No. 15-478

In the Supreme Court of the United States

AMERICAN INTERNATIONAL GROUP, INC., PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the economic substance of a transaction for which a taxpayer claims foreign tax credits on its federal tax return depends in part on whether the transaction was profitable after all foreign taxes were paid.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases:

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-48a) is reported at 801 F.3d 104. The opinion of the district court (Pet. App. 49a-66a) is not published in the *Federal Supplement* but is available at 2013 WL 1286193.

JURISDICTION

The judgment of the court of appeals (Pet. App. 1a-2a) was entered on September 9, 2015. The petition for a writ of certiorari was filed on October 13, 2015. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The United States taxes income earned abroad by U.S. citizens, residents, and domestic entities. 26 U.S.C. 61(a). Accordingly, when calculating its income for U.S. tax purposes, a U.S. corporation must include

income earned abroad, even though that income may also be subject to foreign tax. Domestic taxpayers, however, may claim a dollar-for-dollar tax credit (called the "foreign tax credit") for income taxes paid to another country, subject to numerous technical rules and other limitations. 26 U.S.C. 901-909. The purpose of the credit is to allow taxpayers to avoid double taxation on foreign business or investment income, thereby producing "uniformity of tax burden among United States taxpayers, irrespective of whether they were engaged in business in the United States or engaged in business abroad." Pet. App. 21a (quoting H.R. Rep. No. 1337, 83d Cong., 2d Sess. 76 (1954)).

Like other provisions of the Internal Revenue Code, foreign tax credits are subject to the "economic substance" doctrine. Under that longstanding common-law principle, which was codified by Congress in 2010, "tax benefits * * * with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose." 26 U.S.C. 7701(*o*)(5)(A). The doctrine rests on the presumption that Congress does not intend sham transactions to produce tax benefits, regardless of whether the transactions would technically warrant tax benefits under the pertinent statutory and regulatory provisions. See H.R. Rep. No. 443, 111th Cong., 2d Sess. 295 (2010); see also 12 *Mertens Law of Federal Income Taxation* § 45D:62 (Supp. 2015) ("Entitlement to foreign tax credits is predicated on a valid transaction.").

2. Between 1993 and 1997, petitioner and its subsidiary, AIG Financial Products (AIG-FP), entered into six transactions, for which petitioner claimed

more than $48 million in foreign tax credits for the 1997 tax year. Pet. App. 5a, 8a, 11a. The Internal Revenue Service (IRS) concluded, *inter alia*, that these transactions were shams, and that the economic-substance doctrine therefore prohibited petitioner from claiming the foreign tax credits. *Id.* at 11a.

a. A taxpayer ordinarily would have no economic incentive to engage in a transaction solely to claim foreign tax credits because the credits are designed to create an economic wash in which each dollar of foreign tax paid offsets one dollar of U.S. tax owed. The tax strategy that petitioner employed, however, was designed to transform foreign tax credits into economic profit, at the expense of the U.S. Treasury. In each of the six cross-border transactions that petitioner conducted, petitioner obtained what it characterized as a loan from a foreign bank. Ordinarily in that situation, a borrower may deduct from its gross income any interest payments to a lender, but the lender must pay income tax on those payments. In the complex transactions that petitioner structured, however, petitioner effectively assumed the foreign bank's foreign tax liability, claimed foreign tax credits based on that liability, and then split the value of the credits with the foreign bank in the form of a below-market interest rate.

In general terms, each of petitioner's transactions worked as follows. See Pet. App. 9a-10a. Petitioner's subsidiary AIG-FP created a foreign-domiciled affiliate known as a "special purpose vehicle" (SPV). *Id.* at 9a, 51a. AIG-FP sold preferred stock in the SPV to foreign banks and agreed to repurchase that stock on a future date at the original sale price. *Ibid.* The SPV invested the capital contributed by the banks, paid foreign tax on its income, and distributed most of the net proceeds to the foreign bank as dividends on their shares. *Ibid.*

