No. 15-380

IN THE

Supreme Court of the United States

SALEM FINANCIAL, INC.,

Petitioner,

v.

UNITED STATES,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the Nation's business community.

The Chamber's members rely on the predictable and certain application of the tax laws to plan their business operations in both the short and long terms. In this case, the Federal Circuit—subsequently joined by the Second Circuit—adopted a broad interpretation of the "economic substance" doctrine to override the foreign tax credit provisions of the In-

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[1] Pursuant to this Court's Rule 37.2(a), counsel of record for both parties received timely notice of *amicus curiae*'s intent to file this brief; letters of consent from both parties to the filing of this brief have been submitted to the Clerk. Pursuant to this Court's Rule 37.6, *amicus* states that this brief was not authored in whole or in part by counsel for any party, and that no person or entity other than *amicus*, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

ternal Revenue Code. In conflict with the Fifth and Eighth Circuits, the Federal Circuit ignored the anticipated benefits of the foreign tax credit in assessing whether the transaction at issue had economic substance. The Chamber submits this brief to illustrate the problems that the Federal Circuit's approach would create for businesses, and to emphasize the critical need for this Court's review.

SUMMARY OF ARGUMENT

I. The "economic substance" doctrine permits courts, in certain circumstances, to deprive a taxpayer of tax benefits to which it would otherwise be entitled under the plain terms of the Internal Revenue Code. As an amorphous doctrine, it is inherently uncertain and unpredictable. And as a doctrine applied *post hoc*, it undermines taxpayers' settled expectations about their tax liability potentially years after the relevant transactions occurred. Thus, as this Court's precedents confirm, the doctrine should be applied narrowly, and only when clearly warranted.

II. The Federal Circuit's decision below, however, incorrectly adopted a sweeping interpretation of the economic substance doctrine that greatly expands its proper scope, and thereby created a circuit split that should be resolved by this Court.

A. It is undisputed that BB&T executed a transaction that was effectively a large loan with a foreign lender at favorable interest rates, the proceeds of which were then used to diversify BB&T's funding base and reduce its liquidity risk. *See* Pet. 11. It is also undisputed that BB&T paid taxes to a foreign government as part of this transaction. And it is undisputed that BB&T complied with the extensive statutory and regulatory requirements entitling it to a U.S. tax credit against its foreign taxes. Final-

ly, it is undisputed that Congress enacted the foreign tax credit to protect taxpayers from the evils of double taxation. Yet instead of ending the inquiry there and granting the tax credit, the Federal Circuit invoked the economic substance doctrine and imposed on BB&T the additional burden of proving that the transaction comported with congressional intent in some other, ill-defined respect.

The Federal Circuit erred in imposing that additional burden on BB&T. To ensure the predictable and certain application of the tax laws, this Court should grant review and hold that a taxpayer's payment of foreign taxes and compliance with the foreign tax credit statute and regulations conclusively establish that granting the credit would comport with the congressional purpose of avoiding double taxation.

B. The Federal Circuit's decision and a materially indistinguishable decision by the Second Circuit split with the Fifth and Eighth Circuits, both of which preclude the Commissioner from invoking the economic substance doctrine to manipulate the application of the foreign tax credit. Only by using a creative accounting method that admittedly counts BB&T's foreign taxes as expenses but excludes its foreign tax credits from the analysis was the Federal Circuit able to conclude that BB&T's challenged transaction lacked economic substance. The decisions of the Fifth and Eighth Circuits were correct, and this Court should grant review to eliminate the nationwide uncertainty that the Second and Federal Circuits have created in this important area of tax law.

III. Every participant in the Nation's economy benefits from the predictable and certain application

of the Internal Revenue Code. When businesses cannot assess their tax liability in advance, they may over-report their tax burden or simply shy away from uncertain transactions altogether. Those costs are passed on to nearly every actor in the economy: to workers through lower wages and fewer jobs; to investors through lower rates of return on capital; and to consumers through higher prices. Uncertainty also stunts economic growth, discourages business expansion, and encourages investors to take their money overseas, where tax laws might be more predictable. This Court's review is warranted to avoid imposing these significant costs on American businesses and indeed the Nation's entire economy.

