No. 16-1282

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

SANTANDER HOLDINGS USA & SUBSIDIARIES,

Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

On Appeal from the United States District Court
for the District of Massachusetts
No. 09-11043

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFF-APPELLEE

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RULE 26.1 DISCLOSURE STATEMENT

The Chamber of Commerce of the United States of America is not a publicly traded corporation. It has no parent corporation, and there is no public corporation that owns 10% or more of its stock.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases **Page(s)**

Statute and Legislative Materials

TABLE OF AUTHORITIES
(continued)

Page(s)

Rule

Other Authorities

TABLE OF AUTHORITIES
(continued)

Page(s)

INTEREST OF *AMICUS CURIAE*

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.[1]

The Chamber's members rely on the predictable and certain application of the tax laws in order to plan their business operations in both the short and long terms. In this case, the government has advanced a broad interpretation of the judge-made "economic substance" doctrine in an attempt to override the foreign tax credit provisions of the Internal Revenue Code; the government asks this Court to improperly recharacterize foreign tax benefits to conclude that the transaction at issue here had no economic substance. If accepted, the government's position

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[1] All parties consent to the filing of this brief. Pursuant to Federal Rule of Appellate Procedure 29(c)(5), the Chamber certifies that: (a) no party's counsel authored this brief in whole or in part; (b) no party or party's counsel contributed money that was intended to fund preparing or submitting this brief; and (c) no person, other than the Chamber, its members, or its counsel contributed money that was intended to fund preparing or submitting this brief.

would create uncertainty and confusion in companies' ordinary business planning and would deter companies from engaging in many kinds of beneficial cross-border transactions. The Chamber submits this brief to illustrate the problems that the government's approach would create for businesses.

SUMMARY OF ARGUMENT

I. 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.

The "economic substance" doctrine is a judge-made rule that 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 the Su-

preme Court has repeatedly confirmed, the doctrine should be applied narrowly, and only when clearly warranted. Yet the government in this case incorrectly advances a broad view of the economic substance doctrine that would greatly expand its proper scope.

It is undisputed that Sovereign Bancorp, Inc. ("Sovereign") executed a transaction that was effectively a large loan with a foreign lender at favorable interest rates, which (among other things) allowed Sovereign to diversify its lending sources and thus limit its exposure in the event of a liquidity crunch in the United States. *See* J.A. 805, 1499, 1533, 1535; S.A. 4, 17, *cited in* Santander Br. 13. It is also undisputed that Sovereign paid taxes to the foreign government as part of this transaction. And it is undisputed that Sovereign complied with the extensive statutory and regulatory requirements entitling it to a U.S. tax credit against its foreign taxes. Finally, 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 government invokes the economic substance doctrine, which would impose on Sovereign the additional burden of proving that the transaction at issue comported with congressional intent in some other, ill-defined respect.

The government errs in seeking to impose that additional burden on Sovereign. 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.

II. This Court should decline the government's invitation to expand the economic substance doctrine to manipulate application of the foreign tax credit. Only by using a creative accounting method that counts Sovereign's foreign taxes as expenses—while simultaneously disregarding the economic benefits of the transaction to Sovereign on a dubious "tax effects" theory—is the government able to contend that Sovereign's challenged transaction lacked economic substance. The district court's decision rejecting that approach is correct, and this Court should affirm the decision below to avoid fostering nationwide uncertainty in this important area of tax law.

ARGUMENT

I. The Economic Substance Doctrine Should Be Applied Narrowly, Especially Where Congress Has Expressed A Clear Intent To Avoid Double Taxation.

The government's position in this case rests on its invocation of the judge-made "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. If applied broadly, the economic substance doctrine would create great uncertainty

for taxpayers. Accordingly, the Chamber writes to emphasize the high costs of tax uncertainty, which have been widely recognized by both courts and commentators and which further support the district court's decision here.

A. Companies Rely On Predictability In Application Of The Tax Laws, Whereas Unpredictability Imposes Costs On All Participants In The Nation's Economy.

The Supreme Court has long recognized the need for taxpayers to have certainty and predictability in the application of tax laws. "[I]n tax law," the Supreme Court has emphasized, "certainty is desirable." *United States v. Generes*, 405 U.S. 93, 105 (1972). Indeed, the Court has noted 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.

Overpayment. 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.

Forgoing Business Expansion. "When 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.

Compliance Costs. Uncertainty in tax law also 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 dead-weight 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 makes clear that the costs of uncertainty—overpayment, forgoing business expansion, and compliance expenses—are not borne by businesses alone. Instead, these costs are passed on to various actors in the economy, including workers, investors, and consumers.

Labor. There is extensive evidence that increased tax burdens on employers affect the wages of workers, particularly in a globalized economy. *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).

Investors. 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 inves-

tors 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* Osofsky, *supra*, at 494. 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, 145-46 (James M. Poterba ed., 1995) (concluding that "prior knowledge of changes in tax parameters can improve forecasts of asset investment").