Petitioner and the foreign bank then characterized that transaction very differently to their respective tax authorities. For U.S. tax purposes, petitioner claimed that *it* owned all of the SPV's shares, despite the sale of the preferred stock to the foreign bank. Accordingly, petitioner treated the capital infusion by the foreign bank not as a purchase of shares in the SPV, but rather as a collateralized loan to petitioner. Pet. App. 9a, 52a. Petitioner in turn reported the dividend distributions from the SPV to the foreign bank as tax-deductible interest expenses. *Ibid.* Petitioner also claimed foreign tax credits for the taxes paid by the SPV on its income (again, on the theory that the SPV was solely owned by petitioner). *Id.* at 52a.

Thus, on its 1997 U.S. tax return, petitioner reported a total gross income of $128.2 million on the relevant transactions, but deducted $71.9 million in purported interest expenses, which left petitioner with a pre-credit tax liability of $19.7 million (at the 35% corporate income-tax rate). Pet. App. 9a. Petitioner then claimed an additional $48.2 million in foreign tax credits, based on the foreign tax paid by the SPV, which left petitioner with $28.5 million in net credits that it used to offset U.S. tax on unrelated income. *Ibid.*

As discussed, ordinarily when a lender receives interest payments, it must pay income tax on those payments. But in the tax strategy that petitioner employed, the foreign bank in reporting to its own tax authority did not characterize the transaction as a collateralized loan. Pet. App. 10a. Rather, the foreign bank reported to the foreign tax authority that *the foreign bank*, not petitioner, owned the SPV's preferred shares. *Ibid.* The foreign bank therefore reported the SPV's distributions not as taxable interest income, but as tax-exempt dividends from its purported subsidiary (the SPV). *Ibid.* As a result, the foreign bank "paid, little, if any, tax" on the distribution. *Ibid.* Instead, the SPV paid tax on its income to the foreign tax authority and distributed substantially all of its after-tax cash to the foreign bank.

Because the SPV paid the foreign tax, petitioner claimed foreign tax credits for that tax (based on its representation on its U.S. return that it owned the SPV). That arrangement was mutually beneficial for petitioner and the foreign bank. The foreign bank effectively received after-tax interest income without having to pay tax on that income to its own tax authority. Petitioner claimed interest deductions and foreign tax credits, and was able to agree with the foreign bank on a nominally below-market interest rate by effectively shifting the foreign tax liability from the foreign bank to the SPV, creating U.S. foreign tax credit benefits where there otherwise would have been none. As the court of appeals explained, petitioner "effectively converted certain interest expenses it otherwise would have paid to the foreign banks"—*e.g.*, if it had obtained a loan at an ordinary, pre-foreign tax rate—"into foreign tax payments for which it claimed foreign tax credits that it could use in turn to offset unrelated income and reduce its total U.S. tax bill." Pet. App. 10a.

b. Evidence in the summary-judgment record indicates that the SPVs "had no real employees or business purpose of their own beyond creating tax benefits for both the lender [the foreign bank] and the borrower [AIG-FP].” Pet. App. 32a. As the government's retained expert economist stated based on his preliminary analysis, “absent the claimed tax benefits, the transactions neither generated material economic returns for [petitioner], nor offered the potential for such returns, after accounting for dividend payments, operating expenses, and foreign taxes,” and the “transaction structure inflated the foreign tax liabilities of the SPVs and generated income from tax benefits for [petitioner] at the direct expense of the United States.” *Id.* at 35a (citations omitted). Petitioner's internal documents confirm that the transactions were tax-motivated, describing them as “tax driven” and “tax based deal[s].” *Id.* at 36a (citation omitted; brackets in original).

3. Petitioner filed U.S. tax returns on which it claimed foreign tax credits for the foreign tax paid in the six cross-border transactions that it conducted. Pet. App. 9a. The IRS disallowed petitioner's tax treatment of the transactions, along with the claim for foreign tax credits, in part on the ground that the transactions lacked economic substance, and it imposed accuracy-related penalties. *Id.* at 11a.

