15-572

15 No. 15-572

IN THE

Supreme Court of the United States

THE BANK OF NEW YORK MELLON CORPORATION, AS SUCCESSOR IN INTEREST TO THE BANK OF NEW YORK COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

ALAN E. SCHOENFELD
MICHAEL D. GOTTESMAN
WILMER CUTLER PICKERING
HALE AND DORR LLP
7 World Trade Center
250 Greenwich St.
New York, NY 10007

ROGER RITT
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

SETH P. WAXMAN
Counsel of Record
CATHERINE M.A. CARROLL
JONATHAN A. BRESSLER
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000
seth.waxman@wilmerhale.com

QUESTIONS PRESENTED

This petition concerns the application of the economic-substance doctrine to foreign tax credits petitioner claimed for foreign taxes it paid on a multi-billion-dollar cross-border transaction. The questions presented overlap in part with the questions presented in *Salem Financial* v. *United States*, No. 15-380, which addresses a transaction that is materially identical to the transaction at issue in this case, and *American International Group* v. *United States*, No. 15-478, which seeks review of the same judgment as this petition. The questions presented are:

1. Whether, under *Old Colony Trust* v. *Commissioner*, 279 U.S. 716 (1929), a court evaluating the economic substance of a cross-border transaction should treat foreign taxes as a transaction expense that reduces the transaction's pre-tax profitability, as the Second and Federal Circuits have held, or as a tax, as the Fifth and Eighth Circuits have held.

2. Whether, under *Old Colony Trust* v. *Commissioner*, 279 U.S. 716 (1929), payments a taxpayer receives from an independent counterparty that reflect favorable tax consequences the counterparty expects from the transaction constitute income to be included in pre-tax profitability for purposes of assessing the transaction's economic substance, as the Fifth, Eighth, and Federal Circuits have held, or "tax effects" that must be disregarded, as the Second Circuit has held.

CORPORATE DISCLOSURE STATEMENT

The Bank of New York Mellon Corporation has no parent corporation, and no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

CASES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

Page(s)

IN THE

Supreme Court of the United States

No. 15-

THE BANK OF NEW YORK MELLON CORPORATION, AS SUCCESSOR IN INTEREST TO THE BANK OF NEW YORK COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

Petitioner The Bank of New York Mellon Corporation ("BNY") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the Second Circuit (App. 1a-39a) is reported at 801 F.3d 104. The opinions of the Tax Court (App. 41a-97a) are reported at 140 T.C. 15 and 106 T.C.M. 367.

JURISDICTION

The court of appeals entered judgment on September 9, 2015. App. 1a. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTES AND REGULATIONS INVOLVED

Relevant portions of Section 901 of the Internal Revenue Code, 26 U.S.C. §901, and Treasury Regulation 1.901, 26 C.F.R. §1.901, are reproduced in the Appendix. App. 101a-111a.

STATEMENT

This case involves foreign tax credits BNY claimed on its U.S. federal tax returns for income taxes BNY paid to the United Kingdom on a transaction with U.K.-based Barclays Bank. In the transaction, Barclays lent BNY $1.5 billion for five years at a favorable interest rate. BNY used the loan in its commercial-banking business to generate net interest income. Barclays offered the attractive loan in exchange for BNY's participation in a loan structure that Barclays developed to produce U.K. tax benefits for Barclays. Barclays, in turn, effectively shared its U.K. tax benefits with BNY through the favorable interest rate.

The Internal Revenue Service challenged the transaction on the ground that it lacked economic substance. The Tax Court disallowed BNY's tax credits, and the U.S. Court of Appeals for the Second Circuit affirmed. As a result, BNY must pay income tax twice on the same income from the same transaction—once to the United Kingdom, and once to the United States—translating into hundreds of millions of dollars in double taxation. In reaching that decision, the court of appeals split from its sister circuits on two significant questions

concerning the application of the economic-substance doctrine. This Court should grant review to resolve the acknowledged division among the circuits and to prevent the significant negative consequences of the Second Circuit's decision.

A. The Foreign Tax Credit

The United States taxes U.S. taxpayers' worldwide income, including foreign-source income that is also taxed by a foreign country. 26 U.S.C. §61(a). Absent some offsetting tax credit, a U.S. taxpayer earning income overseas would pay tax on that income twice—once to the foreign country, and once to the United States. *PPL Corp.* v. *Commissioner*, 133 S. Ct. 1897, 1901 n.2 (2013). Recognizing that such "double taxation" would discourage U.S. taxpayers from engaging in international commerce, Congress enacted the foreign tax credit in 1918 "to mitigate against th[at] evil." *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 7 (1932). So long as detailed rules are satisfied, the foreign tax credit entitles U.S. taxpayers to take a dollar-for-dollar credit offsetting their U.S. income taxes by amounts paid as income tax to a foreign country on foreign-source income. 26 U.S.C. §901(b); *see also id.* §27(a). The credit does not reduce the U.S. taxpayer's global tax burden—since the taxpayer must actually owe and pay foreign taxes on the foreign-source income to claim the credit—but simply prevents double taxation of the same income.

The foreign tax credit is critical to the U.S. tax system and U.S. companies' participation in the global economy. Totaling more than $100 billion per year, it is the largest tax credit that U.S. corporations claim. Luttrell, IRS Statistics of Income Bulletin, *Corporate Foreign Tax Credit, 2010*, at 1 (Fall 2014). The credit invariably deprives the U.S. Treasury of tax revenue. But Congress has judged that U.S. taxpayers' income, whether domestic or foreign, should be taxed only once and that foreign governments should have primary taxing jurisdiction over foreign-source income.

Statutes and regulations prescribe that foreign tax credits are available only in carefully delineated circumstances and only up to designated limits. Bittker & Lokken, *Federal Income Taxation of Corporations and Shareholders* ¶15.21[1][a] (7th ed. Supp. 2014); *see* 26 U.S.C. §904(a). Under the "technical taxpayer" rule, for example, a taxpayer cannot claim a credit unless it bears legal liability for the foreign tax. 26 C.F.R. §1.901-2(f). The rules also prescribe when a foreign tax is considered to have been paid by the taxpayer, making non-creditable those foreign taxes that have been "refunded, credited, rebated, abated, or forgiven" by the foreign taxing authority, *id.* §1.901-2(e)(2)(i), or "used (directly or indirectly) by the country imposing such tax to provide a subsidy by any means to the taxpayer, a related person ... , or any party to the transaction or to a related transaction," 26 U.S.C. §901(i)(1). Voluntary or "noncompulsory" payments similarly are non-creditable. 26 C.F.R. §1.901-2(e)(5). These comprehensive rules provide guidance to taxpayers about the scope of the credit. *See* Bittker & Lokken, *supra*, ¶15.21[1][a].

