**BEFORE THE**
**UNITED STATES DEPARTMENT OF JUSTICE**
**OFFICE OF LEGAL COUNSEL**

In the matter of

DEPARTMENT OF TRANSPORTATION,
MARITIME ADMINISTRATION;
and
DEPARTMENT OF COMMERCE, NATIONAL
OCEANIC AND ATMOSPHERIC ADMINISTRATION,

v.

DEPARTMENT OF TREASURY,
INTERNAL REVENUE SERVICE,

regarding authority to administer
the tax aspects of the Capital
Construction Fund program.

# BRIEF OF THE UNITED STATES DEPARTMENT OF THE TREASURY AND THE INTERNAL REVENUE SERVICE


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## INTRODUCTION

The Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS"), an agency of Treasury, hereby submit this brief to the Attorney General and her delegate, the Assistant Attorney General, Office of Legal Counsel ("OLC"), to resolve a jurisdictional dispute that has arisen between Treasury and two other agencies concerning administration of the merchant marine Capital Construction Fund ("CCF") program. The other agencies involved in this dispute are the Maritime Administration ("MARAD"), an agency of the Department of Transportation ("DOT"), and the National Oceanic and Atmospheric Administration ("NOAA"), an agency of the Department of Commerce ("Commerce"). The Attorney General's authority to resolve this jurisdictional dispute arises pursuant to 28 U.S.C. §§ 511-512 (1995) and § 1-401 of Executive Order 12146 (1979). That authority has in turn been delegated to OLC pursuant to 28 C.F.R. § 0.25 (1995).

### The CCF Program

The CCF program is intended to promote the acquisition, construction, and reconstruction of U.S.-flagged merchant and fishing vessels through specific tax incentives. The statutory provisions governing the program are set forth in parallel in two titles of the United States Code: section 607 of the Merchant Marine Act of 1936, as amended ("the MMA"), codified at 46 U.S.C. App. § 1177 (1995); and section 7518 of the Internal Revenue Code of 1986 ("IRC" or "the Code"), codified at 26 U.S.C. § 7518 (1995). In particular, sections 7518(a) through (h) of the Code

repeat sections 607(b) through (i) of the MMA virtually verbatim, with only minor differences in the wording of cross-references.

The CCF program operates by deferring federal income taxes indefinitely on certain income that is set aside for qualifying purposes. U.S. taxpayers may deduct certain amounts deposited into a CCF from their taxable income and exclude from income the earnings on those deposits. <u>See</u> IRC § 7518(c)(2); MMA § 607(d)(2). The amounts that may be deposited into a CCF are limited to the sum of the following items: the portion of a participant's taxable income from qualifying vessels derived from operations in domestic or foreign commerce or in U.S. fisheries; the allowable tax depreciation from such vessels; the net proceeds from the sale or other disposition of such vessels; the insurance or indemnity proceeds attributable to such vessels; and the receipts from the investment or reinvestment of the CCF assets. <u>See</u> IRC § 7518(a); MMA § 607(b). Three types of accounts -- the capital account, the capital gain account, and the ordinary income account -- must be maintained, according to the nature of the deposits. <u>See</u> IRC § 7518(d); MMA § 607(e).

Qualified withdrawals from the CCF can be made for the acquisition, construction, or reconstruction of a qualified vessel, or for the payment of the principal on indebtedness incurred for such a purpose. <u>See</u> IRC § 7518(e); MMA § 607(f). Qualified withdrawals are not included in the participant's taxable income, but they reduce its basis in qualified assets. <u>See</u> IRC § 7518(f); MMA § 607(g). Withdrawals that are not for

qualified purposes are treated as coming first out of the ordinary income account, second from the capital gain account, and last from the capital account. Such non-qualified withdrawals are taxable as ordinary income or capital gain, respectively, if from the first two accounts, but they do not result in any tax if drawn from the capital account. See IRC § 7518(g); MMA § 607(h).

If the basis of a vessel is reduced under these rules and the taxpayer disposes of the vessel, then to the extent of any gain on the disposition an amount equal to the reduction in basis is taxed as ordinary income in the year of the disposition. However, if the taxpayer redeposits the proceeds from the disposition into the CCF, taxation may be further postponed. See IRC § 7518(f)(5); MMA § 607(g)(5).

