No. 98-272

In the Supreme Court of the United States

OCTOBER TERM, 1998

NORFOLK SOUTHERN CORPORATION AND AFFILIATED COMPANIES, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a cargo container is "used in the transportation of property to and from the United States" within the meaning of 26 U.S.C. 48(a)(2)(B)(v) (1982) if the United States is neither the origin nor the terminus of any single trip during the taxable year.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 140 F.3d 240. The opinion of the Tax Court (Pet. App. 18a-78a) is reported at 104 T.C. 13. The supplemental opinion of the Tax Court (Pet. App. 79a-88a) is reported at 104 T.C. 417.

JURISDICTION

The judgment of the court of appeals was entered on March 20, 1998. The petition for rehearing was denied on May 15, 1998 (Pet. App. 89a-90a). The petition for a writ of certiorari was filed on August 12, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1\. a. In 1981, Flexi-Van, Inc., added 38,037 intermodal cargo containers to its container fleet (Pet. App. 2a). Intermodal cargo containers streamline product shipping because they can be transported between vessels, trucks and railroads without any intermediate loading or unloading of their contents (*id.* at 3a). Eighty-five percent of the intermodal containers received by Flexi-Van in 1981 were delivered to it in countries other than the United States (*id.* at 2a).

In November 1981, in exchange for a payment of $18,032,147, Flexi-Van transferred to petitioner Norfolk and Western Railway Company the investment tax credits and accelerated depreciation deductions associated with the 38,037 containers (Pet. App. 2a, 27a). That species of tax-credit-transfer agreement was permitted by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 201, 95 Stat. 203, 26 U.S.C. 168(f)(8) (1982), which was repealed a year later by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 209, 96 Stat. 442. Under the agreement with petitioner, Flexi-Van retained ownership of the containers while transferring the tax benefits that, due to an insufficient need for the deductions and credits, it could not enjoy directly (Pet. App. 2a).[1] Under the agreement, petitioner claimed the investment tax credits and accelerated depreciation deductions associated with all of the 38,037 containers acquired by Flexi-Van in 1981 (*id.* at 2a-3a, 28a-29a).

[1] As used in this brief, "petitioner" refers to Norfolk and Western Railway Company and its petitioning affiliates and parents, as the context makes appropriate.

b. During the period that the investment tax credit and accelerated depreciation schemes were in effect, property used predominantly outside the United States was not eligible for these special tax benefits.[2] See 26 U.S.C. 48(b)(2)(A) (1982); 26 U.S.C. 168(g)(1)(A) (1988). An exception to this rule—known as the "container exception"—allowed these special tax benefits for containers used in transporting property to or from the United States. 26 U.S.C. 48(a), 48(a)(2)(B)(v) (1982); 26 U.S.C. 168(c) (1988).

In 1980, the Commissioner began preparation of a revenue ruling addressing the meaning and scope of the "container exception." The Commissioner notified the industry trade association—*amicus* Institute of International Container Lessors (IICL)—of the revenue ruling project. In early 1982, representatives of *amicus* IICL met with the Internal Revenue Service to provide information about the container leasing industry and to suggest guidelines for determining the circumstances under which containers should qualify for the investment credit (Pet. App. 32a-33a).

On January 29, 1990, respondent issued Revenue Ruling 90-9, 1990-1 C.B. 46. That Ruling required a taxpayer who claims investment tax credits for cargo containers to prove that the containers were "used substantially in the direct transportation of property to or from the United States during each taxable year of its

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[2] The investment credit and the accelerated cost recovery system involved in this case (ACRS) were repealed by the Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 201, 203, 211(a), 100 Stat. 2121-2142, 2143-2146, 2166-2170, for property placed in service after December 31, 1985, in the case of the credit and after March 1, 1986, in the case of ACRS.

recovery period" (*ibid.*). The term "direct transportation" was defined as (*ibid.*):

> the transportation of property by the container with the United States as the origin or terminus of the trip for the container and the property. Thus, a container is not engaged in the direct transportation of property to or from the United States merely because it transports property from one foreign country to another foreign country.

