No. 13-1037

In The

# Supreme Court of the United States

WFC HOLDINGS CORPORATION,
*Petitioner,*

v.

UNITED STATES OF AMERICA,
*Respondent,*

**On petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## BRIEF OF REISS+PREUSS LLP AND TAX STUDENTS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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## INTERESTS OF AMICI CURIAE[1]

Amici are: (1) Reiss+Preuss LLP, an international law firm that advises on corporate and tax issues relating to the inbound investment to the United States; and (2) Sara Alexandre, Jonathan Edderai, Byron Jeffery Lewis, William Talbot and Gafar Zaaloff, tax law students who believe that the economic substance doctrine should not be applied to business transactions on a step by step basis.

Reiss+Preuss LLP focuses its practice on advising European and Latin American companies

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1 Pursuant to Supreme Court Rule 37.6, counsel for amici represents that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than amici or their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for amici represents that all parties were provided notice of amici's intention to file this brief at least 10 days before its due date. Pursuant to Rule 37.3(a), counsel for amici represents that all parties have consented to the filing of this brief. Petitioner has filed a blanket consent to the filing of amicus curiae with the Court. Respondent has granted individual consent to amici, which is located in Appendix 1.

and financial institutions that seek to invest in the United States. Our clients request guidance for compliance with United States tax laws, because even routine transactions often involve multiple steps for business, regulatory, and corporate finance reasons. Therefore, it is particularly important for international investors active within the United States that the traditional application of the economic substance doctrine stands, as opposed to an oppressive, expanded application that requires every step of business transactions to be independently profitable. Thus, this firm respectfully requests that the Court grant certiorari.

Ms. Alexandre and Messrs. Lewis and Talbot are students enrolled in the New York Law School LL.M. in Taxation Program, Mr. Zaaloff is a student attending New York Law School, and Mr. Edderai is

a student currently attending Hofstra Law School. These students recognize the importance of economic substance jurisprudence, but believe that the Eighth Circuit's expansion of the doctrine to require that each step of a profitable transaction have independent economic substance is inappropriate and inconsistent with Court precedent. As future tax practitioners, the students have a particular interest in a well-founded and consistent tax jurisprudence. Thus, these students respectfully request that the Court grant certiorari.

## SUMMARY OF THE ARGUMENT

Ongoing tax uncertainty deters foreign investment in the United States ("US") by imposing significant and unnecessary tax compliance costs. The lack of a comprehensible economic substance jurisprudence compounds tax uncertainty

and hurts the tax bar, which cannot properly advise clients without clarity on the proper administration of the economic substance doctrine.

The Eighth Circuit's decision was improper, because the transaction at issue has economic substance. The economic substance doctrine should not apply to such a transaction, even if it were executed in a tax efficient manner. WFC transferred its underwater leases to its non-regulated affiliate, in accordance with the National Bank Act and the United States Generally Accepted Accounting Principles ("US GAAP"). This disposition allowed WFC to increase profitability via subleases. WFC chose to capitalize Charter in a manner that provided the most efficient capital from a corporate finance perspective. This capital structure allowed WFC to sell Charter stock to Lehman Brothers, at

the time, a source of high-quality financing for broader bank operations.

Tax planning is an important consideration for foreign investors in the US. For example, foreign investors that capitalize separate subsidiaries for purposes of investment in the US may be able to limit their US tax to activities performed by those subsidiaries or avoid effectively connected income associated with an investment in a partnership. An overly broad application of the economic substance doctrine creates significant uncertainty for foreign investors, especially since the investors seek to structure their investments in a tax-efficient manner.

The Eighth Circuit's decision improperly expands and reinterprets the economic substance doctrine in the circuit courts, which negatively

affects business interests, tax professionals, and the legal academy. The Supreme Court should take this opportunity to reverse the Eighth Circuit's decision and clarify the application of the economic substance doctrine in a manner consistent with Congressional intent and a fair and efficient corporate tax regime.

## ARGUMENT

### I. CERTIORARI SHOULD BE GRANTED SO THAT THE COURT CAN CLARIFY THE APPLICATION OF THE ECONOMIC SUBSTANCE DOCTRINE, BECAUSE THE EIGHTH CIRCUIT'S OPINION WILL IMPEDE INVESTMENT IN THE UNITED STATES.

