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Can Legislative History Restore a Repealed IRC Provision?

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Altria Group, Inc. v. United States[1], a federal income tax case pending in federal district court in Virginia, shows the importance of laying groundwork for litigation long before a complaint is filed. At issue is a difficult question of statutory interpretation. The taxpayer ("Altria") – or those in the same position – undoubtedly encouraged Congress to express its intent in legislative history. Although a court will disregard legislative history if the legislation is unambiguous,[2] the congressional committee report for the tax provision at issue becomes pivotal if Altria can successfully show that the meaning of the legislation in context is uncertain.

Altria is a domestic corporation. During the taxable year, 2017, it owned 10.2% of the stock in a foreign corporation, AB InBev ("ABI-Foreign Parent"). Altria is challenging the government's inclusion of earnings of ABI-Foreign Parent's foreign subsidiaries ("ABI-Foreign Subsidiaries") in Altria's federal taxable income, and a $38 million tax liability resulting from the inclusion. Altria argues that it does not control ABI-Foreign Parent, owning only 10.2% of its stock interest, and clearly does not control ABI-Foreign Subsidiaries with only an indirect 10.2% equity interest through ABI-Foreign Parent. To understand what appears to be the government's theory, ABI-Foreign Parent's corporate structure must be described, coupled with explanations of how Subpart F of the Internal Revenue Code works and the effect of a certain a Subpart F provision that was repealed in 2017. Altria's task is to persuade the court to apply the theory of a now repealed statute to find that it still currently affects Altria's income.

ABI-Foreign Parent's corporate structure: ABI- Foreign Parent owns ABI-United States Subsidiary in addition to ABI-Foreign Subsidiaries. The government appears to be arguing that ABI-United States Subsidiary is considered under Subpart F as owning and controlling ABI-Foreign Subsidiaries even though ABI-United States Subsidiary and the ABI-Foreign Subsidiaries are brother-sister corporations. The argument then proceeds with the conclusion that Altria is taxable on ABI-Foreign Subsidiaries' earnings because ABI-United States Subsidiary is considered as controlling them and because Altria is considered as owning an indirect interest in them through ABI-Foreign Parent. How the government's argument reaches this conclusion requires a brief review of Subpart F along with focus on a provision of Subpart F that Congress repealed in 2017, seemingly without appreciating the full effect of the repeal.

Subpart F (IRC §§951-965): Congress enacted Subpart F in 1962 to prevent United States corporations from parking earnings in foreign subsidiaries and avoiding federal income tax on the earnings. If a foreign subsidiary has certain categories of earnings, Subpart F requires its United States shareholders to include the foreign subsidiary's earnings in the United States shareholder's taxable income. To require the inclusion, the foreign subsidiary must be a "Controlled Foreign Corporation" and its shareholder must be a "United States Shareholder," all as defined in Subpart F.

United States Shareholder and Controlled Foreign Corporation: A "United States Shareholder" is a person who directly or indirectly owns, by vote or value, 10% or more of the stock of a controlled foreign corporation.[3] Through ABI-Foreign Parent, Altria indirectly owns 10.2% of the ABI-Foreign Subsidiaries. But that indirect ownership is not, in itself, sufficient to require Altria to be taxed on the ABI-Foreign Subsidiaries' earnings. The United States Shareholder must be a shareholder in a Controlled Foreign Corporation, which is defined as a foreign corporation more than 50% of the stock in which is directly or indirectly owned or constructively owned by United States Shareholders.[4] The ABI-Foreign Subsidiaries consequently must be more than 50% owned by United States Shareholders for Altria to be required to include the Subpart F income of the ABI-Foreign Subsidiaries.

Constructive Stock Ownership Rules: It is a constructive ownership rule that ensnares Altria according to the Government. Constructive stock ownership rules determine if a United States person is a "United States Shareholder" in a foreign corporation, and if a foreign corporation is a "Controlled Foreign Corporation." This means that for certain transactions, a corporation is treated as owning stock owned by another corporation.[5] The constructive ownership rule in issue in *Altria* is downward attribution: If 50% of the stock in a corporation is owned by a person, the corporation is treated as owning the stock owned directly or indirectly by that person. Constructive ownership "moves" the stock downward from the person (50% owner of the corporation) to the corporation, itself.