ARGUMENT

The decision below rests entirely on the Federal Circuit's expansion of the "economic substance" doctrine, under which—even if a taxpayer complies with every statutory and regulatory requirement of the tax laws, and even if the transaction has economic substance in the absence of double taxation—a court may later deprive the taxpayer of benefits to which it would otherwise be entitled. *See* Pet. App. 24a–40a. If left in place, the Federal Circuit's expanded economic substance doctrine would create great uncertainty for taxpayers. The Chamber writes to emphasize the high costs of tax uncertainty, which have been widely recognized by both courts and commentators and which support BB&T's request for this Court to grant review.

I. THIS COURT HAS INVOKED THE ECONOMIC SUBSTANCE DOCTRINE TO OVERRIDE THE INTERNAL REVENUE CODE ONLY IN A NARROW CATEGORY OF CASES.

The economic substance doctrine inherently overrides written law in favor of a *post hoc* judicial redetermination of tax consequences. Accordingly, this Court has confirmed that it should be used only in a narrow category of cases, lest it undermine entirely any certainty and predictability in the Internal Revenue Code.[2]

This Court has held that the economic substance doctrine should be invoked only when the taxpayer entered into a transaction in which there was "*nothing* of substance to be realized" "beyond a tax deduction." *Knetsch* v. *United States*, 364 U.S. 361, 366 (1960) (emphasis added). And while courts have taken different approaches regarding the details of the economic substance inquiry—in particular, whether the inquiry is objective, subjective, or some combination of the two—it is clear that, under any formulation, the inquiry must be conducted in *absolute* terms: For a transaction to lack economic substance, there must be "*no* business purposes other than obtaining tax benefits in entering the transaction," and the transaction must have "*no* economic substance because *no* reasonable possibility of a profit exists." *Compaq Computer Corp.* v. *Comm'r*, 277 F.3d 778, 781 (5th Cir. 2001) (emphasis altered; cita-

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[2] In 2010, Congress codified certain aspects of the economic substance doctrine, with prospective application only. The statute did not modify existing judge-made law regarding "whether the economic substance doctrine is relevant to a transaction." 26 U.S.C. § 7701(*o*)(5)(C).

tion omitted); *see also* Pet. App. 27a (a transaction fails the economic substance test if it was motivated "*only* by tax considerations" (emphasis added)).

The categorical formulation of these inquiries is essential to preventing the economic substance doctrine from becoming a vague and boundless exception to the Internal Revenue Code. Instead, it displaces ordinary application of the tax laws only where the purpose of the taxpayer's activity was *exclusively* to obtain otherwise-unavailable tax benefits.

A cautious approach to applying the economic substance doctrine is necessary because Congress never intended for the Internal Revenue Code, *sub silentio*, to turn on "whether alternative routes may have offered better or worse tax consequences." *Boulware* v. *United States*, 552 U.S. 421, 429 n.7 (2008); *see also*, *e.g.*, *Founders Gen. Corp.* v. *Hoey*, 300 U.S. 268, 275 (1937) ("To make the taxability of [a] transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty."). In other words, taxpayers are generally entitled to make business plans in reliance on the tax laws as written, without being second-guessed because of their desire to structure the transaction in a way that minimizes their tax obligations. *See Gregory* v. *Helvering*, 293 U.S. 465, 469 (1935) ("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.").

A broad interpretation of the economic substance doctrine, in contrast, would create "alongside the Internal Revenue Code . . . an additional (and some-

what autonomous) set of principles for deciding tax disputes." Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. Chi. L. Rev. 859, 864 (1982). And these additional, non-statutory principles would grant to the Commissioner and the courts a "broad mandate to attack perceived 'bad' features of transactions, however firmly anchored within the terms of the Code." *Id.* at 870.

To avoid such a freewheeling departure from the Internal Revenue Code, courts should take a careful approach to the economic substance doctrine, interpreting the doctrine narrowly to enable taxpayers to plan their conduct in reliance on the tax laws as written.

II. THE FEDERAL CIRCUIT'S NOVEL AND SWEEPING APPLICATION OF THE ECONOMIC SUBSTANCE DOCTRINE WARRANTS THIS COURT'S REVIEW.

Rather than applying the economic substance doctrine narrowly, as dictated by the precedents discussed above, the Federal Circuit applied it broadly, engaging in an unfocused and erroneous inquiry into whether the transaction at issue complied with what the court believed to be the true congressional purpose behind the foreign tax credit. The court of appeals' decision is incorrect, gives rise to a circuit split, and calls for this Court's review.