The Eighth Circuit's decision further confuses application of the economic substance doctrine and creates an obstacle to foreign investment in the US. In the decades since the Supreme Court last

addressed this topic in Frank Lyon Co. v. United States, 435 U.S. 561 (1978), circuit court interpretations of the Supreme Court's economic substance jurisprudence have improperly broadened and confused the law. A "bewildering variety of formulations" are now in play at the circuit level. Fid. Int'l Currency Advisor A Fund, LLC v. United States, 747 F.Supp.2d 49, 226 (D. Mass. 2010). The Court should take this opportunity to overturn the Eighth Circuit's decision, by issuing a definitive statement that restores the traditional application of the economic substance doctrine.

**A. Tax Uncertainty Discourages Foreign Investment in the United States**

Foreign investors decide not to invest in the US, due to the lack of clarity for their prospective US tax positions and the excess costs related to US tax

compliance. The Internal Revenue Service ("IRS") recently estimated that tax compliance costs taxpayers $110 billion annually. George Contos et al, Taxpayer Compliance Costs for Corporations and Partnerships: A New Look, IRS Research Bulletin, I.R.S. Pub. 1500 at 7 (June 21, 2012) (available at http://www.irs.gov/pub/irs-soi/12rescontaxpaycompliance.pdf). Private research suggests that annual compliance costs run from $67 billion to $378 billion. Jason J. Fichtner & Jacob Feldman, The Hidden Costs of Tax Compliance, 5 (May 20, 2013) (available at http://mercatus.org/sites/default/files/Fichtner_TaxCompliance_v3.pdf.).

Disparate economic substance jurisprudence further increases US tax compliance costs that already exceed those of other developed economies

and reduces foreign investment in the US. See The World Bank, Paying Taxes, Doing Business (Mar. 27, 2014, 10:30 AM) http://www.doingbusiness.org/data/exploretopics/paying-taxes. In addition, significant negative tax consequences attend administrative or judicial designation of a particular transaction as a "sham," including denial of claimed refunds, assessment of additional tax, and the assessment of significant penalties and interest.

**B. Foreign Investors' Legitimate Tax Planning Would be Hampered by an Expansive Application of the Economic Substance Doctrine**

US tax law provides foreign investors methods to structure their investments in a tax efficient manner and manage their tax compliance costs. For example, a foreign investor may avoid the additional

tax compliance costs associated with having a "permanent establishment" in the US by creating a specific subsidiary to conduct its US business activities. In this manner, the foreign investor limits US tax obligations to business "actively conducted" in the US. A foreign investor may also use a subsidiary to avoid "effectively connected" income when investing in a partnership in the US under I.R.C. § 864 (2013). Alternatively, a foreign investor may elect to have its investment vehicle classified in a tax efficient manner under the "check the box" Treasury Regulations. Treas. Reg. §§ 301.7701-1 to 301.7701-3.[2] Finally, a foreign investor may create a subsidiary to hold real property in the US in order to limit the application of the Foreign Investment in

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[2]The "check the box" regulations allow business entities to elect to be treated as corporations or as partnerships. Treas. Reg. §§ 301.7701-1 to 301.7701-3.

Real Property Tax Act ("FIRPTA"), which requires tax withholding on sales of US real property by foreigners. I.R.C. §§ 897, 1445(a) (2013). These planning techniques occur in the context of overall profitable transactions and are part and parcel of normal business practices that allow an investor to achieve tax efficiency and manage tax compliance costs.

Foreign inbound investors also often incorporate several subsidiaries in the US in order to legally separate different lines of business. These companies look for efficient financing and strategic economic co-investors to participate in the separate businesses. Each affiliate may have independent management deciding how to raise capital for its business. When business judgment calls for the creation of a subsidiary, good business practice

requires the subsidiary be established in the most tax-efficient manner.

A broad application of the economic substance doctrine would call into question the viability of these accepted business and tax planning methods and would impinge on the ability of foreign investors to invest in the US without additional tax compliance costs. Whereas, clarification of the traditional economic substance jurisprudence will reduce these compliance expenditures and shift the economic calculus in favor of investment in the US.