Critically, this regime does not require the foreign country's tax law to conform to U.S. tax law. If the taxpayer legally owes and pays foreign income tax and meets the statutory and regulatory requirements, then the credit is available even if the foreign jurisdiction's law treated the transaction differently than U.S. law would have treated it. For example, a taxpayer may claim foreign tax credits even if the foreign tax is im-

posed "on an item of income that does not constitute income under United States tax principles." 26 C.F.R. §1.904-6(a)(1)(iv); *see* 26 U.S.C. §904(d)(2)(H).

Finally, the foreign tax credit rules do not require taxpayers to prefer domestic transactions to foreign transactions or to minimize the amount of credits they claim. "A taxpayer is not required to alter its form of doing business, its business conduct, or the form of any business transaction in order to reduce its liability under foreign law for tax." 26 C.F.R. §1.901-2(e)(5)(i). Rather, the taxpayer may structure its business as it chooses, including by earning income through a foreign subsidiary or placing assets into a foreign corporation, even if doing so subjects the taxpayer to foreign taxes. *See* Dolan et al., *U.S. Taxation of International Mergers, Acquisitions and Joint Ventures* ¶21.04[4][a] (2014).

B. The STARS Transaction

BNY is a commercial bank.[1] A substantial part of BNY's business is to earn net interest income by borrowing money at relatively low interest rates and lending or investing it at higher rates. In 2001, U.K.-based Barclays Bank approached BNY to offer a transaction that would serve BNY's commercial-banking business objectives. App. 9a, 43a. Under the transaction, which Barclays called a Structured Trust Advantaged Repackaged Securities ("STARS") transaction, Barclays offered to lend $1.5 billion to BNY for five years at a favorable interest rate. Barclays was willing and able

[1] This case involves the tax liabilities of The Bank of New York Company, Inc., which merged with Mellon Financial Corporation in 2007 to form The Bank of New York Mellon Corporation. The Bank of New York Company was the parent of a group of entities that filed consolidated federal tax returns.

to offer BNY the low-cost loan because Barclays had designed STARS to provide Barclays with certain U.K. tax benefits, which Barclays effectively shared with BNY in the form of a reduced—sometimes negative—interest rate. BNY agreed to the transaction, which continued until 2006. App. 9a, 43a, 58a.

As with many billion-dollar international financings, the transaction's structure was complex and had several features necessary for Barclays to achieve its desired U.K. tax treatment. Since most of those features were relevant only to Barclays's tax position under U.K. law, which was approved by the U.K. tax authority, App. 55a, we describe the transaction in simplified form.

First, Barclays required BNY to create a "STARS Trust" and fund it by contributing approximately $7.8 billion of BNY's existing income-producing assets. App. 9a, 46a. Barclays also required BNY to appoint one of its U.K.-based subsidiaries as the Trustee, which subjected the income produced by the assets in the Trust to U.K. taxation. App. 9a-10a, 46a, 52a, 55a.

Second, Barclays made the loan by purchasing Trust shares from BNY for approximately $1.5 billion in cash. App. 10a, 47a, 50a. BNY used the cash for five years in its banking business, App. 91a, 93a, and agreed to repay the loan by repurchasing Barclays's Trust shares for $1.5 billion after five years, App. 10a, 48a, 50a. To satisfy Barclays's U.K. tax objectives, the shares Barclays purchased were entitled to monthly distributions of nearly all the Trust income, but Barclays committed to automatically recontribute the distributions back into the Trust. App. 10a, 47a-48a, 57a.

Third, the parties implemented the loan's interest rate by requiring certain monthly payments. One of

these payments required BNY to pay Barclays a monthly LIBOR-based rate, reduced by a discount that the parties referred to as the "spread." App. 10a, 48a. The spread was calculated to reflect approximately half the pre-tax value of Barclays's expected U.K. tax benefits. App. 33a, 75a n.14. The spread increased the transaction's profitability to BNY by reducing BNY's interest cost for the loan. On net, the loan arrangement resulted in BNY paying an effective interest rate of 300 basis points (3%) below one-month LIBOR—a very attractive rate. C.A. App. 2957, 2973. Whenever one-month LIBOR was less than 3%, the net result was negative interest—*i.e.*, Barclays paid BNY. App 57a. Over the five-year life of the transaction, the spread contributed about $250 million to BNY's net interest income. C.A. App. 2991-2992.

C. Tax Treatment Of The STARS Transaction

1. U.K. tax

Under the U.S.-U.K. tax treaty, the income produced by the Trust assets was taxable in the United Kingdom because the Trustee, a BNY subsidiary, legally resided there. App. 9a-10a, 55a. Unlike the "classical" corporate tax system used in the United States, which taxes corporate earnings twice—once at the corporate level when earned, and again at the shareholder level when distributed—the United Kingdom uses an "integrated" system that effectively collects only a single level of corporate tax by crediting shareholders for taxes imposed on the corporation on the same earnings. *See* Bittker & Lokken, *supra*, ¶3.5.6. The United Kingdom accordingly *imposed* tax twice on the Trust income—once on BNY at the Trust level, and once on Barclays at the shareholder level—but gave Barclays a credit to ensure that the United Kingdom would *collect* tax on the Trust income only once.

Specifically, the United Kingdom imposed on BNY a 22% tax on Trust income. App. 10a, 55a. In total, BNY paid about $100 million per year in U.K. tax in each of 2001 and 2002. App. 58a.[2]

The United Kingdom also imposed on Barclays, as the shareholder deemed by U.K. law to own almost all the Trust income, *supra* p. 6, a 30% tax on almost all the grossed-up (pre-tax) Trust income. App. 11a, 56a. But because the Trust's income had already been taxed at 22% at the Trust level, the United Kingdom allowed Barclays to take a 22% credit, reducing Barclays's liability to 8% of the Trust's income. App. 11a, 56a. Thus, for every $100 of Trust income, the United Kingdom collected and retained $30 in tax—$22 from BNY, and $8 from Barclays.

U.K. law had an additional feature that would yield net U.K. tax benefits for Barclays if Barclays had enough income from other sources to take tax deductions. Because Barclays designed the transaction to count as part of its financial trade—*i.e.*, its business as a lender—U.K. law allowed Barclays to deduct from its unrelated taxable income the distributions that it recontributed to the Trust, *supra* p. 6, which equaled approximately 78% of the Trust's income. App. 11a, 56a. Given Barclays's 30% U.K. corporate tax rate, this deduction translated into a $23.40 reduction in Barclays's

[2] This litigation addresses only the STARS transaction's first two years, for which BNY paid about $200 million in U.K. taxes and claimed an equivalent amount in foreign tax credits on its U.S. tax returns. App. 12a. The Second Circuit's decision will also control tax treatment for the transaction's last three years, for which hundreds of millions of dollars are additionally at stake.

