No. 18-1177

In the Supreme Court of the United States

BRADFORD G. PETERS, AS EXECUTOR OF THE ESTATE OF ANDREW J. MCKELVEY, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Under the Internal Revenue Code, gain or loss on a capital asset generally is recognized when the asset is sold or otherwise disposed of. See 26 U.S.C. 1001. Section 1259 of the Code additionally requires taxpayers to recognize gain on a "*constructive* sale of an appreciated financial position * * * as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale." 26 U.S.C. 1259(a)(1) (emphasis added). A "constructive sale" includes, *inter alia*, a "forward contract," defined as "a contract to deliver a substantially fixed amount of property (including cash) for a substantially fixed price." 26 U.S.C. 1259(c)(1)(C) and (d)(1). Section 1259 also provides that "[t]he Secretary [of the Treasury] shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of [Section 1259]." 26 U.S.C. 1259(f). The Secretary has not promulgated regulations interpreting the term "substantially fixed."

In this case, the court of appeals upheld the Commissioner's determination that the taxpayer had made a constructive sale of stock by agreeing to accept a fixed sum of money up front in exchange for delivering on specified future dates a number of shares determined by a formula based on the share price. The court concluded that the amount of property to be delivered was "substantially fixed," 26 U.S.C. 1259(d)(1), because uncontested evidence showed a greater than 85% probability that delivery of a particular number of shares would be required. The question presented is as follows:

Whether the absence of regulations promulgated by the Secretary construing the statutory term "substantially fixed" precluded the court of appeals from interpreting that term and upholding the Commissioner's determination that a constructive sale had occurred.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-32a) is reported at 906 F.3d 26. The opinion of the Tax Court (Pet. App. 36a-68a) is reported at 148 T.C. 312.

JURISDICTION

The judgment of the court of appeals was entered on September 26, 2018. A petition for rehearing was denied on December 10, 2018 (Pet. App. 71a-72a). The petition for a writ of certiorari was filed on March 8, 2019. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In general, under the Internal Revenue Code, gain or loss on a capital asset is recognized—and therefore taken into account for tax purposes—when the asset is sold or otherwise disposed of. See generally 26 U.S.C.

1001; see S. Rep. No. 33, 105th Cong., 1st Sess. 122 (1997) (Senate Report) (Pet. App. 81a). In the 1990s, Congress became concerned that this general rule had led to the development of tax-avoidance mechanisms that provided taxpayers the benefits of selling appreciated assets without effecting a taxable sale or other disposition. See Senate Report 123 (Pet. App. 83a-84a).

In 1997, to address that concern, Congress enacted Section 1259 of the Code, which requires taxpayers to recognize gain on a "*constructive* sale of an appreciated financial position." Taxpayer Relief Act of 1997, Pub. L. No. 105-34, Tit. X, § 1001(a), 111 Stat. 903-906 (26 U.S.C. 1259) (emphasis added); see Senate Report 123-127 (Pet. App. 84a-93a). Under Section 1259, a taxpayer who makes a constructive sale of an appreciated financial position "shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale." 26 U.S.C. 1259(a)(1).[1]

With exceptions that are not implicated here, Section 1259 states that "[a] taxpayer shall be treated as having made a constructive sale of an appreciated financial position" in stock or certain other property if the taxpayer enters into one of several specified types of transactions with respect to "the same or substantially identical property." 26 U.S.C. 1259(c)(1). One type of transaction that Section 1259 identifies as a "constructive sale" is a "forward contract," which the provision defines

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[1] To avoid double taxation, Section 1259(a)(2) provides that "for purposes of applying [the Internal Revenue Code] for periods after the constructive sale * * * proper adjustment shall be made in the amount of any gain or loss subsequently realized with respect to such position for any gain taken into account by reason of [the constructive sale]." 26 U.S.C. 1259(a)(2).

as "a contract to deliver a substantially fixed amount of property (including cash) for a substantially fixed price." 26 U.S.C. 1259(c)(1)(C) and (d)(1). Thus, a taxpayer who enters into a contract to deliver a "substantially fixed amount" of appreciated stock for a "substantially fixed price" has constructively sold that appreciated stock and must "recognize gain as if [it] were sold * * * at its fair market value on [that] date," even though the taxpayer has not yet actually delivered the stock. 26 U.S.C. 1259(a)(1) and (d)(1).

