

No. 10-1204

In the Supreme Court of the United States

AT&T INC., PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether payments made by the federal government and the governments of Texas, California, and Kansas to petitioner in 1998 and 1999 pursuant to universal service support programs for telecommunications carriers were excludable from petitioner's gross income under 26 U.S.C. 118(a) as contributions to capital.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-29a) is reported at 629 F.3d 505. The report and recommendation of the magistrate judge (Pet. App. 32a-44a) and the order of the district court adopting the magistrate judge's report and recommendation (Pet. App. 30a-31a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 4, 2011. The petition for a writ of certiorari was filed on April 4, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Internal Revenue Code, a taxpayer's gross income is broadly defined as "all income from whatever source derived." 26 U.S.C. 61. Section 118(a) of the Code, however, excludes from the gross income of a corporation "any contribution to the capital of the taxpayer." 26 U.S.C. 118(a). The exclusion for capital contributions applies to contributions made by a corporation's shareholders, and also to payments made by non-shareholders. 26 C.F.R. 1.118-1.

2. In 1998 and 1999, as part of "universal service" support programs for telecommunications carriers, petitioner received payments from the federal government and from the governments of Texas, California, and Kansas. The term "universal service" refers to the goal, first expressed in the Communications Act of 1934, of making telecommunications services available to all Americans, including those whom carriers otherwise would not service due to high costs. See 47 U.S.C. 151 (2006 & Supp. III 2009); *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 405-406 & n.2 (5th Cir. 1999).

Until 1996, the Federal Communications Commission (FCC) and state regulators promoted universal service largely through implicit subsidies that were designed to shift costs from rural to urban areas, from residential to business customers, and from local to long distance services. See *Texas Office of Pub. Util. Counsel*, 183 F.3d at 406. Because local telephone service generally was controlled by monopoly, local carriers could easily shift costs from one set of customers to another within the local markets they served, and implicit subsidies were

therefore effective in promoting universal service. See *Verizon Commc'ns Inc. v. FCC*, 535 U.S. 467, 480 (2002).

Congress enacted the Telecommunications Act of 1996 (1996 Act), Pub. L. No. 104-104, 110 Stat. 56, to open local telecommunications markets to competition. See *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999). To ensure that universal service would survive the introduction of local competition, see S. Rep. No. 23, 104th Cong., 1st Sess. 25 (1995) (1995 Senate Report); H.R. Rep. No. 204, 104th Cong., 1st Sess. 68 (1995), Congress directed the FCC to create “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.” 47 U.S.C. 254(b)(5). Congress further directed the FCC to convene a joint federal-state board to recommend changes to the universal service support system and to promulgate regulations to implement the board’s recommendations. 47 U.S.C. 254(a)(1) and (b). The resulting FCC Order on universal service created various programs through which eligible carriers can receive support. See *In re Federal-State Joint Bd. on Universal Serv.*, 12 F.C.C.R. 8776 (1997) (*FCC Universal Service Order*).

b. Petitioner received the payments at issue in this case pursuant to the high-cost loop support program and the low-income support program. The high-cost loop support program provides funding to carriers whose average cost per loop—*i.e.*, the physical wire that connects a caller to the carrier’s central switching station—exceeds the nationwide average. Under the program, a carrier would be reimbursed for 65% of its loop costs that were between 115% and 150% of the national average, and 75% of its loop costs in excess of 150% of the national average. 47 C.F.R. 36.631(c) (1998).

The low-income support program provides funding to carriers that service low-income customers at reduced charges. Eligible carriers receive universal service support payments for each qualifying low-income customer served, 47 C.F.R. 54.407(b), and the entire support must be passed on directly to the customer in the form of a discount on the total amount due, 47 C.F.R. 54.401(a). Eligible carriers must also reduce their customary charge for commencing telecommunications service and offer a deferred payment schedule for such charges with no interest to qualifying low-income customers. 47 C.F.R. 54.411(a). Carriers receive reimbursement equal to “the difference between the carrier’s customary connection or interest charges and the charges actually assessed to the participating low-income consumer.” 47 C.F.R. 54.413(b).