A. THE DECISION BELOW INCORRECTLY APPLIED THE ECONOMIC SUBSTANCE DOCTRINE TO DEFEAT THE FOREIGN TAX CREDIT'S PURPOSE OF AVOIDING DOUBLE TAXATION.

The tax benefit at issue in this case is a foreign tax credit claimed by BB&T. *See* Pet. App. 2a. The only effect of the claimed credit was to prevent

BB&T from being taxed twice on income earned by a trust that BB&T created—once by a foreign government, and once by the United States. *See* Pet. 11–12. And that, of course, was precisely what Congress intended when it enacted the foreign tax credit: "[T]he primary design of the [foreign tax credit] was to mitigate the evil of double taxation." *Burnet* v. *Chi. Portrait Co.*, 285 U.S. 1, 7 (1932). The foreign tax credit "in effect treats the taxes imposed by the foreign country as if they were imposed by the United States," H.R. Rep. No. 83-1337, at 76 (1954), and thereby "protects domestic corporations that operate through foreign subsidiaries from double taxation of the same income," *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 135 (1989).

It is undisputed that BB&T complied with all statutory and regulatory requirements to receive the tax credit, including actually paying taxes on the relevant income in the foreign country. *See* Pet. 12. It is similarly beyond dispute that the transaction at issue had economic substance in the absence of double taxation.

Notwithstanding all of this, the Federal Circuit embarked on an inquiry to determine whether granting the tax credit would fit within what the court saw as the true intent behind the tax credit. *See* Pet. App. 38a–40a. Rather than end the inquiry into Congress's intent with the conclusion that applying the foreign tax credit is necessary to avoid double taxation, the Federal Circuit pressed on, seeking to divine additional congressional purposes behind the foreign tax credit statute. For example, the court opined that Congress intended the credit to "facilitate purely economic decisions regarding business opportunities overseas." *Id.* at 39a. The court also asserted that, through the foreign tax credit, Con-

gress did not intend to permit companies to "take advantage of a foreign tax system," but instead meant to "achieve capital export neutrality." *Id.* at 38a–39a (citation omitted). Finally, the court quoted *Goldstein* v. *Commissioner*, 364 F.2d 734 (2d Cir. 1966)—a case that did not involve foreign tax credits—for the proposition that courts should not grant foreign tax credits for transactions that have "no purposive reason, other than the securing of a deduction from income.'" Pet. App 39a (quoting 364 F.3d at 742). Apparently influenced by these asserted congressional purposes, the court concluded that BB&T was required to show that "the transaction is the sort that Congress intended to be the beneficiary of the foreign tax credit provision." *Id.* at 27a.

This was erroneous: Congress's intent to avoid double taxation on foreign income was already fully apparent, in general and as to specific details. The general principle—that Congress created the foreign tax credit to prevent double taxation—is undisputed. And the specific conditions under which Congress intended to carry out that principle are fully set forth in the Internal Revenue Code and implementing regulations through a "byzantine structure of staggering complexity." Pet. 2 (citation omitted). Congress specified its intent through this regime; no further speculation into congressional intent is necessary. *See id.* at 27–28.

Thus, while the economic substance doctrine may apply to some types of tax benefits, the Federal Circuit's sweeping application of the doctrine was both novel and particularly inappropriate with regard to the foreign tax credit at issue here. As discussed further below, taxpayers rely on certainty and predictability in the tax laws to plan their future conduct. A taxpayer who (a) knows that the purpose of the for-

eign tax credit is to eliminate double taxation, (b) actually pays a tax on foreign income to a foreign government, and (c) complies with the extensive statutory and regulatory framework governing foreign tax credits, should be permitted to rely on receiving those tax credits. Taxpayers considering foreign transactions should not be required to second- or third-guess whether Congress had some other hidden intent that would enable a court to invalidate the credits *post hoc*.

B. THE DECISION BELOW CREATES A CIRCUIT SPLIT ON APPLYING THE ECONOMIC SUBSTANCE DOCTRINE TO FOREIGN TAX CREDITS.

Apart from the Federal Circuit's erroneously broad application of the economic substance doctrine, this Court should grant review for the independent reason that the Federal Circuit has created a wasteful and unnecessary division of authority among the courts of appeals.

