No. 07-1064

In the Supreme Court of the United States

ALLAN D. KLEINMAN, EXECUTOR OF THE ESTATE OF ELEANOR R. GERSON, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

PAUL D. CLEMENT
Solicitor General
Counsel of Record

NATHAN J. HOCHMAN
Assistant Attorney General

RICHARD FARBER
KAREN G. GREGORY
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Whether 26 C.F.R. 26.2601-1(b)(1)(i), which provides that certain generation-skipping transfers effected by the exercise of general powers of appointment are taxable, constitutes a valid exercise of the Department of the Treasury's rulemaking authority.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases:

Statutes and regulation: Page

Miscellaneous:

In the Supreme Court of the United States

No. 07-1064

ALLAN D. KLEINMAN, EXECUTOR OF THE ESTATE OF ELEANOR R. GERSON, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-12a) is reported at 507 F.3d 435. The opinion of the Tax Court (Pet. App. 13a-72a) is reported at 127 T.C. 139.

JURISDICTION

The judgment of the court of appeals was entered on November 9, 2007. The petition for a writ of certiorari was filed on February 7, 2008. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. As part of its overhaul of the tax laws in 1986, Congress enacted statutory provisions that impose a generation-skipping transfer (GST) tax on transfers of property to persons who are at least two generations

below the transferor (such as grandchildren). Tax Reform Act of 1986 (Tax Reform Act), Pub. L. No. 99-514, § 1431, 100 Stat. 2717 (26 U.S.C. 2601 *et seq.*). Those provisions were designed "to ensure taxation of generation skipping transfers in a comparable manner to outright transfers from one generation to the next, and to remove the estate planning tool of escaping taxation by skipping a generation in an estate transfer." *Comerica Bank, N.A.* v. *United States*, 93 F.3d 225, 228 (6th Cir. 1996).

The GST tax applies to "every" generation-skipping transfer. 26 U.S.C. 2601. As is relevant here, however, Congress excepted "any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985." Tax Reform Act § 1433(b)(2), 100 Stat. 2731. The critical issue in this case is whether that statutory exception applies to a transfer made pursuant to a general power of appointment after September 25, 1985, where the general power of appointment was conferred by a trust that had become irrevocable before that date. In 2000, the Department of the Treasury, acting pursuant to a specific grant of rulemaking authority, see 26 U.S.C. 2663, promulgated a final regulation addressing that issue. In relevant part, the regulation provides that, while "[t]he provisions [governing the GST tax] do not apply to any generation-skipping transfer under a trust * * * that was irrevocable on September 25, 1985," that rule "does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under [the statutory provisions governing the estate and gift taxes]." 26 C.F.R. 26.2601-1(b)(1)(i). In such

circumstances, "[t]he transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985." *Ibid.*

2. In 1968, Benjamin Gerson created a trust, which became irrevocable upon his death in 1973. The trust provided for the creation of three separate trusts upon Gerson's death, one of which was a marital trust to benefit Gerson's wife, Eleanor, who is the decedent in this case. The marital trust conferred upon decedent "an unlimited testamentary power of appointment in respect of the whole of [the trust property]." In 1999, decedent established a trust for the benefit of her grandchildren and more remote descendants; in her will, decedent provided that she was exercising her power of appointment conferred by the marital trust and directing that all property subject thereto should be administered pursuant to the terms of the grandchildren's trust. Pet. App. 2a, 14a-16a.

Decedent died in 2000. Upon her death, the property subject to the marital trust was transferred into the grandchildren's trust, pursuant to the terms of her will; petitioner, the executor of decedent's estate, filed a tax return that did not report any GST tax for the transferred property. The Commissioner of Internal Revenue subsequently determined that there was a deficiency in GST tax of over $1.1 million. Pet. App. 2a, 13a, 16a-17a. Petitioner challenged the deficiency in the Tax Court, claiming that the regulation governing transfers made pursuant to general powers of appointment was invalid.