## II. THE TRANSFER OF UNDERWATER LEASES TO CHARTER HAD ECONOMIC SUBSTANCE WHERE THE DISPOSITION OF THE LEASES WAS (A) REGULATED BY LAW, (B) CONSISTENT WITH THE "HOLDING COMPANY MODEL" AND (C) ALLOWED THE LEASES TO BECOME PROFITABLE

In Frank Lyon Co. v. United States, 435 U.S. 561, 583 (1978), the Supreme Court held that a transaction "compelled or encouraged by business or regulatory realities," has economic substance. In reaching that conclusion, the court found persuasive the relief from regulatory requirements placed on the bank. Id. Under the expanded economic substance doctrine espoused by the Eighth Circuit, taxpayers could be penalized for making decisions that are objectively sensible for their businesses. Here, due to regulations promulgated by the Office of the

Comptroller of the Currency ("OCC"), WFC was compelled by the business realities recognized by the lower courts to dispose of its underwater leases in an economically efficient manner. National Bank Act,12 U.S.C. § 29 (2013); 12 C.F.R. § 34.82(a). The regulations also required disposition of the non-banking property within five years. Id.

Disposition of non-banking property occurs through a transaction that is classified as a "sale" under US GAAP. 12 C.F.R. § 34.83(a)(1). For purposes of the sale of real property, the FASB Accounting Standards Codification ("ASC") deems a sale consummated when the parties are bound by the terms of a contract, all consideration has been exchanged, any permanent financing for which the seller is responsible has been arranged, and all conditions precedent to closing have been performed.

ASC 360-20-40-7. Since these conditions were met here, the transaction was a permissible disposition under the National Bank Act regulations.

Moreover, the transaction was consistent with the "holding company model." At the time WFC issued and sold the Charter preferred stock, bank regulators had become increasingly concerned about the structural risks posed by the entry of banks into nontraditional activities. See Gary Whalen, Bank Organizational Form and the Risks of Expanded Activities, Office of the Comptroller of the Currency, E&PA Working Paper 97-1 (January 1997). The "holding company model" managed these problems by requiring that some nonbanking activities be conducted through distinct subsidiaries of a parent holding company. Id. The use of subsidiaries protected the broader banking operation from

"extraordinary risk," and lessened the risks occasioned by transfers between banking entities. Id. The corporate separation required by the "holding company model" necessitated the adequate capitalization of the non-banking affiliates. Id. The contribution of Treasury securities made Charter's balance sheet more robust and ensured the company was well-capitalized.

The importance of a well-capitalized subsidiary is not limited to the banking sector. To conduct business, companies require a wide variety of real assets to raise operating funds by selling "claims" on those assets and the revenues they generate. Richard A. Brealey, Stewart C. Myers & Franklin Allen, Principles of Corporate Finance, 6-7 (8th ed. 2006). A company with more marketable assets will be more attractive and better able to raise

capital over the long term. Id. The perceived quality of an entity's asset base corresponds to the marketability of its securities. Id. A high-quality base helps lower the cost of capital, expectations, and deal terms, and will require less stringent deal covenants from the issuing entity. Id. The contribution of Treasury securities to Charter increased its marketable asset base, and therefore made it more attractive to potential investors and lowered Charter's cost of capital. In short, WFC was able to improve its bargaining position and sell Charter preferred stock at its desired terms because Charter was well-capitalized.

The transfer of the Treasury securities to Charter had economic substance because without these securities, Charter would have been undercapitalized, underfunded, and unable to cover

the payments on the master lease. It would be inconsistent with the holding company model and common business sense to form a company without contributing sufficient assets to cover its liabilities.

The disposition of the leases also allowed Charter to generate millions of dollars in profit through subleases. WFC Holdings Corp. v. United States, No. 07-3320, 2011 WL 4583817 at *30 ¶ 214 (D. Minn. Sept. 30, 2011). The transfer of the underwater leases had economic substance because the law required the transfer, the law permitted the form of the transfer, the structure of the transfer was consistent with the holding company model, and the transfer allowed Charter to generate profits on the subleases.

