No. 19-435

IN THE
# Supreme Court of the United States

SIH PARTNERS LLLP, EXPLORER CORPORATION,
TAX MATTERS PARTNER,

*Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent*.

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit**

## REPLY BRIEF FOR PETITIONER

THOMAS H. DUPREE JR.
*Counsel of Record*
JACOB T. SPENCER
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue NW
Washington, DC 20036
(202) 955-8500
tdupree@gibsondunn.com

*Counsel for Petitioner*

## RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

## TABLE OF CONTENTS

**Page**

## TABLE OF AUTHORITIES

**CASES** **Page(s)**

## TABLE OF AUTHORITIES
## (*continued*)

**CASES (*continued*)** **Page(s)**



**STATUTE**

## TABLE OF AUTHORITIES
**(*continued*)**

**REGULATIONS** **Page(s)**



**OTHER AUTHORITIES**

## REPLY BRIEF FOR PETITIONER

The opinion below created two circuit splits arising from the IRS's irrational Guarantee Regulation. Congress recognized in Section 956 that guarantees are not the same as loans. Congress thus called upon the IRS to use its expertise to determine when guarantees should be subject to accelerated tax. Instead of bringing its expertise to bear, the IRS promulgated a scheme that treats every guarantee as if it were the underlying loan. And it offered no explanation to justify that choice other than to say that it was "conform[ing]" its regulations to the statute—an impossibility given Congress' express differentiation of loans from guarantees and delegation to the agency to resolve how to treat this difference.

In upholding the Guarantee Regulation and allowing the IRS to apply it to SIH here, the Third Circuit created two circuit splits on important and recurring questions. *First*, in conflict with the D.C., Ninth, and Federal Circuits, the Third Circuit deferred under *Chevron* to a regulator that gave no indication that it applied its expertise and provided no reasoned explanation for the regulation it adopted. *Second*, in conflict with every other circuit to consider the question, the Third Circuit held that the IRS is not bound by its own published Revenue Rulings.

The IRS cannot reconcile the Third Circuit's holdings with the approaches taken by those other circuits. And it cannot deny that the two questions presented raise crucial issues of administrative and tax law. So instead, the IRS tries to defeat certiorari by ignoring what the other circuits have actually said

and rewriting both the agency's explanation for the Regulation and the Third Circuit's opinion.

Other circuits would not afford *Chevron* deference to a regulation supported by a single-sentence explanation that it was intended to "conform" to the statutory scheme—especially when the regulation goes *beyond* the statutory scheme. Those courts consider whether the agency's explanation shows that it brought its policy expertise to bear; they do not simply defer as long as the agency did not believe that its regulations were "compelled" by the statutory scheme and as long as they can in hindsight come up with a plausible explanation for the regulations. Opp. 20.

And, contrary to the IRS's arguments, the Third Circuit did not refuse to apply Revenue Ruling 89-73 after distinguishing it on its facts. *See* Opp. 23-26. Instead, the Third Circuit categorically dismissed Revenue Rulings as irrelevant, expressly holding that they "are not binding" on the IRS. Pet. App. 18a. That stunning holding puts the Third Circuit directly at odds with all other circuits to have considered the question in what is undeniably a critical issue in the daily lives of tax practitioners and taxpayers.

Neither the IRS's attempts to evade the circuit splits created by the opinion below nor its erroneous and irrelevant merits arguments should dissuade this Court from granting review. Certiorari is warranted because the Third Circuit's decision distorts administrative and tax law and directly conflicts with the correct approach taken by other circuits.

## I. THE THIRD CIRCUIT'S APPROACH TO *CHEVRON* DEFERENCE CONFLICTS WITH THE RULE IN OTHER CIRCUITS.

The IRS does not dispute that the Guarantee Regulation sought to "mirror[]" the statutory language (even though the statute did not answer the questions addressed by the Guarantee Regulation). Opp. 4-5. Nor does it contend that the IRS offered any explanation other than describing all regulations issued under Section 956, 26 U.S.C. § 956, as "written to 'conform' to the statutory text." Opp. 17 (quoting 29 Fed. Reg. 2,599, 2,599 (Feb. 20, 1964)). Unlike the Third Circuit, the D.C., Ninth, and Federal Circuits do not defer under *Chevron* in these circumstances, but instead reserve *Chevron* deference for cases where the agency recognizes the statutory gap it is required to fill, brings its expertise to bear, and offers a reasoned explanation for its policy choice. Pet. 12-19.