Background of this dispute

The history underlying Treasury's jurisdictional disagreement with NOAA over the CCF program, which is discussed at some length in NOAA's submission, see Joint Brief of the United States Department of Transportation and Department of Commerce ("Jt. Br.") at 17-20, can be stated succinctly. In 1992, NOAA proposed regulations under the program that may have significant federal income tax consequences for program participants. 57 Fed. Reg. 54356 (Nov. 18, 1992). In particular, the proposed regulations define certain "safety improvements" as "reconstruction of a qualified vessel" under the program. Id. at 54357-58; cf. IRC § 7518(e)(1). Treasury

subsequently advised NOAA that the proposed regulations could not be issued as final regulations without Treasury's approval, but Treasury nevertheless agreed to release the final regulations, exactly as proposed and drafted by NOAA, under the joint authority of both agencies. In fact, Treasury and the IRS signed the regulations and forwarded them to NOAA for signature. NOAA, however, notified the Office of Management and Budget ("OMB") of its intent to issue the regulations unilaterally under its own exclusive authority. When Treasury advised OMB of the jurisdictional disagreement, OMB designated the regulations as a "significant regulatory action," see Exec. Order No. 12866 (Sept. 30, 1993), and accordingly refused to approve the regulations for publication. The dispute was then referred to the Attorney General for resolution under Executive Order 12146.

Summarizing Treasury's disagreement with MARAD is substantially more complicated, due to certain privacy restrictions that Treasury must follow. Section 6103 of the Code prohibits the disclosure of any taxpayer return information except in certain narrow circumstances enumerated in the statute. No exception is provided for a proceeding of this nature. See Exhibit 1 hereto (memorandum dated July 27, 1995, from the Acting Assistant Chief Counsel (Disclosure Litigation) of the IRS, stating the opinion that no exception exists for disclosure in this context). Treasury therefore is prohibited by law from discussing the CCF program in the context of any particular taxpayer or taxpayers who may be participants in it. Nor can

Treasury even acknowledge the existence of the specific factual scenario described by MARAD. See Jt. Br. at 10-17.

Moreover, as a policy matter we believe it would be inappropriate to do so. The rulings sought by either agency here may be obtained solely on legal grounds and independent of any particular taxpayer's situation. Conversely, any taxpayers who may be affected by the resolution of this dispute between the agencies will have available to them the full panoply of remedies provided by the internal revenue laws. The Justice Department does not have jurisdiction to resolve issues affecting individual taxpayers' federal tax liabilities in proceedings like this one, and the Attorney General has likewise consistently, and prudently, refused to consider any questions that might later be committed to judicial review. See Office of Legal Counsel -- Limitation on Opinion Function, 3 Op. Off. Legal Counsel 215 (1979). For these reasons, Treasury will not participate in any discussions with OLC or MARAD concerning any particular taxpayer's circumstances.[1]

Despite the restrictions on disclosure of taxpayer information, MARAD's position can be stated in the abstract. Put simply, MARAD apparently contends that its authority to administer the shipping aspects of the CCF program extends to

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[1] Indeed, Treasury previously notified DOT of its refusal to discuss the IRS's treatment of particular taxpayers. See Jt. Br., App. 15 (letter dated May 16, 1995, from Secretary of the Treasury Robert E. Rubin to Secretary of Transportation Federico Pena). Nevertheless, MARAD insists on raising the issue again in this forum.

making tax determinations that may be in conflict with federal tax policy as developed by Treasury. It contends, for example, that "the determination as to whether a party meets the statutory requirements of the CCF" are "exclusively" within MARAD's jurisdiction. Jt. Br., App. 6 (letter dated May 12, 1994, from the Secretary of Transportation to the Secretary of the Treasury). Similarly, MARAD claims that certain regulations delegate solely "to the Secretary of Transportation or Commerce the authority to disallow a deposit" under the program. See Jt. Br. at 33-34. Because Treasury disagrees with these contentions and has made its disagreement apparent to MARAD in a series of meetings as recently as August, 1995, MARAD has requested OLC to resolve this dispute as well.