3. The Tax Court ruled against petitioner and upheld the regulation. Pet. App. 13a-72a. Applying this

Court's decisions in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472 (1979) (which set out certain factors to be considered in reviewing the validity of a tax regulation), the Tax Court first determined that Congress had not "directly spoken to the precise question at issue," because "[S]ection 1433(b)(2)(A) does not define the phrase 'transfer under a trust.'" Pet. App. 34a-36a. The court reasoned that "nothing in the committee reports suggests that, when Congress referred to 'transfers under a trust,' it ever contemplated or considered a volitional generation-skipping transfer arising from the exercise of a general power of appointment as opposed to a specific transfer by the settlor to identified persons." *Id.* at 37a.

The Tax Court next observed that the legislative history of the Tax Reform Act reflected Congress's intent that "Federal transfer taxes generally should be applied as uniformly as possible" and "generation-skipping transfers having a similar substantial effect should be taxed in a similar manner." Pet. App. 38a. According to the court, the regulation at issue "harmonizes with the origin and purpose of * * * [S]ection 1433(b)(2)(A) and achieves the consistency and uniformity Congress sought." *Ibid.* The court noted that "the regulation is consistent with the general proposition under the GST tax regime that a decedent who dies holding a general power of appointment over property is treated as the 'transferor' of that property for purposes of GST tax." *Ibid.*

The Tax Court added that "the particular purpose of the statute" was "to protect taxpayers who, on the basis of pre-existing rules, made estate-planning arrange-

ments from which they could not reasonably escape and which would otherwise generate GST tax liability." Pet. App. 39a. The court concluded that "[t]he generation-skipping transfers in the present case are not transfers the transitional rules were intended to protect," because "Mr. Gerson did not structure his irrevocable trust in a manner that tied the hands of his heirs, nor was decedent required to make the disputed generation-skipping transfers." *Ibid.*

Three judges of the Tax Court wrote separate concurring opinions; another concurred only in the result. Pet. App. 40a-58a. Five judges dissented. Judge Laro, joined by four other judges, would have held that the text of Section 1433(b)(2)(A) unambiguously foreclosed the Treasury's interpretation. *Id.* at 59a-66a. Judge Vasquez separately contended that the regulation at issue was entitled only to the lesser degree of deference required by *Skidmore* v. *Swift & Co.*, 323 U.S. 134 (1944). Pet. App. 67a-72a.

4. The court of appeals affirmed. Pet. App. 1a-12a. Like the Tax Court, the court of appeals concluded that "the [Treasury's] regulation reasonably construes an ambiguous statutory provision." *Id.* at 2a. As a preliminary matter, the court of appeals held that the regulation was subject to the *Chevron* framework. *Id.* at 4a-5a. Applying *Chevron*, the court of appeals then determined that the text of Section 1433(b)(2)(A) was ambiguous. *Id.* at 5a-11a. The court noted that petitioner contended that the term "under," in the statutory phrase "transfer under a trust," "merely implies that the trust instrument is the root of the * * * power [to skip generations]," whereas the Treasury contended that, in this case, "the transfer was not under a trust irrevocable before 1985, but under [decedent's] will." *Id.* at 10a.

The court concluded that each of those readings of the text was "plausible." *Id.* at 11a.

The court of appeals noted that two other circuits had held, in cases not covered by the regulation at issue here, that Section 1433(b)(2)(A) applied to transfers effected by the exercise of general powers of appointment. Pet. App. 7a (citing *Simpson* v. *United States*, 183 F.3d 812 (8th Cir. 1999), and *Bachler* v. *United States*, 281 F.3d 1078 (9th Cir. 2002)). But the court of appeals rejected petitioner's contention that, under this Court's decision in *National Cable & Telecommunications Ass'n* v. *Brand X Internet Services*, 545 U.S. 967 (2005), it was "require[d] * * * to follow the Eighth Circuit's 'plain language' determination." Pet. App. 9a n.2. The court of appeals explained that the Eighth Circuit had not held that "the statute was so clear that it foreclosed regulation." *Ibid.*