Petitioner subsequently filed a refund suit for the 1997 tax year in the United States District Court for the Southern District of New York. Pet. App. 11a. Prior to the close of fact discovery, petitioner moved for partial summary judgment, arguing that it was entitled to the foreign tax credits as a matter of law because (i) the economic-substance doctrine does not apply to foreign tax credits, and (ii) even if the doctrine were applicable, the transactions at issue here had economic substance. *Ibid.* Petitioner contended that the transactions were profitable without taking into account the foreign tax paid by the SPVs, the U.S. tax on the income it reported from the transactions, and the U.S. tax benefits in the form of foreign tax credits. *Id.* at 10a-11a. The government argued that the transactions were not profitable after taking into account the foreign tax paid by the SPVs, that they otherwise lacked objective economic substance, and that they had no real business purpose apart from tax benefits.

The district court denied petitioner's motion, concluding that additional discovery was necessary. Pet. App. 11a. After fact discovery ended, but before expert discovery began, petitioner renewed its motion for partial summary judgment. *Id.* at 11a-12a. The district court denied the motion, holding that the economic-substance doctrine applies to foreign tax credits and that there were genuine disputes of material fact as to whether petitioner's transactions were shams. *Id.* at 12a; see *id.* at 55a-66a.

The district court certified its order for interlocutory appeal under 28 U.S.C. 1292(b). Pet. App. 12a. The court of appeals granted petitioner's application for interlocutory appeal and heard this matter in tandem with an appeal by another taxpayer from a Tax Court decision raising similar questions about the appropriate treatment of foreign taxes in conducting an economic-substance analysis. *Ibid.*; see *Bank of New York Mellon Corp.* v. *Commissioner*, petition for cert. pending, No. 15-572 (filed Nov. 2, 2015).

4. The court of appeals affirmed the district court's denial of petitioner's motion for partial summary judgment. Pet. App. 3a-46a.

The court of appeals first rejected petitioner's contention that a taxpayer may claim foreign tax credits even if the transaction giving rise to the foreign tax lacked economic substance. Pet. App. 18a-22a. The court explained that the economic-substance doctrine rests on the premise that Congress would not have intended tax benefits to flow from a transaction lacking economic substance or any real business purpose, "even if a transaction's form matches the dictionary definitions of each term used in the statutory definition of the tax provision." *Id.* at 20a (quoting *Altria Grp., Inc.* v. *United States*, 658 F.3d 276, 284 (2d Cir. 2011)). With respect to foreign tax credits specifically, the court determined that "Congress's intent * * * was to prevent double taxation of taxpayers conducting *business* in the United States and abroad," not "sham transactions built solely around tax arbitrage." *Id.* at 21a (citing H.R. Rep. No. 1337, 83d Cong., 2d Sess. 76 (1954)). The court noted that its holding was consistent with Congress's 2010 statutory codification of the economic-substance doctrine (although that codification is not applicable to the pre-2010 transactions at issue here), which Congress enacted in recognition that "[a] strictly rule-based tax system cannot efficiently prescribe the appropriate outcome of every conceivable transaction that might be devised." *Ibid.* (brackets in original) (quoting H.R. Rep. No. 443, 111th Cong., 2d Sess. 295 (2010)).

Turning to the transactions at issue in the appeal, the court of appeals explained that, under its precedents, "[i]n determining whether a transaction lacks 'economic substance,'" a court must consider both "1) whether the taxpayer had an objectively reasonable expectation of profit, apart from tax benefits, from the transaction; and 2) whether the taxpayer had a subjective non-tax business purpose in entering the transaction." Pet. App. 23a. The court of appeals emphasized that "the test is not a rigid two-step process," but rather "a flexible analysis where both prongs are factors to consider in the overall inquiry into a transaction's practical economic effects." *Ibid.* (internal quotation marks omitted).[1] It further explained that the objective component of that analysis focuses in part on "whether the transaction 'offers a reasonable opportunity for economic profit, that is, profit exclusive of tax benefits.'" *Id.* at 25a (quoting *Gilman* v. *Commissioner*, 933 F.2d 143, 146 (2d Cir. 1991), cert. denied, 502 U.S. 1031 (1992)).