The Federal Circuit held that the transaction must be evaluated "independent of the expected tax benefits," even though it included the foreign tax payments giving rise to the credit in assessing whether the transaction was profitable. Pet. App. 27a; *see also id.* at 24a. As the Second Circuit recognized in following the Federal Circuit's decision, the Fifth and Eighth Circuits disagree that "it is appropriate, in calculating pre-tax profit, for a court both to include the foreign taxes paid and to exclude the foreign tax credits claimed." *Bank of N.Y. Mellon Corp.* v. *Comm'r*, 801 F.3d 104, 124 (2d Cir. 2015), *petition for cert. filed*, No. 15-478 (Oct. 13, 2015). As the Fifth Circuit explained in *Compaq*:

> If the effects of tax law, domestic or foreign, are to be accounted for when they subtract from a transaction's net cash flow, tax law effects should be counted when they add to cash flow. To be consistent, the analysis should either count all tax law effects or not count any of them.

277 F.3d at 785; *see also IES Indus., Inc.* v. *United States*, 253 F.3d 350, 354 (8th Cir. 2001) ("[T]he economic benefit to IES was the amount of the *gross* dividend, before the foreign taxes were paid.").

There are high economic costs to uncertainty in the tax laws. If this Court were to decline review, and thus allow the Second and Federal Circuits to apply the economic substance doctrine in a manner that has expressly been rejected by the Fifth and Eighth Circuits, the result would be immediate and widespread uncertainty regarding the foreign tax credit and the economic substance doctrine. Among the four circuits to address the issue, application of the doctrine would turn solely on the geographic region in which the doctrine was applied. And the Commissioner would undoubtedly be emboldened to press the same analytical approach endorsed by the Federal Circuit in every court of appeals that has not yet resolved the issue. This would create widespread confusion, imposing dead-weight economic losses nationwide. And that uncertainty could persist until and unless resolved by this Court.

* * *

This Court should grant review to resolve the conflict among the courts of appeals, correct the Federal Circuit's erroneous application of the economic substance doctrine, and restore the stable regime

that existed under *Compaq* and *IES* for 14 years before the decision below.

III. THE FEDERAL CIRCUIT'S DECISION BELOW UNDERMINES PREDICTABILITY IN THE APPLICATION OF THE INTERNAL REVENUE CODE, IMPOSING UNWARRANTED COSTS ON BUSINESSES AND THE NATION'S ECONOMY.

This Court has long recognized the general need for taxpayers to have certainty and predictability in the application of tax laws. "[I]n tax law," the Court has emphasized, "certainty is desirable." *United States* v. *Generes*, 405 U.S. 93, 105 (1972). Indeed, the Court has explained that "tax law . . . can give no quarter to uncertainty." *Thor Power Tool Co.* v. *Comm'r*, 439 U.S. 522, 543 (1979).

The need for certainty derives from the importance to taxpayers of planning their future conduct: "[M]uch tax planning must proceed on the basis of settled rules. Avoidance of risk and uncertainty are often the keys to a successful transaction." *Chapman* v. *Comm'r*, 618 F.2d 856, 874 (1st Cir. 1980). Thus, the harm flowing from uncertain application of the tax laws is taxpayers' inability to plan for the future. "When courts readily undertake [the] tas[k]" of "reexamin[ing]" tax law principles, taxpayers lose their ability to "rely with assurance on what appear to be established rules." *United States* v. *Byrum*, 408 U.S. 125, 135 (1972). As economists, researchers, and other commentators have concluded, uncertainties in the tax laws impose high costs on taxpayers, and those high costs are shared by all participants in the Nation's economy.

First, uncertainty in tax law imposes substantial costs on businesses and consumers with no resulting benefits. *See*, *e.g.*, Leigh Osofsky, *The Case Against*

Strategic Tax Law Uncertainty, 64 Tax L. Rev. 489, 499–501 (2011); *see also* Seth H. Giertz & Jacob Feldman, Mercatus Ctr., *The Economic Costs of Tax Policy Uncertainty: Implications for Fundamental Tax Reform* 15 (2012) ("[T]he fact that policy uncertainty adversely affects the economy is well established."). Tax uncertainty is at the root of several types of harm, including overpayment of taxes and stunting of economic growth.

When tax law is uncertain, taxpayers tend to over-report their tax burden to avoid an audit or the expense of suing for a refund. *See*, *e.g.*, Marsha Blumenthal & Charles Christian, *Tax Preparers*, *in* The Crisis in Tax Administration 201, 205 (Henry J. Aaron & Joel Slemrod eds., 2004). This results in a transfer of assets away from businesses that is not required by tax law, and which would not occur if the governing rules were sufficiently clear.