The IRS tries (at 20-21) to wave away this conflict by noting that it "did not suggest that Section 956(d) precluded it from adopting" a different regulatory scheme. But that does not distinguish *Peter Pan Bus Lines, Inc. v. Federal Motor Carrier Safety Administration*, 471 F.3d 1350 (D.C. Cir. 2006). *Peter Pan* held that *Chevron* deference is not warranted where the agency fails to "bring its experience and expertise to bear." *Id.* at 1354. The fact that the agency in *Peter Pan* failed to apply its "expertise" because it felt it was "compelled" by the "*plain language*" of the statute, *id.* at 1353-54, whereas the IRS failed to do so here because it felt it was "conform[ing]" to the statute, makes no difference. Deference is not warranted when an agency does not "deploy" its "expertise to produce a reasoned decision," regardless of why it "fails or refuses" to do so. *Vill. of*

*Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 660 (D.C. Cir. 2011).

In fact, the IRS ignores that the Ninth Circuit made precisely that point in *Gila River Indian Community v. United States*, 729 F.3d 1139 (9th Cir. 2013), explaining that deference under *Chevron* is inappropriate *even if* an agency believes it is free to exercise policy discretion and merely fails to explain its policy choice. *See id.* at 1150.

The IRS does not cite a single case upholding a regulation absent an explanation showing that the agency brought its expertise to bear. To the contrary, in *Perez-Guzman v. Lynch*, 835 F.3d 1066 (9th Cir. 2016), the Ninth Circuit deferred under *Chevron* precisely because "the agency's explanation show[ed] it *applied* its expertise" in adopting the regulations. *Id.* at 1079 n.8 (emphasis added); *see also Ass'n of Private Sector Colls. & Univs. v. Duncan*, 681 F.3d 427, 445 (D.C. Cir. 2012) (affording deference because "[t]he agency adopted the regulations based on its 'experience and expertise,' after administering the [statutory] safe harbors for almost a decade").

The IRS attempts (at 21-22) to distinguish *ITT Industries, Inc. v. NLRB*, 251 F.3d 995 (D.C. Cir. 2001), by proclaiming that the Guarantee Regulation itself "acknowledged" the agency's policy discretion by including a limited exception for conduit financing arrangements. But *ITT* holds that an agency acknowledges its discretion by "engag[ing] in considered analysis and explain[ing] its chosen interpretation." *Id.* at 1004.

The IRS cannot distinguish the alternative holding of *Public Citizen, Inc. v. United States Department of Health & Human Services*, 332 F.3d 654 (D.C. Cir. 2003), that agencies do not receive

*Chevron* deference when they simply parrot the statutory language. *Id.* at 661. That key point, which the IRS inaccurately describes (at 23 n.6) as "dicta," applies regardless of whether it is a regulation that is being challenged (as opposed to the manual in that case).

And the IRS does not even attempt to distinguish *BP Energy Co. v. FERC*, 828 F.3d 959 (D.C. Cir. 2016). It quotes (at 22) that case's holding without making any effort to show (because it cannot) that in issuing the Guarantee Regulation, the IRS "grapple[d] with" or "refer[red] back to the statutory text." *Id.* at 965.

The D.C. Circuit, in cases such as *BP Energy* and *Good Fortune Shipping SA v. Commissioner*, 897 F.3d 256 (D.C. Cir. 2018), and the Federal Circuit in *Dominion Resources, Inc. v. United States*, 681 F.3d 1313 (Fed. Cir. 2012), have each articulated a legal standard that would have resulted in vacatur of the Guarantee Regulation. The IRS's suggestion (at 22) that the Third Circuit applied the same standard and merely reached a different result reflecting "the distinct facts at issue" is obviously wrong. The IRS cannot point to any contemporaneous agency statement where it grappled with the statutory text or provided any explanation whatsoever in support of the Guarantee Regulation. And the only explanation the agency *did* offer—that all of its Section 956 regulations were intended to "conform" to the statute, 29 Fed. Reg. at 2,599—is indistinguishable from the cursory explanation rejected in *Dominion Resources*.

The IRS suggests that the Guarantee Regulation must reflect a reasoned policy choice because it includes "an exception for conduit financing arrangements." Opp. 16 (citing 26 C.F.R. § 1.956-2(c)(4)). But that limited exception is no substitute for

a reasoned explanation as to why the agency adopted a categorical rule treating all other loan guarantees as identical to the underlying loan. If it were, *Chevron*'s requirement that the agency provide a reasoned *interpretation* of the statute would be nullified, as the regulation itself would amount to the requisite "explanation."