The 1996 Act authorizes the States to develop their own universal service support systems, provided that such systems are not inconsistent with the federal program. See 47 U.S.C. 254(f). Pursuant to that authority, Texas, California, and Kansas adopted universal service regulations that closely parallel those of the federal system. Gov’t C.A. Br. 15-23.

c. Universal service support payments are funded through mandatory contributions from telecommunications carriers that provide interstate services. 47 U.S.C. 254(d). The contributing carriers are authorized to recover their contributions from their customers, and most carriers do so. See 1995 Senate Report at 27-28; *FCC Universal Service Order*, 12 F.C.C.R. at 8845-8846, 9171 (paras. 125, 773). Those contributions are paid to “eligible telecommunications carrier[s],” who must “use that support only for the provision, maintenance, and up-

grading of facilities and services for which the support is intended.” 47 U.S.C. 254(e).

3. Petitioner received universal service support payments totaling \$723.5 million in 1998 and \$831.3 million in 1999.¹ In accordance with FCC accounting rules, petitioner recorded the payments as “revenue” for financial and regulatory accounting purposes. Pet. App. 28a. Petitioner deposited the payments into its general bank account, into which other customer revenues were deposited and from which operating expenses and other costs were paid. *Ibid.* On its 1998 and 1999 federal income tax returns, however, petitioner did not include the universal service support payments in its gross income. *Id.* at 34a.

The Internal Revenue Service (IRS) determined deficiencies in petitioner’s tax resulting from petitioner’s failure to report the universal service support payments as income. Petitioner paid the deficiencies and filed administrative refund claims, arguing that the payments were nonshareholder capital contributions that are excluded from gross income under 26 U.S.C. 118(a). The IRS denied petitioner’s refund claim, and petitioner filed this suit in federal district court, seeking a refund of more than \$500 million in income tax. Pet. App. 34a.

4. A magistrate judge recommended that summary judgment be granted for the government. Pet. App. 32a-44a. The magistrate judge explained that the deter-

¹ Petitioner received a substantial portion of those payments from the Texas, California, and Kansas programs. See Gov. C.A. Br. 18, 22, 23. In arguing that the support payments were nonshareholder capital contributions under 26 U.S.C. 118(a), petitioner has drawn no distinction (either in the court of appeals or in the petition for a writ of certiorari) between the state and federal payments.

mination whether the payments are capital contributions depends on whether the government intended (a) to subsidize petitioner for revenue that it would otherwise lose by providing service to high-cost and low-income customers, or (b) to enlarge petitioner's capital structure. *Id.* at 36a.

The magistrate judge concluded that the payments were intended to compensate petitioner for lost revenue and therefore were not contributions to capital. Pet. App. 38a-40a. With respect to high-cost support payments, the magistrate judge explained that the payments are "based upon the number of lines in high cost areas multiplied by the amount the cost of the service for these lines exceeds certain national cost benchmarks." *Id.* at 39a (internal quotation marks and citations omitted). The magistrate judge concluded that this formula "reflects an intent to subsidize carriers for lost revenue." *Id.* at 40a. While acknowledging that capital improvements would often be necessary to provide telecommunications service to high-cost areas, and that "the cost of capital improvements undoubtedly affects the amount a carrier claims," *id.* at 39a, the magistrate judge explained that "the cost of capital improvements is not part of the calculation of * * * universal support payments," *id.* at 38a.

With respect to the low-income support payments, the magistrate judge explained that the payments were based on the number of low-income customers receiving discounted service, multiplied by the amount of the discount per customer. Pet. App. 41a. The magistrate judge concluded that "[n]othing in the payment structure for low-income programs implicates capital contributions." *Id.* at 42a.

The district court adopted the magistrate judge's report and recommendation and granted summary judgment for the government. Pet. App. 30a-31a.

5. The court of appeals affirmed. Pet. App. 1a-29a. The court reviewed this Court's decisions interpreting the term "contribution to capital" and derived several principles from those cases. *Id.* at 12a-15a. First, the court stated that the determination whether a non-shareholder payment to a corporation is a capital contribution "is controlled by the intention or motive of the transferor." *Id.* at 15a. Second, the court explained that "[w]hen the transferor is a governmental entity, its intent may be manifested by the laws or regulations that authorize and effectuate its payment to the corporation." *Id.* at 15a-16a. Third, the court stated that a payment is not a capital contribution "if it does not possess each of the first four, and ordinarily the fifth, characteristics of capital contributions" set forth in this Court's decision in *United States v. Chicago, Burlington & Quincy R.R.*, 412 U.S. 401 (1973) (*CB&Q*). Pet. App. 16a.²

The court of appeals concluded that "either by construing the controlling statutes and regulations or by applying the *CB&Q* five-factor test, the governmental