U.K. tax for every $100 in Trust income ($78 × 30%). Subtracting the 8% tax on the Trust income that Barclays had to pay, *supra* p. 8, this deduction yielded Barclays a net after-tax benefit of $15.40 per $100 of Trust income. App. 11a.

It was that expected U.K. tax benefit for Barclays, generated primarily by the financial-trade deduction, that enabled Barclays to offer the loan to BNY at a bargain rate. Barclays's $15.40 after-tax benefit translated into a pre-tax equivalent of $22 per $100 of Trust income ($15.40 ÷ 70%). As noted, the parties had negotiated the amount of the spread—*i.e.*, the amount by which Barclays agreed to reduce BNY's monthly interest costs—to be approximately half the expected pre-tax value of Barclays's U.K. tax benefits, or $11 per $100 of Trust income. App. 33a, 48a. U.K. law allowed Barclays to deduct that spread payment to BNY as well, for an additional benefit to Barclays of $3.30 per $100 of Trust income ($11 × 30%). App. 11a, 56a.

2. U.S. tax

By engaging in the STARS transaction, BNY did not save any money on taxes. BNY reported its income from the Trust assets on its U.S. tax returns as foreign-source income. App. 58a. That income was subject to U.S. income tax because, as discussed, the United States taxes U.S. corporations' worldwide income. *Supra* p. 3. Consequently, in addition to the 22% tax BNY incurred and paid on the Trust income in the United Kingdom, BNY also incurred a 35% U.S. corporate tax on the Trust income. But BNY reported the U.K. tax it had paid on the Trust income and claimed foreign tax credits for those U.K. tax payments. App. 58a. For the two years at issue in this litigation, BNY claimed about $200 million in foreign tax credits, equivalent to the income tax BNY paid to the United Kingdom. *Id.*; *see also supra* p. 8 & n.2.

The foreign tax credits did not reduce BNY's global tax on the Trust income over the life of the transaction, but simply shifted a portion of that tax burden from the United States to the United Kingdom, as invariably occurs whenever the foreign tax credit can be claimed. In particular, of the 35% corporate tax BNY owed on the Trust income in the United States, BNY claimed credits for a portion—the 22% Trust tax it paid to the United Kingdom—and paid the balance to the United States. Without the foreign tax credits, BNY would have had to pay both the 22% U.K. Trust tax and the 35% U.S. corporate tax.[3]

D. Proceedings Below

In 2009, the IRS issued a Notice of Deficiency disallowing BNY's foreign tax credits, and BNY petitioned the Tax Court for a redetermination of the alleged deficiencies. App. 12a. The IRS did not challenge BNY's compliance with the statutory and regulatory requirements governing the foreign tax credit. C.A. App. 45-46. Instead, it asserted that the STARS transaction lacked "economic substance." *Id.*; App. 59a.

The economic-substance doctrine is a common-law doctrine that allows the IRS to disregard a transaction

[3] BNY also paid U.S. income tax on the increased net interest income it earned by participating in STARS, including the $11 per $100 of Trust income that BNY earned in the form of the spread. *See, e.g.*, App. 58a, 88a-89a, 94a. As the foregoing discussion and the Tax Court's explanation demonstrate, App. 58a, the court of appeals was clearly mistaken in stating that the United States "collected no taxes from STARS" and that BNY used the foreign tax credits to "offset its unrelated income and reduce[] its overall U.S. tax bill," App. 12a.

and disallow otherwise valid tax benefits—even though all statutory and regulatory requirements have been satisfied—if "there was nothing of substance to be realized by [the taxpayer] from th[e] transaction beyond a tax deduction." *Knetsch* v. *United States*, 364 U.S. 361, 366 (1960) (disallowing transaction where taxpayer borrowed money at 3.5% to invest at 2.5%). In this case, because BNY's petition arose within the Second Circuit, the Tax Court applied Second Circuit precedent, App. 61a-62a, under which courts test a transaction's economic substance by assessing whether the taxpayer had an objectively reasonable expectation of profit apart from tax consequences and a subjective non-tax business purpose for entering into the transaction, *see Gilman* v. *Commissioner*, 933 F.2d 143, 147-148 (2d Cir. 1991); App. 18a.

After a bench trial, the Tax Court ruled for the IRS, concluding that the STARS transaction lacked economic substance. That conclusion rested on two key legal rulings the court made in assessing BNY's expectation of profit. First, the Tax Court treated BNY's U.K. tax payments as "non-tax" "transaction costs" that reduced BNY's expected profits. App. 65a-66a. The court acknowledged that the Fifth and Eighth Circuits had rejected this treatment of foreign taxes—indeed, the Fifth Circuit had reversed the Tax Court precedent on which the Tax Court relied. App. 65a n.9. Nonetheless, the court adhered to its prior decision because it was "not bound" by those decisions in a case arising outside of those circuits. *Id.*

Second, the Tax Court disregarded the spread, which reduced BNY's interest costs on the $1.5 billion loan, and instead evaluated BNY's expected profits as if BNY had paid a higher interest rate. App. 72a-76a. Although the spread was a private obligation under-taken by Barclays to give BNY the negotiated favorable interest rate and serve BNY's commercial-banking business purposes, the court rejected the spread as an impermissible "tax effect" because it reflected a portion of Barclays's U.K. tax benefits. App. 76a.[4]

Having placed its thumb on the scale by ruling that any assessment of the transaction's profitability must count U.K. taxes as a cost but exclude the economic benefits BNY derived from the spread, the Tax Court found that the transaction provided no objective opportunity for profit. And having rejected BNY's business purpose for entering into the transaction as a "tax effect," the court found no subjective purpose but tax avoidance. The court accordingly upheld the IRS's disallowance of BNY's foreign tax credits.[5]

Applying de novo review, App. 13a-14a, the court of appeals affirmed, agreeing with the Tax Court as to both key legal rulings. App. 20a-25a, 31a-33a. The court began by asking "whether, for purposes of the economic substance doctrine, foreign taxes should be

[4] The court also refused to consider as evidence of economic substance the $1.5 billion loan, the income BNY expected to earn by investing the loan proceeds, and the income BNY earned from the Trust assets. App. 67a-68a, 71a-72a, 76a-80a. The court of appeals agreed with that analysis. App. 31a-35a. Those decisions were incorrect, but BNY does not challenge them in this petition. A favorable ruling from this Court on the questions presented in the petition would require relief for BNY regardless of those other errors.