The court of appeals rejected petitioner's argument that, in determining whether a transaction would have been profitable absent the U.S. tax benefits, a court should also ignore foreign tax paid on the transaction. After stating that "[o]ther circuits have taken disparate approaches" to the relevance of post-foreign-tax profitability, Pet. App. 25a; see *id.* at 25a-33a, the court agreed with the Federal Circuit's conclusion "that foreign taxes are economic costs that are properly deducted in assessing profitability for the purposes of economic substance," but that "the lack of post-foreign-tax profit d[oes] not conclusively establish that a transaction lacks objective economic substance," *id.* at 25a-26a (citing *Salem Fin., Inc.* v. *United States*, 786 F.3d 932 (Fed. Cir. 2015), petition for cert. pending, No. 15-380 (filed Sept. 29, 2015)). The court explained that "[t]he purpose of calculating

[1] The 2010 codification of the economic-substance doctrine requires the taxpayer to establish both factors. See 26 U.S.C. 7701(*o*)(1).

pre-tax profit" in an economic-substance analysis "is to discern, as a matter of law, whether a transaction meaningfully alters a taxpayer's economic position other than with respect to tax consequences." *Id.* at 29a-30a. The court concluded that whether a foreign transaction is profitable after foreign tax is paid is relevant to that inquiry. *Id.* at 30a. The court cautioned, however, that post-foreign-tax profitability is not the only relevant consideration, *id.* at 32a-33a, and that a proper analysis "look[s] to the overall economic effect of the transaction," *id.* at 33a, as well as to "whether the taxpayer ha[d] a legitimate, non-tax business purpose for entering into the transaction," *ibid.*

Applying that standard to the summary-judgment record here, the court of appeals held that "there are disputed issues of material fact as to both the objective and subjective economic substance of the cross-border transactions" that petitioner conducted. Pet. App. 34a. "Under the objective prong," the court determined, "there are unresolved material questions of fact regarding the overall economic effect of the cross-border transactions and the reasonableness of [petitioner's] expectation of non-tax benefits." *Id.* at 35a. The court further observed that, with respect to those issues, "expert discovery has not yet commenced." *Ibid.* And "[u]nder the subjective prong," the court continued, "there are also material questions of fact regarding [petitioner's] business purpose for entering the cross-border transactions," because "a reasonable factfinder could conclude that [petitioner] lacked a legitimate, non-tax business purpose." *Id.* at 36a.

ARGUMENT

The court of appeals correctly held that genuine disputes of material fact preclude the grant of partial summary judgment to petitioner with respect to the question whether its cross-border transactions lacked economic substance. The court of appeals disagreed with decisions of the Fifth and Eighth Circuits that had considered, in "factually different contexts," the relevance for economic-substance purposes of a cross-border transaction's lack of post-foreign-tax profitability. Pet. App. 26a-27a. The court below did not attach dispositive significance to that consideration, however, and the court left open the possibility that petitioner could demonstrate on remand that its transactions had economic substance. Moreover, in light of the 2010 statutory codification of the economic-substance doctrine, which specifically addresses the treatment of foreign taxes, the question presented lacks substantial prospective importance. This Court's review is not warranted.[2]

1. As an initial matter, review is not warranted at this time because the case is currently in an interlocutory posture, and the court of appeals did not resolve the question whether petitioner's cross-border transactions had economic substance. Rather, the court held only that "the government, as the non-moving party, * * * offered sufficient evidence to permit a reasonable factfinder to find in its favor." Pet. App.

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[2] Two other petitions for writs of certiorari raising the same question (one of which seeks review of the same Second Circuit decision as the petition here) are currently pending. See *Bank of New York Mellon Corp.* v. *Commissioner*, No. 15-572 (filed Nov. 2, 2015); *Salem Fin., Inc.* v. *United States*, No. 15-380 (filed Sept. 29, 2015).