² In *CB&Q*, the Court "distill[ed] from [its prior] cases some of the characteristics of a nonshareholder contribution to capital": (1) the payment "must become a permanent part of the transferee's working capital structure"; (2) the payment "may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee"; (3) the payment "must be bargained for"; (4) "[t]he asset transferred foreseeably must result in benefit to the transferee in an amount commensurate with its value"; and (5) "the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect." 412 U.S. at 413.

entities * * * did not intend to make capital contributions to [petitioner].” Pet. App. 16a. The court stated that it “need not pause to determine whether one method of determining the intention or motive of the transferor is more appropriate than the other” because “[b]y alternately bringing each method to bear on this case, we reach the same result.” *Ibid.*

a. In applying those alternative modes of analysis, the court of appeals first considered the “statutes authorizing the [universal service support] payments, the administrative orders implementing those statutes, and the resulting regulations,” and concluded that the payments were intended to supplement petitioner’s gross income. Pet. App. 16a. The court observed that the 1996 Act, the *FCC Universal Service Order*, and the pertinent regulations all emphasized the need for high-cost and low-income customers to receive “‘comparable’ telephone services at ‘affordable rates.’” *Id.* at 17a. The court further explained that the support payments at issue here were “intended to compensate the telecommunications companies for the difference between the costs of providing service to high-cost and low-income customers and what those customers can afford to pay.” *Ibid.*

Based on that statutory and regulatory framework, which evinced an overarching intent to “assur[e] [petitioner] of competitive rates of income” for providing services to high-cost and low-income customers, the court of appeals concluded that the payments “were clearly intended to be income for [petitioner] and not capital contributions.” Pet. App. 20a. The court found further support for that conclusion in the 1996 Act, which provides that universal service support payments “can be

used for the payment of a wide variety of expenses, with the only condition being that the funds go toward costs that fit within the infinitely broad category of payments ‘for the provision, maintenance, and upgrading of facilities and services for which the support is intended.’” *Id.* at 23a (quoting 47 U.S.C. 254(e)). Because the state programs undisputedly were “consistent with and analogous to” the federal universal service support program, the court of appeals likewise concluded that the payments petitioner received from Texas, Kansas, and California should have been included in petitioner’s gross income. *Id.* at 20a-22a.

b. The court of appeals also analyzed the five characteristics of capital contributions set forth in *CB&Q*, and it concluded that the universal service support payments “fail to satisfy three of the four mandatory characteristics, showing that they were not capital contributions.” Pet. App. 24a. The court acknowledged that petitioner had engaged in “lobbying and advocacy” in an effort to influence the development of the federal and state universal support programs. *Ibid.* The court concluded, however, that petitioner did not “bargain[] for” the payments because the support programs ultimately were “unilaterally imposed by law upon [petitioner] and other carriers.” *Ibid.*

The court of appeals further held that the universal service support payments were compensation to petitioner for providing specific services. Pet. App. 25a-28a. The court relied in part on *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943), in which a public utility agreed to expand services if potential customers “pa[id] the estimated cost of the necessary construction,” *id.* at 99, and this Court concluded that the payments were not

capital contributions because they “were to the customer the price of the service,” *id.* at 102-103. The court of appeals concluded that petitioner’s universal service support payments were similar to the payments in *Detroit Edison* because they “are in effect a vehicle or conduit by which the telecommunications carriers are compensated for the specific, quantifiable services that they provide directly to high-cost and lower-income customers and for the universal, system-wide service they provide in making those customers accessible to other consumers in the system.” Pet. App. 28a.

Finally, the court of appeals concluded that the payments had not become a permanent part of petitioner’s working capital structure. Pet. App. 28a-29a. The court explained that the payments “did not provide money exclusively for the specific purpose of making capital improvements, such as building an airport or locating and constructing a plant,” *ibid.*, but instead were “supplemental income * * * to provide the telephone companies an enhanced return on their investment,” *id.* at 29a. The court concluded that because petitioner had “failed to demonstrate that the [universal support] payments had more than one or two of the essential characteristics of a capital contribution instead of four or more as prescribed by *CB&Q*,” petitioner was not entitled to treat the payments as capital contributions. *Ibid.*