Finally, the court of appeals determined that the regulation constituted a reasonable interpretation of Section 1433(b)(2)(A). Pet. App. 11a-12a. The court noted that a general power of appointment has long been viewed as essentially identical to outright ownership of property for tax purposes. *Id.* at 11a. "Thus," the court reasoned, "the regulation conforms the grandfather clause to other elements of the tax scheme." *Ibid.* The court added that "the other exceptions to the GST tax * * * all represent inescapable contingencies that justify grandfathering," whereas "[petitioner's] proposed interpretation protects disproportionately broad reliance on prior tax laws." *Ibid.* While the court acknowledged that "[t]he parties debate the breadth of reliance the legislature intended to protect," it observed that "the legislature gave no guidance other than its ambiguous words." *Id.* at 12a. The court concluded that

"[t]his is precisely the type of decision entrusted to agency discretion." *Ibid.*

ARGUMENT

Petitioner renews his contention (Pet. 10-26) that 26 C.F.R. 26.2601-1(b)(1)(i), which provides that certain generation-skipping transfers effected by the exercise of general powers of appointment are taxable, constitutes an invalid exercise of the Treasury's rulemaking authority. The court of appeals' decision upholding the regulation is correct and does not conflict with any decision of this Court or of another court of appeals. Moreover, because the regulation at issue involves the interpretation of a transitional rule that applies only to trusts that became irrevocable more than 20 years ago, this case presents a question of diminishing significance. Further review is not warranted.

1. The court of appeals correctly held that the Treasury's regulation is valid. Under the familiar framework of *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the first step of the inquiry is "whether Congress has directly spoken to the precise question at issue." *Id.* at 842. If the legislative intent is clear, that is the end of the matter, "for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-843. As the court of appeals correctly observed (Pet. App. 10a-11a), the text of the relevant statutory provision—Section 1433(b)(2) of the Tax Reform Act—does not specifically address the question whether the generation-skipping transfer tax applies to a transfer made pursuant to a general power of appointment after September 25, 1985, where the general power of appointment was conferred by a trust that had become

irrevocable before that date. Indeed, by its terms, Section 1433(b)(2) applies only to "[a] generation-skipping transfer under a trust which was irrevocable on September 25, 1985," whereas a transfer effected by a general power of appointment that was conferred by a trust can easily be viewed as a transfer *by the party exercising the power of appointment*, rather than a transfer under the trust itself. In this case, the generation-skipping transfer at issue occurred only because decedent exercised her power of appointment in favor of her grandchildren (and more remote descendants) after September 25, 1985; nothing in the initial trust instrument indicated that the creator of the trust even contemplated that a generation-skipping transfer would eventually occur. It is at best uncertain whether the text of Section 1433(b)(2) applies to such a transfer.

Under *Chevron*, the second step of the inquiry is "whether the agency's [interpretation] is based on a permissible construction of the statute." 467 U.S. at 843. In this case, the Treasury's interpretation was not only a permissible one, but the one more closely in accord with the purpose of the transitional rule: namely, "to protect those taxpayers who, on the basis of pre-existing rules, made arrangements from which they could not reasonably escape," not "to allow taxpayers who * * * seek to continue benefitting from a tax advantage that Congress has eliminated." *E. Norman Peterson Marital Trust* v. *Commissioner*, 78 F.3d 795, 801 (2d Cir. 1996). As the lower courts explained (Pet. App. 11a-12a, 39a-40a), the practical effect of a contrary interpretation of Section 1433(b)(2) would be to allow taxpayers to avoid paying GST tax on voluntary generation-skipping transfers, such as the transfer at issue here, that were

made well after the effective date of the provisions imposing that tax.

More broadly, the Treasury's interpretation was consistent with the treatment of general powers of appointment under other provisions of the Internal Revenue Code. It is a well-established principle of federal tax law that possession of a general power of appointment is tantamount to ownership of the property subject to the power. Thus, where an individual exercises (or releases) a general power of appointment, that exercise (or release) is treated as a gift of the underlying property by that individual for purposes of the federal gift tax. 26 U.S.C. 2514(b); see 5 Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 121.6.1, at 121-39 to 121-40 (2d ed. 1993) (Bittker & Lokken). And where an individual holds a general power of appointment at the time of his death, the underlying property is treated as if it were owned by the individual, and is thereby included in the individual's estate, for purposes of the federal estate tax. 26 U.S.C. 2041(a)(2); see 5 Bittker & Lokken ¶ 128.1, at 128-3 to 128-4.