The Ruling expressly applies to all tax years. It recognized, however, that taxpayers would sometimes lack adequate records to trace the usage of their cargo containers to establish whether they entered the United States during a particular year. The Commissioner therefore contemporaneously issued Revenue Procedure 90-10, 1990-1 C.B. 467, to allow taxpayers to elect to treat one half of the containers put in service in 1981 as qualified for the investment credit without any showing that the containers had in fact ever been present in the United States (Pet. App. 3a-4a).

c. Upon an audit of its tax returns for the years 1981 through 1985, petitioner could not document which of the containers had actually been used to transport property to and from the United States. Petitioner nonetheless declined to make an election under Revenue Procedure 90-10 to have half of the containers treated as qualified. The Internal Revenue Service therefore issued notices of deficiency disallowing the investment credits and accelerated depreciation deductions claimed by petitioner for 1981 through 1985 (Pet. App. 4a).

2. Petitioner sought review of the asserted deficiencies in the Tax Court. Petitioner contended that, although 26 U.S.C. 48(a)(2)(B)(v) (1982) authorized an

investment tax credit only for containers "used in the transportation of property to and from the United States," the word "used" in this statute should be understood to include property that is merely "available for use" in such transportation. Petitioner further contended that the Commissioner could not properly adopt an "actual use" test in 1990 and apply that test "retroactively" to prior years (Pet. App. 4a-5a).

The Tax Court disagreed with petitioner. The court interpreted the statutory phrase "used in the transportation of property to and from the United States" (26 U.S.C. 48(a)(2)(B)(v) (1982)) to mean that the containers must have "some minimum contact with the United States" (Pet. App. 58a). The court concluded that this standard was met if the containers were used in the United States "at least once" during the year placed in service and also (to avoid recapture of the resulting tax benefits) in each subsequent year (*id.* at 59a-60a).

The Tax Court concluded that the Commissioner did not abuse his discretion in applying Revenue Ruling 90-9 to the tax years involved in this case (Pet. App. 74a-78a). The court found "no evidence" that, after Revenue Ruling 90-9 was published, respondent "irrationally applied the ruling to some taxpayers but not to others" (*id.* at 75a). The court concluded that, even if the Commissioner had applied a different standard to other taxpayers or other years, the Commissioner may retroactively correct a mistake of law, at least absent an "unconscionable injury" (*id.* at 76a-77a), which did not exist in this case (*id.* at 78a).

The parties presented expert evidence at trial regarding the numbers of containers owned by Flexi-Van that were actually used in the United States. This evidence was based upon available leasing records for containers and on statistical analyses of world trade routes and container shipping (Pet. App. 4a-5a, 63a-70a). Based on this evidence, petitioner was allowed the tax benefits it sought for approximately 54 % of the containers that it purchased in 1981 (*id.* at 71a-74a).[3]

3. The court of appeals agreed with the Tax Court that a container must "touch" the United States at least once during the year to qualify for the credit. The court rejected petitioner's contention that a container that is actually used exclusively in foreign trade routes may nonetheless qualify for the credit if it is potentially "available for use" in the United States. Noting that, "[i]n the statute, 'used' is limited by the phrase 'in the transportation of property to and from the United States,'" the court of appeals concluded that "[t]he transportation of property to and from the United States thus provides the qualification as to the type of property for which the investment tax credit is available" (Pet. App. 8a). In the court's view, "[t]o interpret the statute to include property located anywhere in the world that is *available* for use in the transportation of property to and from the United States defeats that limitation" (*ibid.*).

The court of appeals also rejected petitioner's argument that it was an abuse of discretion for the Service to apply Revenue Ruling 90-9 retroactively to the 1981 tax year. The court reasoned that, "[w]hether or not the Commissioner has changed his position or regardless of what his interpretation had been the day before or several years before, the Commissioner must follow the law enacted by Congress and the regulations duly

[3] Petitioner no longer challenges the findings of the Tax Court as to the number of containers actually used by Flexi-Van in the United States.

promulgated under that law, and not his rulings should they depart from the law" (Pet. App. 14a). The court also noted that the container industry "was not surprised by the position reflected in Rev. Rul. 90-9," but, "[o]n the contrary, it provided input to the Commissioner as the Ruling was developed over a period of ten years" (*ibid.*). Not only was the interpretation of the container exception "open for question even before [petitioner] purchased the tax credits involved in this case," but "the basic principle of tax law—that the taxpayer has the burden of demonstrating its claim for tax credits * * *—was firmly established well before 1981" (*id.* at 15a).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. During the tax years in issue, 26 U.S.C. 38 provided an investment tax credit for qualifying tangible property used in a trade or business or held for the production of income and having a useful life of three years or more at the time the property was placed in service. This investment tax credit was intended "to encourage modernization and expansion of the Nation's productive facilities and thereby improve the economic potential of the country, with a resultant increase in job opportunities and betterment of our competitive position in the world economy." S. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962). The credit was also intended to "increase[] the relative attractiveness of investment at home compared with investment abroad." *Id.* at 12. In keeping with that purpose, the statute generally provided that the property to which the investment tax