ARGUMENT

Petitioner contends (Pet. 18-28) that the payments it received in 1998 and 1999 from federal and state universal service support programs were contributions to capital that were excludable from petitioner’s gross income under 26 U.S.C. 118(a). The court of appeals correctly

rejected that argument, and its decision does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. a. In *United States v. Chicago, Burlington & Quincy R.R.*, 412 U.S. 401 (1973) (*CB&Q*), this Court stated that a payment's status as a capital contribution depends on "the intent or motive of the transferor." *Id.* at 411. The Court identified as "indicia of the transferor's intent or motive" "the nature of the benefit to the transferor, rather than to the transferee, and * * * whether that benefit was direct or indirect, specific or general, certain or speculative." *Ibid.*

The court of appeals correctly concluded that the support payments at issue in this case were intended to supplement petitioner's income. As the court explained, the 1996 Act, the *FCC Universal Service Order*, and the pertinent regulations indicate that the payments are calculated to "compensate the telecommunications companies for the difference between the costs of providing service to high-cost and low-income customers and what those customers can afford to pay." Pet. App. 17a. The relevant support programs "do not require carriers to show that universal service funds are used on capital improvements"; rather, "claims and payments are based on the cost of providing service and revenue lost providing service." *Id.* at 40a. That is especially true for the low-income support payments, which subsidize the provision of services that would not typically require new capital expenditures. See *id.* at 41a-42a.

The court of appeals' ruling accords with the decision of the Eleventh Circuit in *United States v. Coastal Utilities, Inc.*, 514 F.3d 1184 (2008), *aff'g* and adopting 483 F. Supp. 2d 1232 (S.D. Ga. 2007), in which the court held

that payments made pursuant to the federal high-cost support program and a similar Georgia program were not capital contributions. The court explained that although the payment amounts “were largely based on investment expenditures,” the calculations also reflected “operational, maintenance, administrative, and other expenses that are unrelated to capital.” *Coastal Utils.*, 483 F. Supp. 2d at 1242. The court concluded that “the broad range of costs and expenses that are tied into the calculation of the universal support payments shows that the subsidies are more properly considered as supplements to general revenue and not as specific capital contributions.” *Ibid.* The district court for the District of Kansas has likewise concluded that payments received from the federal high-cost support program are not contributions to capital. *Sprint Nextel Corp. v. United States*, No. 09-2325-KHV/JPO, 2011 WL 836738, at *12 (D. Kan. Mar. 4, 2011) (explaining that universal service support payments “are measured by a variety of expenses” and do not have the characteristics of capital contributions identified in *CB&Q*).

b. Petitioner contends (Pet. 21) that the court of appeals’ decision is inconsistent with this Court’s analysis in *CB&Q*, under which a payment’s status as a capital contribution depends on the benefit to the transferor. In petitioner’s view (*ibid.*), that factor indicates that universal service payments are capital contributions because the purpose of those programs is to create a general, indirect benefit to the public rather than a specific benefit to the government. As the court explained in *Coastal Utilities*, that argument “misreads the distinction made by the case law.” 483 F. Supp. 2d at 1245.

If a payment is made in exchange for specific goods and services, that payment is income and not a capital contribution. *Detroit Edison Co. v. Commissioner*, 319 U.S. 98, 102-103 (1943). It does not follow, however, that every government payment intended to produce a general public benefit is a capital contribution. That is “one of the key insights of *CB&Q*,” *Coastal Utils.*, 483 F. Supp. 2d at 1245, in which the Court *declined* to treat as capital contributions facilities provided by the government “primarily for the benefit of the public to improve safety and to expedite highway traffic flow.” *CB&Q*, 412 U.S. at 414. The Court explained that “[a]lthough the assets were not payments for specific, quantifiable services performed by *CB&Q* for the Government as a customer, other characteristics of the transaction lead us to the conclusion that, despite this, the assets did not qualify as contributions to capital.” *Id.* at 413-414. Petitioner’s approach, which would “make virtually all government subsidies contributions to capital, except where the government received specific goods and services in return for the payments,” *Coastal Utils.*, 483 F. Supp. 2d at 1245-1246, is also inconsistent with the fundamental rule that exclusions from income are to be narrowly construed. See *Commissioner v. Schleier*, 515 U.S. 323, 328 (1995).

Petitioner further contends (Pet. 21-22) that the court of appeals’ decision conflicts with *Edwards v. Cuba R.R.*, 268 U.S. 628 (1925), and *Brown Shoe Co. v. Commissioner*, 339 U.S. 583 (1950), cases in which this Court found that the payments at issue were capital contributions. Petitioner argues (Pet. 22) that, if the payments in this case were income because they “supplement[ed] [petitioner’s] revenue,” then the payments in *Edwards*,

268 U.S. at 630-631 (subsidies to promote construction of railroad) and *Brown Shoe*, 339 U.S. at 584 (payments by community groups to expand factory operations into community) also should have been treated as income rather than capital contributions because those payments likewise supplemented the taxpayers' revenues. Petitioner's argument reflects a misunderstanding of the court of appeals' opinion.

