No. 03-1449

In the Supreme Court of the United States

AEROQUIP-VICKERS, INC. AND SUBSIDIARIES, FKA TRINOVA CORPORATION AND SUBSIDIARIES, PETITIONERS

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

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QUESTION PRESENTED

Whether the court of appeals correctly applied de novo review to determine whether the Tax Court erred in refusing to give deference to an Internal Revenue Service (IRS) Revenue Ruling interpreting an IRS regulation.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-40a) is reported at 347 F.3d 173. The opinion of the Tax Court (Pet. App. 42a-67a) is reported at 108 T.C. 68.

JURISDICTION

The judgment of the court of appeals was entered on October 20, 2003. A petition for rehearing was denied on January 21, 2004 (Pet. App. 41a). The petition for a writ of certiorari was filed on April 19, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under former Section 38 of the Internal Revenue Code, 26 U.S.C. 38 (1982), a taxpayer who acquired certain property for use in its trade or business (Section 38 property) was allowed an investment tax credit (ITC) calculated by reference to the property's useful life. To ensure accurate estimation of a property's useful life, former Section 47(a)(1) required that the taxpayer "recapture" or repay the ITC if the taxpayer disposed of Section 38 property before the end of its estimated useful life. Section 1.1502-3(f)(3) of the Treasury Regulations, promulgated by the Internal Revenue Service (IRS), creates an exception to this rule for transfer of Section 38 property between members of a consolidated group. 26 C.F.R. 1.1502-3(f)(3). Thus, Example 5 of 26 C.F.R. 1.1502-3(f)(3) indicates that no recapture is required if Section 38 property is transferred to a consolidated subsidiary, and the subsidiary's shares are subsequently sold to a third party in a different tax year. In Revenue Ruling 82-20, however, the Commissioner of Internal Revenue determined that ITC recapture is required if there is no intention at the time the transfer occurs to keep the Section 38 property within the consolidated group. See Rev. Rul. 82-20, 1982-1 C.B. 6.

2. In 1986, petitioner Aeroquip-Vickers, Inc. (formerly known as Trinova Corporation) transferred Section 38 property to a wholly-owned subsidiary with which it filed a consolidated tax return. Pet. App. 1a-2a. Immediately thereafter, petitioner distributed the stock of the subsidiary to one of its shareholders, thus causing the subsidiary and the Section 38 property to leave the consolidated group. *Id.* at 2a, 3a-4a. Although the Section 38 property was not at the end of

its useful life, petitioner did not report any recaptured ITC on its tax returns. *Id.* at 2a. Rather, relying on Example 5 of 26 C.F.R. 1.1502-3(f)(3), petitioner claimed that the transfer of Section 38 property occurred within a consolidated group and was not subject to the recapture rule. The Commissioner disagreed and asserted a deficiency against petitioner for its failure to include recaptured ITC in its 1986 consolidated tax return. Pet. App. 2a.

3. Petitioner sought a redetermination of the deficiency in the United States Tax Court, which concluded that petitioner was not required to recapture any ITC. Pet. App. 42a-67a. The Tax Court reasoned that under Example 5 of 26 C.F.R. 1.1502-3(f)(3) "the mere transfer of section 38 assets within a consolidated group does not trigger recapture," and the subsequent "transfer of stock" of the consolidated subsidiary to a third party also "would not trigger the recapture of such credit." Pet. App. 47a, 48a.

The Tax Court rejected the Commissioner's argument that recapture was required under Revenue Ruling 82-20. Pet. App. 48a. In its view, the Revenue Ruling had no force because it was in "conflict" with "Example (5) of the regulations." *Id.* at 52a. The Tax Court acknowledged (*id.* at 53a) that its interpretation of Revenue Ruling 82-20 was inconsistent with decisions of the Second and Ninth Circuits, both of which interpret Revenue Ruling 82-20 as applying when Section 38 property is transferred to a subsidiary with the intent to make a subsequent transfer of the subsidiary to a third party, whereas 26 C.F.R. 1.1502-3(f)(3) applies when the transactions are sufficiently separated in time as to demonstrate the absence of such intent. See *Walt Disney, Inc.* v. *Commissioner*, 4 F.3d 735 (9th Cir. 1993); *Salomon, Inc.* v. *United States*,

976 F.2d 837 (2d Cir. 1992). The Tax Court "disagree[d] with both the result and reasoning of the Courts of Appeals" and asserted that "the fact that the transfer of the assets and the transfer of the stock occurred in the same, rather than different, taxable years does not provide a meaningful basis for distinguishing Rev. Rul. 82-20 * * * from Example (5) of the regulations." Pet. App. 52a.