[5] On BNY's motion for reconsideration, the Tax Court held that because the $1.5 billion loan served a purpose beyond the creation of tax benefits, BNY could deduct interest on the loan at a LIBOR-based rate that disregarded the spread. App. 85a-97a. The Commissioner cross-appealed that ruling, which the court of appeals affirmed. App. 35a-37a.

treated as costs when calculating pre-tax profit." App. 20a. The court explained that the answer to that question will affect whether a transaction appears profitable and thus has economic substance. *Id.* It noted that "[o]ther Circuits have taken disparate approaches," with the Federal Circuit having treated foreign taxes arising from a materially identical STARS transaction as "economic costs that are properly deducted in assessing profitability for the purposes of economic substance," and the Fifth and Eighth Circuits having held that "foreign taxes are not economic costs and should not be deducted from pre-tax profit." App. 20a-22a.[6]

The court of appeals concluded that it "agree[d] with the Federal Circuit in *Salem* and disagree[d] with decisions of the Fifth and Eighth Circuits." App. 38a. The court asserted that "[t]he purpose of calculating pre-tax profit in this context is not to perform mere financial accounting," but to "discern, as a matter of law, whether a transaction meaningfully alters a taxpayer's economic position other than with respect to tax consequences." App. 24a. The court accordingly concluded that it was appropriate, "when assessing the objective economic substance of a transaction, to include the foreign taxes paid but to exclude the foreign tax credits claimed in calculating pre-tax profit." App. 25a.

The court acknowledged that "commentators have criticized this approach" as "'contorting' the economic substance doctrine 'beyond any recognizable bounds.'" App. 25a. But the court found those criticisms "unpersuasive," reasoning that "[t]he purpose of the foreign tax credit is to facilitate global commerce by making

[6] The Federal Circuit's analysis of this issue is the subject of the pending petition for certiorari in *Salem Financial* v. *United States*, No. 15-380 (Sept. 2015).

the IRS indifferent as to whether a business transaction occurs in this country or in another." App. 26a.

As to the spread, the court of appeals held that the Tax Court "did not err in excluding the tax-spread that Barclays paid BNY from calculated profit." App. 32a. Although the court did not find—and the IRS did not contend—that the spread constituted a "rebate" of BNY's U.K. taxes under the regulation that specifically determines when foreign taxes are not creditable due to a rebate or subsidy, 26 C.F.R. §1.901-2(e)(2)(i), the court concluded that the spread should be disregarded as a "tax effect" because BNY referred to the spread colloquially as a "'rebate from Barclays'" and because Barclays paid the spread "to share the tax benefits of STARS with BNY." App. 32a. According to the court, BNY had no legitimate reason for entering into the STARS transaction, because the spread did not lower BNY's monthly interest costs on the $1.5 billion loan, but was instead "a way for Barclays to share ... its expected U.K. tax benefits with BNY." App. 34a.

In light of this "sharing of tax benefits"—as well as the transaction's "circular cash flows" and BNY's acknowledgment that it would not have entered into the transaction unless it could avoid double taxation by obtaining foreign tax credits—the court concluded that BNY "used an extremely convoluted transaction structure to take maximum advantage of U.S. and U.K. tax benefits" by obtaining "reimburse[ment] for half of its U.K. tax payments and simultaneously claim[ing] a foreign tax credit in the United States for the full payment amounts." App. 33a.

REASONS FOR GRANTING THE PETITION

I. THE CIRCUITS ARE SPLIT ON TWO FUNDAMENTAL QUESTIONS CONCERNING APPLICATION OF THE ECONOMIC-SUBSTANCE DOCTRINE

The economic-substance doctrine dates to *Gregory* v. *Helvering*, in which this Court explained:

> The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.

293 U.S. 465, 469 (1935) (citations omitted).

This Court has referenced the economic-substance doctrine only a few times since *Gregory*, but it has emphasized that the IRS must respect genuine transactions between independent entities that generate non-tax benefits. *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 583-584 (1978). The Court has likewise reiterated that "[t]he fact that favorable tax consequences were taken into account" by a U.S. taxpayer upon entering into a transaction "is no reason for disallowing those consequences." *Id.* at 580. The Court has thus rejected economic-substance challenges where "[t]ax considerations well may have had a good deal to do with the specific terms" of the challenged transaction, *United States* v. *Consumer Life Ins.*, 430 U.S. 725, 739 (1977), and even where an "acknowledged purpose" of the transaction was to achieve particular tax results, *Cottage Sav.* v. *Commissioner*, 499 U.S. 554, 557 (1991).

In the courts of appeals, "[s]ince *Gregory*, the economic substance doctrine 'has been applied differently from circuit to circuit and sometimes inconsistently within circuits.'" *United States* v. *Coplan*, 703 F.3d 46, 91 (2d Cir. 2012). Relevant here, the courts of appeals are openly split on two related questions central to application of the economic-substance doctrine: First, how to account for foreign taxes paid, and second, how to account for income that derives from tax benefits a counterparty receives in connection with the transaction. These questions are readily answerable through straightforward application of this Court's jurisprudence, as the Fifth and Eighth Circuits have recognized. The court of appeals in this case, however, ignored that case law, split with the Fifth and Eighth Circuits, and unnecessarily complicated the analysis. In doing so, the Second Circuit followed the Federal Circuit's approach in another STARS case as to the first issue, but split from that court on the other issue, further deepening the courts of appeals' disagreement.

A. The Circuits Are Split On How To Account For Foreign Taxes When Assessing A Transaction's Economic Substance

The principal question for the court of appeals in applying the economic-substance doctrine was whether the STARS transaction held an objectively reasonable prospect of pre-tax profitability—that is, whether the transaction could reasonably be expected to make money apart from tax considerations. To make that determination, the court first had to determine how much pre-tax income BNY could anticipate from the transaction. That inquiry should have been guided by this Court's decision in *Old Colony Trust* v. *Commissioner*, 279 U.S. 716 (1929). In that case, an employer withheld taxes from an employee's salary and paid them on the employee's behalf. *Id.* at 729. This Court determined

that because the employee received an economic benefit from the employer's payment of the tax, his taxable income included the gross amount before withholding, not the net amount actually received after taxes. *Id.* *Old Colony* thus stands for the principle that income is measured for tax purposes by the gross pre-tax amount, not the net after-tax amount. Under that principle, foreign taxes—like the tax withheld in *Old Colony*—should not be treated as an expense that reduces pre-tax income.

Ignoring—indeed, never mentioning—*Old Colony*, the Second Circuit held that "foreign taxes are economic costs for purposes of the economic substance doctrine and thus should be deducted from profit *before* calculating pre-tax profit." App. 27a; *see also* App. 32a ("as a matter of law, foreign taxes should be deducted when calculating pre-tax profit"). The court therefore reduced BNY's expected pre-tax profit by the amount of BNY's U.K. taxes. App. 32a. The court recognized that this approach had been criticized by tax experts on several grounds—including that it "'contort[ed]' the economic substance doctrine 'beyond any recognizable bounds,'" App. 25a—but nonetheless concluded that it was "appropriate, in calculating pre-tax profit, for a court both to include the foreign taxes paid and to exclude the foreign tax credits claimed," App. 38a.