The court of appeals did not hold that every payment that supplements the taxpayer's revenue is income rather than a capital contribution. Rather, its decision was based on the specific ways in which the high-cost and low-income support payments were calculated, and the range of expenses for which the funds could be used. Pet. App. 16a-23a. Although the payments in *Edwards* and *Brown Shoe* increased the taxpayer's revenue, other characteristics of the payments showed that they were intended to be contributions to capital. In *Edwards*, the entire amount of the subsidies was dedicated to railroad construction, and "the subsidy payments were proportionate to mileage completed," which "indicate[d] a purpose to reimburse plaintiff for capital expenditures." 268 U.S. at 631-632. In *Brown Shoe*, the payments were not directed toward specific goods or service but were instead intended to encourage the expansion of the company into the community, which "manifested a definite purpose to enlarge the working capital of the company." 339 U.S. at 591. The court of appeals' decision in this case, which was based on the specific characteristics of universal service support payments, is consistent with those decisions.

c. Petitioner criticizes the court of appeals (Pet. 20) for "questioning" whether *CB&Q* supplies the principles

to conduct the capital contribution inquiry. But this Court did not hold in *CB&Q* that the five characteristics it identified were the exclusive criteria for determining whether particular payments are capital contributions. Rather, the court stated that the characteristics it described were “*some* of the characteristics of a nonshareholder contribution to capital.” *CB&Q*, 412 U.S. at 413 (emphasis added). The court of appeals appropriately examined, in addition to the *CB&Q* factors, the nature and method of computing the universal service support payments and the various expenses for which the payments could be used. As the court of appeals explained (Pet. App. 22a-23a), that is precisely the analysis this Court applied in *Texas & Pacific Ry. v. United States*, 286 U.S. 285 (1932), in concluding that government subsidies designed to guarantee a minimum level of operating income were not capital contributions.

Petitioner contends (Pet. 27-28) that this Court’s review is warranted because the court of appeals “refus[ed] to settle on a single standard” to determine whether the payments at issue here were capital contributions. That argument is misconceived. The court of appeals examined the universal service payments under two alternative analytic frameworks, first “by construing the controlling statutes and regulations” and then “by applying the *CB&Q* five-factor test.” Pet. App. 16a. The court found it unnecessary to choose between those approaches because it “reach[ed] the same result in both applications.” *Ibid.* Far from providing a reason for this Court to grant review, the court of appeals’ recognition that the choice between those approaches would not affect the ultimate outcome makes this case a particularly unsuitable vehicle for clarifying the manner in

which capital contributions should be identified. See *Black v. Cutter Labs.*, 351 U.S. 292, 297 (1956) (“This Court * * * reviews judgments, not statements in opinions.”).

2. Petitioner further contends (Pet. 23-28) that the court of appeals misapplied the *CB&Q* factors in determining that the universal service support payments were not contributions to capital. That factbound argument does not warrant this Court’s review, and the court of appeals correctly analyzed the *CB&Q* factors in any event.

a. Petitioner contends (Pet. 10-11, 23-24) that it “bargained for” the universal service support payments, see *CB&Q*, 412 U.S. at 413, by participating in the development of the programs. But Congress and the FCC ultimately established the criteria for receiving universal service support payments, and telecommunications carriers could receive payments only if they adhered to those governmentally imposed terms. Carriers cannot alter the terms of eligibility, the mechanisms for determining payments, or any other feature of the program. Thus, as the court of appeals correctly concluded (Pet. App. 24a-25a), universal service support payments are not the result of bargaining between the government and telecommunications carriers.