Requested Rulings

Treasury requests a ruling from OLC that, except as otherwise expressly provided in section 7518 of the Internal Revenue Code, exclusive final authority to administer and to issue regulations under section 7518 lies with Treasury and the IRS. In the alternative, Treasury requests a ruling that authority to issue regulations interpreting the CCF provisions that affect the determination of tax liability is jointly shared by Treasury and the IRS on the one hand and DOT (MARAD) or Commerce (NOAA) on the other.

Thus, under Treasury's view, MARAD and NOAA have the exclusive power to determine the eligibility of applicants to enter CCF agreements, to negotiate the terms and conditions of

such agreements, to enter into those agreements, to supervise their operation, and to promulgate regulations concerning the procedural aspects of the CCF program. Treasury, on the other hand, retains exclusive, or at least joint, authority to issue regulations with respect to any aspects of the statutory provisions that may affect the determination of tax liability. Under either scenario, tax determinations that are made administratively (e.g., in taxpayer-specific examinations and closing agreements or in revenue rulings and procedures) are exclusively within the authority of Treasury and the IRS to administer and enforce the internal revenue laws.

MARAD and NOAA jointly submitted a brief concerning this dispute to OLC on June 30, 1995, which requests two different rulings from OLC: 1) that DOT and Commerce "have the authority to issue regulations and enter into binding agreements to implement the CCF program;" and 2) that such regulations and agreements are "binding" on Treasury and the IRS. Jt. Br. at 2. Although Treasury agrees that DOT and Commerce are authorized to issue certain regulations and to enter into agreements under the CCF program, we disagree both with DOT's and Commerce's interpretation of the "binding" effect of such agreements and with their overall understanding of how the CCF program should be implemented. Our disagreement concerns which agency is responsible for determining the extent of the tax benefits applicable to a CCF participant.

In other words, the issue here is ultimately which department is charged with administering the federal income tax system. The analysis supporting Treasury's view that it is the agency charged with regulating and enforcing the provisions of section 7518, except where such authority is specifically granted to another agency, is set forth below.

## SUMMARY OF ARGUMENT

Treasury's position derives from a straightforward reading of the governing statutes and may be simply stated. Treasury has exclusive jurisdiction to issue regulations under the CCF program's tax provisions, section 7518 of the Internal Revenue Code, except in the handful of situations where section 7518 expressly provides otherwise. This jurisdiction results from the 1986 enactment of section 7518, which made that provision subject to the exclusive, plenary authority granted to Treasury in Code section 7805 to issue regulations under all provisions of the Code. In the alternative, Treasury has joint jurisdiction with DOT and Commerce to issue all regulations relating to the "determination of tax liability" under the CCF program. This jurisdiction is derived from section 607(1) of the MMA, which explicitly grants Treasury such joint regulatory authority. Finally, whether regulatory authority is solely Treasury's or is joint, Treasury undeniably has exclusive administrative and enforcement powers over the CCF program's tax provisions by virtue of section 7801 of the Code. The history of

the CCF program, as well as sound policy considerations, also require these results and confirm that they are correct.

MARAD's and NOAA's argument that Treasury has no authority over any part of the CCF program, except in those areas specifically designated as requiring "joint" regulations, is clearly erroneous. Their argument is based almost entirely on section 607(a) of the MMA, which grants MARAD and NOAA the power to enter CCF agreements with program participants and to negotiate and set the terms and conditions of those agreements. However, MARAD and NOAA read far too much into section 607(a), for that provision does not provide them with any authority to determine or promise the tax consequences of CCF agreements. Moreover, the MARAD/NOAA argument misinterprets the 1986 addition of the CCF tax provisions to the Code, perversely reading it as a reduction in the jurisdiction Treasury and the IRS had over the tax aspects of the program. Finally, their argument ignores the directive in MMA section 607(l) that the agencies issue joint regulations with Treasury over any matters that affect the "determination of tax liability." Clearly the MARAD/NOAA claim of exclusive power over the CCF program's tax aspects is untenable.

Entering a CCF agreement with MARAD or NOAA is a necessary condition for a participant to obtain the tax benefits of the CCF program, but it is far from sufficient to guarantee those benefits. CCF participants must still comply with the extensive tax rules set forth in both MMA sections 607(b) through

(i) and Code sections 7518(a) through (h). The correct allocation of responsibilities under the CCF program requires that the tax consequences of any agreement continue to be determined by Treasury and the IRS.