credit applies "does not include property which is used predominantly outside the United States." 26 U.S.C. 48(a)(2)(A) (1982). The House and Senate reports emphasized that property used predominantly outside of the United States is generally ineligible for the credit "since the primary purpose of the credit is to encourage investment within the United States."[4] S. Rep. No. 1881, *supra*, at 17; H.R. Rep. No. 1447, 87th Cong., 2d Sess. 12 (1962).

Congress enacted a number of specific statutory exceptions to the requirement that property be used predominantly within the United States. The exception involved in this case—the "container exception"—extended the credit to "any container of a United States person which is used in the transportation of property to and from the United States." 26 U.S.C. 48(a)(2)(B)(v) (1982). The courts below concluded that a container is not "used in the transportation of property to and from the United States" within the meaning of this statute unless the United States is the origin or terminus of at least one trip of the container during the taxable year (Pet. App. 8a, 59a-60a).

This interpretation of the statute manifestly conforms to the common meaning of its terms. The ordinary meaning of the requirement that containers be "used in the transportation of property to and from the United States" (26 U.S.C. 48(a)(2)(B)(v) (1982)) is that

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[4] Treasury Regulations generally provided that property was considered to be used predominantly outside the United States within the meaning of Section 48(a)(2)(A) if it was physically located outside the United States more than one-half of any taxable year or more than one-half of the time from the date placed in service until the end of the year. 26 C.F.R. 1.48-1(g)(1)(i).

the container be actually used in transporting property to and from the United States.[5] Petitioner's alternative contention-–that the statute encompasses any property "available for use" in the United States—obviously robs the statute of meaning.[6] The plain object of the statute is to differentiate between uses of property that have sufficient contact with the United States to warrant enjoyment of the credit and those that do not. As the court of appeals correctly concluded, petitioner's construction "would mean that virtually every container" owned by a United States taxpayer—regardless of how used—would be eligible for the credit (Pet. App. 11a). As the court explained, "[s]uch a result would render the portion of § 48(a)(2)(B)(v) which reads 'in the transportation of property to and from the United

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[5] For the first time in this Court, petitioner argues that containers *not* used in this country nonetheless qualify under the "container exception" if their foreign use is sufficiently related to or "with respect to" commerce in the United States (Pet. 11, quoting *Dunn* v. *Commodity Futures Trading Comm'n*, 519 U.S. 465, 470 (1997)). The statutory term involved in *Dunn* ("transactions in foreign currency"), however, obviously differs in text and purpose from the statute involved in this case. In any event, because petitioner did not raise this contention in the courts below, it is not properly presented in this case. See, *e.g.*, *Lawn* v. *United States*, 355 U.S. 339, 362 n.16 (1958); *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 272 (1931).

[6] Petitioner erroneously relies (Pet. 4 nn. 3, 4) on a reference in committee reports under a different statute that related to a ban on deductions for the "actual use" of an entertainment "facility." H.R. Rep. No. 1447, *supra*, at 22. Petitioner does not address the fact that the statute involved in that situation—like the statute involved in this case—applies to the "use" of a facility (26 U.S.C. 274(a)(1)(B) (emphasis added)) without further specifying that an "actual" use must occur. In any event, the language, context and purpose of that other provision obviously differs from, and does not control the interpretation of, the statute involved in this case.

States' meaningless" (*ibid.*). Cf. *Bailey* v. *United States*, 513 U.S. 137, 146 (1995) (rejecting an expansive reading of firearm "use" during a crime under 18 U.S.C. 924(c)(1) because it would "undermine[ ] virtually any function" for the related statutory penalty for "carrying" such a weapon during the crime). [7]

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[7] As both courts below noted (Pet. App. 11a, 50a), the word "used" has no fixed meaning in the Internal Revenue Code. The courts therefore derived their understanding of the statute from its entire context and phrasing. Petitioner misplaces its reliance (Pet. 4 n.3) on other provisions of the Internal Revenue Code that, in different contexts, refer to some type of "actual use" of property. As the courts below correctly concluded, the statutory requirement that property be "used in * * * transportation" implies an "actual" use, not a mere "availability for use."

