by U.K. law against United States tax under the foreign tax credit provision. The Bureau of Internal Revenue had historically

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[11] *Keen v. Commissioner*, 15 B.T.A. 1243, 1246 (1929).

[12] *Id.* at 1243.

[13] *Id.* at 1243, 1246 (emphasis added).

[14] 34 B.T.A. 782 (1936).

[15] 302 U.S. 573 (1938).

[16] The discussion here of *Biddle* strays a bit beyond my essential purpose in this review of the pre-regulations case law; nothing in *Biddle* is really inconsistent with my general idea, that the ''creditability'' question is principally one of the relative congruence of the foreign tax base with the United States base. But if contemporary comment is going to praise the decision in *PPL* as a victory for both ''taxpayers'' and ''tax administration'' — with observations such as ''The Court saved *Biddle v. Commissioner*, 302 U.S. 573 (1938), from death by an overly formalistic test, perhaps one requiring that foreign jurisdictions invoke the magic words 'gross receipts' or 'gross income' in enacting tax laws,'' Sapirie, ''*PPL*: A Victory for Substance over Form,'' 2013 *TNT* 102-5 (5/28/13) — then perhaps this represents a propitious moment to set the record straight on precisely what *Biddle* was and what it contributes in the modern era to *either* taxpayers or tax administration, the whole matter reminding me a bit of the line in the Randy Newman song ''The Beehive State,'' that ''we're going to tell the whole country about Utah/Because nobody seems to know.''

More to the point, the background of *Biddle* and its relation to administrative law is germane to the questions addressed in part IX, and those raised by the recent *Home Concrete* and *Mayo Foundation* decisions of the Court, as noted below at note 20.

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allowed the credit in these circumstances,[17] but had changed its position and now disallowed the credit. The Supreme Court upheld the Bureau. It held:

> Inclusion of the deducted amount in the base on which surtax is calculated, together with the provisions for refund of the tax to the stockholder who, in any event, bears its economic burden, are logical recognitions of the British conception that the standard tax paid by the corporation is passed on to the stockholders.
>
> Our revenue laws give no recognition to that conception. Although the tax burden of the corporation is passed on to its stockholders with substantially the same results to them as under the British system, our statutes take no account of that fact in establishing the rights and obligations of taxpayers. Until recently they have not laid a tax, except surtax, on dividends, but they have never treated the stockholder for any purpose as paying the tax collected from the corporation. Nor have they treated as taxpayers those upon whom no legal duty to pay the tax is laid. Measured by these standards our statutes afford no scope for saying that the stockholder of a British corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that §131 extends to such a stockholder a credit for a tax paid by the corporation — a privilege not granted to stockholders in our own corporations.[18]

Its passage most influential on later decisions suggested, but did not announce, the idea of testing foreign taxes to determine whether they were income taxes in a ''United States sense'':

> At the outset it is to be observed that decision must turn on the precise meaning of the words in the statute which grants to the citizen taxpayer a credit for foreign 'income taxes paid.' The power to tax and to grant the credit resides in Congress, and it is the will of Congress which controls the application of the provisions for credit. The expression of its will in legislation must be taken to conform to its own criteria unless the statute, by express language or necessary implication, *makes the meaning of the phrase 'paid or accrued,'* and hence the operation of the statute in which it occurs, *depend upon its characterization by the foreign statutes and by decisions under them. Cf. Crew Levick Co. v. Pennsylvania*, 245 U.S. 292, 294; *Weiss v. Weiner*, 279 U.S. 333, 337; *Burnet v. Harmel*, 287 U.S. 103, 110.

Section 131 does not say that the *meaning of its words* is to be determined by foreign taxing statutes and decisions, and there is nothing in its language to suggest that in allowing the credit for foreign tax payments, a shifting standard was adopted by reference to *foreign characterizations and classifications of tax legislation*. The phrase 'income taxes paid,' as used in our own revenue laws, has for most practical purposes a well understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in §131.[19]

As to ideology, *Biddle* was decided in January 1938, only a few months after the first Justice appointed by President Roosevelt, Hugo Black, had been confirmed, replacing Justice Van Devanter, one of the ''Four Horsemen'' who had been implacably opposed to the New Deal. The Black appointment had triggered a bitter confirmation battle. That battle had been preceded by a battle in early 1937 over President Roosevelt's famous ''Court packing'' plan, which had been preceded in turn by a series of Supreme Court decisions overturning legislation enacted as part of the New Deal. Those decisions, in turn, reflected a 60- or 70-year pattern, in which the Supreme Court and lower federal courts raised obstacles, under the due process clause, the ''dormant'' commerce and admiralty clauses, and other provisions, to social welfare legislation and the empowerment of administrative agencies.

Biddle was a 6-3 decision. The opinion was written by Justice Stone, one of the Court's three pre-New Deal liberals, and joined by the other two members of this liberal bloc (Justices Cardozo and Brandeis), Justice Black, and the two center-right Justices (Chief Justice Hughes and Justice Roberts), whose ''switch in time'' (i.e., their transition from anti- to pro-New Deal positions) had ''saved nine'' (i.e., helped to defeat the Court-packing scheme). The three remaining members of the ''Four Horsemen'' (Justices McReynolds, Butler, and Sutherland) dissented, although by this point they were too exhausted, or disgusted, by the trend of decision to write an opinion.

In the period after World War II, the tax law became divorced from ideological conflicts over administrative procedures or judicial ''activism,'' and it be-

[17] S.M. 3040, IV-1 C.B. 198; S.M. 5363, V-1 C.B. 89; I.T. 2401, VII-1 C. B. 126; GCM 3179, VII-1 C.B. 240.

[18] *Biddle v. Commissioner*, 302 U.S. 573, 581 (1938).