In addition to its substantive provisions, Section 1259 also confers rulemaking authority on the Secretary of the Treasury. Section 1259(c)(1)(E) authorizes the Secretary to promulgate regulations to treat as "constructive sale[s]" "other transactions * * * that have substantially the same effect" as the types of constructive sale enumerated in the statute. 26 U.S.C. 1259(c)(1)(E). And Section 1259(f) grants the Secretary general authority to adopt implementing regulations, stating that "[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section." 26 U.S.C. 1259(f). To date, Treasury has not exercised its rulemaking authority under either of these provisions.

2. This case concerns the application of Section 1259 to a "variable prepaid forward contract" (VPFC), an uncommon and complex financial instrument.

a. A VPFC is an agreement through which a "short" party promises to deliver to a "long" party a variable amount of property on a future date in exchange for cash up front. Pet. App. 2a. In a typical VPFC, the short party holds a large quantity of low-basis, appreciated stock, and the long party is an investment bank. *Ibid.* The long party agrees to pay the shareholder a

substantial sum of money up front, in exchange for the shareholder's agreement to deliver on a specified future settlement date a number of shares of stock determined by a formula based on the share price on a specified valuation date. *Id.* at 2a-3a. "A VPFC usually sets a floor price and a cap price that limit the number of shares to be delivered in the event that the share price on the valuation date is below the floor price, above the cap price, or between them." *Id.* at 3a. The shareholder secures its obligation with the maximum number of shares that it may be required to deliver at settlement under the formula. *Ibid.*

Ordinarily, entering into a VPFC does not trigger an immediate constructive sale of the shareholder's underlying stock under Section 1259 because, by design, the number of shares to be delivered is variable and not "substantially fixed." 26 U.S.C. 1259(d)(1). Instead, VPFCs are generally treated as "open" transactions on which the shareholder, even though already in receipt of the proceeds of the future sale, recognizes no gain or loss until settlement, when the required number of shares (based on the stock price on the valuation date) is known and delivered. See Rev. Rul. 03-7, 2003-1 C.B. 363, 365 (holding that a VPFC calling for delivery in three years of a variable amount of stock was not a contract to deliver a "substantially fixed" amount of property and therefore did not cause a constructive sale).

b. The taxpayer in this case is the late Andrew J. McKelvey, who died in November 2008. Petitioner is the executor of McKelvey's estate. McKelvey was the founder and principal shareholder of Monster Worldwide, Inc., a publicly traded company that maintains the job-search website monster.com, and he held millions of shares of Monster stock. In September 2007, McKelvey

entered into two VPFCs with two different investment banks, Bank of America, N.A., and Morgan Stanley & Co. International plc. Pet. App. 4a-5a, 8a-9a; Pet. ii.

Under the two VPFCs together, the banks agreed to pay McKelvey cash totaling approximately $194 million in September 2007.[2] Pet. App. 11a. In exchange, McKelvey agreed to deliver to the banks a year later (on specified dates in September 2008) shares of Monster stock. *Id.* at 5a, 8a, 11a-12a. The aggregate number of shares to be delivered would be between approximately 5.4 million and 6.5 million shares, with the precise number to be determined by a formula set forth in each contract based on the share price on specified future valuation dates. *Ibid.* If the share price on the valuation dates was below a "floor price" specified in each contract —slightly less than $31 per share—McKelvey would be required to deliver the maximum number of shares (approximately 6.5 million). *Id.* at 5a-6a, 9a. Delivery of a lower number of shares would be sufficient to fulfill McKelvey's obligations under the VPFCs only if the share price exceeded the floor price. *Ibid.* McKelvey also retained the option to deliver at settlement the cash equivalent of the number of shares owed under the formula. *Ibid.* McKelvey secured his delivery obligation by pledging the maximum number (6.5 million) of shares. *Id.* at 11a-12a.