Unable to reconcile the Third Circuit's approach to *Chevron* with that of other circuits, the IRS insists (at 14-15) that this case "primar[ily]" concerns whether the Guarantee Regulation was "arbitrar[y] and capricious[]" and thus "do[es] not implicate" *Chevron*. But the Third Circuit cited *Chevron*, discussed *Chevron*, and deferred to and upheld the Guarantee Regulation by misapplying *Chevron*. Pet. App. 13a-16a. That is not surprising, because *Chevron* was the primary issue raised by SIH on appeal. *See* SIH CA3 Br. 25. And, in *Chevron*'s own language, the fundamental question in an express delegation case like this one is whether the agency's implementing regulations "are arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984). Thus, the question whether this unexplained and irrational rule warranted *Chevron* deference is squarely presented.

Likewise, the IRS's incorrect assertion (at 16) that the result would be the same even if the Guarantee Regulation is invalid under *Chevron* provides no reason to deny certiorari. Congress expressly delegated authority to the *IRS* to implement Section 956(d). The IRS's failure to promulgate valid regulations does not leave *courts* free to "interpret the relevant statutory language de novo" (Opp. 16) and impose accelerated tax as they see fit. Section 956(d)

is not self-executing, *contra* Opp. 19 n.5, an erroneous argument that the IRS forfeited in the Tax Court, *see* SIH CA3 Reply 8-10. And in the absence of a valid regulation imposing accelerated tax, any ambiguity in the Tax Code must be interpreted in favor of the taxpayer. *See Gould v. Gould*, 245 U.S. 151, 153 (1917).

The IRS's attempted justifications for the Guarantee Regulation, *see*, *e.g.*, Opp. 12-14, are wrong and irrelevant both to the merits and to whether to grant certiorari. None of that reasoning was provided by the agency when it promulgated the Guarantee Regulation or Congress when it enacted Section 956(d).

Finally, Congress has not acquiesced in the Guarantee Regulation merely because it has not amended Section 956(d). *See* Opp. 19. "Until this suit," the Guarantee Regulation "had not been challenged," Opp. 6, precisely because the IRS had not applied the Regulation woodenly to avoid "strange results," IRS Field Service Advice No. 200216022, at 12 (Jan. 8, 2002). And the notion that longstanding IRS regulations implementing "unamended" statutes "are deemed to have received congressional approval," *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 561 (1991)—an application of *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979)—is no longer good law. *See Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 55 (2011).

At bottom, the IRS does not dispute that *Chevron*'s purpose is to defer *only* when the agency actually exercised its expertise. Because the Third Circuit rejected that principle—in direct conflict with the holdings of three other circuits—certiorari is warranted.

## II. THE THIRD CIRCUIT'S HOLDING THAT PUBLISHED REVENUE RULINGS DO NOT BIND THE IRS CONFLICTS WITH DECISIONS OF OTHER CIRCUITS.

The IRS does not attempt to defend the Third Circuit's holding that published Revenue Rulings "are not binding" on the IRS. Pet. App. 18a. Nor does the IRS seriously dispute that the Third Circuit's holding created a conflict with other circuits. Instead, it contends certiorari should not be granted because one of the Revenue Rulings at issue in this case—Revenue Ruling 89-73—can be distinguished on its facts from the transaction at issue here. *See* Opp. 24-26. Not only is that incorrect, but the Third Circuit never considered that argument because it held, categorically and erroneously, that Revenue Rulings do not bind the IRS.

The IRS cannot dispute that other circuits have held that Revenue Rulings bind it. *See* Pet. 25-28. Its attempt to distinguish those cases fails. The IRS notes (at 26) the Fifth Circuit's statement that Revenue Rulings are binding "where the law is unclear." *Estate of McLendon v. Comm'r*, 135 F.3d 1017, 1024 (5th Cir. 1998). But that is precisely the circumstance where a taxpayer would need to rely on a Revenue Ruling. And that phrase certainly does not undermine the circuit split on whether Revenue Rulings are binding when the law is unclear—i.e., nearly all litigated cases, including this one.

The IRS's attempt (at 27-28) to distinguish cases from the Sixth, Ninth, and D.C. Circuits is even less persuasive. Holding that specific Revenue Rulings do not apply in particular situations is nothing like dismissing Revenue Rulings as non-binding and irrelevant—as the Third Circuit did. The Third

Circuit's approach is irreconcilable with the uniform rule in other circuits, where Revenue Rulings "are authoritative and binding on the IRS." *The Limited, Inc. v. Comm'r*, 286 F.3d 324, 337 (6th Cir. 2002).