[19] *Id.* at 578–79 (emphasis added).

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came conventional, if not *de rigeur*, to view prior law from the vantage point of this divorce.[20] But the income tax jurisprudence of the 1920s and 1930s was not separate from the more general ideological quarrels, and in many respects it clouds, if it does not suppress, a proper understanding of the content of this early precedent to regard that law otherwise. Justice Stone's opinion and the decision in *Biddle* were precursors of a period of harshly anti-taxpayer Supreme Court decisions, which revised or overhauled earlier, more moderate views — decisions such as *Higgins v. Smith*,[21] *Helvering v. Hort*,[22] *Helvering v. Bashford*,[23] *Helvering v. Horst*,[24] *Helvering v. Clifford*,[25] *Anderson v. Helvering*,[26] even *Moline Properties, Inc. v. Commissioner*.[27] *Biddle* is an early avatar of the spirit of this period. Many of these decisions — *Bashford* and *Higgins v. Smith*, certainly, as well as *Anderson* and *Clifford* — became dead letters, either on account of legislative change, administrative action, judicial disinterest, or a combination of the three. Others, like *Moline Properties*, however, lived on in influence. *Biddle* would become one of these.

The second point, however, is that *Biddle* does not hold the proposition frequently and carelessly imputed to it — that to qualify for the foreign tax credit, a foreign tax must be an income tax ''in the United States sense.'' The passage in *Biddle* cited for this proposition are the two paragraphs quoted above.[28] But those passages concern the term ''income taxes *paid*,'' not the term ''income tax''; and they make clear that what the Court is interpreting, is whether the imputed or ''deemed paid'' tax is *paid* within the meaning of the predecessor of §901. The United Kingdom *tax* there in question was an income tax by any standard and beyond any question. That the decision involved the nature of the payment, not the nature of the tax, is made clear, too, and notwithstanding the passage's general reference to the ''words of the statute,'' by Justice Stone's exegesis of why the mode of payment deemed by United Kingdom law does not constitute ''payment'' under the foreign tax credit provision.[29]

A third point is that a substantial argument can be made that *Biddle* is wrongly decided, even on its own terms. For it simply is not true, and was not true at the time, that ''[o]ur revenue laws give no recognition'' to the ''conception'' of an imputation credit, or that they in no way ''treated the stockholder for any purpose as paying the tax collected from the corporation.'' The indirect credit does exactly this, and has done so since 1918.

Finally, the actual result in *Biddle* has had and continues to have little practical application. Within seven years of the decision, in 1945, the United States entered into a treaty with the United Kingdom under which the United States agreed to allow the credit disallowed by *Biddle*. The United States has accorded this treatment in other conventions with imputation credit systems similar to that of the United Kingdom. I have been unable to locate anyone who can assert for certain that there are no conventions with any nations applying such a system that do not allow the credit. But neither can I find anyone who knows of a treaty with such a nation that does not allow the credit, or even of a non-treaty country with such a system where a credit is disallowed under *Biddle*.

On the other hand, the fact that *Biddle* does not stand for the proposition that a tax must be an ''income tax in the United States sense'' is also of little

[20] Of course, the last couple years have seen suggestions that after the long divorce there perhaps should be a reconciliation. These suggestions follow the Supreme Court's decisions in *Mayo Foundation for Med. Educ. Research v. United States*, 131 S. Ct. 704 (2011), and *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012), holding that deference to regulations under *Chevron*, *U.S.A. v. Natural Resources Def. Council*, 468 U.S. 836 (1984), applies to tax regulations as it does to the regulations of agencies other than the IRS, and suggesting more generally that general administrative law principles apply in the tax field as they do to any other agency matters. The *Mayo Foundation* decision was a government victory, and led the Chief Counsel of the Service two weeks after the decision to give a ''Dragon Speech'' to the annual luncheon of the New York State Bar Association, holding that the decision had slain four ''dragons'' which impeded the enforcement of tax regulations. Certain practitioners responded with suggestions of how the Supreme Court's invitation to apply administrative law precepts more broadly in the tax field could be exploited to tie the government's hands (rendering *Mayo Foundation* something of a Pyrrhic victory). Smith, ''Life After *Mayo*,'' 2011 *TNT* 119-2 (6/1/11); Salem, ''*Mayo* Dissected: Some Dragons Slain, Some Still Breathing Fire,'' *Tax Notes* (3/14/11), 2011 *TNT* 50-5. For a recent example of comment in the latter vein, respecting a transfer pricing issue, and, in my judgment, badly misconstruing *Home Concrete*, see ''3M Could Succeed in Legal Challenge of Transfer Pricing Regulation, Practitioner Says,'' 2013 *TNT* 118-5 (6/18/13) (reporting remarks of Mark R. Martin of McDermott Will & Emery at ABA transfer pricing conference in Miami, concerning a challenge by *3M Corporation, 3M Co. v. Commissioner*, No. 005816-13 (T.C. 2013), to Regs. §1.482-1(h)(2)(i) and (ii), under *Procter & Gamble Co. v. Commissioner*, 95 T.C. 323 (1990), *aff'd*, 961 F.2d 1255 (6th Cir. 1992); *Exxon Corp. v. Commissioner*, T.C. Memo 1993-616 (1993); and *Commissioner v. First Security Bank of Utah*, 405 U.S. 394 (1972)).

These suggestions should be borne in mind, too, in connection with the considerations outlined in Part IX below.

[21] 308 U.S. 473 (1940).

[22] 313 U.S. 28 (1941).

[23] 302 U.S. 454 (1938).

[24] 311 U.S. 112 (1940).

[25] 309 U.S. 331 (1940).

[26] 301 U.S. 404 (1940).

[27] 319 U.S. 436 (1943).