## III. THE ISSUANCE AND SALE OF CHARTER PREFERRED STOCK HAD ECONOMIC SUBSTANCE BECAUSE TAXPAYERS ARE FREE TO FINANCE THEIR BUSINESSES VIA ECONOMICALLY EFFICIENT STRUCTURES THAT GENERATE FINANCIAL PROFIT.

Prior to this matter, the Eighth Circuit had explained that economic substance entails an anticipation that a "'potential for profit exist[ed]'for the transaction outside of tax considerations." IES Indus. Inc. v. United States, 253 F.3d 350, 353 (8th Cir. 2001). Additionally, the taxpayer's basis for anticipating a potential profit must meet the "objective" standard, which the Federal Circuit explained to be a "reasonable expectation of potential profit" founded upon the "information available to a prudent investor at the time the taxpayer entered into the transaction." Stobie Creek Invs. LLC v.

United States, 608 F.3d 1366, 1375 (Fed. Cir. 2010); Salina P'ship LP v. Comm'r, T.C.M. (CCH) 2000–352, No. 25084-96, 2000 WL 1700928 at *12 (T.C. Nov. 14, 2000).

To substantiate its belief that the sale of the Charter preferred stock lacked economic substance, the District Court opined that: (1) "Lehman's interest was unaffected by Charter's profits, because its stock was more similar to debt than equity," (2) the issuance of the Preferred Stock could not be predicted to enhance WFC's ability to dispose of the underwater leases," and (3) "bringing in Lehman had no non-tax value, and increased transaction costs." WFC Holdings v. United States, No. 07–3320, 2011 WL 4583817 at *42, *45(D, Minn. Sept. 30, 2011). Respectfully, amici contend that the District Court's assertions are incorrect, because the issuance

and sale of stock at market rates are independently economically significant transactions that cannot be disregarded simply because they were executed in a tax-efficient manner.

**A. The Economic Substance Doctrine Should Not Apply To The Decision To Issue Preferred Stock, Especially When The Stock Provides Tier 1 Capital.**

Numerous authorities suggest that it is generally inappropriate to raise the economic substance doctrine in transactions involving the choice of whether to capitalize a company using debt or equity. See United Parcel Service of America v. United States, 254 F.3d 1014, 1019 (11th Cir. 2001). The court in UPS noted, "[t]here may be no tax-independent reason for a taxpayer to choose between . . . different ways of financing a business, but it does not mean the taxpayer lacks a business

purpose. To conclude otherwise would prohibit tax planning." UPS, 254 F.3d at 1019. In addition, the Joint Committee on Taxation explained that the codification of the economic substance doctrine in I.R.C. § 7701(o) (2013) does not alter the treatment of certain traditionally respected transactions such as the choice to capitalize with debt or equity, or the choice of business entity. Staff of J. Comm. on Taxation, 111th Cong., Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, In Combination with the Patient Protection and Affordable Care Act 152 (J. Comm. Print. 2010). The IRS has also indicated that the new economic substance statute was not intended to apply to decisions about whether to capitalize a company with debt or equity or organizational transactions under I.R.C. § 351 (2013). See Guidance for Examiners and Managers on the Codified

Economic Substance Doctrine and Related Penalties, LB&I Control No: LB&I-4-0711-015, July 15, 2011. Nevertheless, the District Court ignored longstanding precedent and Congressional intent by scrutinizing Charter's decision to capitalize with preferred stock.

Notwithstanding the District Court's incorrect application of the economic substance doctrine to WFC's contribution to Charter (the I.R.C. § 351 transaction) and the subsequent stock sale (the capital raising), WFC actually had sound business justification for issuing and selling the Charter preferred stock. A critical feature of the Charter preferred stock is that, at the time it was issued, it could have been considered "Tier 1" capital. 12 C.F.R. § 225 (A)(iv)(1). "Tier 1" status with respect to capital is crucial, because the quantity held indicates

the bank's financial strength and whether the company can adequately cover its losses and still remain viable. International Banking and Financial Market Developments, BIS Quarterly Review, (March 1999). Consequently, Tier 1 capital plays a pivotal role in a company's ability to attract investors and lenders, and to raise funds by borrowing against the value of its Tier 1 capital. Id.