The government argues that downward attribution takes the stock owned by ABI-Foreign Parent in the ABI-Foreign Subsidiaries and constructively attributes that stock to ABI-United States Subsidiary, thus making ABI-United States Subsidiary the parent of ABI-Foreign Subsidiaries and making ABI-Foreign Subsidiaries "Controlled Foreign Corporations" controlled by a "United States Shareholder," ABI-United States Subsidiary. In this case, the issue is whether Altria is to be treated as a United States Shareholder of the ABI-Foreign Subsidiaries when Altria lacks effective control of the ABI-United States Subsidiary, the constructive parent (but really the brother corporation) and of the ABI-Foreign Subsidiaries.

A literal reading of the constructive ownership rules reaches the result that the ABI-Foreign Subsidiaries are Controlled Foreign Corporations. That happened – arguably inadvertently – when in 2017, Congress amended the constructive stock ownership rules in Subpart F in the Tax Cuts and Jobs Act (TCJA).[6]

Tax Cuts and Jobs Act: Prior to enactment of the TCJA, downward attribution from foreign shareholders of a potential Controlled Foreign Corporation was *turned off* – meaning was not applied – by prior IRC §958(b)(4) for Subpart F purposes.[7] The TCJA appears to *turn on* downward attribution from foreign shareholders of a potential Controlled Foreign Corporation for Subpart F purposes by repealing IRC §958(b)(4). If downward attribution is turned off, ABI-United States Subsidiary does not constructively own the stock of the ABI-Foreign Subsidiaries, and, in turn, the ABI-Foreign Subsidiaries are not Controlled Foreign Corporations. Altria argues that despite the repeal, other sections[8] of Subpart F continue the rule that a United States Shareholder must have some capacity to control the Controlled Foreign Corporation, which, in its case, is absent. And here, Altria relies on the legislative history to the TCJA stating that downward attribution remains turned off despite the repeal of IRC §958(b)(4) because "control," the essence of Subpart F, does not exist for unrelated persons.

Legislative History Favoring the Taxpayer's Interpretation: The taxpayer's complaint cited the Senate Budget Committee Report,[9] which stated that the repeal of downward attribution for Subpart F purposes was not intended to treat a foreign corporation as a Controlled Foreign Corporation with respect to a United States Shareholder if the United States Shareholder is "not a related person" to the shareholder the Controlled Foreign Corporation. The taxpayer's complaint also cited a floor colloquy between senators Hatch and Perdue stating that the repeal of downward attribution was not intended to apply to unrelated persons.[10]

Undisputed Purpose of the Repeal: Congress intended the TCJA's downward attribution turn-on to apply only to a de-controlling transaction.[11] The bill was not, however, amended to limit the scope of the repeal to a de-controlling transaction, and if the legislative history is disregarded, downward attribution appears to be turned on for all Subpart F purposes. Altria takes a surgical approach to the repeal: It applies to decontrolling transactions but not to transactions like its own, so that a person with no effective control is not a United States Shareholder of a foreign corporation that is

a Controlled Foreign Corporation only by downward attribution.[12]

The Treasury Department: The Treasury Department agrees that the repeal of downward attribution went too far for several tax provisions, but not for Subpart F. Where the Treasury Department could identify specific regulatory authority delegated to it by Congress to override the repeal, it did so for these provisions.[13] The Treasury Department did not do so for Subpart F presumably because the Treasury Department could not identify specific regulatory authority granted by Congress to limit the scope of the repeal for Subpart F purposes.

The Federal District Court Proceeding: Altria reported its share of the earnings of the ABI-Foreign Subsidiaries as if downward attribution had been turned on. It then filed a refund claim with the IRS on the theory expressed in the TCJA legislative history that downward attribution was not turned on in the absence of a controlling relationship between Altria and ABI-United States Subsidiary. The IRS did not allow the refund, and Altria sued for refund in the federal district court in Virginia.