[28] *Biddle v. Commissioner*, 302 U.S. 573, 578 (1938).

[29] *Id.* at 578, 581–82.

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importance, because it was so read by a line of cases following it, and those cases pretty clearly established the principle, however much their reliance on *Biddle* for it may have been misplaced.

V

The lower courts wasted little time extrapolating from *Biddle*. In *Keasbey & Mattison Co. v. Rothensies*,[30] the Court denied a credit for an Ontario mining tax, which began with the gross value of output at the time of sale *or use*, and did not allow deductions for indirect costs. The Court said it was ''conceded that in the application of the statute the criteria prescribed by our revenue laws are determinative of the meaning of the term 'income taxes' as used therein,'' citing *Biddle*.[31] The Court referred to the enactment of the ''in lieu of'' provision as ''presumptive evidence that Congress recognized that the prior act was of limited application.''[32]

Keasbey & Mattison was followed by other decisions adopting the principle thus imputed to *Biddle*. In *New York & Honduras Rosario Min. Co. v. Commissioner*,[33] and *Commissioner v. American Metal Co.*,[34] the Second Circuit reformulated the test by saying that ''the determinative question is 'whether the foreign tax is the substantial equivalent of an ''income tax'' as that term is understood in the United States.' ''[35]

In *Lanman & Kemp-Barclay & Co. v. Commissioner*,[36] the Tax Court denied a credit for the ''patrimony'' portion of a tax imposed by Colombia, which was essentially a tax on assets. The Court said it was ''well settled that the determination . . . is to be made not upon the characterization of the foreign law, but under the criteria established by the internal revenue laws of the United States,'' citing *Biddle* and *Keasbey & Mattison Co.*, and quoting *American Metal Co.*, and stressed that ''[t]he doctrine that only those increases in value of property which are *actually realized* by the owner constitute taxable income is basic to the income tax system of the United States.''[37]

In *Bank of America v. United States*,[38] the Court of Claims denied a credit for taxes imposed on the gross interest income of banks by three less developed countries: Argentina, Thailand, and the Philippines. The court held that the ''criteria of United States law'' principle required that the foreign tax be calculated to reach ''net gain,'' by allowing recovery of significant costs and expenses; and that the taxes on gross income did not meet that condition, because it was possible in some circumstances that the tax would be imposed in a year when the bank suffered a net loss in the country involved.[39]

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[30] 133 F.2d 894 (3d Cir. 1943).

[31] *Id.* at 894, 897.

[32] *Id.* at 894, 898. The Revenue Act of 1942, P.L. 77-753, 56 Stat. 798, enacted the predecessor of §903 of the Code, allowing a credit for taxes imposed ''in lieu of'' income taxes. The enactment confirms the analysis, set forth in the text, of *Biddle* as a peculiar case of ''anti-conservative'' reaction by the late-New Deal-era Court. During the so-called ''Lochner era,'' the progressive, pro-welfare, pro-administration initiatives of the legislatures, at the state level and of Congress, were tempered or frustrated by the restrictive stance of the courts, couched often in terms of protecting private rights. By 1941, President Roosevelt had appointed seven of the Supreme Court Justices. Also, in the midterm elections of 1938, the moderate-conservative coalition of Republicans and Southern Democrats regained control of Congress for the first time since 1930, control that coalition would hold for at least the next 20 years. This led to a reversal of the roles of the earlier era. The progressive, welfare- and administration-protective excesses of this Court, often insensitive to or restrictive of private rights, were frequently restrained or overturned by Congress, the leading instance being the adoption of the middle ground Administrative Procedure Act in 1946, 5 U.S.C. §551 *et seq.* (2006). The 1942 Revenue Act in general, and the adoption of §903, which was intended to limit *Biddle*, reflected this pattern as well. Its compromise nature, as well perhaps as the fact that it was enacted under the exigencies of total war, has made the 1942 enactment one of the most measured revenue enactments in the history of the Republic, and many of whose initiatives (like wage withholding and the provisions governing employee health and pension benefits) have long endured and become major elements not only of the tax system but of the American economy as well.

The §903 provision, like many congressional efforts to restrain an enthusiastically pro-administrative Judiciary, had limited impact, largely because the administration, and, more importantly, the courts, largely ignored it. See note 39 below.

[33] 168 F.2d 745 (2d Cir. 1948).

[34] 221 F.2d 134 (2d Cir. 1955).

[35] *Id.*, quoting *New York & Honduras Rosario Min. Co. v. Commissioner*, 168 F.2d 745, 747 (2d Cir. 1948).

[36] 26 T.C. 582 (1956).

[37] *Id.* at 582, 588 (emphasis added).

[38] 459 F.2d 513 (1972).

[39] The *Bank of America* decision was an aggressive application of the prior principles in any event. The United States itself imposes gross income taxes, in the form of withholding taxes, as do most developed countries, and it would be quite troubling, from the standpoint of the international treaty network and long accepted international tax norms, to question whether those could be credited against home country tax. These taxes are deemed by the current regulations as acceptable substitutes for taxes which expressly seek to define ''net gain.'' And the *Bank of America* Court ignored §903, the ''in lieu of'' provision, notwithstanding that the legislative history from 1942 seemed to contemplate coverage of precisely the type of tax at issue before the *Bank of America* Court:

> Your committee believes further amendments should be made in section 131. Under that section as it now stands, a credit is allowed against United States tax for income, war profits or excess profits taxes paid or accrued to any foreign country or to any possession of

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In the 1970s, the Saudi oil rulings,[40] and the credits based on ''posted prices,'' became the dominant issue in relation to the foreign tax credit, and it would become a focus of general political, in addition to professional tax community, attention. This focus led to the development of the current regulations. The process of developing them was a long and arduous one, begun in 1977 and not completed until after a change in administrations in 1983. The post-*Biddle* case law is the inspiration of the most significant elements of the regulations. That law was the source of authority for the principle that a tax must be an income tax ''in the United States sense,'' and that this meant that the tax has to be ''likely to reach net gain in the ordinary circumstances to which it applies.''[41] *Keasbey & Mattheson*, *Lanham*, and *Bank of America*, too, are the sources, respectively, for the three characteristics which under the regulations determine whether an income tax is ''reasonably calculated to reach net gain.'' *Keasbey & Mattheson* is the authority (or inspiration) for the ''gross receipts'' requirement; *Lanham* and *American Metal* for the ''realization'' requirement; and *Bank of America* for the ''allowance of significant costs and expenses'' requirement.