Thus, the receipt of the Charter preferred stock was particularly advantageous for WFC. The $4 million received in Tier 1 capital translated into at least $32 million of spending power that WFC could devote to its operations and investments. Wells Fargo & Co/MN, Annual Report (Form 10-K) 90-91 (Mar. 17, 2000); See Brief for Petitioner at 46, WFC Holdings Corp. v. United States, 728 F.3d 736 (8th Cir. 2013) (No. 11-3616). This eight to one ratio

arising out of Tier 1 status is significant when considering the Garland property held by WFC. Prior to the transaction, the Garland lease accounted for almost half of the liabilities assumed by Charter, and the building required over $30 million of upgrades and refurbishments. See Brief for Petitioner at 46. With the upgrades completed, the Garland building went on to generate a large profit. Id. The fact that Charter refurbished the Garland building ten years after the transaction at issue reflects the economic substance of the disposition of the Garland lease. Therefore, it was a business reality that relatively small amounts of money classified as Tier 1 capital could provide a reasonable and objective basis for expecting considerable profits, which would serve as bona fide encouragement to WFC to engage in the preferred stock transaction. See Id.

## B. The Sale of Charter Preferred Stock To Lehman Was Financially Efficient For WFC for Non-Tax Reasons

The District Court erroneously portrayed the issuance of the stock and the sale to Lehman as economically insufficient. The court noted that the increased transaction costs of issuing the preferred stock were a burden that WFC did not have to accept. WFC Holdings Corp. v. United States, 728 F.3d 736 (8th Cir. 2013). The Court failed to consider that the preferred stock was issued at a market rate, and the entire cost of the issuance was included in the stock price and completely recouped by WFC in the sale. See Brief for Plaintiff-Appellant at 30, WFC Holdings Corp. v. United States, 728 F.3d 736 (8th Cir. 2013) (No. 11-3616). From an economic perspective, the creation and sale to

Lehman Brothers of Charter preferred stock improved the quality of Charter's capitalization.

Businesses generally raise funds according to a "pecking order" of financing options. Richard A. Brealey, Stewart C. Myers & Franklin Allen, Principles of Corporate Finance, 366 (8th ed. 2006). The ideal option is internal financing. Id. Issuing debt is considered the second best measure to raise funds, followed by the issuance of a hybrid security, *e.g.*, preferred stock. Id. Issuing common stock is the least desirable option. Id.

WFC raised capital according to this pecking order. First, WFC utilized internal financing by transferring Treasury securities, together with the leases, to Charter in exchange for preferred stock. If Charter had issued debt to raise further funds, it would have eliminated WFC's ability to sell a

security capable of generating Tier 1 capital. See supra discussion of Tier 1 capital at [23-25]. Consequently, WFC employed the next best financing alternative, the issuance and sale of preferred stock.

Preferred stock is also an attractive asset for investors because of the economic benefits associated with the form. Preferred stock yields commonly exceed non-preferred yields, and are senior to common stock in a liquidation scenario. Nick Louth, Preference Shares Boast Yields of 7-10%, Financial Times (May 28, 2010). The choice to issue and sell preferred stock is an established non-tax strategy within the financial community; Warren Buffett invested in preferred stock of General Electric at the height of the banking crisis, and in preferred stock of Bank of America in 2011. Id. Lehman held the

Charter stock for fifteen years until it was repurchased by WFC during the Lehman bankruptcy, providing long-term funding to WFC and underlining the genuine economic motivations behind the sale. Through the incorrect application an expansive economic substance doctrine, the lower courts failed to recognize the significant non-tax benefits provided by preferred stock.

The Charter transaction was not a "sham," but a legitimate business transaction executed in a tax-efficient manner. WFC's decision to contribute the leases to Charter followed by the sale of preferred stock was motivated by: (1) regulatory requirements; (2) the potential to realize profits; (3) a desire to improve the bank's capital structure and (4) the opportunity secure high-quality financing. These valid business purposes illustrate that this was an

economically substantial transaction, of the kind Congress and the Court have traditionally sought to protect. The Court should intervene to reaffirm Congressional intentions, to enforce its own long-standing jurisprudence, and to offer businesses, both domestic and international, clear guidance on how US tax law will view their future transactions.

## CONCLUSION

For the forgoing reasons, amici respectfully request that the court grant the petition for a writ of certiorari.

Respectfully submitted,

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