36a. The Second Circuit directed the district court on remand to apply "a 'flexible' analysis" that considers both whether petitioner "had an objectively reasonable expectation of profit, apart from tax benefits, from the transaction[s]," and "whether [petitioner] had a subjective non-tax business purpose in entering the transaction[s]." *Id.* at 23a. The court of appeals made clear that, although the transactions' lack of post-foreign-tax profitability is relevant to the first component of that analysis, the district court ultimately must assess "the transaction's overall economic effect," which "is a question of fact" that does not turn exclusively on post-foreign-tax profitability. *Id.* at 33a.

This Court disfavors review of interlocutory appeals. See *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916) ("[E]xcept in extraordinary cases, the writ is not issued until final decree."); see also *Virginia Military Inst.* v. *United States*, 508 U.S. 946, 946 (1993) (Scalia, J., respecting the denial of the petition for a writ of certiorari) ("We generally await final judgment in the lower courts before exercising our certiorari jurisdiction."). This case does not present circumstances that warrant review at this time. Petitioner may yet prevail under the standard that the court of appeals directed the district court to apply on remand, or the lower courts may conclude that the transactions would be shams even without taking into account their lack of post-foreign-tax profitability. In either event, the question on which petitioner seeks review would ultimately be irrelevant to the disposition of this case.

2. The court of appeals correctly held that petitioner is not entitled to summary judgment because a

reasonable factfinder could conclude that the relevant transactions lacked economic substance. As the government's expert witness determined in his preliminary analysis, "aside from the tax benefits, the transactions involved little, if any, potential for economic return," because they "neither generated material economic returns for [petitioner], nor offered the potential for such returns, after accounting for dividend payments, operating expenses, and foreign taxes." Pet. App. 35a (brackets and citation omitted). "Overall," he continued, "the value of the foreign tax credits produced far exceeded any independent potential for economic return from the cross-border transactions." *Ibid.* As the court of appeals observed, moreover, petitioner's "own internal documents described the cross-border transactions as 'tax driven' and 'tax based deal[s].'" *Id.* at 36a (citation omitted; brackets in original). Accordingly, a reasonable trier of fact could conclude that the transactions failed the two-part standard that the Second Circuit applies in economic-substance cases. See *id.* at 35a-36a.

Petitioner contends (Pet. 10-12) that the court of appeals erred by holding that foreign tax must be treated as an expense in determining whether the transactions were profitable absent the U.S. tax benefits, which the court identified as one consideration relevant to the objective prong of the two-part standard. See Pet. App. 32a-33a. That argument lacks merit.

The purpose of the economic-substance doctrine is to distinguish between legitimate business transactions and transactions that are "shaped solely by tax-avoidance features that have meaningless labels attached." *Frank Lyon Co.* v. *United States*, 435 U.S.

561, 584 (1978); see Pet. App. 30a. For that reason, courts generally ask "whether the transaction 'offers a reasonable opportunity for economic profit, that is, profit exclusive of tax benefits.'" Pet. App. 25a (quoting *Gilman* v. *Commissioner*, 933 F.2d 143, 146 (2d Cir. 1991), cert. denied, 502 U.S. 1031 (1992)). In the context of the foreign-tax-credit regime, that inquiry should focus on whether the transaction is profitable after foreign tax is paid.

Congress provides foreign tax credits to ensure a "uniformity of tax burden" between U.S. taxpayers engaged in legitimate business activities abroad and U.S. taxpayers engaged in domestic business activities. Pet. App. 21a (quoting H.R. Rep. No. 1337, 83d Cong., 2d Sess. 76 (1954)). Where foreign taxes and other costs of a taxpayer's putative foreign business overwhelm any potential for profit, that imbalance, at minimum, raises a serious concern that the transaction may be a sham. Legitimate businesses do not often engage in activities whose costs, inclusive of taxes, subsume any profit potential. To be sure, circumstances may arise in which such behavior would be rational even apart from its U.S. tax consequences. See Pet. App. 32a-33a ("Transactions involving nascent technologies * * * often do not turn a profit in the early years unless tax benefits are accounted for.") (quoting *Salem Fin., Inc.* v. *United States*, 786 F.3d 932, 950 (Fed. Cir. 2015), petition for cert. pending, No. 15-380 (filed Sept. 29, 2015))). But the court below accounted for that possibility by treating post-foreign-tax profitability as an important but not dispositive factor in the economic-substance analysis.

