



PPL Corp. v. Commissioner of Internal Revenue

Brief For Southeastern Legal Foundation, CATO Institute, And Goldwater Institute As Amici Curiae In Support Of The Petition For Writ Of Certiorari

by [Cato Institute](#) on 8/13/2012

An American energy company called PPL bought one of many state-owned British utilities privatized in the 1980s. In 1997, PPL thus became subject to the U.K.'s new "windfall tax," which was based in part on "profit-making value"—the utility's average annual profit multiplied by an imputed price-to-earnings ratio. Various American energy companies subject to this tax filed claims with the IRS for a "foreign income tax" credit, which the IRS denied in 2007, asserting that the British tax was not a creditable one under the "foreign income tax" provision of the Internal Revenue Code (Section 901). The IRS claimed that the windfall tax did not satisfy the "predominant character" standard (was not predominantly an income tax) because the British statute used the term "profit-making value" instead of "net income" and "gross receipts," and the tax rate was defined "as a percentage of an imputed value ... rather than directly as a percentage of net income." After the federal tax court held that PPL was entitled to the foreign tax credit, the U.S. Court of Appeals for the Third Circuit reversed. Explaining that a tax exemption is a privilege extended by legislative grace, the appellate court held the tax not to be creditable because it reached beyond realized profit and did not tax actual gross revenue. In a different case last year, however, the U.S. Court of Appeals for the Fifth Circuit held that the British windfall tax was indeed creditable because (1) it reached realized income and (2) gross revenue was an inherent part of the calculation. The Fifth Circuit explained that the form and label of the foreign tax are not determinative and that the predominant character standard requires the IRS to analyze the history and intent of a tax to assess whether it tries to reach some net gain.

Cato now joins Southeastern Legal Foundation and Goldwater Institute in urging the Supreme Court to take PPL's case because it implicates fundamental issues of property rights, free markets, and the arbitrary exercise of government power—and the circuit split creates uncertainty for American businesses overseas. We argue that taxpayers have the right to be free from double taxation and that here the IRS and Third Circuit improperly disregarded the substance of the windfall tax and applied an overly rigid construction of its terms. Ultimately, a foreign tax's form or label cannot mask its substantive character and intent for legal purposes. American businesses operating overseas should be able to rely on a stable, substantive application of U.S. tax law instead of arbitrary interpretations and constructions manipulated to generate payments to the IRS.

Please see full brief below for more information.