The Federal Circuit took the same approach in another STARS case, concluding that the foreign taxes paid by the U.S. taxpayer counted against the taxpayer's expectation of profit. *Salem Fin.* v. *United States*, 786 F.3d 932, 948-949 (Fed. Cir. 2015), *petition for cert. filed*, No. 15-380 (Sept. 2015); *see* App. 38a (Second Circuit: "we agree with the Federal Circuit in *Salem*").

The Second and Federal Circuits acknowledged that their approach squarely contradicted the Fifth and Eighth Circuits' approach to the same question. App. 38a (Second Circuit: "we ... disagree with decisions of the Fifth and Eighth Circuits"); *see also Salem*, 786 F.3d at 944-946. In cases addressing similar facts, the Fifth and Eighth Circuits held that foreign taxes—like U.S. taxes—must not be deducted as an expense from the taxpayer's gross income in calculating pre-tax profitability for purposes of the economic-substance doctrine. *See Compaq Computer* v. *Commissioner*, 277 F.3d 778 (5th Cir. 2001); *IES Indus.* v. *United States*, 253 F.3d 350 (8th Cir. 2001). In the transactions at issue in *Compaq* and *IES*, U.S. companies bought shares in Dutch companies just before the dividend record date (purchasing stock that was pregnant with immediately forthcoming dividends), collected the dividend, and then immediately sold the shares at a loss. The companies claimed foreign tax credits for taxes they paid to the Netherlands to offset their U.S. tax on the dividend income, and used the loss on the sale of shares to offset unrelated capital gains. *See Compaq*, 277 F.3d at 779-780; *IES*, 253 F.3d at 352.

Reversing the lower courts' determinations that the transactions lacked economic substance, the Fifth and Eighth Circuits concluded that the question of how to treat foreign tax payments was readily answered by "the venerable principle" articulated in *Old Colony*. *Compaq*, 277 F.3d at 783; *see IES*, 253 F.3d at 354. When a taxpayer earns income subject to a foreign tax, "the economic benefit to [the taxpayer] [is] the amount of ... gross [income] before the foreign taxes [are] paid." *IES*, 253 F.3d at 354. That situation "is no different from an employer withholding and paying to the government income taxes for an employee: the full

amount before taxes are paid is considered income to the employee." *Id.* If the tax had been paid to the United States rather than the Netherlands, "there would have been no argument that [the gross amount] was not income to [the taxpayer]"; and it was "irrelevant" "[t]hat the tax was imposed by the Netherlands rather than by the United States." *Compaq*, 277 F.3d at 783-784. "Pre-tax income is pre-tax income regardless of the ... origin of the tax." *Id.* at 784.

In *Compaq*, the Fifth Circuit criticized the IRS's approach—the same approach the Second Circuit adopted here. As the Fifth Circuit explained, the IRS inexplicably "treated the [foreign] tax as a cost of the transaction, but did not treat the corresponding U.S. tax credit as a benefit of the transaction." *Compaq*, 277 F.3d at 782. That "half pre-tax, half after-tax calculation" of profit was an unfair and "curious method of calculation": By "count[ing]" taxes "only when they subtract from cash flow," the IRS "stack[s] the deck against finding the transaction profitable." *Id.* at 785. "To be consistent," the court explained, "the analysis should either count all tax law effects or not count any of them." *Id.*

The Second Circuit in this case committed precisely the error the Fifth Circuit warned against and, in doing so, openly "disagree[d] with decisions of the Fifth and Eighth Circuits." App. 38a. The Federal Circuit went one further, offering that it would have held the transactions at issue in *Compaq* and *IES* to be without economic substance. *Salem*, 786 F.3d at 947-948.

B. The Circuits Are Split On How To Treat Payments That Reflect A Counterparty's Tax Benefits When Assessing A Transaction's Economic Substance

In testing the STARS transaction's pre-tax profitability, the Second Circuit also had to determine how to treat the economic benefit BNY derived from the spread, which reduced BNY's monthly interest costs on the $1.5 billion loan. *Supra* pp. 6-7, 14. As discussed, Barclays expected to receive certain U.K. tax benefits based on the STARS structure, and the parties negotiated the spread to reflect half the pre-tax value of Barclays's expected U.K. tax benefits. The spread lowered BNY's effective interest rate, to the tune of approximately $250 million over the life of the loan. *See supra* p. 7. BNY argued that this spread conferred real economic value and was properly included in pre-tax profits for purposes of assessing the transaction's economic substance.

The court of appeals disagreed. In the court's view, the spread was not an expense reduction or income, but rather an impermissible "tax effect" attributable exclusively to a "sharing of tax benefits" by Barclays. App. 32a, 34a. Adopting an argument that even the Tax Court had declined to endorse, the court of appeals further concluded that the spread was a "'rebate from Barclays'" that "reimbursed" BNY for its U.K. tax payments and should therefore be excluded from pre-tax profit. App. 32a-33a. And ignoring this Court's statement that "[t]he fact that favorable tax consequences were taken into account is no reason for disallowing those consequences," *Frank Lyon*, 435 U.S. at 580, the court of appeals criticized BNY for "tak[ing] maximum advantage of U.S. and U.K. tax benefits," App. 33a; *cf. Boulware* v. *United States*, 552 U.S. 421,

429 n.7 (2008) (economic substance does not depend on "whether alternative routes may have offered better or worse tax consequences").

In so holding, the court this time departed not only from the Fifth and Eighth Circuits, but also from the Federal Circuit, which concluded that, under *Old Colony*, an equivalent payment on another STARS transaction counted as income to the taxpayer.

As discussed, the issue in *Old Colony* was whether the amount of tax withheld and paid on the taxpayer's behalf by the taxpayer's employer counted as income to the taxpayer. The Court concluded that it did. 279 U.S. at 729. "The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed," so that the employer's payment of the income tax "constituted income to the employee." *Id.*; *see also Diedrich* v. *Commissioner*, 457 U.S. 191, 195-197 (1982) (donee's payment of a gift tax constituted income to the donor under *Old Colony*).