When the original contracts were executed in September 2007, the price of Monster stock was approximately $33 per share—making the aggregate value of

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[2] The two VPFCs were separate, and their terms were not identical, see Pet. App. 5a-10a, but the differences between them are not material to the issue presented in the petition for a writ of certiorari. For simplicity, we discuss the two VPFCs collectively and aggregate the amounts of dollars and shares involved.

the maximum number of shares to be delivered under the two contracts approximately $218 million. Pet. App. 11a & n.8. According to the Commissioner's expert, Dr. Hendrik Bessembinder, the probability that the price of Monster stock would still exceed the floor price on the valuation dates in September 2008 was approximately 53%. *Id.* at 22a-23a, 27a. To calculate that probability, Dr. Bessembinder applied the "widely accepted Black-Scholes probability formula." *Id.* at 27a. That formula—which is "'perhaps the world's most well-known options pricing model,'" and for which its creators won the 1997 Nobel Prize in Economics—can "be used to determine the probability that a stock will reach a certain price by a certain date." *Id.* at 22a & n.16 (citation omitted).

Between September 2007 and July 2008, however, the price of Monster stock fell precipitously to approximately $18 per share, slightly more than half of the floor price. Pet. App. 8a, 10a, 28a. As far as the VPFCs were concerned, this was a favorable development for McKelvey. If the stock price did not recover and rise above the floor price in the two months remaining before the valuation dates, McKelvey would be required to deliver all 6.5 million shares, but those shares would be worth only approximately $114 million—roughly $80 million less than the amount of cash ($194 million) he had already received from the banks. *Id.* at 10a. If settlement of the VPFCs had occurred as scheduled, McKelvey would "have realized a substantial capital gain." *Ibid.*

Rather than accept that outcome, McKelvey paid the banks more than $11.6 million to amend the contracts by extending the valuation and settlement dates, from the original dates in September 2008 to new dates in January and February 2010. Pet. App. 8a, 10a, 12a. All

of the other terms and conditions of the original contracts remained the same. *Ibid.* When the amended contracts were executed in July 2008, the price of Monster stock had fallen so far below the floor price (or was "'deep in the money,' in stock-market parlance") that, according to Dr. Bessembinder's analysis, the probability that the stock price would recover and exceed the floor price on the newly extended valuation dates was less than 15%. *Id.* at 21a-23a. Thus, in contrast to the original VPFCs—for which the odds were slightly better than even (approximately 53%) that McKelvey would be required to deliver fewer than the maximum number of shares (approximately 6.5 million)—under the amended contracts Dr. Bessembinder calculated a greater than 85% probability that McKelvey would be required to deliver the maximum number of shares. *Id.* at 23a. In the proceedings below, petitioner "presented no evidence to challenge any of Dr. Bessembinder's data or calculations." *Id.* at 29a.

2. a. On November 27, 2008, approximately four months after executing the amended contracts and more than a year before the new settlement dates, McKelvey died. Pet. App. 4a. In 2009, McKelvey's estate settled the contracts early by delivering to the banks approximately 6.5 million shares, which were then worth approximately $88 million. *Id.* at 11a-12a. Thus, over the entire life of the contracts, McKelvey had netted more than $182 million in cash ($194 million originally received less $11.6 million paid to extend the contracts), in exchange for which his estate delivered shares that were worth approximately $88 million at the time of delivery. See *ibid.*

Neither McKelvey nor his estate, however, paid income taxes with respect to the transactions. Pet. App.