Ultimately, the IRS seems to acknowledge the circuit split, or what it calls (at 28) "some tension . . . among the circuits regarding the binding effect of revenue rulings." And it observes in a footnote (at 24 n.7) that it never "argue[d] below that revenue rulings generally do not bind the IRS." Indeed, the IRS takes care not to advance that argument in this Court, apparently recognizing the deep confusion for taxpayers that would result if it could disregard Revenue Rulings at its whim. Nor could the IRS credibly do so, given its own regulations stating that taxpayers are entitled to "rely" on published Revenue Rulings. 26 C.F.R. § 601.601(d)(2)(v)(*e*).

As a result, the IRS is unable to defend the Third Circuit's categorical holding that "[a] ruling is not a regulation and does not bind the IRS." Pet. App. 18a. Rather than confess error, however, or confront the massive problems this will create for taxpayers in the Third Circuit, the IRS attempts to rewrite the holding as though it is limited to "these circumstances" and a single "revenue ruling." Opp. 24. But that is not what the Third Circuit wrote or held.[*]

---

[*] The IRS notes (at 23-24) that the Third Circuit agreed with the Tax Court that neither the text of Section 956(d) nor its implementing regulations require a facts-and-circumstances approach. *See* Pet. App. 17a-18a. But SIH's argument was premised on Revenue Ruling 89-73, *not* the text of the statute and regulations, as the IRS had previously disavowed a wooden approach to that text. The Tax Court failed to address Revenue Ruling 89-73. *See* Pet. App. 63a-65a.

To distract from the Third Circuit's erroneous holding, the IRS (repeatedly) argues that Revenue Ruling 89-73 should not apply here. *See*, *e.g.*, Opp. 24-26, 28. But those arguments go to the merits—and not even the merits of the question presented to this Court. That question is whether the IRS is "bound by its own published Revenue Rulings." Pet. i. If so, then the Third Circuit would decide in the first instance whether Revenue Ruling 89-73 applies here. The IRS's merits arguments provide no reason to deny certiorari.

Even so, the IRS is incorrect on the merits. It simply ignores the principle announced by the Revenue Ruling that "[t]he facts and circumstances of *each* case must be reviewed to determine if, in substance, there has been a repatriation of the earnings of the [CFC]." Rev. Rul. 89-73, 1989-1 C.B. 258 (emphasis added). Its insistence (at 24-25) that the Revenue Ruling applies only to loans, not to guarantees, is impossible to square with its view that loans and guarantees are interchangeable in the Section 956 context. And contrary to the IRS's assertion (at 25-26), SIH does not contend that Revenue Ruling 89-73 gives it the "right" to demand that the IRS disregard the form of the transaction and treat the guarantees here as something other than guarantees. Rather, the IRS must consider whether there was a repatriation in substance even when the form of a transaction meets the literal requirements for a Section 956 inclusion. And, although the IRS suggests otherwise (at 28), SIH cited (yet the Third Circuit ignored) several rulings where a transaction met the literal requirements of Section 956, but the IRS declined to apply the statute in favor of its repatriation-in-substance test. *See* SIH CA3 Br. 33-34 & nn. 8-9; SIH CA3 Reply 18. Had it done so here,

SIH would have unquestionably prevailed, as the guarantees effected no repatriation of funds to the United States.

The IRS also has nothing to say about the fact that the Third Circuit's decision conflicts with Revenue Rulings defining constructive dividends, other than to assert (at 29 n.9) that the Third Circuit's erroneous holding regarding the qualified divided rate is not "encompassed in the questions presented." But that is incorrect, as that holding cannot be reconciled with those Revenue Rulings (or with the Tax Code) and must be reversed if Revenue Rulings are binding.

The Third Circuit's holding—that Revenue Ruling 89-73 is irrelevant *because it does not bind the IRS*—will have significant consequences, precluding taxpayers in the Third Circuit from ordering their tax affairs in reliance on Revenue Rulings. The IRS does not dispute that this question is important and recurring. *See* Pet. 30-33. Its argument (at 28-29) that this case is a "poor vehicle" for addressing that question is meritless. The question is squarely presented and was decided by the Third Circuit in a way that conflicts with every other court of appeals to consider it. There is no reason to delay certiorari to see how the Third Circuit or the Tax Court "will apply the decision" in future cases. Opp. 29. Taxpayers who have the right to rely on Revenue Rulings should not be forced to wait to see if the Third Circuit meant what it said.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

THOMAS H. DUPREE JR.
*Counsel of Record*
JACOB T. SPENCER
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue NW
Washington, DC 20036
(202) 955-8500
tdupree@gibsondunn.com

*Counsel for Petitioner*

December 17, 2019