In addition, "[w]hen businesses are uncertain about taxes," they "adopt a cautious stance" because "it is costly to make a . . . mistake." Steven J. Davis, *et al.*, Am. Enter. Inst., *Business Class: Policy Uncertainty Is Choking Recovery* (Oct. 6, 2011). Because "investors usually look at the longer-term tax structure in making major investment decisions," increasing uncertainty in the tax laws causes businesses to withhold capital from investments that could benefit both them and the economy. Duanjie Chen & Jack Mintz, *New Estimates of Effective Corporate Tax Rates on Business Investment*, 64 Tax & Budget Bull. 1, 2 (2011). In many cases, it may be impossible to determine in advance whether a particular investment is worthwhile if its ultimate tax consequences are unpredictable.

Finally, uncertainty in tax law increases the costs of tax planning and compliance. Faced with unpredictable standards for determining whether the tax laws and regulations will be applied as written, taxpayers must pay considerable sums for advice from accountants and attorneys, or else bear the economic cost of shying away from bona fide opportunities that are both potentially profitable and tax efficient, such as the transaction at issue in this case. These compliance and administrative costs are deadweight losses to the economy. As the Treasury Department itself has recognized, "[t]he cost of those lawyers and accountants adds to the price of every product, but they do nothing to make our factories more efficient, our computers faster or our cars more durable." Press Release, Dep't of the Treasury, Treasury Secretary Paul O'Neill Statement on Treasury's Plan to Combat Abusive Tax Avoidance Transactions (Mar. 20, 2002).

Second, the relevant research confirms the basic economic principle that increased costs on businesses get passed on to various actors in the economy, including workers, investors, and consumers.

There is a broad consensus that globalization increases the share of tax burdens borne by workers. *See* Li Liu & Rosanne Altshuler, *Measuring the Burden of the Corporate Income Tax Under Imperfect Competition*, 66 Nat'l Tax J. 215, 233 (2013); *see also* David F. Bradford, *Untangling the Income Tax* 133–39 (1986) (increasing costs to businesses from tax uncertainty causes depressed wages for workers); Robert Carroll, Tax Found., *Special Report No. 169: The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States* 1–5 (2009) (showing that states with higher corporate tax rates had lower worker wages).

Moreover, when businesses over-report their tax burden, those additional tax costs are also borne in part by investors in the form of diminished return on capital. *See* Julie Anne Cronin, *et al.*, *Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology*, 66 Nat'l Tax J. 239, 260 (2013); Jennifer Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis*, 66 Nat'l Tax J. 185, 211 (2013). A lower return on capital, in turn, results in less investment and a drag on economic growth. It also encourages investors to take their capital overseas. *See, e.g.*, Kenneth Klassen, *et al.*, *Geographic Income Shifting by Multinational Corporations in Response to Tax Rate Changes*, 31 J. Acct. Res. 141, 141–43 (1993 supp.); Gravelle, *supra*, at 211. Large multinational companies, in particular, are likely to shift investment away from the United States when domestic tax burdens increase or become less predictable. *See* Klassen, *supra*, at 170–72. In this respect, uncertainty in the tax laws' application inhibits capital investment in the United States. *See* R. Glenn Hubbard, *et al.*, *Have Tax Reforms Affected Investment?*, *in* 9 Tax Policy and the Economy 131, 145 (James M. Poterba ed., 1995) (concluding that "prior knowledge of changes in tax parameters can improve forecasts of asset investment").

Finally, "corporate tax rate changes have [also] been passed on . . . to consumers in the form of higher prices." J. Richard Aronson, *et al.*, *The Potential for Short-Run Shifting of a Corporate Profits Tax*, 66 Bull. of Econ. Res. 1, 2 (2014). As a result, uncertainty in tax law likely causes consumers to pay higher prices for products—with no resulting increase in quality. In contrast, because certain and predictable application of the tax laws lowers costs to

businesses, it also likely results in lower costs to consumers.

*   *   *

The Federal Circuit's approach creates great uncertainty for all U.S. taxpayers considering transactions in foreign jurisdictions. As courts and commentators have recognized, this uncertainty and unpredictability harms businesses, and indeed the entire economy, by increasing costs in a number of respects without any corresponding benefits. To minimize these dead-weight losses, courts should strive to apply the Internal Revenue Code and its implementing regulations in ways that enable certain, predictable tax planning. This Court should grant review and reverse.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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