## ARGUMENT

I. TREASURY HAS EXCLUSIVE JURISDICTION OVER SECTION 7518 EXCEPT WHERE EXPRESSLY PROVIDED OTHERWISE.

A. Treasury has comprehensive statutory jurisdiction over federal taxation.

Congress has granted the Secretary of the Treasury ("the Secretary") comprehensive jurisdiction over matters that affect federal taxation. The statutory basis for this authority is found first in Code section 7801(a), which states in full:

> **(a) Powers and duties of the Secretary.** Except as otherwise **expressly** provided by law, the administration and enforcement of this title [Title 26, the Internal Revenue Code] shall be performed by or under the supervision of the Secretary of the Treasury. (Emphasis added.)

Many of the Secretary's powers are delegated within Treasury to the Commissioner of Internal Revenue ("the Commissioner"), see IRC § 7802(a), or to such other Treasury employees (including the IRS) "as the Secretary deems proper for the administration and enforcement of the internal revenue laws." See IRC § 7803. The Secretary's powers include authority to conduct examinations of taxpayers and their books and records, see IRC §§ 7601, 7602(a), 7602(b), to determine deficiencies in certain taxes (including income taxes), see IRC § 6212(a), to assess all taxes imposed by

the Code, see IRC § 6201(a), and to make refunds in cases of overpayments. See §§ IRC 6401, 6402.

Further, Congress has given the Secretary "broad authority" to prescribe regulations "for the enforcement of the tax laws." Commissioner v. Engle, 464 U.S. 206, 227 (1984). The statutory provision granting this power, section 7805(a) of the Code, states in full:

> **(a) Authorization.** Except where such authority is **expressly** given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe **all** needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue. (Emphasis added.)

As the Supreme Court has declared, there are sound policy reasons for this grant of broad rule-making power to the Secretary:

> [It] helps ensure that in "this area of limitless factual variations," United States v. Correll, 389 U.S. 290, 307 (1967), like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," United States v. Moore, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect.

Nat'l Muffler Dealers Assn. v. United States, 440 U.S. 472, 477 (1979). In other words, centralized control of federal tax policy within the United States Government is necessary both to guarantee the technical accuracy of the policy decisions made and ultimately to ensure the uniformity, fairness, and integrity of the system. Therefore, within Treasury, the Secretary has in

turn delegated the regulatory authority over tax issues to the "masters of the subject," the Commissioner and the Assistant Secretary for Tax Policy. See IRC § 7802(a); Treas. Reg. § 301.7805-1(a); Treasury Dept. Order No. 111-02, 1981-1 C.B. 698.

No other agency has been granted similarly sweeping powers concerning federal taxation, and no other agency has the same mastery of that subject. In particular, neither NOAA nor MARAD has any general authority over tax issues. While those agencies may have similar powers, and similar sophistication, in their respective fisheries or commercial shipping fields, it is undeniable that they lack Treasury's comprehensive jurisdiction and expertise over tax matters.

B. Section 7518 is subject to Treasury's general grant of authority over taxes.

It is a "familiar canon of statutory construction" that:

> the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.

Consumer Product Safety Comm'n v. GTE Sylvania, 447 U.S. 102, 108 (1980); see also United States v. Turkette, 452 U.S. 576, 580 (1981). Applying this standard, section 7518, which sets forth the tax provisions that govern the CCF program, clearly falls within the Secretary's general powers over all provisions in the Code. Thus, the Secretary of the Treasury may administer and

enforce section 7518 (pursuant to the authority of Code section 7801) and issue interpretative regulations concerning it (pursuant to the authority of Code section 7805). Every paragraph of section 7518 prescribes rules that directly affect the federal income tax of the participants in the program.[2] This is manifestly a tax benefit provision, incorporated by Congress in the Internal Revenue Code and thus intentionally made subject to the general powers of the Secretary.