VI

There remain a considerable range of policy disputes about the provisions of these regulations. The point to stress here, however, is that the cases and regulations both clearly base the determination on an examination of the *foreign base*, without taking into account the foreign rate, and in this regard they are clearly on the right track. This is true, as far as I know, of all decisions in this area prior to the Tax Court's *PPL* decision and the Fifth Circuit's in *Entergy*, now affirmed by the Supreme Court's *PPL* decision. As detailed above, those decisions accept a tax the base of which can be and frequently is greatly in excess of the United States base, and look to the relatively low rate of the tax to defend its qualification for the credit. In this regard, they depart from all prior decisions as well as from the regulations.

The link of the conception of creditability to the question of ''tax base intersection'' can be examined by looking to the provisions of the regulations concerning ''dual capacity taxpayers.'' The regulations provide that, prior to determining whether a ''levy'' constitutes an ''income tax,'' one must first determine whether the levy constitutes a ''tax.'' They provide that if a taxpayer receives a ''specific economic benefit'' (SEB) in connection with the levy, the levy is a charge for the benefit, and not a tax. They also provide that if the levy is both an exaction for general revenue purposes and a charge for a ''specific economic benefit,'' the taxpayer is a ''dual capacity taxpayer'' (DCTP) and the ''qualifying levy'' (QL) must be split between a portion that is a charge for the benefit (which is ordinarily a deductible expense, rather than a creditable tax) and the portion that is a creditable tax. And the regulations provide that the amount of each portion is determined either by a ''facts and circumstances'' test, or under a safe harbor.

The regulations provide a formula for the safe harbor as follows:

$$(11) \qquad C_t = (A - B - C) \times \left[\frac{D}{1 - D}\right]$$

where C represents the total payment under the qualifying levy (QL) in question; C_t represents what is being determined, viz., the portion of C that is allowable as a creditable ''tax''; D represents the foreign tax rate; A represents gross receipts for purposes of the foreign levy; and B represents allowable deductions.[42] It is with respect to A and B that the regulations make special provision. They provide, in perhaps the most prolix fashion known to the English language, that ''if provisions of the qualifying levy increase or decrease the liability imposed on dual capacity taxpayers compared to the general tax liability of persons other than dual capacity taxpayers by reason of the determination or treatment of gross receipts or of costs and expenses, the provisions generally applicable in computing such other persons' tax base under the general tax shall apply to determine gross receipts and costs and expenses for purposes of comput-

> the United States. In the interpretation of the term income tax, the Commissioner, the Board, and the courts have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit. *Thus if a foreign country in imposing income taxation authorized, for reasons growing out of the administrative difficulties of determining net income or taxable basis within that country, a United States domestic corporation doing business in such country to pay a tax in lieu of such income tax but measured, for example, by gross income, gross sales or a number of units produced within the country, such tax has not heretofore been recognized as a basis for a credit. Your committee has deemed it desirable to extend the scope of this section.*

S. Rep. No. 1631, 77th Cong., 2d Sess. 131–32 (emphasis added).

[40] Rev. Rul. 55-296, 1955-1 C.B. 386, *revoked*, Rev. Rul. 78-63, 1978-1 C.B. 228.

[41] Regs. §1.901-2(a)(3)(i).

[42] Regs. §1.901-2A(e)(1).

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ing the qualifying amount.''[43] In other words, if there is a discrepancy between the ''base'' of the QL as applied to DCTPs and the ''base'' of the QL as applied to non-DCTPs, the formula applies using the base as applied to non-DCTPs.

We will not care, for purposes of our discussion, whether this discrepancy arises from the treatment of gross receipts, on the one hand, or costs and expenses, on the other. So let us designate the amount of the base discrepancy as *X*. Now we know that:

(12) $C = D\,(A - B + X)$

We also know that:

(13) $C = C_t + C_r$

where C_r represents the portion of the QL payments that is a ''royalty,'' or other payment for a specific economic benefit (SEB).

If we plug equation (13) into equation (11), we get:

(14) $C_t = (A - B - C_t - C_r) \times [\frac{D}{1-D}]$

or:

(15) $\left(1 + \left[\frac{D}{1-D}\right]\right) \times C_t = (A - B - C_r) \times [\frac{D}{1-D}]$

and that resolves to:

(16) $C_t = (A - B - C_r) \times D$

Now make one further assumption, that the base as computed for purposes of the QL as applied to non-DCTPs is the same as the base for purposes of United States law. In these circumstances, equation (6) gives a formula for the amount creditable which is the same amount that would be generated by a rule parallel to the ''base limitation'' of the estate tax (§2014(b)(1)): *their* rate, times *our* base (i.e., our determination of what the *intersection* of the base as we and as they define it).

This may be easier if we plug numbers into the equations. The numbers are drawn from an example in the regulations.[44] Assume that A is 120*u*, B is 30*u*, D is 40%; and that the ''royalty'' element is generated by the disallowance of costs and benefits of 10*u*. Thus, X is 10*u*, and, according to equation (2), C is 40*u*. Plugging in equation (11), C_t, the amount creditable is 120*u*, minus 30*u*, minus 40*u* (or 50*u*), multiplied by ⅔, or 33⅓*u*. This is equivalent to, plugging in equation (16), (120*u*, minus 30*u*, minus 6⅔*u*) (or 83⅓*u*) (''our base''), times 40% (''their rate'').[45]

[43] Regs. §1.901-2A(e)(2).

[44] Regs. §1.901-2A(e)(8), *Ex. 1*.

[45] The need to account for the deductibility of the ''royalty'' is why one cannot simply multiply the foreign tax rate times the base discrepancy to determine the amount not allowed as a credit. In the example, that would generate a ''royalty'' of 4*u* and a creditable tax of 36*u*, but that is too great a tax allowance if the deduction for the ''royalty'' is to be taken into account.

VII

Apart from the question of the ''outliers,'' and the question whether the ''base'' of the windfall tax generally reached only profits earned by the taxpayers prior to imposition of the tax, there were two other major arguments against allowing a credit for the tax. Both were identified by the Alstott-Graetz amicus brief.[46] Neither is mentioned in any of the judicial opinions concerning the windfall tax.

The first was the question whether the windfall tax was a ''tax'' for purposes of the regulations. The Alstott-Graetz brief suggests that the windfall tax can be construed as a payment to the government for the specific economic benefit of charging a premium over market prices, and suggests that such a right is ''within the ambit of the general definition of'' the term ''specific economic benefit,'' as used in the regulations. Other arguments could be made in relation to the ''specific economic benefit'' idea — in particular, that, to the extent the tax was a partial addition to the flotation price, it was imposed in exchange for the shareholders' acquisition of the assets involved.[47]

A variant of the argument would be to treat the windfall tax as imposed partly in the United Kingdom's taxing capacity and partly as a compulsory payment for a specific economic benefit. An Appendix sets forth the manner in which the safe harbor ''splitting'' rule of Regs. §1.901-2A would apply to a hypothetical taxpayer subject to the windfall tax, which enjoyed average annual profits at a rate of 50% of ''flotation value'' over the four-year test period (and thus generated a windfall profits base in excess of its aggregate profits for the four-year period).

The second argument is that the purely retroactive ''one-off'' character of the windfall tax alone destroys its qualification for a foreign tax credit. The Alstott-Graetz amicus brief argues this point on two grounds: first, the United States income and windfall profits taxes, enacted since 1913, have always been prospec-

[46] Brief of Anne Alstott, Marvin Chirelestein, Mihir Desai, Michael Graetz, Daniel Halperin, Mitchell Kane, Lawrence Lokken, Robert Peroni, and Alvin Warren as Amici Curiae. The brief is reproduced at 2013 *TNT* 19-23 (1/18/13). The Supreme Court cites the brief as ''Brief of Alstott et al.'' The brief is signed by an attorney and by Michael Graetz, one of the amici. The brief is referred to as the ''Alstott-Graetz brief'' herein.

[47] As the amicus brief argues, ''[t]he fact that the payment obligation arose after the granting of the economic benefit should not be dispositive,'' because if ''the levy would be non-creditable if assessed during the initial period we do not see how that defect could be cured simply by delaying the timing of the imposition of the levy, given that it applies only to those parties who received the specific economic benefit.'' Alstott-Graetz Brief, above note 46, 2013 *TNT* 19–23 (1/18/13).

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tive; second, that those taxes have always been assessed based upon an annual accounting period, with a citation to *Burnet v. Sanford & Brooks Co.*,[48] the Supreme Court decision articulating the proposition that this feature of the United States income tax is a fundamental one. As to the latter characteristic, the brief asserts that to be creditable a foreign tax must have this feature, notwithstanding that no such requirement is explicitly set forth in the regulations:

> Surely the requirement of 'net gain' in the 'normal circumstances of its operations in which it applies' under 26 C.F.R. section 1.901-2(a)(3)(i) of the regulations implies the crucial income tax role of an annual accounting period; otherwise, it would not be describing a tax 'with the predominant character of an income tax.' This point is so clear that it was not essential for Treasury to restate it explicitly in the regulations. In contrast, the UK windfall tax was imposed one-time only on the shortfall in flotation values.[49]

I am far less certain that any such requirement is implicit in the regulations. The regulations say that a tax is likely to reach net gain in the normal circumstances to which the tax applies "if and only if" the three characteristics listed in the regulations obtain. As I suggest above, *Keasbey & Mattheson*, *Lanham*, and *Bank of America*, respectively, together support the position that a foreign levy is an income tax "only if" the three listed characteristics obtain: each of those cases disqualifies a tax based on the absence of one of the three characteristics. But neither collectively nor separately do those cases support the "if" prong of the regulations. The regulations nevertheless plainly adopt that prong as part of their rule, and do with evident consciousness of the issue. Thus, the regulations appear, at least to me, to foreclose the possibility that characteristics of the United States income tax other than the three listed features could be deemed crucial to allowing a credit for the tax.

Nevertheless, the argument has considerable force, not the least on account of the fact that the most "perverse incentives," to use the phrase of the amicus brief, would flow from allowing a credit for a nonperiodic, "one-off," purely retroactive tax. As I suggested in my earlier article, there may be linguistic gynmastics by which one could find that the regulations imply this requirement; or, following the amicus brief's suggestion one could treat the matter as so "clear" that there was no reason to mention it in the regulations. If these are not availing, however, the matter is of sufficient logical and policy seriousness as to raise a question about the validity of the "if" prong of the regulations, which, as I suggest above, does not appear to have support in the pre-regulations case law.

In any event, the matter is not mentioned in the Supreme Court's decision.