The same principle should have applied here, as the Fifth and Eighth Circuits have recognized. There is no dispute that, if Barclays had simply paid half of BNY's U.K. taxes on BNY's behalf, that amount would have been income to BNY under *Old Colony*. *See Compaq*, 277 F.3d at 784 ("[T]he payment of Compaq's Netherlands tax obligation by Royal Dutch was income to Compaq."); *IES*, 253 F.3d at 354 ("[I]ncome was realized by the payment of IES's foreign tax obligation by a third party."). The Second Circuit, however, appears to have concluded that because Barclays did not pay BNY's U.K. taxes directly, but instead "share[d] the U.K. tax benefits of STARS" indirectly through the spread, a different rule applied. App. 26a.

That approach is irreconcilable with *Old Colony*. Even the Federal Circuit recognized as much in *Salem*, despite its many other errors, concluding that equivalent payments to the taxpayer (BB&T) from Barclays—referred to in that STARS transaction as "Bx payments"—constituted pre-tax income: "Like the taxpayer in *Old Colony*, BB&T realized an immediate economic benefit by receiving the Bx payments from Barclays." 786 F.3d at 945. Those payments "were made in consideration of BB&T's services rendered under the STARS transaction," and "[u]nder the principle of *Old Colony*, the reimbursements that BB&T received from Barclays must therefore be treated as income to BB&T, not tax effects." *Id.*; *see also id.* at 946 ("We ... conclude that the Bx payments should not be characterized as tax effects. Pursuant to *Old Colony* and its progeny, the Bx payments are income to BB&T.").

That application of *Old Colony* accords with the rules governing foreign tax credits. Under the technical-taxpayer rule, the foreign tax credit is available to the party that legally owed and paid the foreign tax; whether that party bore the foreign tax's ultimate economic burden is irrelevant. *See Biddle* v. *Commissioner*, 302 U.S. 573, 581 (1938); 26 C.F.R. §1.901-2(f)(1). The "technical taxpayer" can claim foreign tax credits "even if another party to a direct or indirect transaction with the taxpayer agrees, as part of the transaction, to assume the taxpayer's foreign tax liability." 26 C.F.R. §1.901-2(f)(2). As discussed, *supra* p. 4, the statutes and regulations governing foreign tax credits contain carefully delineated exceptions to that principle in cases where the U.S. taxpayer's foreign tax payment has in substance been "rebated" by the foreign government or used by the foreign government to confer a "subsidy" on the taxpayer or its counterparty; but those rules

do not apply where, as here, the taxpayer's initial tax payment is retained by the foreign government. *See* IRS Chief Couns. Adv. 2005-32-044 (May 5, 2005); *Biddle*, 302 U.S. at 580-581 (corporation that bore legal liability for corporate tax was considered to have paid tax, even though shareholders could obtain a "refund ... of [their] proportionate share"). The IRS has thus never contended—and the court of appeals never found—that the spread payments from Barclays constituted a "rebate" or a "subsidy" under these rules. *Supra* p. 14.

Although it openly followed the Federal Circuit on other issues, the Second Circuit never acknowledged its departure from *Salem* on the spread point. The Second Circuit stands alone—against the Fifth, Eighth, and Federal Circuits—in refusing to recognize private payments from a counterparty as income to the taxpayer for economic-substance purposes when those payments reflect a "sharing of tax benefits" and in concluding that such payments should be disregarded as a "rebate" even though they do not fall within the rules specifically defining rebates. App. 34a. The Federal Circuit rejected that precise position, explaining that it was aware of "no authority" to support it. *Salem*, 786 F.3d at 946. And the Second Circuit's approach "cannot be squared with prior judicial decisions" holding that "even when an unrelated party has paid 100 percent of a taxpayer's taxes, that payment must still be considered income to the taxpayer." *Id.* (citing *Old Colony*, 279 U.S. at 729).

II. The Splits Undermine The Uniformity Of Tax Administration, Impede The Proper Function Of The Foreign Tax Credit, And Threaten Significant Negative Consequences

A. There Is A Special Need For Uniformity And Certainty In National Tax Administration

The acknowledged circuit split warrants this Court's review. This Court has long recognized the particular need for uniformity in the administration of the federal tax system. *See, e.g., Aquilino* v. *United States*, 363 U.S. 509, 514 (1960); *Putnam's Estate* v. *Commissioner*, 324 U.S. 393, 396 (1945). In advocating for grants of certiorari, the Solicitor General has likewise underscored the "significant governmental and public interest in the uniform administration of federal tax law." U.S. Br. 20, *Beard* v. *Commissioner*, No. 10-1553 (July 2011) (recommending certiorari); *see also* U.S. Br. 14, *PPL Corp.* v. *Commissioner*, No. 12-43 (Sept. 2012) (recommending certiorari where one-to-one circuit conflict "implicate[d] the important federal interest in uniform enforcement of the federal tax laws"). The division among the courts of appeals is deeper here than in other federal tax cases in which the Solicitor General has advocated and the Court has granted review.[7] Without this Court's intervention, "inequalities in the administration of the revenue laws" will persist. *Commissioner* v. *Sunnen*, 333 U.S. 591, 599 (1948).

Inconsistency and uncertainty is particularly intolerable in regard to the foreign tax credit, which plays an enormous role in the U.S. economy. The foreign tax credit "is the largest tax credit claimed by corporations," accounting for more than $100 billion in tax credits annually. Luttrell, IRS Statistics of Income Bulletin, *Corporate Foreign Tax Credit, 2010*, at 1 (Fall 2014). In 2010, "the foreign-source taxable income of corporations claiming a foreign tax credit (6,922) accounted for 46 percent of worldwide taxable income reported by all corporations (1,686,171 corporations)." *Id.* Corporations across a range of sectors—including manufacturing, service, mining, insurance, real estate, and finance—claimed foreign tax credits "tall[ying] 75.5 percent of all U.S. income tax before credits and 62.5 percent of U.S. income tax after credits." *Id.* at 2. The circuit splits at issue here thus undermine uniformity in one of the most significant areas of tax law.

[7] *See, e.g., PPL* U.S. Br. 14 (certiorari warranted to resolve one-to-one conflict); Petition for a Writ of Certiorari, *United States* v. *Quality Stores, Inc.*, No. 12-1408, at 22-25 (May 2013) (certiorari warranted to resolve two-to-one conflict).

B. The Second Circuit's Errors Will Discourage Foreign Investment, Frustrating The Purpose Of The Foreign Tax Credit

The foreign tax credit was enacted to facilitate U.S. businesses' commercial activity abroad by "mitigat[ing] the evil of double taxation." *Burnet* v. *Chicago Portrait Co.*, 285 U.S. 1, 3 (1932). The Second Circuit's approach to both questions presented frustrates that purpose and threatens to impede foreign investment.

1. By treating foreign tax as an expense that reduces pre-tax income, the Second Circuit effectively ensures that many cross-border transactions will be subject to double taxation unless the taxpayer can show that the foreign transaction was incrementally more profitable than a comparable domestic transaction. The Second Circuit evaluates the profitability of foreign transactions *after* deducting foreign tax, while evaluating domestic transactions as if they were tax-free. This approach sweeps away the parity between

foreign and U.S. tax that is at the center of the foreign tax credit, and effectively requires a taxpayer to prove that the foreign transaction would have been profitable even if taxed twice. As other courts have recognized, this unfairly stacks the deck against taxpayers who make foreign investments, and it subverts Congress's purpose to facilitate transactions that would make no economic sense in the face of double taxation. *See, e.g., Compaq*, 277 F.3d at 785.

For example, suppose a U.S. citizen owns a U.S. business that generates a pre-tax profit of $9 million per year. He determines that moving the business to the United Kingdom would decrease his costs by $1 million and thereby increase his pre-tax profits to $10 million a year. Because the United States taxes worldwide income, the owner would continue to owe U.S. taxes, and would also incur U.K. taxes of $3 million (assuming a 30% U.K. tax rate). Under the Fifth and Eighth Circuits' analysis, the owner could claim foreign tax credits for his U.K. tax, leaving his worldwide tax bill unchanged (except to the extent he pays additional tax on his increased profits). The Second Circuit, in contrast—like the Federal Circuit—would count the $3 million U.K. tax against the move's profitability, but ignore all the taxpayer's income except the $1 million incremental gain, thereby treating the owner's decision to move the business as if it resulted in a $2 million loss. As a result, the court would find the move objectively unprofitable and disallow the foreign tax credit.

Indeed, whenever the increase in profit between a domestic transaction and a foreign transaction is less than the anticipated tax in the foreign country, the foreign transaction will always be "unprofitable" under the Second Circuit's approach. The court's rule would thus treat a broad range of ordinary business transactions as lacking in economic substance. Disallowing the foreign tax credit in these circumstances would make double taxation commonplace and discourage companies from engaging in international transactions—precisely contrary to the result Congress intended. The Second Circuit approved of those pernicious consequences on the puzzling ground that "[t]he purpose of the foreign tax credit is to facilitate global commerce by making the *IRS* indifferent as to whether a business transaction occurs in this country or in another," App. 26a (emphasis added)—a grave misapprehension of the foreign tax credit.

2. The Second Circuit's treatment of the spread is similarly consequential. The upshot of the court's analysis is that when economic benefits to one party reflect a counterparty's favorable tax position, those benefits must be ignored as impermissible "tax effects" for purposes of testing the transaction's pre-tax profitability. That approach preordains that an array of foreign transactions will be deemed to lack economic substance. Suppose a U.S. bank provides a high-interest-rate loan to a U.K. manufacturer that receives green-energy tax credits under U.K. law to produce solar panels. This transaction plainly has economic substance for the U.S. bank, which stands to earn significant interest income. But under the Second Circuit's approach, if the manufacturer's willingness to pay the high rate stemmed from the fact that it was saving money in the form of U.K. tax benefits, the court would disregard the U.S. bank's actual profit as a "tax effect."

This rule particularly hamstrings foreign transactions, which are often priced to account for differences between U.S. and foreign tax regimes. It also ignores this Court's consistent recognition that "the tax laws affect the shape of nearly every business transaction," and that "[t]he fact that favorable tax consequences were taken into account" by parties to a transaction "is no reason for disallowing those consequences." *Frank Lyon*, 435 U.S. at 580. That holding applies with particular force where, as here, the "tax effect" is a tax benefit under foreign law to a foreign counterparty whose tax position is not at issue.

C. The Second Circuit's Approach Penalizes Rational Tax Planning

As Judge Hand observed, "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." *Helvering* v. *Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935). Consistent with that principle, this Court has rejected economic-substance challenges notwithstanding that "[t]ax considerations well may have had a good deal to do with the specific terms" of the challenged transaction, *Consumer Life*, 430 U.S. at 739, and even where an "acknowledged purpose" of the transaction was to achieve particular tax results, *Cottage Savings*, 499 U.S. at 557. Indeed, even a U.S. taxpayer's "'major motive' to reduce taxes will not vitiate an otherwise substantial transaction." *Consumer Life*, 430 U.S. at 739.

It is impossible to square those pronouncements with the Second Circuit's application of the economic-substance doctrine, which threatens to frustrate permissible tax planning in at least two ways.

First, the Second Circuit's approach penalizes taxpayers that consider the expected tax consequences of a transaction and negotiate arm's-length transaction terms that reflect those consequences. By calculating the spread to reflect a portion of Barclays's expected

U.K. tax benefits, BNY and Barclays made transparent the role that tax considerations permissibly play in the pricing of "nearly every business transaction." *Frank Lyon*, 435 U.S. at 580. But the Second Circuit completely dismissed the spread when calculating the STARS transaction's pre-tax profitability because the spread "monetiz[ed] and transferr[ed]" Barclays's U.K. tax treatment to BNY. App. 32a.

It is a common practice, however, for parties to account for tax consequences when structuring a transaction. When one party to a transaction comes out in a better tax position than the other, parties commonly adjust the price to account for the disparity, and doing so does not deprive the transaction of economic substance. For example, a seller might agree in exchange for an increase in sale price to accommodate a buyer's tax preferences by structuring a transaction as an asset sale rather than a stock sale. The Second Circuit's approach jeopardizes that kind of ordinary planning.

That approach is particularly inappropriate when the tax benefits at issue are foreign tax credits resulting from a cross-border transaction, where the tax preferences the parties accommodated were those of an unrelated foreign counterparty under the tax laws of its own country. *See* Dolan, *The Foreign Tax Credit Diaries—Litigation Run Amok*, 140 Tax Notes 895, 901 (2013); Cummings, *The Economic Substance Doctrine as Penalty*, 138 Tax Notes 1465, 1470 (2013). To avoid income being dismissed as a "tax effect" for economic-substance purposes, U.S. taxpayers would have to look behind the terms of every foreign transaction to determine whether the terms were shaped by a foreign country's tax treatment of the counterparty. If they were, the taxpayer would have to either forgo the transaction or take the risk that the benefit it expected to receive could be disregarded as a "tax effect." That result would impose an immense burden on international transactions.

Second, by overriding the highly reticulated statutes and regulations governing the foreign tax credit with requirements and limitations of the court's own making—applied retrospectively years after the transaction—the Second Circuit's approach undermines taxpayers' ability to rely on the rules in place at the time of a transaction.