This plenary administrative or regulatory power over tax matters is reserved solely to the Secretary under both section 7801 and section 7805 of the Code unless such power is **"expressly"** given by law to someone other than the Secretary. Section 7518 does include such express grants of authority in several places (and corresponding provisions are set forth in section 607 of the MMA). First, because section 7518(i) incorporates by reference the definitions set forth in MMA section 607(k), including the definition of the term "Secretary," the Secretary -- of DOT or Commerce, rather than of Treasury --

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[2] Paragraphs (a), (b), and (e) of section 7518, respectively, describe the kinds of CCF fund deposits, investments, and withdrawals that qualify for the tax benefits under the program; paragraphs (d) and (h) set forth accounting procedures and special rules for corporate reorganizations and changes in partnerships; and paragraphs (c), (f), and (g) discuss the federal income tax treatment of the deposits and qualified or non-qualified withdrawals, respectively. Only the definitional provision, paragraph (i), which cross-references section 607(k) of the MMA, requires reference outside the Code.

is specifically delegated the following responsibilities in section 7518:[3]

1. Specifying trustee and fiduciary requirements for funds. IRC § 7518(b)(1); MMA § 607(c)(1).

2. Approving interest-bearing securities and the percentage of funds which may be kept in stocks. IRC § 7518(b)(2); MMA § 607(c)(2).

3. Defining the extent to which barges and containers may be constructed outside the United States. IRC § 7518(e)(1) (last sentence); MMA § 607(f)(1).

4. Determining (under joint regulations, discussed below) the failure to fulfill any substantial obligation under any agreement. IRC § 7518(e)(2); MMA § 607(f)(2).

5. Determining whether excess amounts in the fund shall be treated as non-qualified withdrawals. IRC § 7518(g)(5)(d); MMA § 607(h)(5)(d).

Further, DOT or Commerce and Treasury are required to issue "joint regulations" concerning the following seven subjects:[4]

1. To define "net proceeds" from the sale or disposition of any agreement vessel or insurance or indemnity attributable

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[3] It should be noted that this list differs somewhat from the list of exclusive powers MARAD/NOAA claim for themselves in their joint submission, see Jt. Br. at 25-26. In part, this is because they focus almost entirely on provisions from MMA § 607 that were not "carried over" into IRC § 7518, a topic which we discuss below.

[4] This list also differs slightly from the lists set forth in the MARAD/NOAA brief, see Jt. Br. at 24 n.7 and 27, which omit reference to IRC § 7518(f)(4) and MMA § 607(g)(4). The seventh item on the MARAD/NOAA lists -- joint regulations under MMA § 607(l) -- is discussed below, as there is no corresponding provision in IRC § 7518.

to any agreement vessel. IRC § 7518(a)(1)(C); MMA § 607(a)(1)(C); see also IRC § 7518(c)(1)(B); MMA § 607(d)(1)(B) (cross-referencing this definition in determining whether gain is taken into account).

2. To set the time by which deposits must be made in a fund. IRC § 7518(c)(2); MMA § 607(d)(2).

3. To define procedures for determining the failure to fulfill any substantial obligation under any agreement. IRC § 7518(e)(2); MMA § 607(f)(2).

4. To set the ordering rule for adjustments to basis that result from certain withdrawals to pay principal on debt. IRC § 7518(f)(4); MMA § 607(g)(4).

5. To set terms and conditions under which redeposit of amounts will avoid ordinary income recapture upon a sale or disposition. IRC § 7518(f)(5); MMA § 607(g)(5).

6. To set the interest rate for non-qualified withdrawals. IRC § 7518(g)(4)(B); MMA § 607(h)(4)(B).

7. To define when transfers of funds in corporate or partnership reorganizations will not be treated as non-qualified withdrawals. IRC § 7518(h); MMA § 607(i).

The term "joint regulations" is defined in MMA § 607(k)(6) and incorporated by reference in Code § 7518(i).

The plain language of section 7518 itself thus demonstrates that Treasury has the primary authority to administer virtually all tax aspects of the CCF program. Out of all the detailed tax rules set forth in section 7518, only the dozen specific items listed above are expressly carved out of Treasury's general authority to enforce the Code or to prescribe

regulations under it, as required by Code sections 7801 and 7805 before Treasury's exclusive jurisdiction is diminished. Of those exceptions, moreover, over half require only partial sharing of Treasury's authority with other agencies.

Most importantly for present purposes, however, **none** of the specific exceptions to Treasury's exclusive powers is at issue in this dispute over administration of the CCF program. The parties are essentially in agreement that DOT or Commerce has exclusive authority for five specific statutory obligations under section 7518 and MMA section 607, and we similarly agree that there are seven enumerated areas in which those agencies are particularly required to issue joint regulations.[5]

### C. The legislative history of the CCF program confirms that Treasury has exclusive jurisdiction over tax aspects of the program.

In general, courts do not look to legislative history for guidance if a statute is plain and unambiguous on its face. E.g., TVA v. Hill, 437 U.S. 153, 184 n.29 (1978). Treasury submits that its authority to administer and enforce section 7518 and to issue regulations under that provision is plain and unambiguous on the face of that section and the rest of the Code, and, consequently, that there is no need to examine the legislative history of that provision or the CCF program as a whole. Analysis of that history, nevertheless, confirms

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[5] As noted in the previous footnotes, the agencies evidently have some slight differences in interpreting exactly what the dozen enumerated items are, but we are certainly in agreement as to the overall principle.

Treasury's position that it has exclusive power over the federal tax aspects of the CCF program. Indeed, Treasury and the IRS have been involved in regulating and enforcing the tax benefits of this program and its predecessor since World War II, and history since then shows that Congress has consistently urged greater involvement by IRS and Treasury with respect to the tax aspects of the merchant marine tax incentive program.

As MARAD and NOAA point out, see Jt. Br. at 28-29, one condition of receiving subsidies under the original MMA of 1936 was that a ship owner was required to keep capital reserve funds and special reserve funds that were said to be "exempt" from federal income tax (although the term "exempt" was interpreted administratively to mean "tax-deferred"). Even under that statutory scheme, however, the IRS, and not MARAD (or its predecessor agency), had the authority to determine the tax consequences arising from such funds. Starting in 1947, as MARAD's own brief puts it:

> the **tax aspects** of the reserve funds were administered through closing agreements separately negotiated **between the IRS and each program participant.** See generally States S.S. Co. v. Internal Revenue Service, 683 F.2d 1282, 1284 (9th Cir. 1982); Pacific Far East Line, Inc. v. United States, 544 F.2d 478, 480-81 (Ct. Cl. 1976).

Jt. Br. at 28-29 (emphasis added).

In 1970 Congress expanded the tax benefit program to non-subsidized shippers and re-wrote the MMA provision governing the funds. See generally Merchant Marine Act of 1970, Pub. L. No. 91-469, § 21, 84 Stat. 1018, 1026-32 (1970). The legislative

history includes a letter from the General Counsel of Treasury explaining to the Senate Commerce Committee some problems with the existing program:

> The present system of reserve funds is very difficult to administer because the provisions are not part of the Internal Revenue Code and the Merchant Marine Act of 1936 refers to fund deposits as tax-exempt funds. In the past, the Internal Revenue Service has negotiated a series of detailed individual closing agreements with each of the shippers to whom this system applies. As noted above, the proposed legislation would extend the reserve fund system to many more taxpayers, and this will impose a heavier administrative burden on the Internal Revenue Service.

S. Rep. No. 1080, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4188, 4245. The letter goes on to urge that Treasury be expressly given broad regulatory powers to supplement its pre-existing authority to enter closing agreements:

> Accordingly, the Treasury Department urges the Committee to retain the broad rule-making authority that would be granted to the Secretaries of Commerce **and Treasury** by section 20(i) of the bill [now MMA § 607(1)]. This broad authority will permit the issuance of regulations of general applicability for taxpayers covered by the reserve fund system.

Id. (emphasis added).

Thus when Congress amended the program, it clearly expected Treasury to continue to administer the tax aspects of the funds on a wider scale than merely by closing agreements. The legislative history states:

> Since under present law only 13 shipping companies use the tax deferred reserve funds, **the Treasury Department was able to administer the funds** through closing

> agreements signed with each company. This bill's expansion of the availability of the tax deferral privilege, however, makes it impractical for the **Treasury Department to continue the practice of signing closing agreements** with each company. For this reason the bill provides a more specific statutory framework for determining the tax status of deposits into and withdrawals from the fund.

See H.R. