No. 18-1474

In the Supreme Court of the United States

SUNOCO, INC.,

Petitioner,

v.

UNITED STATES,

Respondent.

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

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

GEORGE M. CLARKE, III
VIVEK A. PATEL
KATHRYN E. RIMPFEL
ERIC M. BISCOPINK
BAKER & MCKENZIE LLP
815 Connecticut Ave., NW
Suite 1200
Washington, DC 20006
(202) 452-7000

GREGORY G. GARRE
Counsel of Record
BENJAMIN W. SNYDER
LATHAM & WATKINS LLP
555 Eleventh St., NW
Suite 1000
Washington, DC 20004
(202) 637-2207
gregory.garre@lw.com

Counsel for Petitioner

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

TABLE OF AUTHORITIES—Continued

Page(s)

OTHER AUTHORITIES

INTRODUCTION

This case presents a basic question about how tax credits operate. As the petition explained (at 11-14), other lower courts have long treated credits as a means of *satisfying* tax liability. A "payment by credit," they have held, is "for all purposes . . . received as equivalent" to "a payment in cash." *United States v. Piedmont Mfg. Co.*, 89 F.2d 296, 299 (4th Cir. 1937). That rule is hardly surprising. When a customer applies a store credit to the purchase of a shirt, the credit doesn't lower the price of the shirt; it operates to pay for it. Likewise, a closing credit extended in connection with the purchase of a home doesn't lower the price of the home; it helps to pay for it.[1] And, as the government itself acknowledges (at 13), the amounts withheld from an employee's paycheck under federal law—which are allowed "as a credit against the tax imposed," 26 U.S.C. § 31(a)(1)—don't reduce the amount of taxes incurred by the employee; they *satisfy* those taxes.

In the decision below, however, the Federal Circuit proceeded on a fundamentally different premise—that credits do not satisfy an outstanding liability, but instead prevent the liability from ever being incurred in the first price. Pet. App. 8a (framing the question as whether Sunoco can "deduct, as a cost of goods sold, an excise-tax expense *that it never incurred or paid*" (emphasis added)). That led it to conclude that

---

[1] Such credits are a common feature in home purchases and typically covered by a "credit against the purchase price" clause. *See, e.g., Credit Against the Purchase Price Sample Clauses*, Law Insider, https://www.lawinsider.com/clause/credit-against-the-purchase-price (last visited August 6, 2019).

Sunoco cannot deduct hundreds of millions of dollars in excise taxes that it incurred in connection with the sale of gasoline and satisfied using tax credits it earned through its blending activities.

The divergence on this basic question of how to treat tax credits has indisputably massive implications. Even focusing narrowly on the specific tax credit at issue here, it affects billions of dollars in taxes paid by companies that took up Congress's call to increase use of environmentally friendly, domestically produced fuel sources—as the brief filed by *amicus* American Fuel & Petrochemical Manufacturers underscores (at 2, 5). *See* Pet. 22. But the disagreement applies to other credits, too, compounding the implications of the decision below and magnifying the need for this Court's intervention. Notably, while the government says (at 25) that the question presented is "of diminishing importance," it never denies it is important. And if the Federal Circuit had come out the other way, the government almost certainly would view the billions of tax dollars impacted by the question presented as a powerful consideration in favor of certiorari. *See id.*

The government responds to the conflict in the lower courts primarily with a prolonged defense (at 9-21) of the *merits* of the Federal Circuit's approach here. That defense is deficient in numerous respects. Indeed, the government simply assumes—from the very outset of its brief—that the credits at issue are *not* used to "pay" a tax liability that already has been incurred, the crux of the question that is presented by this case. *See* BIO 2 (framing question presented as whether a taxpayer may deduct costs of an excise tax it "did not actually incur or pay because it received" the credit at issue). And it argues (at 15) that

Congress's use of tax credits was "simply an 'accounting sleight-of-hand'" that the Federal Circuit was free to disregard. But the government's merits arguments are appropriately addressed in briefs *on the merits*. They do not obviate the need for this Court to resolve the dispute over whether tax credits satisfy liability or prevent it from arising at all.

As to that issue—the one that really matters at this stage—the government (at 22-25) has conspicuously less to say. It claims there is no clean split in the lower courts because the cases holding that tax credits operate to satisfy tax liability all concerned credits other than the one here. But the Federal Circuit's decision proceeds from the premise that tax credits are *necessarily* different from payments—a premise that would have led to different outcomes in cases involving those other credits, too. The government's efforts to downplay the split therefore fail. And if other circuits are correct that the default rule is that tax credits operate to satisfy tax liability, rather than to prevent it from arising to begin with, then Sunoco is entitled to have the statute at issue interpreted in light of that rule.

The petition should be granted.

ARGUMENT

I. THE FEDERAL CIRCUIT'S DECISION IS AT ODDS WITH THE LONGSTANDING TREATMENT OF TAX CREDITS

Congress passed the Jobs Act against a backdrop in which tax credits had long been treated as a means of satisfying existing tax liability. *See* Pet. 11-12. Lower courts, building on statements by this Court, held that a "payment by credit" is "for all purposes . . .

received as equivalent" to "a payment in cash." *Piedmont Mfg. Co.*, 89 F.2d at 298-99 (discussing *Graham v. Goodcell*, 282 U.S. 409 (1931)). And they have recognized that when a taxpayer earns a credit by engaging in specific government-incentivized activity, the credit "d[oes] not reduce [the] underlying tax liability" but instead is "effectively utilized to *discharge* [the taxpayer's] full tax liability." *Consolidated Edison Co. of N.Y., Inc. v. United States*, 10 F.3d 68, 74 (2d Cir. 1993) (emphasis added).

Congress is presumed to have intended that ordinary treatment of tax credits to apply here. *See Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990); Pet. 14. That is how objective observers in the Congressional Research Service understood Congress's actions. *See* Pet. 8. Those experts recognized that, under the usual treatment of a tax credit, Congress's conversion from a reduced-rate excise tax regime to a regime that employed excise-tax credits would increase the total amount of excise tax paid. *See* Salvatore Lazzari, Cong. Research Serv., CRS Report RL32979, *Alcohol Fuels Tax Incentives* at Summary (July 6, 2005). And they likewise recognized that fuel producers would be able to deduct their full excise tax payments when calculating taxable income. *See* Molly F. Sherlock, Cong. Research Serv., CRS Report R41227, *Energy Tax Policy: Historical Perspectives On and Current Status Of Energy Tax Expenditures* 23 n.45 (May 2, 2011).

The government's attempts to explain away this background rule are unpersuasive. Take the wage-withholding credit established in Section 31 of the Internal Revenue Code, which states that certain amounts withheld by an employer "shall be allowed

. . . as a credit against the tax imposed." 26 U.S.C. § 31. The government concedes (at 14) that this tax credit—which tracks the language in the credit at issue here, Section 6426(a)(1)—is used to satisfy tax liability rather than to prevent that liability from arising in the first place. Pointing to 26 U.S.C. § 6211(b)(1), the government claims (at 13-14) this is because Congress "created an express exception for the Section 31 credit, such that—unlike ordinary tax credits–it does not reduce the relevant tax liability." But Section 6211 does not support this claim.

Section 6211 relates only to the "Definition of a deficiency," which is defined in subsection (a)(1) as the excess of the actual tax imposed over "the amount shown as the tax by the taxpayer upon his return" and any "amounts previously assessed . . . as a deficiency." 26 U.S.C. § 6211(a)(1). Subsection (b)(1) then provides that *"[f]or purposes of this section* . . . [t]he tax imposed by Subtitle A and the tax shown on the return shall both be determined without regard to payments on account of estimated tax [and] without regard to the credit under section 31." *Id.* § 6211(b)(1) (emphasis added). Section 6211 thus serves the limited purpose of determining the amount of a tax deficiency; it does not create a special, overarching rule under which Section 31 credits affect tax liability differently than other credits, as the government claims in an attempt to explain its different treatment of the credits under Section 31 and Section 6426.