Consumers. In some instances, "corporate tax rate changes have 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.

* * *

As courts and commentators have recognized, uncertain and unpredictable application of tax laws harms taxpayers, and ultimately the economy, by increasing

their 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.

B. The Supreme 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, the Supreme Court has confirmed that it should apply only to a narrow category of cases, lest it undermine entirely any certainty and predictability in the Internal Revenue Code.[2]

The Supreme 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

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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).

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; citation omitted).

The categorical formulation of these inquiries is essential to prevent the economic substance doctrine from becoming a broad and entirely unpredictable 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 limited 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 not required to maximize their tax burden; rather, they generally are 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 somewhat 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.

C. The Government's Broad Application Of The Economic Substance Doctrine Is Particularly Inappropriate As Applied To The Foreign Tax Credit, Through Which Congress Expressed A Clear Intention To Avoid Double Taxation Of Foreign Income.

Rather than applying the economic substance doctrine narrowly, as dictated by the precedents discussed above, the government asks this Court to apply it

broadly, engaging in an unfocused inquiry into whether the transaction at issue complied with what the government now claims to be the true congressional purpose behind the foreign tax credit.

The tax benefit at issue in this case is a foreign tax credit claimed by Sovereign. *See*, *e.g.*, J.A. 1127. The only effect of the claimed credit was to prevent Sovereign from being taxed twice on income from the transaction—once by a foreign government, and once by the United States. *See* Santander Br. 11. 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 Sovereign 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* Santander Br. 2. It is similarly beyond dispute that the transaction at issue had economic substance in the absence of double taxation.

Notwithstanding all of this, the government embarks on an inquiry to determine whether granting the tax credit would fit within what the government presumes to be the true intent behind the tax credit. *See*, *e.g.*, U.S. Br. 29–30. 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 government presses on, seeking to divine additional congressional purposes behind the foreign tax credit statute. The government opines, for example, that Congress intended the credit "only for *purposive* activity." *Id.* at 29 (citation omitted). And it asserts that Sovereign must therefore prove that its transactions could potentially "generat[e] a significant profit *without* factoring in the disputed tax benefit." *Id.* at 48.

This is 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. *See*, *e.g.*, U.S. Br. 29. 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." Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 15.21[1][a] (7th ed. Supp. 2015). Congress specified its intent through this regime; no further speculation into congressional intent is necessary.

Thus, while the economic substance doctrine may apply to some types of tax benefits, the government's searching inquiry into congressional intent is inappropriate and unnecessary with regard to the foreign tax credit at issue here. As discussed above, taxpayers rely on certainty and predictability in the tax laws in order to plan their future conduct. A taxpayer who (a) knows that the purpose of the foreign 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 the government to invalidate the credits *post hoc*.

* * *

The government's approach would create great uncertainty for all U.S. taxpayers considering transactions in foreign jurisdictions, imposing dead-weight losses on the economy as a whole, and this Court should reject it.

II. This Court Should Prevent The Government From Recharacterizing Foreign Tax Consequences In An Economic Substance Inquiry.

Apart from the government's erroneously broad application of the economic substance doctrine, this Court should affirm the decision below for the independent reason that the government's alternative approach picks the wrong side in a division of authority among the courts of appeals.

Among other things, the government believes that, in applying the economic substance doctrine, this Court should exclude from "economic income" the payments that Sovereign received from the foreign lender because those payments were supposedly "nothing more than a partial return" of the foreign taxes that Sovereign paid as part of the transaction (and for which Sovereign claimed a U.S. tax credit). U.S. Br. 25; *see also id.* at 37. Although some courts seemingly have followed this approach, it has been squarely—and correctly—rejected by the Fifth and Eighth Circuits.

"The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed." *Old Colony Trust Co. v. Comm'r*, 279 U.S. 716, 729 (1929). Thus, as the Fifth Circuit explained in *Compaq*, "the payment of Compaq's Netherlands tax obligation by Royal Dutch was income to Compaq." 277 F.3d at 784; *see also IES Indus., Inc.* v. *United States*, 253 F.3d 350, 354 (8th Cir. 2001) ("[I]ncome was realized by the payment of IES's foreign tax obligation by a third party."). Because the payments that Sovereign received were (in the government's own view) tantamount to payment of the foreign tax by the foreign lender, those payments must necessarily be included as income in the economic substance inquiry. *See* U.S. Br. Add. 10. This Court should reject the government's theory that the transaction can be disregarded for lack of economic sub-

stance merely because the parties allegedly considered and "shared" (U.S. Br. 35) anticipated tax consequences.

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment below.

Respectfully submitted,

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1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 29(d) because it contains 3759 words, as determined by the word-count function of Microsoft Word 2010, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

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CERTIFICATE OF SERVICE

I hereby certify that on August 22, 2016, an electronic copy of the foregoing brief was filed with the Clerk of Court for the United States Court of Appeals for the First Circuit using the appellate CM/ECF system.

I further certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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