Petitioner errs in relying (Pet. 10-11 n.8) on *P. Dougherty Co.* v. *Commissioner*, 159 F.2d 269 (4th Cir. 1946), cert. denied, 311 U.S. 838 (1947); *Sears Oil Co.* v. *Commissioner*, 359 F.2d 191 (2d Cir. 1966), and *Kittredge* v. *Commissioner*, 88 F.2d 632 (2d Cir. 1937), for the proposition that the word "use" necessarily means only an availability for use rather than an actual use. These decisions do not purport to define the word "used" in every context; instead, they interpret statutory phrases such as "used in a trade or business" or "placed in service." See 26 U.S.C. 167. The phrase "used in the trade or business" has been defined as "equivalent to 'devoted to the trade or business'; that is to say, that property once used in the business remains in such use until it is shown to have been withdrawn from business purposes." *Kittredge* v. *Commissioner*, 88 F.2d at 634. Those decisions, however, are of no help to petitioner. There is no question that the containers involved in this case were devoted to the trade or business of Flexi-Van—whether or not they were used in the United States. In drafting the container exception, Congress did not authorize a tax credit for all containers used in a taxpayer's trade or business; instead, it authorized the credit only for such containers "used in the transportation of property to and from the United States" (26 U.S.C. 48(b)(2)(B)(v) (1982)).

b. Even if Section 48(a)(2)(B)(v) were ambiguous, consideration of the entire statutory scheme and its purposes, as reflected in the legislative history, fully supports the interpretation adopted by the courts below. *United Savings Ass'n of Texas* v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). Petitioners never come to grips with the fact that, in designing this investment tax credit scheme, Congress intended to "increase[] the relative attractiveness of investment at home compared with investment abroad." S. Rep. No. 1881, *supra*, at 12. A cargo container that is manufactured abroad, delivered to a foreign location and not used to ship property to or from the United States can hardly be considered "investment at home" that stimulates the Nation's economy. Although subsidizing any purchase of an asset by a United States taxpayer could improve that company's financial position, Congress plainly did not intend to provide subsidies for activities that did not stimulate "investment at home compared with investment abroad."

c. Petitioner incorrectly contends (Pet. 12 n.9) that this interpretation of the statute by the courts below creates an inconsistency with other statutory exceptions available under the investment tax credit. The exceptions to which petitioner refers concern other types of property used in transportation and shipping, including "any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States" (26 U.S.C. 48(a)(2)(B)(i) (1982)), "any motor vehicle of a United States person * * * which is operated to and from the United States" (26 U.S.C. 48(a)(2)(B)(iv) (1982)) and any "vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States" (26 U.S.C. 48(a)(2) (B)(iii) (1982)).

These related statutory provisions, however, clearly reflect that aircraft and motor vehicles, like containers, must also touch the United States to be eligible for the credit. Indeed, in describing the aircraft exception, the House Report states that "[t]he term 'to and from the United States' is not intended to exclude an aircraft which makes flights from one point in a foreign country to another such point, *as long as such aircraft returns to the United States with some degree of frequency*." H.R. Rep. No. 1447, *supra*, at A19 (emphasis added). The House Report also speaks of a frequency requirement for motor vehicles. *Id.* at A20. Indeed, as the Tax Court noted, petitioner ultimately acknowledged that there is "an actual use requirement for aircraft[] * * * and motor vehicles" (Pet. App. 56a).[8]

d. The decision of the courts below is firmly grounded in the text, history and purpose of the statute. No other court has reached a different conclusion. There is thus no conflict among the circuits to warrant review by this Court.

2. Petitioner errs in asserting (Pet. 15-20) that the Commissioner's ruling was improperly given "retroactive" effect. The Ruling merely interpreted the language of the statute. A ruling that does no more

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[8] As petitioner (Pet. 12 n.9) points out, the Commissioner has construed the different wording of the vessel exception to apply to United States flag vessels, whether or not they touch the United States. 26 C.F.R. 1.48-1(g)(2)(iii); Rev. Rul. 69-509, 1969-2 C.B. 3. The language of the statutory vessel exception refers to vessels documented under this country's laws that are "operated in the foreign or domestic commerce of the United States" (26 U.S.C. 48(a)(2)(B)(iii) (1982)). That text is plainly different from, and broader than, the container exception.

than interpret a statute "is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand." *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 135 (1936). In issuing an interpretive ruling, the Commissioner does no more than state his understanding of what the law has always meant. Although the agency's formal interpretation of the "container exception" was not issued until January 1990, any delay in action "by the Treasury can hardly operate as a controlling administrative practice, through acquiescence, tantamount to an estoppel." *Helvering* v. *Hallock*, 309 U.S. 106, 120-121 (1940). As this Court explained in *Dickman* v. *Commissioner*, 465 U.S. 330, 343 (1984), "[t]he Commissioner is under no duty to assert a particular position as soon as the statute authorizes such an interpretation." See also *Bob Jones University* v. *United States*, 461 U.S. 574 (1983).