As the lower courts recognized (Pet. App. 11a, 38a-39a), it would be inconsistent with the treatment of general powers of appointment under those provisions to treat a transfer of property effected by a general power of appointment as if it were a transfer under the trust that conferred the power of appointment for purposes of the GST tax's transitional rule. See H.R. Rep. No. 426, 99th Cong., 1st Sess. 827 (1985) (explaining that the GST tax was "coordinat[ed]" with the gift and estate taxes); cf. *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44 (1939) (stating that the gift and estate taxes "are *in pari materia* and must be construed together"). For pur-

poses of the gift and estate taxes, the conferral of a power of appointment (unless timely disclaimed) is itself in effect a transfer to the holder of the power, and the exercise of that power constitutes a *second* transfer—here, a transfer under decedent's will (the instrument under which the power was exercised), not under the trust that initially conferred the power. Pet. App. 10a.

2. Petitioner does not contend that the court of appeals' decision conflicts with the decision of any other court of appeals with respect to the specific question presented by this case—*i.e.*, whether 26 C.F.R. 26.2601-1(b)(1)(i) constitutes a valid exercise of the Treasury's rulemaking authority. Instead, petitioner contends only that the court of appeals' decision upholding the regulation violates the principle of *National Cable & Telecommunications Ass'n* v. *Brand X Internet Services*, 545 U.S. 967 (2005), that "a judicial precedent holding that [a] statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction." *Id.* at 982-983. The court of appeals considered and rejected that contention, see Pet. App. 9a n.2, and it was correct to do so.

In support of his argument, petitioner relies on two cases in which courts of appeals held, without regard to the Treasury's regulation, that Section 1433(b)(2)(A) applied to transfers effected by the exercise of general powers of appointment. See *Simpson* v. *United States*, 183 F.3d 812 (8th Cir. 1999); *Bachler* v. *United States*, 281 F.3d 1078 (9th Cir. 2002). In neither of those cases, however, did the court hold that the statute was "unambiguous" under the "demanding *Chevron* step one standard." *Brand X*, 545 U.S. at 982, 984. In *Simpson*, which predated (and precipitated) the Treasury's regu-

lation, the Eighth Circuit held that a transfer effected by the exercise of a general power of appointment was a "transfer under a trust" because "[t]he transfer was made possible by the trust." 183 F.3d at 814. While the court did state that "[t]he words of Section 1433(b)(2)(A) are clear, at least to us," and that there was not "substantial uncertainty as to the meaning" of the provision, the court also attached weight to the fact that "there [was no] regulation, temporary or permanent, that applies to the particular sort of transfer made here—a transfer of the entire corpus of the trust remaining at the time of the exercise of the power [of appointment]." *Id.* at 816. That fact would have been irrelevant if, as petitioner contends, the Eighth Circuit had believed that Congress directly spoke to the precise question at issue when it enacted Section 1433(b)(2)(A)—for, if it had, any regulation providing that Section 1433(b)(2)(A) did not apply to transfers effected by the exercise of general powers of appointment would fail step one of *Chevron*. As the court of appeals in this case recognized, nothing in *Simpson* thus suggests that the Eighth Circuit would have invalidated the Treasury's regulation if it had been in place at the time. See Pet. App. 9a n.2 (concluding that "*Simpson* never held that the statute was so clear that it foreclosed regulation").

Similarly, in *Bachler*, the Ninth Circuit held that a transfer effected by the exercise of a general power of appointment was a "transfer under a trust," on the ground that "[t]he transfer could not have been effected if it had not been under the trust." 281 F.3d at 1080. At the same time, however, the court noted that it was "not express[ing] any opinion on the validity of [26 C.F.R.] 26.2601-1(b)(1)(i)," which had been promulgated while proceedings in the case were ongoing and was not made

retroactively applicable to the time period at issue in that case. *Bachler*, 281 F.3d at 1080 n.1. There would have been no basis for the Ninth Circuit to reserve the question of the validity of the Treasury's regulation if it had believed that Congress had unambiguously addressed the question at issue in Section 1433(b)(2)(A) itself; indeed, the Ninth Circuit's opinion could be read as suggesting only that the text of Section 1433(b)(2)(A) was *silent* on that question. See *id.* at 1080 (stating that "[t]he statute * * * makes no exclusion for the exercise of a general power of appointment"). Like the Eighth Circuit's decision in *Simpson*, therefore, the Ninth Circuit's decision in *Bachler* did not trigger the *Brand X* rule.

