No. 22-9

In the Supreme Court of the United States

WHIRLPOOL FINANCIAL CORPORATION & CONSOLIDATED SUBSIDIARIES, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

RODNEY H. STANDAGE
WHIRLPOOL CORPORATION
325 N. LaSalle Dr.
Chicago, IL 60654
(269) 277-6623

MARK A. OATES
ROBERT H. ALBARAL
BAKER & MCKENZIE LLP
300 E. Randolph Dr.
Suite 5000
Chicago, IL 60601
(312) 861-7594

GREGORY G. GARRE
Counsel of Record
JEAN A. PAWLOW
ERIC J. KONOPKA
LATHAM & WATKINS LLP
555 Eleventh Street, NW
Suite 1000
Washington, DC 20004
(202) 637-2207
gregory.garre@lw.com

Counsel for Petitioners

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

TABLE OF AUTHORITIES—Continued

Page(s)

OTHER AUTHORITIES

INTRODUCTION

The "significant administrative law issue" presented by this case is whether a statute expressly conditioned on regulations promulgated by an agency may be enforced against a regulated party by a court that simply disregards the terms—and limits—of the implementing regulations. Andy Grewal, *The Solicitor General Embraces Phantom Regulations*, Yale J. on Regul. Notice & Comment (Oct. 21, 2022).[1] That straightforward question arises here because the tax statute in this case (26 U.S.C. § 954(d)(2)) explicitly contemplates results "under regulations" prescribed by an agency, a construct that "pervade[s] the United States Code." Grewal, *supra*; *see* PWC Br. 5-7. The Commissioner long ago issued detailed regulations implementing § 954(d)(2); until the decision below, he consistently enforced § 954(d)(2) under those regulations; and taxpayers like Whirlpool relied on the regulations in structuring their affairs. Yet, in the divided decision below, the Sixth Circuit imposed tax liability without even considering the regulations—even though the Commissioner had never previously argued, in this case or elsewhere, that § 954(d)(2) could be enforced without the regulations. That ruling turns ordinary administrative-law principles on their head and—as amici explain—has far-reaching consequences for the administration of tax and non-tax statutes alike.

In response, the Commissioner runs away from, and tries to obscure, the Sixth Circuit's actual decision in this case. He concocts a revisionist history

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[1] Available at https://www.yalejreg.com/nc/the-solicitor-general-embraces-phantom-tax-regulations/.

that seeks to mask the fact the Sixth Circuit reached a result never before urged (or even imagined) by the Commissioner. He rewrites the statute so Congress's "under regulations" language is meaningless. And he makes the basic question presented "appear wildly impenetrable," in an attempt to strip this case of its broader significance. Grewal, *supra.* But these are just diversions. As Judge Nalbandian explained below, Congress explicitly gave "Treasury a role in defining when branch transactions generate FBCSI"; Treasury "accepted" that role by promulgating the § 954(d)(2) regulations; and tax liability may be assessed only in accordance with those regulations, just as Congress directed. Pet. App. 30a (dissent). The Sixth Circuit's contrary decision not only conflicts with the decisions of this Court and others, but upends the settled reliance interests of regulated parties like Whirlpool. *See* NAM Br. 17; PWC Br. 7-8; SVTDG Br. 2-4. Certiorari is warranted.

ARGUMENT

A. The Commissioner's Response Rests On A Patently Revisionist History Of This Case

The reason the Sixth Circuit's split decision has generated such controversy is that—despite the plain language of § 954(d)(2) assigning "Treasury a role in defining when branch transactions generate FBCSI," Pet. App. 30a (dissent)—the court simply ignored the § 954(d)(2) regulations in deciding the case. That result not only was not argued by the Commissioner below; it had not been contemplated in the 60-year history of § 954(d)(2). Throughout his response, the Commissioner nevertheless contends he has argued all along that the tax could be imposed without the regulations. That is incorrect.