VIII

As noted, the conclusion of the amicus brief suggests that allowing a credit for the windfall tax, by "treating a one-time retroactive tax on differences in value" as creditable, "would provide a roadmap for foreign governments to shift the costs of acquiring privatized assets away from the owners of these assets to the U.S. fisc and American taxpayers."[50] Indeed, the approval of a credit for a tax with that feature creates at least possibilities for foreign governments to "tap into" the U.S. fisc, and United States taxpayers, even outside a privatization context. A tax like the windfall tax could be used for a partial nationalization of an enterprise, regulated or not, that never was in government hands. Indeed, it is not clear, if periodicity and prospectivity are not deemed to be fundamental features of an income tax "in a United States sense," why a foreign government could not wait until after results were in, examine a company's returns for a past period, and retroactively impose a tax on its "income," as defined for United States purposes. The company would then pay the tax and could secure reimbursement through a foreign tax credit claim in the United States.

There is a question, however, whether the Supreme Court's opinion has this consequence, because the Supreme Court did not explicitly address whether the retroactive, nonperiodic aspect of the tax defeats its creditability. Ordinarily, if such a tax were imposed by a foreign sovereign and a credit claimed for it, the *PPL* decision would stand as authority for its creditability, because this feature of the later tax would be indistinguishable from the windfall tax allowed as a credit by *PPL*. The question is the extent to which Footnote 6 of the Court's opnion changes this. Footnote 6 says that, notwithstanding that the argument there identified is crucial to the disposition of the issue the Court decided, the Court expresses no view as to the merits of the argument. Justice Sotomayor agrees that the Court should not address an argument raised only by amici.

United States lawyers may be called upon to advise both companies and foreign governments concerning

[48] 282 U.S. 359, 364 (1931)

[49] Alstott-Graetz brief, above, note 46, 2013 *TNT* 19–23 (1/18/13).

[50] *Id.*

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the eligibility of future tax proposals or enacted taxes for the U.S. foreign tax credit. They will have to grapple with the implications of Footnote 6, for these and other issues seemingly decided though not addressed by the Court's opinion.

IX

The difficulty with Footnote 6 derives from the distinction between an issue and an argument. It is understood that if a litigant does not properly preserve an *issue* on appeal, its right to raise the issue, or any aspect of it, is waived. The same is not true of various arguments as to an issue that is properly preserved on appeal. A litigant is not required to preserve arguments. Once an issue is properly before it, an appellate court should take into account any argument that may be dispositive of the issue. If it does not, the status of its precedent will be clouded, because the decision will be interpreted in light of all the facts of the case, and subsequent cases presenting similar or identical facts will be subject to analysis based on the decision the appellate court renders. There is a matter of fairness to the side opposing the newly introduced argument. But an appellate court has devices available to it to protect litigants against surprise, including delay of its decision, rebriefing or reargument, or, in serious cases, remand to a lower court.

This is what makes Footnote 6 disquieting. The "argument" to which the footnote refers is one which would dispose of the issue before the Court. Yet the Court says that, because it was not properly "preserved," the Court does not address its merits. Justice Sotomayor agrees, on the basis of a "principle" that the Court should not ordinarily address an argument pressed only by amici.

And the matter is compounded because there are the other two issues, equally dispositive of the case, also raised only by amici, which will be present in any later case presenting similar facts.

Compounding these difficulties is the fact that the author of the Court's opinion is Justice Thomas — and Justice Thomas, in certain opinions issued early in this century, takes a particular view either of tax adjudication generally, or of the interpretation of revenue regulations in particular, never adopted by the full Court. The *PPL* decision, however, may reflect those views, and to the extent it does, it raises questions about the Court's overall approach to tax cases, or at least to the interpretation of regulations, and raises questions about how the Court's precedents are to be interpreted in later cases, especially where interpretation of regulations is involved.

Justice Thomas authored the Court's decision in *Gitlitz v. Commissioner*.[51] The decision involved the question whether, when an S corporation has cancellation of indebtedness income that is excluded under §108(a) of the Code, the taxpayer is entitled nevertheless to include the amount of the income in the basis of its shares. The Service, Tax Court, and Court of Appeals had held that the taxpayer could not include the amount in the basis of the shares. The Supreme Court reversed, in language that has had considerable influence, including influence on the Revenue Service:

> [C]ourts have discussed the policy concern that, if shareholders were permitted to pass through the discharge of indebtedness before reducing any tax attributes, the shareholders would wrongly experience a "double windfall": They would be exempted from paying taxes on the full amount of the discharge of indebtedness, and they would be able to increase basis and deduct their previously suspended losses. [Citation omitted]. Because the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern. [Footnote omitted].[52]

In two later decisions, Justice Thomas authored separate opinions in which he expressed views, which, like this passage from *Gitlitz*, suggested that courts should interpret tax laws (or at least tax regulations) strictly against the tax administration. The first is *United Dominion Industries, Inc. v. United States*,[53] which involved the interpretation of provisions of the consolidated return regulations governing the special 10-year carryback of "specified liability" losses. The Court eschewed the government's interpretation of the consolidated return regulations. In

[51] 531 U.S. 206 (2001).

[52] *Id.* at 206, 219–20 (2001). *Gitlitz* was before *PPL* the most recent opinion for the Court in a tax case authored by Justice Thomas. Paradoxically, in that case, too, the government, in the Court's word "abandoned" an "argument" that had been adopted by the Court of Appeals. The Court said it found the abandonment "odd," because that argument "predominated in the Commissioner's argument to the Court of Appeals," and that "[n]otwithstanding the Commissioner's attempt at oral argument to distance himself from the reasoning of the Court of Appeals on this issue — the Commissioner represented to us that the Court of Appeals developed its reading of the statute sua sponte, Tr. of Oral Arg. 22–24, 27 — it [was] apparent from the Commissioner's brief in the Court of Appeals that the Commissioner supplied the very sequencing theory that the Court of Appeals adopted." 531 U.S. 219 n.8. In *Gitlitz*, the Court addressed, and rejected the unargued argument. In contrast to *PPL*, there was not even an amicus advancing the argument before the Supreme Court.