Indeed, by addressing "credit[s] under section 31" and "payments" together under the same rule, Section 6211 confirms that Congress understood both to operate in the same way. *Id.* That is consistent with the default rule long recognized in the Second and Fourth Circuits. *See* Pet. 11-14. Under the Federal

Circuit's approach, by contrast, a taxpayer whose withholding credit equals or exceeds her otherwise applicable tax would be treated as not having incurred any tax liability *at all*. Not even the government defends that absurd result. In short, Section 31 confirms that the Federal Circuit decided this case based on a fundamentally mistaken understanding of the background rules against which Congress was legislating.[2]

The government's attempts to distinguish *Graham*, *Piedmont Manufacturing*, and *Consolidated Edison* fail for a similar reason. The government concedes (at 22-23) that the credits at issue in *Graham* and *Piedmont Manufacturing* were "properly viewed as a prepayment of [a taxpayer's] future tax liability rather than a reduction in that liability."[3] And it (more grudgingly) acknowledges (at 24) that the Second Circuit concluded that the prepayment credit in *Consolidated Edison* "was effectively utilized to discharge Con Edison's full tax liability.'" Sunoco agrees. The difference here is that the Federal Circuit refused to recognize the premise accepted in those cases—that credits satisfy tax liability rather than

---

[2] Section 31 also refutes the government's argument (at 10) that Congress's use of the formulation of "credit against" the tax imposed means that the credit cannot operate as a payment. Indeed, "credit against" is commonly used when a credit operates to pay or satisfy an underlying liability. *See* note 1, *supra*.

[3] The government claims (at 23) that "credits resulting from a taxpayer's own out-of-pocket expenditures" are somehow different from the credits earned under Section 6426. But there is no difference: Blending credits arise from a producer's out-of-pocket expenditures, too—indeed, the reason Congress created the credits in the first place was to encourage producers to incur the additional costs of blending fuel.

prevent liability from arising in the first place. Indeed, the Federal Circuit's decision here gives no indication that credits can *ever* satisfy tax liability, underscoring how far the Federal Circuit veered from existing precedent. *See* Pet. App. 8a, 10a.

In other words, the "crucial difference" (BIO 23) between the decision below and *Graham, Piedmont Manufacturing*, and *Consolidated Edison* is that they applied inconsistent legal rules. That conflict is precisely why this Court's intervention is needed.

II. THE GOVERNMENT'S MERITS ARGUMENTS ARE UNPERSUASIVE

The government fares no better in attempting to evade this conflict by arguing (at 14-21) that there is something special about Section 6426. By saying that Section 6426(a)(1) established a "credit against the tax imposed," Congress made clear that the "tax imposed" was a fixed obligation that existed independent of the credit, and "against" which the credit could be applied. To achieve the result the government is arguing for and that the Federal Circuit adopted, by contrast, Congress would have needed to say something like "shall be allowed as a credit in calculating the amount of tax to be imposed." But, of course, Congress said no such thing—and its direction that the credit should be applied "against" a tax that had already been "imposed" confirms it intended the ordinary default rule to apply.

Section 9503(b) just reinforces this reading. Congress adopted Section 9503(b) at the same time it created the Section 6426 blending credits at issue. Section 9503(b) makes express Congress's understanding that, following the Jobs Act, taxes would be "received under section[] . . . 4081" in two

ways: Some would be paid in cash, and others would be satisfied with "credits under section 6426." 26 U.S.C. § 9503(b)(1). And Congress provided that in determining the amount of tax revenue to transfer to the Highway Trust Fund—the "purposes of this paragraph"—the Treasury should not make any "reduction for credits under section 6426." *Id.*

The Federal Circuit's approach is irreconcilable with Section 9503(b). If Section 6426 credits do not pay tax liability under Section 4081 but rather prevent it from ever coming into existence in the first place (as the Federal Circuit held), the only way for Congress to have ensured *full* funding of the Highway Trust Fund would have been to take account of *both* the "taxes received under section[] . . . 4081" *and* the "credits [awarded] under section 6426." 26 U.S.C. § 9503(b)(1). The fact that Congress could instead focus just on the taxes "received," without needing to add in the credits separately, shows it expected Section 6426 credits to operate just as credits ordinarily do—as a means of satisfying tax liability.

The government seeks to counteract the clear implications of Section 9503(b) by transitioning to its argument (at 15-16) that "[w]hen Congress wants a tax credit to operate as a payment, it uses some form of the word 'pay.'" The examples it gives, however, all involve payments from the government *to the taxpayer*; they are distinct from the scenario here, where a taxpayer earns a credit and then uses that credit to satisfy its outstanding tax liability *to the government*. Moreover, as the Section 31 withholding credit shows, there is no general rule that credits operating in that fashion ordinarily "use[] some form of the word 'pay.'" *See supra* at 4-6.

The government's reliance (at 12-13) on Section 4081(b) is likewise misplaced. That provision deals with credits earned not through the efforts of the taxpayer, but rather through the payment by a third party of that third party's own tax liability. *See* 26 U.S.C. § 4081(b)(2). That unique scenario—in which a credit is earned through the actions of one taxpayer but assigned to another—sheds no light on the scenario here, where a single blender has undertaken congressionally favored activities to earn a tax credit and then applied that credit to satisfy its own tax liability. The real anomaly, for which the government has no answer, is that under the government's interpretation a blender that receives its credits as a cash payment from the government pays no income tax on the value of the credits, while a blender who generates identical credits and uses them to satisfy its excise tax liability *does* pay income tax on the value of the credits. Pet. 18-19.

The government also cannot account for the legislative history confirming that Congress intended the credits to operate as a means of paying tax liability. The Conference Report explicitly states that the Section 6426 credit would be "treated as a *payment* of the taxpayer's tax liability." H.R. Rep. No. 108-755, at 304 (2004) (Conf. Rep.) (emphasis added); *see* Pet. 15-16. The government dismisses (at 19) this statement because it appeared in the Conference Report's "discussion of the House Bill," but the Conference Report itself stated that—with one exception not relevant here (dealing with "neat" alcohol used as fuel)—the Senate amendment was "similar to the House bill" as it to pertained to alcohol fuels, Conf. Rep. at 305.

The government separately relies (at 17-18) on a Joint Committee on Taxation report from 1981 to argue that Congress wanted the excise tax credit to have exactly "'the same net tax effect'" as the income tax credit provided in Section 40 (which is added to gross income). But relying on legislative history from 1981 to interpret a statute enacted more than two decades later is fundamentally misguided. Even the government concedes that, following the Jobs Act, a taxpayer with no excise tax liability can take its Section 6426 credit as a direct payment that need not be included in gross income, *see* Pet. App. 10a, whereas if the same taxpayer took the Section 40 credit instead it *would* have to include the amount of that credit in its gross income, *see* BIO 17. The notion that Congress intended the Jobs Act to maintain parity between the Section 6426 excise-tax credit and the Section 40 income-tax credit therefore falls apart, regardless of what Congress might have intended in the 1980s.

Finally, the government also has no answer to another gaping problem with its interpretation: if the credits operate to reduce the amount of tax liability imposed to begin with, then how exactly would the Jobs Act increase the taxes going into the Highway Trust Fund—a key objective of the amendments (*see* Pet. 4-6)? The government's proposed solution (at 15) that Congress *said* one thing, but (wink, wink) meant another—the "'sleight of hand'"—denigrates, rather than gives effect to, Congress's intent.

III. THIS COURT'S INTERVENTION IS WARRANTED

The government has no basis for distinguishing the Federal Circuit's decision below from the

decisions of this Court and other circuits that have recognized (correctly) that when Congress awards a taxpayer a credit for engaging in certain favored activities, the taxpayer can use that credit to *satisfy* an existing tax liability. And this disagreement over how tax credits operate has massive economic consequences. The government notes that the specific tax credit at issue here expired in 2011, but it does not dispute that *billions* of dollars in potential tax liability remain at issue as a result of that expired credit. *See* Pet. 21; *see also* American Fuel & Petrochemical Manufacturers Br. 2, 5. And the Federal Circuit's misguided treatment of tax credits is likely to have implications for other credits as well, magnifying the ongoing importance of the issue. This Court should intervene to ensure the disagreement among the circuits does not lead to divergent tax outcomes for taxpayers who are situated identically in all relevant respects other than the circuit in which their tax disputes are litigated.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

GEORGE M. CLARKE, III
VIVEK A. PATEL
KATHRYN E. RIMPFEL
ERIC M. BISCOPINK
BAKER & MCKENZIE LLP
815 Connecticut Ave., NW
Suite 1200
Washington, DC 20006
(202) 452-7000

GREGORY G. GARRE
Counsel of Record
BENJAMIN W. SNYDER
LATHAM & WATKINS LLP
555 Eleventh St., NW
Suite 1000
Washington, DC 20004
(202) 637-2207
gregory.garre@lw.com

Counsel for Petitioner

August 7, 2019