For starters, neither the § 954(d)(2) regulations nor any other interpretive guidance issued by the IRS maintained that § 954(d)(2) could be enforced apart from—and regardless of—the regulations implementing § 954(d)(2). *See* NAM Br. 17. That explains why the Commissioner's attempt to tax Whirlpool has always been based on his position that the income at issue was FBCSI *under the regulations*. The Commissioner never argued that he could impose the tax based on § 954(d)(2) alone—regardless of his own regulations—as the Sixth Circuit majority held.

In seeking summary judgment in the Tax Court, the Commissioner relied *exclusively* on the regulations, without ever suggesting that § 954(d)(2) was self-executing or independently resolved this case. The Commissioner argued that § 954(d)(2) "effectuate[s] Congress' intent" by "*authoriz[ing] the issuance of regulations* to determine when a branch" arrangement produces FBCSI. CA6 App. 2554-55 (emphasis added); *see* Pet. 23. And the Commissioner acknowledged that the regulations serve a critical "narrowing" function to ensure that manufacturing income is not treated as FBCSI, CA6 App. 2584-85—just as Judge Nalbandian did. Pet. App. 27a-28a.

The Tax Court likewise recognized that the regulations "*govern[]* application of the branch rule" in § 954(d)(2), and thus focused its opinion on the governing regulations. Pet. App. 73a (emphasis added); *see id.* at 56a-57a & n.7, 60a-64a, 73a-91a. The Tax Court's reference to the "bare text" of § 954(d)(2) was, at best, prologue to its lengthy discussion of the "governing" regulations—which it would have skipped had it believed the statutory text was dispositive. *Id.* at 73a. The Commissioner's suggestion (at 20) that the Tax Court's opinion

contains "alternative holding[s]"—one based on the text of § 954(d)(2) alone, one based on the regulations—is refuted by the court's opinion.

All this is confirmed by the Commissioner's Sixth Circuit brief. The Commissioner did not call the Tax Court's passing reference to the "bare text" of § 954(d)(2) an "alternative holding"; indeed, he did not mention it at all. Pet. App. 73a; *see* Comm'r CA6 Br. 21-23. Nor did the Commissioner suggest, much less argue, that this case could be decided on the text of § 954(d)(2) alone—a fact he conceded below. *See, e.g.*, Comm'r CA6 Resp. to Reh'g Pet. 6 & n.4. To the contrary, at oral argument, counsel for the Commissioner conceded that § 954(d)(2) is "not a standalone provision." CA6 Oral Argument 32:02-14.[2] The Sixth Circuit's "surprising" decision to apply the statute without the regulations inappropriately deprived Whirlpool of a meaningful appeal on the issues actually raised by the parties. SVTDG Br. 1.[3]

Ordinarily, agencies are bound by their own regulations—and held to the same standards as other parties in litigation. NAM Br. 14-15. Neither the Commissioner nor the Sixth Circuit should be permitted to impose a tax based on a position never

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[2] Available at https://www.opn.ca6.uscourts.gov/internet/court_audio/aud2.php?link=audio/06-09-2021%20-%20Wednesday/20-1899%20Whirlpool%20Financial%20Corp%20v%20CIR%20et%20al.mp3&name=20-1899%20Whirlpool%20Financial%20Corp%20v%20CIR%20et%20al.

[3] The Commissioner notes (at 20) that the notices of deficiency cited "Section 954(d)." But that boilerplate reference does nothing for him. As discussed, the relevant subsection (§ 954(d)(2)) itself requires regulations to be executed, and the Commissioner relied on those regulations—until the decision below.

advanced by the Commissioner before the Tax Court, the Sixth Circuit, or even elsewhere. That is reason enough to vacate the decision below and remand with instructions to consider the regulations.[4]

If the Commissioner wishes to revisit the need for (or validity of) his own regulations, he should be required to do so in a manner that complies with the Administrative Procedure Act and gives regulated parties notice of his new position. As amici have explained, regulated parties have unusually well-settled reliance interests in the regulations that have governed taxation under § 954(d)(2) for nearly 60 years. NAM Br. 17; PWC Br. 7-8; SVTDG Br. 2-4.[5]

B. The Commissioner's Defense Of The Decision Below Is Based On A Blatant Misreading Of The Statute

The Commissioner's attempt to defend the Sixth Circuit's decision reinforces the need for review.

1. The Commissioner admits that "Congress does sometimes 'expressly condition[]' the operation of a

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[4] Advancing the very tax exceptionalism that this Court has denounced (*see infra* at 12), the Commissioner argues that "the *Chenery* principle" is inapplicable in Tax Court proceedings. BIO 20 (parenthetical). We disagree. But in any event, the problem here is that the agency never advanced the "separate rationale" (BIO I, 13, 15) adopted by the Sixth Circuit for taxing Whirlpool—not in initially deciding to impose the tax, not in the Tax Court, and not in the Sixth Circuit (before its decision).

[5] The Commissioner's claim (at 27) that this case is an "unsuitable vehicle" because Whirlpool did not challenge the statute-only rationale until its rehearing petition is disingenuous. Until the decision below, no one had ever argued that the statute could be enforced without the regulations. Pet. 23-24; NAM Br. 2; SVTDG Br. 1. Whirlpool challenged that position as soon as it was adopted.

statute on agency regulations"; he just denies that § 954(d)(2) is such an instance. BIO 16 (alteration in original) (citation omitted). But the words "under regulations" precede, govern, and thus supply a necessary condition to what income "shall constitute" FBCSI. 26 U.S.C. § 954(d)(2); *see, e.g.*, *Ardestani v. INS*, 502 U.S. 129, 135 (1991) ("'[U]nder' means 'subject [or pursuant] to' or 'by reason of the authority of.'" (second alteration in original) (citation omitted)); Pet. 20-21. As Professor Grewal put it, "any English speaker can understand [§ 954(d)(2)'s] structure. . . . If someone were told that she faced consequences 'under the law,' she would quite naturally assume that the law must be examined to determine those consequences." Grewal, *supra*; *see* Pet. App. 27a (dissent) (explaining "natural[]" reading of § 954(d)(2)'s "under regulations" proviso).

The Commissioner claims (at 14) that the words "under regulations" are an "ordinary delegation[] of regulatory authority." But Congress uses different language when it wants to delegate regulatory authority without conditioning the statute on regulations, as it did elsewhere in § 954 and the legislation that enacted it—*e.g.*, "[t]he Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section." Revenue Act of 1962, Pub. L. No. 87-834, § 2(a), 76 Stat. 960, 963; *see* 26 U.S.C. § 954(c)(4)(A), (c)(5)(C), (c)(6)(A), (h)(8) (similar). The language and structure of § 954(d)(2) are completely different. The statute is explicitly *conditioned* on regulations prescribing a particular result—*i.e.*, "when branch transactions generate FBCSI." Pet. App. 30a (dissent).

The Commissioner's interpretation of § 954(d)(2) renders Congress's use of "under regulations" in

defining what income "shall constitute" FBCSI superfluous—and eliminates the role "Congress gave Treasury . . . in defining when branch transactions generate FBCSI." *Id.* at 27a; *see* Pet. 21, 25.

2. The Commissioner's failure to account for the "under regulations" language of § 954(d)(2) dooms his efforts to distinguish *Dunlap v. United States*, 173 U.S. 65 (1899), and this Court's other precedents on non-self-executing statutes. Pet. 17-20.

The Commissioner contends (at 16) that these cases "involved distinct statutes with distinct language that *expressly* conditioned the provisions' operation on agency regulations." But if the phrase "under regulations" is not an express condition on the operation of § 954(d)(2), "[o]ne must wonder what words the [Commissioner] would have wanted Congress to use." Grewal, *supra*; *see* Pet. 20-23. And the statutes in the cases cited in the petition contain an "under regulations" condition or a textually similar condition to the same effect. Pet. 17-20. None of the incidental textual differences between these statutes and § 954(d)(2), to which the Commissioner clings (at 16-19 & n.6), alters the obvious condition-imposing nature of the words "under regulations," and the Commissioner never explains why they would.

Instead, the Commissioner claims that § 954(d)(2) is unlike these statutes because it contains "clear 'conditions' and following 'consequences' for courts to apply in the absence of implementing regulations." BIO 18-19 (citation omitted). But his position requires him to read § 954(d)(2) *without* its reference to regulations. The words "under regulations" impose another condition on the statute, authorizing certain consequences only as specified in valid regulations

that have gone through notice-and-comment rulemaking. Pet. 22-23; *see* Pet. App. 27a (dissent).

3. The Seventh and Ninth Circuit decisions cited by the Commissioner (at 22-23) do not help him either. In those cases, nobody engaged with *Dunlap* or this Court's other precedents on non-self-executing statutes. Nevertheless, the decisions themselves recognized *Dunlap*'s core premise that "implementing regulations [may be] a precondition to enforcement" of a statute. *Temsco Helicopters, Inc. v. United States*, 409 F. App'x 64, 67 (9th Cir. 2010); *see Pittway Corp. v. United States*, 102 F.3d 932, 935 (7th Cir. 1996). Moreover, in those cases, the statutes called for regulations simply to deal with routine procedural issues. This case is fundamentally different. Section 954(d)(2) is a technical tax statute in a specialized area that explicitly conditions what income shall constitute FBCSI on regulations. As the Commissioner himself argued, regulations under § 954(d)(2) address core issues around whether branch income can be FBCSI at all, not just how to handle ancillary procedural issues. *See supra* at 3-5.

Notably too, the Commissioner's cases involved situations in which *no regulations* existed. The Seventh and Ninth Circuits may have struggled with what to do when an agency neglects its duty to promulgate regulations expressly called for by statute. But here regulations implementing § 954(d)(2) *have existed for over 50 years*. The Commissioner's cases do not remotely bless ignoring regulations that implement a statute that is expressly conditioned on the regulations, as here. Cases from this Court that Whirlpool cited, by contrast, squarely recognized that when a statute is effectuated "under regulations," complying with the regulations (as

Whirlpool did here) is necessary to comply with the statute itself. Pet. 18-19.

In any event, at most the Commissioner's cases show that courts of appeals have taken an "inconsistent and haphazard approach" to addressing whether statutes conditioned on regulations may be enforced in the absence of such regulations. Grewal, *supra*. That inconsistency—which "has yielded substantial confusion over numerous major areas of federal tax law," *id.*—heightens the need for review.

C. The Commissioner's Attempts To Mask The Importance Of This Case Fail

In a last-ditch effort to dissuade the Court from granting review, the Commissioner both downplays the significance of this case and overcomplicates it. Here again, he paints a distorted picture.

The Commissioner tries to trivialize the importance of this case by characterizing the decision below (at 16) as a "statute-specific holding." But the effects of this case extend far beyond § 954(d)(2) and the tax context. Statutes that "contemplate[] results 'under regulations' prescribed by an agency' . . . pervade the United States Code." Grewal, *supra*; *see, e.g.*, PWC Br. 6-7; Pet. 32. And as the intense interest of numerous amici and commentators underscores, the Sixth Circuit's decision to ignore the § 954(d)(2) regulations is of widespread importance because taxpayers and other regulated parties need to be able to rely on regulations. *See, e.g.*, PWC Br. 7-8; NAM Br. 14-20; SVTDG Br. 9-10; Pet. 28-33; *see also, e.g.*, Jeffrey M. Kadet, *The Lessons of* Whirlpool, 108 Tax Notes Int'l 53, 60 (Oct. 3, 2022) (this aspect of the Sixth Circuit majority's decision "has provided fuel for much of the controversy that erupted following the

decision"). The Sixth Circuit's decision allows the IRS to induce taxpayers to rely on the regulations in structuring their affairs and then pull the rug out from under them by ignoring the regulations.