The court of appeals did not hold that the absence of post-foreign-tax profitability is determinative of the economic-substance question. See Pet. App. 32a-33a. Rather, the court explicitly adopted the approach of the Federal Circuit in *Salem Financial*. See *id*. at 29a. Under that approach, the fact that "a taxpayer has incurred a large foreign tax expense that would render the transaction unprofitable absent the foreign tax credit" triggers "careful review of the transaction" to determine whether it "meaningfully alters the taxpayer's economic position (other than with regard to the tax consequences) and whether the transaction has a bona fide business purpose." *Salem Fin.*, 786 F.3d at 950; see Pet. App. 33a. But as the court of appeals explained, the "objective economic substance inquiry * * * does not end at profit," Pet. App. 32a, because "[t]here is no simple device available to peel away the form of [a] transaction and to reveal its substance," *id.* at 33a (second set of brackets in original) (quoting *Frank Lyon*, 435 U.S. at 576); accord *Salem Fin.*, 786 F.3d at 949. Thus, "although inquiring into post-foreign-tax profit can be a useful tool for examining the economic reality of a foreign transaction * * * a transaction that fails the profit test [need not] necessarily be deemed a sham." *Salem Fin.*, 786 F.3d at 950. That contextual, transaction-specific analysis reflects a sound application of economic-substance principles.[3]

[3] Petitioner contends (Pet. 11-12) that considering foreign taxes as expenses under the economic-substance test "creates a mismatch" with how foreign taxes are treated in computing taxable income. That argument ignores the different purposes of the two calculations. The economic-substance doctrine exists to identify sham transactions, not to identify items of revenue and loss for the purpose of determining an entity's taxable income, and examining pre-tax profitability is merely one tool used in the analysis of whether a tax transaction is a legitimate business activity or an

3. Petitioner contends (Pet. 8-10) that the court of appeals' holding conflicts with decisions in *Compaq Computer Corp. & Subsidiaries* v. *Commissioner*, 277 F.3d 778 (5th Cir. 2001) (*Compaq*), and in *IES Industries, Inc.* v. *United States*, 253 F.3d 350 (8th Cir. 2001). Those decisions, however, concerned materially different transactions and do not squarely conflict with the holding below.

In *Compaq*, the U.S. taxpayer had purchased stock of publicly traded foreign corporations before a dividend record date. 277 F.3d at 779. The price of the stock reflected the impending dividends, minus the amount of the foreign taxes that would be withheld on those dividends. *Ibid.* The taxpayer then immediately sold the stock back to the original seller at a reduced price to reflect the fact that the original seller would not be entitled to dividends. *Id.* at 780. The taxpayer received the dividends minus the withheld foreign taxes. *Ibid.* On its U.S. tax return, the taxpayer claimed capital losses and a foreign tax credit for the taxes that the foreign corporations had withheld from the dividends. *Ibid.* The Tax Court found that the dividend payment (as reduced by the withholding) was less than the loss on the sale, so that the transaction was not profitable overall before the U.S. tax benefits were claimed. *Id.* at 782. It therefore disallowed those benefits. *Id.* at 780.

The Fifth Circuit reversed, stating that "[t]o be consistent, the analysis should either count all tax law effects or not count any of them." 277 F.3d at 785.

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abusive manipulation of the tax code. Pet. App. 29a-30a. Petitioner also ignores that foreign tax expenses are deductible in computing taxable income if the taxpayer so chooses in lieu of claiming the foreign tax credit. 26 U.S.C. 164(a)(3), 275.