[53] 532 U.S. 822 (2001).

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dissent, Justice Stevens argued that as a general matter "when a provision of the Code and the corresponding regulations are ambiguous, this Court should defer to the Government's interpretation."[54] Justice Thomas wrote a brief separate concurring opinion for the sole purpose of responding to Justice Stevens' position (something which, apparently, Justice Souter's opinion for the Court refrained from doing).

Justice Thomas disagreed with the dissent, arguing that "[a]t a bare minimum, in cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter."[55] Justice Thomas quoted an ancient Missouri decision, *Leavall v. Blades*,[56] to the effect that "[w]hen the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it," and four Supreme Court precedents.[57] It is ambiguous precisely what Justice Thomas here means by a "bare minimum": he may be suggesting that the construction against the revenue gatherer may be applicable *beyond* cases involving the interpretation of a regulation; alternatively, he may be suggesting that in such cases, the presumption against the government should be stronger than a mere "construction against" the government position.

Boeing Co. v. United States[58] involved the interpretation of regulations governing the allocation of research and experimental deductions in the context of domestic international sales corporations (DISCs). Justice Stevens authored the opinion of a 7-2 majority upholding the government's interpretation of its regulations. Justice Thomas authored a dissent, joined by Justice Scalia. The dissenting opinion began by reaffirming the views the Justice had expressed in his concurrence in *United Dominion Industries*, with the observation that "[b]efore placing its hand in the taxpayer's pocket, the Government must place its finger on the law authorizing its action," citing his opinion in *United Dominion Industries*, and quoting parenthetically the language from *Leavell v. Blades*.[59]

It is possible to see the approach of the Court in *PPL*, and in Footnote 6 in particular, as a facet, if not a corollary of the approach suggested by Justice Thomas in the separate opinions in *Boeing* and *United Dominion Industries* (and most likely underlying the opinion for the Court in *Gitlitz* as well). The refusal to entertain an argument not properly, carefully, precisely preserved by the *government as tax collector*, much less one reliance on which the government affirmatively disclaimed at oral argument, can be seen as an adjunct of an approach that is disposed to rule for a taxpayer unless the government places its "finger" on the law authorizing its action (in placing its "hand" in the taxpayer's "pocket"). Corroborating this view, strongly, is a passage, discussing the non-decided argument, from the oral argument, the very point at which the government made clear it was not relying on the "outlier" argument. In the discussion at oral argument of the amicus's "argument," the Chief Justice echoed the stance of Justices Thomas and Scalia in *Boeing*, in suggesting the Supreme Court should not "do a better job of getting money from people than the IRS does":

> CHIEF JUSTICE ROBERTS: We had a lot of — your friend had a lot of questions on the different periods, the initial periods and changing the D value and what that did to the — that is not an argument that you've made, is it?
>
> MS. O'CONNELL: That's right. I think we generally agree with the Petitioner that a tax is — is either an income tax or not an in-

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[54] *Id.* at 822.

[55] *Id.* at 822, 838–39.

[56] 237 Mo. 695, 700–701, 141 S.W. 893, 894 (1911).

[57] He also cited *United States v. Merriam*, 263 U.S. 179 (1923) ("If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer"); *Bowers v. New York & Albany Literage Co.*, 273 U.S. 346, 350, (1927) ("The provision is part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers"); *American Net & Twine Co. v. Worthington*, 141 U.S. 468, 474 (1891); *Benziger v. United States*, 192 U.S. 38 (1904).

Justice Stevens in the dissent was in turn not altogether uncomfortable with at least limited application of Justice Thomas's view. Justice Stevens conceded that Justice Thomas "accurately points to a tradition of cases construing 'revenue-raising laws' against their drafter," but said that "when the ambiguous provision in question is not one that imposes tax liability but rather one that crafts an exception from a general revenue duty for the benefit of some taxpayers, a countervailing tradition suggests that the ambiguity should be resolved in the government's favor." 532 U.S. at 839 n.1 (Stevens, J., dissenting).

Thus, Justice Thomas's (and later Justice Scalia's) position in some measure has some general approval among the Justices. Neither Justice Souter's opinion in *United Dominion*, nor any other opinion for the Court has expressly disclaimed, limited, or criticized it.

[58] 537 U.S. 437 (2003).

[59] *Id.* at 437, 457 (2003). Justice Thomas's views could have been interpreted as questioning whether *Chevron* deference should be accorded to tax regulations, because he did not confine his suggestion to circumstances where judicial review applies only to an agency's interpretation of its own regulations. Any such inference would appear to be destroyed by Justice Thomas's concurrence in the Court's later unanimous opinion in *Mayo Foundation for Med. Educ. Research v. United States*, 131 S. Ct. 704 (2011), and in the plurality opinion of Justice Breyer in *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012). See also note 20 above.