The Commissioner likewise tries to obscure the importance of this case by making it seem overly complicated. But as noted, the question presented is straightforward. This Court need not address how the regulations apply to the facts of this case. The *only* question here is whether the regulations must be applied *at all*. Pet. i. That question matters regardless what version of the regulations applies and is important for every statute that is to be effectuated "under regulations." Accordingly, resolving this case is as simple as answering the question presented in the negative, confirming that the Sixth Circuit erred in deciding this case without considering the regulations, and remanding for consideration of the parties' arguments concerning the regulations—the inquiry that Judge Nalbandian undertook in dissent.[6]

While dismissing the importance of this case, the Commissioner overlooks that the Sixth Circuit's decision "creates two different tax regimes": one in

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[6] Because the only question presented is whether the regulations must be considered in the first place, the fact the § 954(d)(2) regulations have been amended (BIO 23-26) is irrelevant. Moreover, the Commissioner's suggestion (at 13) that the Court should deny certiorari because the regulations would "dictate the same result" is disingenuous. The Sixth Circuit majority never even considered the § 954(d)(2) regulations given its unprecedented conclusion that the statute alone controls—and Judge Nalbandian, who *would have* decided this case based on the regulations, (correctly) concluded that the income at issue is outside the scope of the FBCSI exception. Pet. App. 35a-39a; *see* Pet. 13-14; CA6 Reh'g Pet. 15-17.

the Sixth Circuit, where § 954(d)(2) may be enforced without regard to the regulations, and another in the rest of the country, where the regulations govern—and limit—whether income qualifies as FBCSI. SVTDG Br. 19. While the Commissioner says (at 26) that the Sixth Circuit has not adopted a "categorical rule," no other circuit has held that § 954(d)(2) may be enforced without regard to the Commissioner's regulations. "This disparity creates uncertainty as to taxation of billions of dollars of transactions," and alone warrants certiorari. SVTDG Br. 19.

Finally, the Commissioner inappropriately dismisses the substantial reliance interests upended by the decision below. The public is generally entitled to rely on regulations—and expects the agency to follow them. *See, e.g.*, *United States v. Pennsylvania Indus. Chem. Corp.*, 411 U.S. 655, 674 (1973). That reliance interest is much stronger where, as here, the statute's operation is expressly conditioned on regulations. *See, e.g.*, *United States v. Caceres*, 440 U.S. 741, 753 (1979); And businesses *have* relied on the § 954(d)(2) regulations in making hundreds of millions of dollars of investments in structuring their overseas operations. SVTDG Br. 3; *see* NAM Br. 17; PWC Br. 7-8. Yet, resorting to just the kind of tax exceptionalism that this Court has denounced, *see Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55 (2011), the Commissioner asks this Court to disregard those reliance interests and leave in place the Sixth Circuit decision imposing tax liability based on a theory not advanced by the Commissioner, in this case or ever before.[7]

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[7] The Commissioner says that everyone knows "agency regulations may not 'alter the clearly expressed intent of

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

RODNEY H. STANDAGE
WHIRLPOOL CORPORATION
325 N. LaSalle Dr.
Chicago, IL 60654
(269) 277-6623

MARK A. OATES
ROBERT H. ALBARAL
BAKER & MCKENZIE LLP
300 E. Randolph Dr.
Suite 5000
Chicago, IL 60601
(312) 861-7594

GREGORY G. GARRE
Counsel of Record
JEAN A. PAWLOW
ERIC J. KONOPKA
LATHAM & WATKINS LLP
555 Eleventh Street, NW
Suite 1000
Washington, DC 20004
(202) 637-2207
gregory.garre@lw.com

Counsel for Petitioners

November 2, 2022

Congress.'" BIO 23 (citation omitted). But, as discussed, the clearly expressed intent of Congress is that § 954(d)(2) would be implemented "under regulations." If those regulations are contrary to the intent of Congress, the solution is to invalidate them and require the IRS to promulgate new ones; it is not for courts to impose a tax without the regulations on which Congress expressly conditioned the statute's operation.