12a. McKelvey's 2008 income-tax return, filed by the estate, reported no income attributable to the execution of the amended contracts. *Id.* at 12a-13a. The estate took the position that, although the amended contracts had extended the settlement and valuation dates, they had not resulted in a taxable exchange of old contracts for new ones, but had merely continued the open transactions under the original contracts, and that no capital gain could be recognized on those original contracts until settlement occurred (which was after McKelvey's death). *Id.* at 12a. Nor was any income tax paid in 2009, when the shares were delivered to the banks to settle the contracts. By reason of McKelvey's death, those shares (which had passed to the estate) had a "stepped-up basis" under 26 U.S.C. 1014(a) (2012 & Supp. V 2017). Pet. App. 13a. Under that provision, an estate's basis in property acquired from a decedent is generally the property's fair market value on the date of the decedent's death. See 26 U.S.C. 1014(a) (2012 & Supp. V 2017). Because the price of Monster shares had declined between McKelvey's death and the date the estate delivered the shares to the banks, no capital gain existed relative to the estate's stepped-up basis. Pet. App. 13a; see *id.* at 11a.

b. The Commissioner disagreed and determined a deficiency of more than $41 million in McKelvey's 2008 federal income tax. Pet. App. 13a. That deficiency was based in part on the Commissioner's determination that the amended contracts constituted forward contracts, and that McKelvey's entry into the amended contracts

thus had constituted a constructive sale of approximately 6.5 million shares of Monster stock, on which McKelvey had realized long-term capital gains. *Ibid.*[3]

The Commissioner concluded that, although the terms of the original VPFCs providing for delivery of a variable number of shares (between approximately 5.4 and 6.5 million) remained unchanged, by the time McKelvey entered into the amended contracts, the number of shares to be delivered at settlement was "substantially fixed" within the meaning of Section 1259. Pet. App. 21a. When the amended contracts were executed, the "price of Monster stock had fallen so far below the floor price of each contract" that the possibility the price would exceed the floor price on the valuation dates was "remote." *Ibid.* As noted, the Commissioner's expert Dr. Bessembinder calculated a greater than 85% probability (measured as of the date the amended contracts were executed) that McKelvey would be required to deliver the maximum number of shares at settlement. *Id.* at 21a-23a & n.17, 28a-29a. Dr. Bessembinder's analysis also showed that, even if the number of shares to be delivered decreased below the maximum, that decrease would likely be insubstantial. *Id.* at 28a-29a. For example, if the share price rose to $31 per share, slightly exceeding the floor price, the number of shares to be delivered would change by less than one percent. *Ibid.*

3. Petitioner, the administrator of McKelvey's estate, filed suit in the Tax Court challenging the Commissioner's deficiency determination. Pet. App. 14a. The

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[3] The Commissioner additionally determined that McKelvey had realized short-term capital gains by the substitution of the terms of the original VPFCs for those of the amended contracts. Pet. App. 13a, 16a-20a. That determination is not at issue in this Court.

court ruled for petitioner on all issues. *Id.* at 46a-68a. As relevant here, the court held that the execution of the amended contracts had not resulted in a constructive sale under Section 1259. *Id.* at 66a-68a. The court did not address the merits of the Commissioner's determination that the number of shares to be delivered thereunder was "substantially fixed" at the time the amended contracts were executed. Instead, the court concluded that the amended contracts had merely extended the "open" transactions under the original contracts and therefore could not constitute separate instruments that might give rise to a constructive sale. *Id.* at 67a-68a.

4. The court of appeals reversed. Pet. App. 1a-32a.

a. The court of appeals rejected the Tax Court's premise that the amended contracts did not constitute new contracts and had merely continued the original VPFCs as open transactions. See *id.* at 18a-19a; see also *id.* at 29a-30a. The court of appeals "agree[d] with the Commissioner that extension of the valuation dates" had "resulted in amended contracts that replaced the original contracts." *Id.* at 18a-19a. Petitioner does not seek review of that ruling in this Court. Pet. 11 n.6.

b. The court of appeals then analyzed, and upheld, the Commissioner's determination that McKelvey's entry into those new contracts had resulted in constructive sales under Section 1259. Pet. App. 20a-32a. The court explained that, for purposes of determining whether the amount of property to be delivered was "substantially fixed," the "key step" in the Commissioner's constructive-sale inquiry was the application of "probability analysis" to assess the likelihood "that the price of Monster stock would recover and exceed the

floor price by the valuation date of each amended contract." *Id.* at 21a-22a. The court noted that "[w]hether probability analysis may be used to determine that an amount of property is 'substantially fixed' for purposes of subsection 1259(d)(1) is a novel question" that the statutory language does not explicitly address. *Id.* at 23a; see *id.* at 26a. The court further observed that, "although Congress authorized the issuance of 'necessary or appropriate' regulations to implement the constructive sale statute," the Secretary had not issued regulations either approving or disapproving the use of probability analysis in this context. *Id.* at 26a.