Congress and the IRS had developed comprehensive rules governing when foreign tax credits are unavailable because a taxpayer's foreign tax payment has in substance been "rebate[d]" by the foreign government. *See* 26 C.F.R. §1.901-2(e); 26 U.S.C. §901(i). The Commissioner never contended that those rules applied here—most obviously, because the spread was paid by Barclays, a private party, not by the United Kingdom. *See* 26 U.S.C. §901(i)(1) (rebate must be provided "by the country imposing [the foreign] tax"). But the court of appeals moved the goalposts, opting to treat the spread as a "'rebate'" that "reimbursed" BNY for its U.K. tax without even acknowledging the very rules that defined a "rebate" at the time BNY entered the transaction. App. 32a. This Court has called for predictability in the tax laws precisely to protect taxpayers from that kind of approach. *E.g.*, *Thor Power Tool* v. *Commissioner*, 439 U.S. 522, 543, (1979) ("[T]ax law ... can give no quarter to uncertainty."); *United States* v. *Generes*, 405 U.S. 93, 105 (1972) ("[I]n tax law ... certainty is desirable."); *United States* v. *A.B. Leach & Co.*, 300 U.S. 268, 275 (1937) ("'There must be a fixed and indisputable mode of ascertaining a stamp tax.'"). And even if it had any merit, it is an approach that should apply uniformly, not inconsistently across the circuits.

III. THERE IS NO BASIS FOR AWAITING FURTHER PERCOLATION, AND THIS CASE PRESENTS AN IDEAL VEHICLE TO RESOLVE THE ACKNOWLEDGED AND CONSEQUENTIAL SPLIT

Review of the questions presented is warranted without delay. The transaction at issue here (like other STARS cases pending in this Court and the lower courts) involves hundreds of millions of dollars in tax liabilities—more than in many other tax cases in which this Court has granted review.[8] And other cases presenting similar transactions and issues are in the pipeline.[9]

The indeterminacy occasioned by the Second Circuit's approach reflects broader uncertainty among practitioners, the government, and the courts as to how to implement the economic-substance doctrine. *See* *Coplan*, 703 F.3d at 91. Courts have described the

---

[8] Hundreds of millions of dollars in foreign tax credits are at stake for BNY's transaction, *supra* p. 8 & n.2; another $500 million is at stake in Salem's similar transaction. Salem Pet. 11. *Compare* *Beard* U.S. Br. 20 (government recommending certiorari where "over $12 million" was at stake); *Quality Stores* U.S. Pet. 25 (government advocating certiorari with "a total amount at stake of more than $1 billion" among all cases); Petition for a Writ of Certiorari, *PPL Corp.*, at 34 (July 2012) (noting $550 million was at stake); *PPL Corp.* U.S. Br. 14 (government advocating certiorari).

[9] *See* *Santander Holdings USA* v. *United States*, 977 F. Supp. 2d 46, 53 (D. Mass. 2013) (STARS transaction had economic substance; other issues pending); *Wells Fargo & Co.* v. *United States*, No. 09-cv-2764 (D. Minn. filed Oct. 5, 2009). As the Solicitor General has explained in advocating for certiorari in other recent tax cases the Court has granted, the pendency of cases concerning similar transactions in the lower courts supports this Court's review because of the importance of establishing nationally uniform tax treatment. *See* *Quality Stores* U.S. Pet. 25; *PPL* U.S. Br. 13.

IRS's invocation of the doctrine as a nebulous, results-oriented "trump card," *In re CM Holdings*, 301 F.3d 96, 102 (3d Cir. 2002), used by the IRS to invalidate otherwise legitimate transactions that "smell[] bad" to the IRS, *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 265 (3d Cir. 1998) (McKee, J., dissenting). The leading tax treatise calls the economic-substance doctrine "exquisitely uncertain." Bittker & Lokken, *Federal Taxation of Income, Estates, and Gifts* ¶4.3.1 & n.8 (2013). Even the Treasury Department has recognized these concerns. In 1999, it reported that the economic-substance and related anti-abuse doctrines are "inherently subjective," that "courts have applied them unevenly," and that "a great deal of uncertainty exists as to when and to what extent these standards apply, how they apply, and how taxpayers may rebut their assertions." Department of the Treasury, *The Problem of Corporate Tax Shelters: Discussion, Analysis, and Legislative Proposals* 94 (July 1999).

Congress's recent codification of the economic-substance doctrine amplifies the need for clarification. That 2010 statute—which imposes significant penalties on any taxpayer that violates it, *see* 26 U.S.C. §6662(a)-(b)—codifies pre-existing "common law doctrine," 26 U.S.C. §7701(o)(5)(A). It prescribes that "[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted." *Id.* §7701(o)(5)(C). As directed by Congress, the IRS thus continues to apply pre-codification economic-substance case law. *See* IRS Notice 2010-62, at 4 (Oct. 4, 2010) ("The IRS will continue to rely on relevant case law under the common-law economic substance doctrine in applying ... section 7701(o)(1).").

Nothing in the 2010 legislation resolves the circuit splits at issue here. For example, with respect to the treatment of foreign tax payments in assessing the economic substance of cross-border transactions, Congress directed the Secretary of the Treasury to "issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit *in appropriate cases*." 26 U.S.C. §7701(o)(2)(B) (emphasis added). Five years later, Treasury has issued no such regulation. Absent any prospective regulation on that issue, courts continue to apply their own inconsistent rules.[10]

This case presents an ideal opportunity to resolve the circuits' disagreements. On a complete record after trial, the Second Circuit issued a final judgment holding conclusively that BNY's transaction lacked economic substance based on de novo legal conclusions about what counted as BNY's pre-tax expenses and income. The court held as a matter of law that BNY's 22% U.K. tax was a transaction cost that reduced the STARS transaction's pre-tax profitability, and that the spread was a "tax effect" that should be ignored in calculating profit. The court departed from its sister circuits as to each issue, and each issue presents a concrete context within which this Court can provide valuable guidance on the proper application of the economic-substance doctrine. Correcting either of the Second Circuit's er-

[10] Treasury's recent revision of its regulations to disallow credits for future STARS transactions do not diminish the need for review. *See* 76 Fed. Reg. 42,036 (July 18, 2011) (promulgating 26 C.F.R. §1.901-2(e)(5)(iv)). That regulation applies only prospectively; it does not apply to this case or any other pending STARS case. Moreover, the regulation does not purport to resolve the circuit splits presented here, which concern issues that affect transactions of any form, not just STARS.

rors would require reconsideration of the judgment in the IRS's favor.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ALAN E. SCHOENFELD
MICHAEL D. GOTTESMAN
WILMER CUTLER PICKERING
HALE AND DORR LLP
7 World Trade Center
250 Greenwich St.
New York, NY 10007

ROGER RITT
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

SETH P. WAXMAN
Counsel of Record
CATHERINE M.A. CARROLL
JONATHAN A. BRESSLER
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
(202) 663-6000
seth.waxman@wilmerhale.com

NOVEMBER 2015

APPENDICES