In addition, the Tax Court concluded that recapture was not required under the "step transaction" doctrine. Under this doctrine, multiple transactions are treated as a single event for tax purposes if the taxpayer devises the transactions as part of a single plan. Pet. App. 53a-54a. The court reasoned that the step transaction doctrine did not apply because each of petitioner's transactions had a legitimate business purpose. *Ibid.*

4. The court of appeals reversed. Pet. App. 1a-40a. The court initially observed that Revenue Ruling 82-20 was not automatically entitled to deference in light of this Court's decisions in *Christensen* v. *Harris County*, 529 U.S. 576, 587 (2000), and *United States* v. *Mead Corp.*, 533 U.S. 218, 226-227 (2001), which held that agency interpretations that "lack the force of law" are entitled to deference "only to the extent that those interpretations have the 'power to persuade.'" Pet. App. 12a, 14a (quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944)). The court of appeals nonetheless concluded that "the underlying rationale of Revenue Ruling 82-20 is valid, 'reflects the agency's longstanding interpretation of its own regulations,' and thus deserves 'substantial judicial deference.'" *Id.* at 15a (quoting *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001)). The court of appeals dismissed the contention that Revenue Ruling 82-20

was inconsistent with Example 5 of 26 C.F.R. 1.1502-3(f)(3), holding that the regulation "involves a situation where the asset transfer occurs in one year and the spin-off takes place in the following year, while Revenue Ruling 82-20 applies to situations where (as in the instant case) the asset transfer is 'immediately' followed by the spin-off." Pet. App. 14a-15a. Finally, the court concluded that the Commissioner properly applied the step transaction doctrine. The court reasoned that "although the individual steps of the transaction had a legitimate business reason, the transaction must be treated as a single unit and judged by its end result," in this case an attempt to avoid liability for ITC recapture. *Id.* at 17a-18a.

Judge Clay dissented. He concluded that the majority had erroneously deferred to the Commissioner (Pet. App. 19a-24a), and that Revenue Ruling 82-20 was "inconsistent with § 1.1502-3(f)(2)(i) because the treasury regulation focuses on making the transferee responsible for the Section 38 property, whereas the Revenue Ruling looks to the 'intent' of the parties in the consolidated group." *Id.* at 32a.

ARGUMENT

Petitioner argues only that the court of appeals erred in failing to defer to the Tax Court and asks this Court to decide whether "the Tax Court is due some level of respect beyond that of a district court" by virtue of its "special expertise * * * in interpreting the tax laws of the United States." Pet. 10, 11. Petitioner, however, failed to advance that argument in the court of appeals. In addition, the court of appeals correctly applied the de novo standard of review, and its decision does not conflict with any decision of this Court or any other

court of appeals. Further review is therefore not warranted.

1. Petitioner failed to argue in the court of appeals that Tax Court decisions should be accorded some special deference. To the contrary, petitioner and the government *agreed* that courts of appeals should review Tax Court decisions on questions of law de novo. See Pet. C.A. Br. 16 ("The Tax Court's findings of fact are thus reviewed for clear error and its application of law is reviewed *de novo*."); Gov't C.A. Br. 26 ("The Tax Court's holding presents a question of law that this court reviews *de novo*."). Petitioner's rehearing petition similarly failed to raise any question about the applicable standard of review. Accordingly, whether a Tax Court decision is entitled to some special deference is not a question preserved for this Court's review. See *Adarand Constructors, Inc.* v. *Mineta*, 534 U.S. 103, 109 (2001); *Zobrest* v. *Catalina Foothills School Dist.*, 509 U.S. 1, 8 (1993); *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970).

2. In addition, there is no conflict among the courts of appeals that would warrant this Court's review. With respect to the primary legal issue decided below, the courts of appeals uniformly hold that Revenue Ruling 82-20 is a reasonable interpretation of the relevant statute and regulations that applies when the initial transfer within the consolidated group is made with the intention of subsequently transferring the property outside the consolidated group. See Pet. App. 14a-15a; *Salomon Inc.* v. *United States*, 976 F.2d 837, 841 (2d Cir. 1992) (holding that Revenue Ruling 82-20 is not "unreasonable, nor inconsistent with prevailing law"); *Walt Disney* v. *Commissioner*, 4 F.3d 735, 741 (9th Cir. 1993) (holding that "Revenue Ruling 82-20 and Exam-

ple 5 of the Consolidated Return Regulations are not inconsistent because they address different situations").