The court of appeals accordingly construed the statute as an original matter and was "persuaded" that Section 1259 permits the use of probability analysis to determine whether the amount of property to be delivered is "substantially fixed." Pet. App. 25a-26a. The court observed that "the modifier 'substantially' informs us that the amount need not be exactly fixed and that Congress contemplated some leeway." *Id.* at 23a. The court further explained that "[t]ax laws are to be applied with an eye to economic realities," and that "[p]robabilities are an economic reality affecting [stock] transactions." *Id.* at 26a (citing, *inter alia*, *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 573 (1978)). Indeed, the court noted, "[v]irtually all stock transactions rest on the market's (albeit differing) perceptions of the probabilities of share price movement." *Ibid.* The court further explained that the Black-Scholes formula that the Commissioner's expert had used to calculate the probabilities in this case is itself "a major determinant of option prices that are bid and asked every day in options markets," so that "the economic reality pertinent to this case is not only the use of probability analysis in general

but the use of the widely accepted Black-Scholes probability formula in particular." *Id.* at 26a-27a.

The court of appeals also noted that the use of VPFC extensions "to obtain [the] up-front payment without having to settle and incur a large capital gain" is such an "alluring" tax-avoidance device that "[a] taxpayer and his VPFC long party can often be expected to repeat these extensions for the taxpayer's life, knowing that at his death the shares will have a stepped-up basis in the hands of his estate." Pet. App. 27a. The court concluded that allowing a taxpayer to receive an up-front VPFC payment (in this case, approximately $194 million) "without ever incurring the capital gains tax that would have been due had the payment resulted from a sale of the stock" is a result "[t]he Internal Revenue Code should not be readily construed to permit." *Id.* at 27a-28a.

The court of appeals emphasized that its holding "does not affect all amended VPFCs but only those amended to become forward contracts where the number of shares to be delivered at settlement is substantially fixed because of a share price significantly below the floor price." Pet. App. 28a. Acknowledging "the somewhat limited frequency of situations in which amendment of the valuation date of a VPFC will create liability for capital gains taxes," the court "conclude[d] that probability analysis may be used for such a purpose." *Ibid.*

c. The court of appeals upheld the Commissioner's determination that, when the amended contracts at issue here were executed, the number of shares to be delivered was "substantially fixed" under Section 1259, given the Commissioner's uncontested evidence that there was then a greater than 85% probability that

McKelvey would be required to deliver the maximum number of shares on the settlement date. Pet. App. 28a-32a. The court observed that "[t]he taxpayer had the burden to prove the determinations in the Commissioner's notice of deficiency erroneous," and that the estate had "presented no evidence to challenge any of Dr. Bessembinder's data or calculations." *Id.* at 29a (citing T.C. R. 142(a) and *Welch* v. *Helvering*, 290 U.S. 111, 115 (1933)).

The court of appeals found it unnecessary to articulate any "bright line" concerning the magnitude of the probability that the number of shares to be delivered will not change. Pet. App. 28a. In this case, the court noted, the probability of more than 85% is "very high," and "the share prices yielding th[at] percentage[ ] were * * * barely more than half of the floor prices." *Ibid.* Finding "no basis to conclude that the amount of shares to be delivered at settlement was not 'substantially fixed' on the dates each contract was amended," the court held that "[c]onstructive sales of the [6.5 million] shares therefore resulted." *Id.* at 29a.