At a minimum, it is questionable whether the Eighth or Ninth Circuit concluded that the language of Section 1433(b)(2)(A) was "unambiguous" under the "demanding *Chevron* step one standard," *Brand X*, 545 U.S. at 982, 984—and therefore whether the Eighth or Ninth Circuit would hold that the Treasury's regulation was invalid under *Chevron* analysis. If either circuit were to do so in a future case, the Court could address the resulting conflict concerning the validity of the Treasury's regulation at that time. The hypothetical possibility that either circuit would invalidate the regulation, however, provides an insufficient basis to grant review here.

More broadly, petitioner's reliance on *Brand X* rests on a fundamental misunderstanding of that decision. According to petitioner, once a single court of appeals (or, presumably, even a district court—or for that matter the Tax Court or a bankruptcy court) has concluded in a final, unreviewable decision that a statutory provision must be read in a certain way, the agency charged with administering that statute is subject to a binding

nationwide prohibition against promulgation of a regulation adopting a different interpretation, because any such "regulation is, in fact, trumped by a prior judicial construction holding that the agency's interpretation was 'unambiguously foreclose[d]' by the statute's plain language." Pet. 22 (quoting *Brand X*, 545 U.S. at 983). In effect, petitioner claims that *Brand X* overturned decades of agency "non-acquiescence" practice and compelled agencies to accept the first final lower-court "plain-language" interpretation of a statute (including, presumably, interpretations announced in cases to which the agency was not even a party).

Brand X held nothing of the kind. The question addressed in that case was not whether an agency would be bound *nationwide* by a prior lower-court decision interpreting the relevant statutory provision. Rather, the question was whether the obligation of courts to give *Chevron* deference to reasonable agency interpretations of ambiguous statutes was sufficient to trump an otherwise *binding precedent* of the *same court* when that court was presented with a challenge to an intervening agency interpretation that conflicted with the binding precedent of that same court. See *Brand X*, 545 U.S. at 982 ("The [Ninth Circuit] declined to apply *Chevron* because it thought the [FCC's] interpretation of the Communications Act foreclosed by the conflicting construction of the Act *it* [*i.e.*, the Ninth Circuit] had adopted in [its prior decision]."") (emphasis added). In *Brand X*, the lower court had held that its earlier precedent "overrode the [FCC's] 'interpretation,' regardless of whether [the earlier decision] had held the statute to be unambiguous." *Ibid.* It was *that* rationale that the Supreme Court rejected in *Brand X*, holding instead that "judicial interpretations contained *in precedents*" are held to "the

same demanding *Chevron* step one standard." *Ibid.* (emphasis added). Thus, the rule announced in *Brand X* applies only when the initial judicial interpretation is otherwise binding "under the doctrine of *stare decisis*," and has no application where, as here, the allegedly inconsistent judicial interpretations have no binding force. *Id.* at 984.

3. Finally, the question presented in this case is of diminishing significance, because the regulation at issue involves the interpretation of a transitional rule that applies only to trusts that became irrevocable more than 20 years ago. In fact, the underlying transitional rule has generated only a handful of cases since it was enacted in 1986 as part of the Tax Reform Act. And we are aware of only one other currently pending case involving the specific question presented here—and the decision below will be binding in that case (which also arises in the Sixth Circuit). See *Timken* v. *United States*, No. 5:04-cv-01188-JRA (N.D. Ohio); see generally Br. of Estate of Louise Blyth Timken et al. Because the question presented is unlikely to recur frequently, further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

PAUL D. CLEMENT
Solicitor General

NATHAN J. HOCHMAN
Assistant Attorney General

RICHARD FARBER
KAREN G. GREGORY
Attorneys

APRIL 2008