The secondary issue petitioner identifies—the standard of review that courts of appeals should apply when reviewing a Tax Court decision (Pet. 8-13)—was correctly decided by the court of appeals and does not implicate a meaningful conflict among the circuits.

a. The applicable standard of review is clearly defined in Section 7482(a)(1) of the Internal Revenue Code (26 U.S.C.):

> The United States Courts of Appeals * * * shall have exclusive jurisdiction to review the decisions of the Tax Court * * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury.

Petitioner thus errs in asserting that "the Tax Court is due some level of respect beyond that of a district court." Pet. 10. Section 7482(a)(1) plainly bars such heightened "respect" by mandating that courts of appeals review Tax Court decisions "in the *same* manner" and "to the *same* extent" as district court decisions. 26 U.S.C. 7482(a)(1) (emphasis supplied). Indeed, this Court long ago noted that the very "purpose" of Section 7482 was "to remove from the law the favored position (in comparison with District Court and Court of Claims rulings in tax matters) [previously] enjoyed by the Tax Court." *Commissioner* v. *Duberstein*, 363 U.S. 278, 291 n.13 (1960).

b. Contrary to petitioners' claim (Pet. 10-11), the Second, Third, Fifth, Sixth, Seventh, Eleventh, and D.C. Circuits consistently review Tax Court decisions de novo, although they employ varying verbal formula-

tions in doing so.* While the Ninth Circuit has observed that Tax Court opinions may be "entitled to respect because of its special expertise in the field," *Magneson* v. *Commissioner*, 753 F.2d 1490, 1493 (9th Cir. 1985), more recent decisions from that Circuit confirm that it conducts a de novo review. See *Graham* v. *Commissioner*, 822 F.2d 844, 848 (9th Cir. 1987). That court, indeed, has observed that "[t]he frequent recitations of special deference are apparently mutations that this court has ignored when we disagree with the Tax Court. * * * To the extent that expressions of deference in reviewing questions of law are harmless honorifics among fellow judges, they waste ink. To the extent that they sow confusion, they are best ignored." *Vukasovich, Inc.* v. *Commissioner*, 790 F.2d 1409, 1413 (9th Cir. 1986). See *Best Life Assurance Co.* v. *Commissioner*, 281 F.3d 828, 830 (9th Cir. 2002) ("[W]e give no special deference to the Tax Court's decisions."); *Custom Chrome, Inc.* v. *Commissioner*, 217 F.3d 1117, 1121 (9th Cir. 2000) (same); *AMERCO, Inc.* v. *Commissioner*, 979 F.2d 162, 164 (9th Cir. 1992) (same). In any event, to the extent the Ninth Circuit's precedent may not be entirely uniform on this subject, a

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* *Madison Recycling Assocs.* v. *Commissioner*, 295 F.3d 280, 285 (2d Cir. 2002) (no deference); *Geisinger Health Plan* v. *Commissioner*, 985 F.2d 1210, 1212 (3d Cir. 1993) (review plenary); *ABKCO Indus., Inc.* v. *Commissioner*, 482 F.2d 150, 155 (3d Cir. 1973) (same); *Yarbro* v. *Commissioner*, 737 F.2d 479, 483 (5th Cir. 1984) (independent analysis); *Horton* v. *Commissioner*, 33 F.3d 625, 627 (6th Cir. 1994) (de novo review); *Smith* v. *Commissioner*, 926 F.2d 1470, 1474 (6th Cir. 1991) (same); *Hackl* v. *Commissioner*, 335 F.3d 664, 666 (7th Cir. 2003) (no special deference); *Exacto Spring Corp.* v. *Commissioner*, 196 F.3d 833, 838 (7th Cir. 1999) (same); *Estate of Caporella* v. *Commissioner*, 817 F.2d 706, 708 (11th Cir. 1987) (de novo review); *InverWorld, Ltd.* v. *Commissioner*, 979 F.2d 868, 875-876 (D.C. Cir. 1992) (de novo review).

conflict among decisions of the same court of appeals is a matter properly resolved by that court. *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) ("It is primarily the task of a Court of Appeals to reconcile its internal difficulties.").

3. Review is also unwarranted in this case because resolution of the question presented would not affect the judgment below. The court of appeals' decision is supported by an alternative ground that the petition does not appear to challenge, namely the court's determination that the "step transaction doctrine" is applicable in this case. Pet. App. 15a-18a. Thus, the result would be the same even under petitioner's newly asserted view of the law.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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