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> come tax for everybody that [is] subject to the tax and that you look at it in the normal circumstances in which it applies. But I do completely agree that the fact that the D figure changes makes this — just reinforces the idea that the substance of this tax —
>
> CHIEF JUSTICE ROBERTS: Well, but that is — again, that's not an argument you've made.
>
> MS. O'CONNELL: No, but our the amicus did make it. I mean, that —
>
> CHIEF JUSTICE ROBERTS: Well, the amicus did, but *I don't think we should do a better job of getting money from people than the IRS does*.
>
> MS. O'CONNELL: Well, the point is that — the fact that there is a D variable there shows that what parliament was trying to do was to place an annual earnings figure on each company to create a value for it. A company — it's not similar to an excess profits tax in that way, that where a company that operated for only six months is paying the tax at the same level that a company would be that was making profits at the same rate for the entire four-year period.
>
> CHIEF JUSTICE ROBERTS: No, that's a good articulation of the argument you haven't made.[60]

These past positions of Justice Thomas, taken together with the Chief Justice's observations, raise a couple of interesting questions, both about the Court's future tax jurisprudence and about the future application of the *PPL* decision. The first is whether and the extent to which the Court is adopting a principle of strict construction of the tax against the government. The refusal to consider the ''outlier'' issue and the explicit statement in Footnote 6 that the Court was not considering the ''merits'' of that ''argument'' suggest that this is the approach the Court is at least implicitly taking. This is reinforced by the other arguments of the amici, which to me appear to be substantial if not strong arguments. Indeed, I believe *PPL* is a surprising decision in light of the regulations, prior case law, and, as I described above, the essential functioning of the foreign tax credit as a substitute for an explicit ''base limitation.''

The second question concerns the scope of the *PPL* decision itself. Lawyers applying or interpreting the decision will have, as I suggested above, to grapple with the question of the extent to which the decision decides arguments not explicitly addressed by the Court's opinion. The question of the ''outliers'' is one of these; I suppose it is clear enough from the opinion that this matter was *not* decided by the Court. But issues arising from the fact that the tax base in the case for most companies covered exceeded past profits for the periods identified by the tax; from the purely retroactive and nonperiodic nature of the tax; and from the fact that the exaction could be seen as in exchange for a ''specific economic benefit'' were not addressed at all. The Court did not say it was not passing on their merits, and the case would seem to stand as precedent with respect to them.

Apart from this, the Court's flirtation with strict construction of the tax positions of the government raises intriguing questions concerning the response of government litigants — both the Service and the Justice Department — to such a development, especially to the extent the development by the Court is a largely silent or muted one. *Boeing* notwithstanding, the government has not fared well in the Supreme Court tax decisions in recent years, at least outside the context of employment tax cases.[61] The government was plainly unenthusiastic about the Supreme Court's hearing the windfall tax cases: the government did not seek review of the decision it lost, in the Fifth Circuit, in *Entergy Corp. v. Commissioner*.[62] A number of quarters have criticized or questioned the government's decision to ''drop'' the ''outlier'' argument at oral argument, or still more its failure to raise the other issues, including the ''tax'' qualification and retroactivity questions. Indeed, the Alstott-Graetz amicus brief all but implies some criticism of this sort of the government's approach.

But this restrained approach may have in the end benefited the government, and indeed the government may have shrewdly understood all along that matters might eventuate this way. Justice Sotomayor, too, by concurring rather than dissenting, and articulating a stance of restraint about arguments advanced by amici, may have exercised a wisdom superficially belied by her outwardly club-footed anticipation of ''another day'' or ''context.'' By withholding solid arguments, the government (and by eschewing a dissent, Justice Sotomayor) may have avoided a precedent that might have rejected those arguments, on however substantial grounds, foreclosing the possibility of their in-

[60] A transcript of the oral argument is at 2013 *TNT* 35-15 (2/21/13) (emphasis added).

[61] *Mayo Corporation* and *United States v. Cleveland Indians Baseball Company*, 532 U.S. 200 (2001), are both 21st century taxpayer victories in the Supreme Court. Both involved employment taxes (the question whether certain individuals should be characterized as ''employees,'' rather than independent contractors, under the federal contributions statutes).

[62] 683 F.3d 233 (5th Cir. 2012).

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vocation in the future. Instead, moreover, the government (and perhaps Justice Sotomayor) secured an opinion that all but concedes its incompleteness, and affirmatively leaves open the possibility of raising those arguments in the future, even in a case involving the same foreign tax and thus presenting virtually identical facts.

And this speculation sheds some light on the dangers or difficulties of the ''finger on the law'' approach in modern circumstances: it is easy for the tax administration to ''game'' the anticipation of that approach, and to exploit it repeatedly to limit the judiciary's capacity for comprehensively ruling on and controlling the content of the tax law. This becomes more emphatically the case to the extent the doctrine is practiced *sub silentio* but not espoused by the Supreme Court, so that the lower courts adopt it only sporadically or not at all. Thus, what might have been an appealing and even effective approach in the pastoral Show Me State of the early 20th century may have only untoward and counterproductive consequences if applied broadly to the complex realities of modern industrial America.

One government official has publicly expressed skepticism, since the announcement of the decision, about whether the decision will have a broad or lasting impact on the foreign tax credit generally.[63] At the same time, the *PPL* decision appears to be a very liberal one with respect to allowing foreign tax credits, and to open questions about the creditability of taxes the qualification of which, prior to the decision, would have been subject to serious doubt. At the same time, the Court's stated restraint from deciding a major argument presented to it suggests substantial grounds for viewing the decision as limited, perhaps even to its own facts.

But whatever the consequences for the foreign tax credit, which in my judgment are unlikely to be salutary, the case may have broader impact — or may be part of a pattern of decision or approach — by its implications for judicial approaches to interpretive questions in tax cases. Justice Thomas's stance in Footnote 6, in light of his prior opinions and especially in light of the position of the Chief Justice at oral argument, suggest this may be what the future holds.

[63] See ''*PPL* Decision Unlikely to Have Broad Impact, IRS Official Says,'' 2013 *TNT* 124-5 (6/27/13) (remarks of Barbara Felker, Chief, Branch 3, Office of the Associate Chief Counsel (International)).

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