The court explained that, "[i]f the effects of the transaction are computed consistently," the taxpayer had "made both a pre-tax profit and an after-tax profit from the * * * transaction." *Id.* at 786. The Fifth Circuit then evaluated whether the "choice to engage in the * * * transaction was solely motivated by the tax consequences of the transaction," and concluded that it was not. *Id.* at 787. "Instead," the court explained, "the evidence show[ed] that [the taxpayer] actually and legitimately also sought the (pre-tax) * * * profit it would get from the * * * dividend," and that "[a]lthough * * * the parties attempted to minimize the risks incident to the transaction, those risks did exist and were not by any means insignificant." *Ibid.* The Fifth Circuit therefore concluded that "[t]he transaction was not a mere formality or artifice but occurred in a real market subject to real risks." *Id.* at 788. The Eighth Circuit in *IES Industries*, which considered a materially identical transaction, conducted a similar analysis and reached the same holding. See 253 F.3d at 354-356.

In the decision below, the court of appeals, citing *Compaq* and *IES Industries*, acknowledged that, "[i]n factually different contexts, the Fifth and Eighth Circuits have taken a different approach" than did the court below. Pet. App. 26a-27a. But although the Fifth and Eighth Circuits treated post-foreign-tax profitability as irrelevant to the economic-substance analysis, neither court held that *pre*-foreign-tax profitability conclusively establishes the economic substance of the relevant transaction. Even after determining that the transactions at issue produced pre-foreign-tax profits, those courts considered other indicia of the transactions' economic effect and the taxpayers' intent. See *Compaq*, 277 F.3d at 786-787 ("[T]he evidence in the record does not show that Compaq's choice to engage in the ADR transaction was solely motivated by the tax consequences of the transaction."); *IES Indus.*, 253 F.3d at 356 ("We hold, considering all the facts and circumstances, that the ADR trades in which IES engaged did not, as a matter of law, lack business purpose or economic substance.").

Thus, although the Fifth and Eighth Circuits concluded that post-foreign-tax profitability is not a relevant consideration in the economic-substance analysis, their determinations that the transactions at issue had economic substance were ultimately attributable to those courts' determinations that the relevant transactions involved "a real risk of loss and an adequate non-tax business purpose." *Compaq*, 277 F.3d at 788; see *IES Indus.*, 253 F.3d at 354-356. In this case, by contrast, the court of appeals determined (after reviewing a summary-judgment record that did not include final expert reports) that, "viewing the evidence in the light most favorable to the government," a factfinder could reasonably conclude that "the transaction structure inflated the foreign tax liabilities of the SPVs and generated income from tax benefits for [petitioner] at the direct expense of the United States"; that the "SPVs had no substantive business activities of their own"; and that petitioner "lacked a legitimate, non-tax business purpose in entering [into] the transactions." Pet. App. 35a-36a (citation and internal quotation marks omitted). Those features were not present in *Compaq* and *IES Industries*.

There is accordingly no sound basis to conclude that the Fifth and Eighth Circuits would have reached a different holding than did the court below with respect to the cross-border transactions at issue here, which the government contends were designed solely to permit petitioner to transform interest expense on a purported loan from a foreign bank into a foreign tax liability that generated foreign tax credits. While the Fifth and Eighth Circuits disregarded a particular consideration (the absence of post-foreign-tax profitability) that the court of appeals here viewed as warranting close scrutiny of the transactions, their decisions do not support petitioner's contention that it is entitled to partial summary judgment on the economic-substance question.

4. The question presented in this case lacks substantial prospective importance. As petitioner acknowledges (Pet. 12), when Congress codified the economic-substance doctrine in 2010, it specifically addressed the treatment of foreign taxes in the economic-substance analysis. Section 7701(*o*)(2)(B) provides that the Secretary of the Treasury "shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases." That provision reflects Congress's unambiguous rejection, with respect to transactions entered into after March 30, 2010 (the codification's effective date), of petitioner's view that foreign taxes should never be treated as expenses for purposes of economic-substance analysis. Although the Secretary has thus far proceeded case by case rather than through regulation, see I.R.S. Notice 2010-62, 2010-40 I.R.B. 411-412, Section 7701(*o*)(2)(B) reflects Congress's evident view that the profitability of a transaction after foreign taxes are imposed can be relevant to the economic-substance inquiry. The question wheth-

er the same approach is appropriate with respect to pre-codification transactions is of no substantial continuing importance.[4]

