No. 09-1339

In The
Supreme Court of the United States

NESTLÉ PURINA PETCARE COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITIONER'S REPLY BRIEF

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ARGUMENT

I

The government admits that a square conflict exists between the decision below and the Ninth Circuit's *Boise Cascade* ruling. The government does not dispute the importance of the issue presented in light of the millions of Americans who are participants in ESOP plans.

Nor does the government offer any reasoned explanation of how one transaction (the cashout distribution) must be deemed to be "in connection with" another independent transaction (the redemptive dividend) when (a) cashout distributions can be and were funded from sources other than redemptive dividends; (b) redemptive dividends can be and were used by the ESOP for purposes other than paying cashout distributions; (c) no other tax case has ever adopted the "statutory integration" theory announced by the Tax Court *sua sponte*; (d) the interpretation of "in connection with" in this case conflicts with the meaning accorded to that term in other contexts; and (e) the decision below defeats the Congressional purpose of encouraging capital distributions and violates the legislative imperative to construe the applicable statutes generously rather than by "restrictive regulations and rulings."

In lieu of a discussion of these considerations, the government misstates the facts by declaring, "Because the amount petitioner seeks to deduct is the

very amount it paid to reacquire its stock from the ESOP Trust, the payment was 'in connection with the reacquisition of [petitioner's] stock' under any natural understanding of that phrase" (BIO 9). On the contrary, the deductions sought by petitioner are not the "very amounts" it paid to redeem its stock, but rather the portion of those sums that were paid out to departing plan participants. See Stip. ¶¶78, 80, 90. Therefore, "under any natural understanding" the deductions sought by petitioner are not in connection with the reacquisition of its stock.

The government largely parrots the earlier Eighth Circuit opinion in *General Mills*, which "employed essentially the same reasoning" (BIO 6) as the Tax Court's novel "single integrated transaction" analysis. The government, like the Eighth Circuit, misconstrues the opinion in *Boise Cascade*, alleging that it "consider[ed] only the distribution from the trust to the plan participants" (BIO 8). But the Ninth Circuit understood, as the government admits, that both a redemptive dividend and cashout distribution are needed for a deductible "applicable dividend." Therefore, the Ninth Circuit was aware that the bar of §162(k) would apply only if *both* transactions were "in connection with" the redemption of stock. Because the redemptive dividend was so obviously in connection with the redemption of stock, the court properly focused on whether the cashout distribution – the second required transaction – was also in connection with the redemption of stock. In the context of facts

almost identical to those here, the court held that the cashout distribution was an independent transaction, not "in connection with" a redemption and, therefore, correctly concluded that the bar of §162(k) was not applicable. In sum, *Boise Cascade* was right, and the government's (and Eighth Circuit's) criticism of it is off base.

II

As expected, the government attempts to limit the "ongoing significance" of the circuit split by regulating its way out of a losing litigation position (BIO 9-10). As pointed out in footnote 11 of our Petition, such made-for-litigation regulations should not be given *Chevron* deference. Apart from the fact that the regulation is inconsistent with the statute, it is unlikely – or at best idle speculation – that the Ninth Circuit would now refuse to follow *Boise Cascade* as the law of the Circuit merely because the losing party in that case expressed disagreement and non-acquiescence with the decision and purported to overrule it administratively. That's the kind of thing that makes judges mad. The circuit conflict is alive and well and deserves this Court's resolution.*

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* In seeking to convince the Court that the Ninth Circuit would follow the newly-enacted regulations, the government states that the *Boise Cascade* court "acknowledged that the government's construction represented a 'possible sense' of the phrase 'in connection with'" (BIO 10). That is a serious distortion of what the court actually said: "The government would

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III

The government seeks this Court's imprimatur to engage in repetitive relitigation of the same losing issue, free of the shackles of collateral estoppel that would bind any private litigant (BIO 10-11). Its reliance on *United States v. Mendoza*, 464 U.S. 154 (1984), is overstated. The issue in *Mendoza* was whether the government was collaterally estopped by an unappealed district court decision in another case holding that the Nationality Act had been applied in a manner to discriminate against Filipinos as a class and had denied them due process. In ruling that nonmutual offensive collateral estoppel did not apply "to preclude relitigation of *issues such as those involved in this case*" (*id.* at 162, emphasis added), the Court emphasized that the government had made a discretionary decision not to appeal the earlier judgment and should not be precluded from obtaining a determination of the issue by an appellate court. *Id.* at 163.