Altria is asking the court to turn-off downward attribution. The taxpayer argues that a United States Shareholder, with its group of other United States Shareholders, must have the ability to control the foreign corporation,[14] which is the theorical essence of Subpart F, and which for Altria, with respect to the ABI-Foreign Subsidiaries, is lacking. The legislative history for the repeal of the turn-off absolutely supports Altria. From a theoretical perspective, the taxpayer's request of relief has merit. For the district court, the question is whether it can rely on the other sections of Subpart F and the legislative history to treat downward attribution as turned off despite the TCJA amendment that repealed the specific statutory provision that turned off downward attribution.

Altria argues further that if repeal of downward attribution applies, then the repeal is unconstitutional as to it. The argument is based on the pending case *Moore v. United States,* ***[15]*** which has been argued in the current Supreme Court term and likely will be decided this year. In *Moore,* the taxpayer argues that a taxpayer can be taxed on income only if the taxpayer "realizes" the income, and income realized by a foreign corporation beyond the control of the taxpayer is not realized by the taxpayer. The Supreme Court in *Moore* might rule that a shareholder who is a member of the control group of shareholders may be considered as realizing the income for constitutional purposes. That does not necessarily resolve the constitutional issue for Altria because its relationship to ABI-United States Subsidiary still may be too attenuated as a constitutional matter.

Please contact the authors of this alert or your Miller Canfield attorney if you would like to discuss this alert.

[1] Civil Action No. 3:23-CV-293-MHL E.D. Va. (5-1-23). The proceedings currently are stayed pending a decision by the United States Supreme Court in *Moore v. United States*, No. 22-800, *argued* (U.S. Dec. 5, 2023).

[2] "Whether or not legislative history is ever relevant, it need not be consulted when, as here, the statutory text is unambiguous." *U.S. v. Woods*, 571 U.S. 31, 46 (U.S., 2013).

[3] IRC §951(b).

[4] IRC §957(a).

[5] IRC §958(b).

[6] P.L. 115-97 (2017).

[7] IRC §958(b)(4), applying the constructive ownership rules of IRC §318(a) to Subpart F.

[8] IRC §§951(b), 957(a).

[9] Committee Print, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Prt. 115-20, (December 2017), as reprinted on the website of the Senate Budget Committee, available at https://www.budget.senate.gov/taxreform (Explanation of Provision at p. 383: "This provision is not intended to cause a foreign corporation [ABI Foreign Subsidiaries] to be treated as a controlled foreign corporation with respect to a U.S. shareholder [Altria] as a result of attribution of ownership under section 318(a)(3) to a U.S. person [ABI United States Subsidiary] that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder [Altria] as a result of the repeal of section 958 (b)(4)." (Explanatory insertions added.) The Government's answer denies that the Budget Committee Report is legislative history.

[10] Tax Cuts and Jobs Act – Conference Report; Congressional Record Vol. 163, No. 207 (Senate - December 19, 2017) Page S 8110.

[11]H.R. Rep. No. 115-409, at 387 (2017); H.R. Rep. No. 115-466, at 507-508 (2017) (Conf. Rep. "[T]he conferees intend to render ineffective certain transactions that are used to as a means of avoiding the subpart F provisions. One such transaction to avoid subpart F involves effectuating "de-control" of a foreign subsidiary …. Such a de-controlling transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders." Altria did not de-control a foreign subsidiary.

[12] H.B. 5751, 118th Cong., 2nd Sess. (9-27-23) would amend the Internal Revenue by reenacting IRC §958(b)(4) and adding IRC §951B to continue taxation of de-controlling transactions. The bill would have an effective date that would preclude downward attribution for taxpayer like Altria.

[13] Varma & Azebu, "Repeal of the Limitation on Downward Attribution: Three Years Later," 170 Tax Notes Fed. 891 (Feb. 8, 2021).

[14] IRC §957(a).

[15] See our prior Alert on *Moore* at https://www.millercanfield.com/resources-Will-Supreme-Court-Invalidate-Sections-of-Tax-Cuts-and-Jobs-Act.html.