ARGUMENT

The court of appeals correctly upheld the Commissioner's determination that McKelvey had entered into constructive sales of stock under 26 U.S.C. 1259 by executing the amended contracts. Neither the court's determination that Section 1259 permitted the Commissioner to engage in probability analysis to ascertain whether the number of shares to be delivered was "substantially fixed," 26 U.S.C. 1259(d)(1), nor its conclusion that the number of shares was "substantially fixed" in this case, *ibid.*, conflicts with any decision of this Court or another court of appeals. Contrary to petitioner's

contention, the fact that the Secretary has not promulgated regulations clarifying that statutory term did not preclude the court of appeals from construing Section 1259(d)(1) and applying it to this case. Further review is not warranted.

1. The court of appeals correctly held that, in determining whether a transaction constitutes a forward contract and thus a constructive sale under 26 U.S.C. 1259, the Commissioner may rely on analysis of the probability that the number of shares a party will be required to deliver at settlement will not change. Pet. App. 20a-28a. The court also correctly upheld the Commissioner's application of probability analysis to the circumstances of this case. *Id.* at 28a-32a.

a. The court of appeals correctly held that probability analysis may be used to determine whether the amount of property that a particular contract requires to be delivered is "substantially fixed" within the meaning of Section 1259(d)(1) at the time the contract is formed. See Pet. App. 23a-28a. As the court observed, "the modifier 'substantially'" indicates "that the amount need not be exactly fixed and that Congress contemplated some leeway." *Id.* at 23a. More generally, this Court has long held that, "[i]n the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding." *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 573 (1978) (citation omitted). "The Court has never regarded 'the simple expedient of drawing up papers' as controlling for tax purposes when the objective economic realities are to the contrary." *Ibid.* (citation omitted). Nothing in Section 1259's text suggests that Congress intended to depart from that longstanding principle.

Indeed, Congress enacted Section 1259 to close a loophole exploited by taxpayers who had entered into transactions designed to obtain the benefits of selling property without triggering the capital-gains and other tax consequences of a sale. See pp. 1-2, *supra*. To construe the phrase "substantially fixed" in Section 1259 as precluding consideration of practical economic realities, including probability analysis that is routinely used in pricing the underlying market transactions, would subvert that congressional intent. Nothing in Section 1259's text, the statutory context, or this Court's precedent compels that illogical result.

b. The court of appeals' factbound application of probability analysis here also was correct and does not warrant further review. The Commissioner presented evidence from his expert Dr. Bessembinder, based on the "widely accepted Black-Scholes probability formula," showing a greater than 85% probability that McKelvey would be required to deliver at settlement the maximum number of shares specified in each of the amended contracts. Pet. App. 27a; see *id.* at 21a-23a. Dr. Bessembinder's analysis further showed that "the probability that [McKelvey] would have to deliver a number of shares close to th[at] total, which would still be a substantially fixed amount, was even higher." *Id.* at 29a.

Although petitioner "had the burden to prove the determinations in the Commissioner's notice of deficiency erroneous," petitioner "presented no evidence to challenge any of Dr. Bessembinder's data or calculations." Pet. App. 29a. In holding that Dr. Bessembinder's analysis showed the number of shares to be "substantially fixed," the court of appeals found it unnecessary to draw a "bright line," instead concluding that, in

the circumstances of this case, the probability the Commissioner established was sufficient. *Id.* at 28a-29a. Petitioner identifies no sound reason to reject that case-specific conclusion.

c. Petitioner does not contend that the court of appeals' decision conflicts with any decision of another circuit. The court below described the question as a "novel" one, Pet. App. 23a, and it explained that its holding accords with the one analogous appellate decision it identified, see *id.* at 24a-26a (discussing *Progressive Corp. & Subsidiaries* v. *United States*, 970 F.2d 188 (6th Cir. 1992)). Although petitioner contends (Pet. 12 n.7) that *Progressive Corp.* is distinguishable, he does not suggest that *Progressive Corp.* or any other appellate decision is inconsistent with the ruling below.