The 2010 codification also enumerated the requirements for a transaction to be deemed to have economic substance, one of which is that "the transaction changes in a meaningful way (*apart from Federal income tax effects*) the taxpayer's economic position." 26 U.S.C. 7701(*o*)(1)(A) (emphasis added). That language further supports the view that only U.S. tax consequences, not foreign-tax consequences, should be excluded when determining whether a transaction had economic substance. Although Congress intended to codify the preexisting common-law doctrine, 26 U.S.C. 7701(*o*)(5)(A), Congress's understanding of that doctrine as reflected in the 2010 codification will be highly relevant in resolving economic-substance disputes going forward. Because the transaction at issue here preceded the 2010 codification's effective date (and thus would provide the Court no opportunity to apply and construe the codification), and because it is unclear whether any disagreement among the circuits will persist in cases that are governed by that codification, further review is not warranted.[5]

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[4] Even apart from Congress's 2010 codification of the economic-substance doctrine, the tax benefits generated by the transaction at issue in *Compaq* and *IES Industries* have been separately eliminated, see 26 U.S.C. 901(k); *IES Indus.*, 253 F.3d at 356 n.5 (noting legislative amendment), as have those generated by the transactions at issue in this case and in *Salem Financial*, see 26 C.F.R. 1.901-2(e)(5)(iv).

[5] Petitioner contends in a footnote (Pet. 7 n.3) that the court of appeals erred at the threshold in applying the economic-substance doctrine to prohibit a taxpayer from claiming foreign tax credits where it complies with all relevant statutory requirements. Peti-

tioner did not identify that issue as a question presented for this Court's review and has therefore forfeited it. Sup. Ct. R. 14.1(a). In any event, the court of appeals correctly rejected petitioner's argument. Pet. App. 18a-22a; see generally Br. in Opp. at 19-24, *Salem Fin.*, *supra* (No. 15-380). This Court has long understood the economic-substance doctrine to reflect the premise that Congress would not have intended sham transactions to produce tax benefits *even if* the transactions technically comply with the statutory and regulatory provisions that authorize such benefits. See *Knetsch* v. *United States*, 364 U.S. 361, 365-366 (1960); *Gregory* v. *Helvering*, 293 U.S. 465, 467-470 (1935); see also *Frank Lyon*, 435 U.S. at 583-584. The courts of appeals likewise have consistently applied the economic-substance doctrine to reject tax shelters that technically complied with applicable tax rules but lacked economic substance. *E.g.*, *WFC Holdings Corp.* v. *United States*, 728 F.3d 736, 742-743 (8th Cir. 2013), cert. denied, 134 S. Ct. 2724 (2014); *Sala* v. *United States*, 613 F.3d 1249, 1253-1254 (10th Cir. 2010), cert. denied, 132 S. Ct. 91 (2011); *Dow Chem. Co.* v. *United States*, 435 F.3d 594, 599 (6th Cir. 2006), cert. denied, 549 U.S. 1205 (2007); *Winn-Dixie Stores, Inc. & Subsidiaries* v. *Commissioner*, 254 F.3d 1313, 1315-1316 (11th Cir. 2001) (per curiam), cert. denied, 535 U.S. 986 (2002); *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 245-246 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999). The text and history of the 2010 codification reflect the same understanding. See 26 U.S.C. 7701(*o*)(5)(A) (defining the term "economic substance doctrine" to mean "the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose"); H.R. Rep. No. 443, 111th Cong., 2d Sess. 295 (2010) (explaining that, because a "strictly rule-based tax system cannot efficiently prescribe the appropriate outcome of every conceivable transaction that might be devised," "many courts have long recognized the need to supplement tax rules with anti-tax-avoidance standards, such as the economic substance doctrine, in order to assure the Congressional purpose is achieved") .

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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