The lower courts have expressed the view that the *Mendoza* "rule against applying the principles of issue preclusion against the government is not absolute." *N.L.R.B. v. Donna-Lee Sportswear Co.*, 836 F.2d 31, 37 (1st Cir. 1987). In *Benjamin v. Coughlin*, 905

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have us construe this in the broadest possible sense to capture within [§162(k)'s] net any expenses associated with the transaction, however remote." *Boise Cascade*, 329 F.3d at 757.

F.2d 571, 576 (2d Cir. 1990), the court applied nonmutual offensive collateral estoppel to prevent a state government from contending that a prison regulation was valid after the state appellate courts had ruled to the contrary in another case. The Second Circuit distinguished *Mendoza* on the grounds that a "significant[ ]" factor in *Mendoza* was the decision of the Solicitor General not to appeal the prior adverse district court judgment and the desire to avoid premature estoppel and assurance for the government to obtain an appellate determination of the issue. *Id.* *See also Harris v. Martin*, 834 F.2d 361, 365 (3d Cir. 1987) (issue in *Mendoza* was whether the government's failure to appeal an adverse district court judgment would redound to the benefit of a litigant in a subsequent case; where government had failed to appeal adverse judgment, it could not relitigate the issue under Fed. R. Civ. P. 60(b) after an appellate court had ruled against it in another case).

Of particular interest is the astute opinion in *Colorado Springs Production Credit Ass'n v. Farm Credit Administration*, 666 F.Supp. 1475, 1478 & n.2 (D. Colo. 1997). There the court applied offensive nonmutual collateral estoppel to preclude a federal agency from relitigating the validity of regulations which had been struck down by another federal district court in litigation with another party. The court emphasized that *Mendoza* was limited to "issues such as those involved in that case." *Id.* at 1478. Those

issues were of constitutional dimension and significance, and the court suggested that *Mendoza* should accordingly be limited to constitutional determinations and that *Mendoza* did not intend to dictate a rigid exclusion of nonmutual offensive collateral estoppel.

The Colorado court was correct. *Mendoza* does not apply here because (a) this case has no constitutional issues, and (b) the government, instead of foregoing an appeal in *Boise Cascade*, did in fact appeal and lost in the Ninth Circuit. It therefore had obtained the appellate determination that was missing in *Mendoza*, and the estoppel arises not from a trial court ruling but from a prior decision of a coequal United States Court of Appeals.

Furthermore, for the reasons noted in our Petition and ignored by the government, tax cases stand on a different footing than the run of other federal cases. Citizens – corporate and individual alike – make plans and conduct their affairs based on the tax laws that are implicated in their every decision. Thus, when a federal appellate court decides a close question of federal tax law, it is disruptive of orderly affairs when another circuit comes to a different conclusion after substantial reliance by citizens on the earlier declaration of the law. The present case is a graphic example. Even if, therefore, collateral estoppel itself is not directly applicable, notions of uniformity and predictability require respect for the tax decisions of another circuit in the

absence of extraordinary circumstances not present here. *Square D Co. v. Comm'r*, 438 F.3d 739, 744 (7th Cir. 2006); *Gibraltar Fin. Corp. v. United States*, 825 F.2d 1568, 1572 (Fed. Cir. 1987).

IV

The government's two-paragraph discussion of Question Presented number 3 (BIO 11-12) is as unenlightening as the Eighth Circuit's analysis of that issue. It is tantamount to an assertion that a quacking, waddling, web-footed, flat-billed, feathered bird is not a duck because they say it isn't. The government's *ipse dixit* has no textual support in the statute. Nothing in the definition of "dividends paid" in §561 can reasonably be construed to preclude the "Deduction for Dividends Paid" specifically allowed by §404(k). Moreover, as noted in the Petition and not contested by the government, the parties stipulated that "the dividends at issue were indeed dividends under §316 (and therefore were 'dividends' for purposes of §561") (Pet. 10). Because the government's and the Eighth Circuit's interpretation of §162(k)(2)(A)(iii) requires a qualification that does not appear in the plain language of that statute, their position is untenable. Section 162(k)(2)(A)(iii) unambiguously excludes from the bar of §162(k)(1) the "applicable dividends"

authorized by §404(k), and the Eighth Circuit's circular conclusion to the contrary cannot withstand scrutiny.

Respectfully submitted,

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