The narrow scope of the court of appeals' holding further counsels against review. The court recognized that "using probability analysis to prevent capital gain avoidance in this case does not affect" all VPFCs, which are themselves uncommon, or even "all amended VPFCs." Pet. App. 28a. Rather, the use of probability analysis (and consequently the legal determination whether Section 1259(d)(1) permits such use) affects only those VPFCs that are "amended to become forward contracts where the number of shares to be delivered at settlement is substantially fixed because of a share price significantly below the floor price." *Ibid.*

Petitioner repeatedly contends (Pet. 11, 17, 20, 36, 37) that review is warranted precisely because of the novelty of the question presented—on the theory that the court of appeals' resolution of that question will "retroactively" subject petitioner and others to previously inapplicable taxes. That argument lacks merit. "A judicial construction of a statute is an authoritative

statement of what the statute meant before as well as after the decision of the case giving rise to that construction." *Rivers* v. *Roadway Express, Inc.*, 511 U.S. 298, 312-313 (1994); see also, *e.g.*, *Fleming* v. *Fleming*, 264 U.S. 29, 31-32 (1924) (Taft, C.J.). And taxes on income a taxpayer fails to report are necessarily assessed after the fact. The tax imposed here is no more "retroactive" than a tax imposed in any other case where a taxpayer mistakenly believes that its interpretation of the applicable law is correct and is disappointed when a court disagrees.

2. Petitioner does not directly challenge the substance of the court of appeals' interpretation of Section 1259 or the court's application of that provision to this case. Instead, petitioner principally contends (Pet. 14-34) that, in the absence of regulations clarifying Section 1259's application to circumstances like those presented here, the court lacked power to apply the statute at all. Petitioner argues that, because Congress authorized and directed the Secretary of the Treasury to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of [Section 1259]," 26 U.S.C. 1259(f), and because the Secretary has not issued regulations elucidating Section 1259(d)(1)'s "substantially fixed" requirement, the provision is "unenforceable." Pet. 17, 25. That contention lacks merit.

Courts' authority to interpret statutes stems from the fact that "[t]hose who apply the rule to particular cases, must of necessity expound and interpret that rule." *Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137, 177 (1803). If Congress authorizes an Executive agency to promulgate regulations implementing a statute, and the agency adopts regulations that construe a particular

provision, those regulations may bear on a court's construction of the relevant statutory language, as when a court defers to an agency's reasonable regulatory interpretation under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). But the absence of a pertinent administrative interpretation does not disable a court with jurisdiction over a dispute to which a statute is asserted to apply from interpreting the statute. Here, moreover, although the Commissioner has not promulgated regulations to implement Section 1259, the court of appeals had before it the administrative interpretation of that provision reflected in the Commissioner's deficiency determination.

To be sure, Congress may choose to make a particular action by an Executive agency a condition precedent to the application of a statute. A statute, for example, may authorize an agency to set rates to which regulated entities' prices must adhere, see, *e.g.*, *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 600 (1944) (upholding statute delegating to Federal Power Commission authority to adopt "just and reasonable" rates for wholesale sales of natural gas (citation omitted)), or to impose other requirements with which regulated parties must comply, see, *e.g.*, *In re Kollock*, 165 U.S. 526, 532-533 (1897) (upholding statute authorizing Commissioner to issue regulations defining packaging requirements for oleomargarine and imposing penalties for selling improperly packaged products); see also, *e.g.*, 19 U.S.C. 1629(c) (authorizing Secretary of the Treasury to apply U.S. customs law in whichever foreign countries he chooses, including "criminal laws of the United States relating to the importation or exportation of merchandise, filing of false statements, and the unlawful removal of merchandise from customs custody");

15 U.S.C. 78p(e), 78u-5(b), 78ff (exempting certain transactions and statements from statutory disclosure and other requirements that carry criminal penalties unless in violation of Securities and Exchange Commission regulations).