Petitioner argues (Pet. 23-24) that the court of appeals’ interpretation of “bargaining” would prevent “any payment made pursuant to any statute or regulation” from being characterized as a capital contribution. That is incorrect. Congress can certainly enact statutes that allow parties to negotiate the terms of payments made from appropriated government funds. The laws that

established the universal support programs at issue here, however, did not authorize such negotiations.

b. Petitioner further contends (Pet. 24-26) that for a payment to be compensation for a specific service, which would indicate that the payment is income and not a capital contribution, see *CB&Q*, 412 U.S. at 413, the benefit of the service must be provided directly to the transferor. That is incorrect. The applicable Treasury regulation states that “the exclusion [for capital contributions] does not apply to any money or property transferred to the corporation in consideration for goods or services rendered,” 26 C.F.R. 1.118-1, without specifying who must be the beneficiary of the goods or services. And the Court in *CB&Q* did not hold that the benefit of a specific service provided by the transferee must inure directly to the transferor; it stated that a contribution to capital “may not be compensation, *such as* a direct payment for a specific, quantifiable service provided for the transferor by the transferee.” 412 U.S. at 413 (emphasis added); see *Deason v. Commissioner*, 35 T.C.M. (CCH) 978 (1976), *aff’d*, 590 F.2d 1377 (5th Cir. 1979) (payments from Department of Labor to corporation that provided job training were compensation for services, notwithstanding that services were provided to individual trainees and not to Department of Labor).

The relevant “indicia of the transferor’s intent or motive” in this case are “whether th[e] benefit was direct or indirect, specific or general, certain or speculative.” *CB&Q*, 412 U.S. at 411. The court of appeals correctly concluded that the payments petitioner received were direct compensation for the service of providing telecommunications services to high-cost and low-income customers at below-market rates. Pet. App. 25a-

28a. That the payments for providing those benefits to customers were made by someone other than the direct beneficiaries does not alter the support payments' character as compensation for specific services.

c. Petitioner further contends (Pet. 26-28) that the court of appeals, in concluding that the universal service payments did not become a permanent part of petitioner's working capital structure, see *CB&Q*, 412 U.S. at 413, "impose[d] an earmarking requirement that is not in the statute and is directly foreclosed by this Court's precedent." But even assuming that "earmarking" is not an essential characteristic of a capital contribution, petitioner offers no alternative basis for concluding that the support payments at issue here *did* become a permanent part of its working capital structure. Petitioner identifies sound bites of legislative history (Pet. 7-8) reflecting Congress's recognition that universal service would require buildout of telecommunications infrastructure. But the undisputed facts in this case established that petitioner deposited the support payments into its general bank account, into which other customer fees were deposited and from which a wide variety of expenses were paid, and that the payments were not directed toward particular projects or spent only on infrastructure development. Pet. App. 28a. Petitioner would be especially hard-pressed to show that payments made pursuant to the low-income support program, which must be passed directly to the customer in the form of a discount, 47 C.F.R. 54.411(a), became a part of petitioner's permanent capital structure.

3. As petitioner observes (Pet. 29-31 & n.16), the IRS has indicated through revenue procedures that it will allow payments made under several federal grant

programs to be treated as capital contributions.³ Those grant programs, however, differ significantly from the universal service support program. For example, payments made pursuant to the Smart Grid Investment Matching Program (Pet. 29-30) may be used only for capital investments and not for ongoing or routine operating and maintenance expenditures. 42 U.S.C. 17386 (Supp. III 2009). The IRS determined on that basis that it would not challenge a taxpayer's characterization of such grants as contributions to capital. See Rev. Proc. 10-20, §§ 2-4, 2010-14 I.R.B. 528. Similarly, in a revenue procedure that expressly excludes payments made pursuant to the universal service support program, the IRS has indicated that it will treat grants for specific types of broadband infrastructure projects as capital contributions. Rev. Proc. 10-34, 2010-41 I.R.B. 426. Unlike universal service support payments, these grants are limited to capital expenditures and exclude any other administrative or program expenses. See Rev. Proc. 10-20, § 2, 2010-14 I.R.B. at 528; Rev. Proc. 10-34, § 2, 2010-41 I.R.B. at 427.

In contrast, the IRS consistently has taken the position that payments received by a corporation under the federal universal service support program are not contributions to capital under Section 118(a), because the government's motivation for providing the payments is "to compensate the carriers for the shortfall in operat-

³ Revenue procedures are not agency rulings. See 26 C.F.R. 601.601(d)(2)(i)(b). The revenue procedures cited by petitioner merely describe, as a matter of administrative convenience, the conditions under which the IRS will not challenge the recipient's allocation of grant payments between capital and non-capital for specific grant programs.

ing income for providing services at a discount to certain customers and/or providing services to customers in high cost areas at below cost rates.” Rev. Rul. 07-31, 2007-1 C.B. 1275, 1276. That ruling, which remains in effect, is entirely in accord with the court of appeals’ decision and the Eleventh Circuit’s decision in *Coastal Utilities*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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