In any event, the Commissioner's interpretation of the plain language of the container exception to require actual use within the United States hardly came as a surprise to the container industry. Respondent began developing a position on the container exception in 1980. The container leasing industry was well aware that the matter was under study from that time. Indeed, *amicus* IICL consulted with respondent several times in 1982 (Pet. App. 33a). Although the ruling project was not concluded in 1982, the issue resurfaced in 1984 and 1985 in connection with the audits of Reliance Holdings Group, Inc. (Reliance) and Flexi-Van. Those audits resulted in proposed adjustments, one of which is the subject of this suit (*id.* at 29a, 33a). Flexi-Van and Reliance protested the statutory interpretation of the examining agents, and the industry again marshaled forces to advocate its position (*id.* at 34a;

C.A. App. 1106-1212, 1219-1254, 1256-1489). The container leasing industry as a whole—and Flexi-Van in particular—was thus plainly on notice that the Service was likely to disagree with the industry's expansive reading of the container exception.

Moreover, even if the Commissioner's "actual use" requirement "represent[ed] a departure from prior administrative practice, * * * it is well established that the Commissioner may change an earlier interpretation of the law, even if such a change is made retroactive in effect." *Dickman* v. *Commissioner*, 465 U.S. at 343. See *Dixon* v. *United States*, 381 U.S. 68, 72-75 (1965); *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180, 183-184 (1957). The fact that the Commissioner remains free to correct a mistake of law even when a taxpayer has relied to his detriment on a prior administrative position "is no more than a reflection of the fact that Congress, not the Commissioner, prescribes the tax laws." *Dixon* v. *United States*, 381 U.S. at 73. [9]

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[9] As the court of appeals noted (Pet. App. 7a, 13a), it has always been incumbent upon taxpayers claiming the investment credit not only to satisfy the statutory prerequisites to eligibility, but to maintain records sufficient to prove that entitlement. 26 U.S.C. 6001; 26 C.F.R. 1.46-3(e)(6), 1.47-1(e)(1), 1.6001-1. Flexi-Van and petitioner chose to interpret the container exception self-servingly in a manner that failed to comport with their recordkeeping requirements. They never sought and never obtained any assurance that their recordkeeping failures would be immaterial to their quest for a statutory tax credit. Reliance requested technical advice (Pet. App. 34a), and that advice, Tech. Adv. Mem. 90-45-001 (May 3, 1990), was consistent with Ruling 90-9 (Pet. App. 75a). As the Tax Court noted (Pet. App. 75a), however, "there is no evidence that, after the issuance of Rev. Rul. 90-9, * * * respondent irrationally applied the ruling to some taxpayers but not to others."

Finally, given the fact that it was "firmly established" (Pet. App. 15a) by 1981 that a taxpayer bears the burden of substantiating the facts that are the basis for any tax credit claim, the court of appeals was correct in observing that "[i]t is exceptional that [petitioners] * * * could believe that they were entitled to claim such credits without maintaining sufficient records to prove them" (*ibid.*). The contention of petitioner that there is an element of harshness in requiring a taxpayer to provide evidentiary support for an asserted tax credit is thus entirely lacking in substance. Any such asserted harshness is mitigated in this context in any event by Revenue Procedure 90-10, *supra*, which permits taxpayers, without the necessity of tracing container movements, to elect to treat as eligible for the credit a specified percentage of their containers, based on the overall industry's United States container capacity of 50 %. 1990-1 C.B. at 468. This safe-harbor percentage was a reasonable accommodation of the factual difficulties in substantiating entitlement to the credit.

In any event, when pressed to develop the applicable facts, petitioner was able to assemble an evidentiary record that supported the findings of the courts below that approximately 54 % of the containers involved had been used in the United States. See page 6, *supra*. Petitioner thereby garnered a greater percentage of the total tax benefits that it claimed than it would have received under the safe harbor rule of the Revenue Procedure. Petitioner therefore lacks standing to challenge the safe harbor rule because it did not apply to the determination of its taxes.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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