When a statute makes particular agency action a precondition to the statute's application, and the precondition has not been satisfied, courts appropriately decline to enforce the statute. See, *e.g.*, *Alexander* v. *Commissioner*, 95 T.C. 467, 473 (1990) (lack of regulations rendered provision inapplicable where statute "unambiguously provide[d] that [the provision] 'shall apply only to the extent provided in regulations prescribed by the Secretary'"), aff'd, 999 F.2d 544 (9th Cir. 1993). In *Dunlap* v. *United States*, 173 U.S. 65 (1899), on which petitioner relies (Pet. 22-24), the Court held that a manufacturer could not claim a rebate on alcohol taxes because the statute that authorized such a rebate made issuance of implementing regulations by the Secretary of the Treasury a condition precedent to the rebate's availability. See 173 U.S. at 70-77. The statute in *Dunlap* allowed "[a]ny manufacturer * * * to use alcohol in the arts, or in any medicinal or other like compound, * * * under regulations to be prescribed by the Secretary of the Treasury," and it authorized a rebate of alcohol taxes upon the manufacturer's "satisfying the collector of internal revenue * * * that he has complied with such regulations." *Id.* at 70. The Secretary had declined to issue such regulations, however, after concluding that enforcement would be impracticable without additional appropriations from Congress. See *id.* at 75. A taxpayer contended that a rebate was nevertheless available, on the theory that "the right to repayment was absolutely vested by the statute, dependent

on the mere fact of actual use in the arts, and not on use in compliance with regulations." *Id.* at 71.

The Court rejected that contention. See *Dunlap*, 173 U.S. at 70-77. The Court explained that the text and context of the statute showed that Congress did not intend the tax rebate to be available unless and until the Secretary had issued implementing regulations. See *id.* at 72-74. The Court explained that, "when Congress undertook to provide for refunding the tax on alcohol when used in the arts, it manifestly regarded adequate regulations to prevent loss through fraudulent claims as absolutely an essential prerequisite." *Id.* at 74. "[T]he right" to the rebate thus "was conditioned on the performance of an executive act, and the absence of performance left the condition of the existence of the right unfulfilled." *Id.* at 71.

If Congress had likewise conditioned the treatment of forward contracts as constructive sales on Treasury's issuance of regulations defining the term "substantially fixed," the absence of such regulations would have precluded the Commissioner from treating the contract amendments at issue here as constructive sales. But Section 1259(f)'s general authorization and direction to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of [Section 1259]," 26 U.S.C. 1259(f), does not establish any such condition precedent. The language of Section 1259(f) is similar to many other commonplace grants of rulemaking authority. That language resembles, for example, the general "[a]uthorization" to regulate conferred by 26 U.S.C. 7805(a), which states that the Secretary "shall prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason

of any alteration of law in relation to internal revenue." *Ibid.* Moreover, Section 1259's reference to "such regulations as may be necessary or appropriate to carry out the purposes of [Section 1259]," 26 U.S.C. 1259(f), indicates that Congress vested the Secretary with significant discretion to determine whether any regulations, and if so which ones, are necessary and appropriate to implement the provision and achieve Congress's goals.

Lower courts have repeatedly held that similar grants of rulemaking authority do not make issuance of regulations a condition precedent to enforcement of the substantive statutory provisions that the agency is authorized to construe. See *Temsco Helicopters, Inc.* v. *United States*, 409 Fed. Appx. 64, 67 (9th Cir. 2010) (concluding that the text and history of 26 U.S.C. 4263(c), which requires a carrier to pay a particular tax if that tax is not collected from another entity "'under regulations prescribed by the Secretary,'" "d[id] not establish that regulations are a precondition to applying § 4263(c)"); *Parker-Hannifin Corp.* v. *Commissioner*, 139 F.3d 1090, 1099 (6th Cir. 1998) ("absence of regulations, while not helpful, [was] beside the point" where statute set forth requirements for claiming deduction and stated that Treasury "shall prescribe such regulations as may be appropriate to carry out the purposes of this subpart," 26 U.S.C. 419A(i) (Supp. V 1987)); *H Enters. Int'l, Inc.* v. *Commissioner*, 105 T.C. 71, 79, 84 (1995) (lack of regulations did not render provisions inapplicable where statute stated that Treasury "'shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of [the] provisions'" but did not state or imply that the provisions "apply only to the extent prescribed by regulations" (citation omitted)). Petitioner identifies no court of appeals decision holding that an

analogous grant of rulemaking authority made the issuance of regulations construing a statutory term a precondition to enforcement of the statute. Further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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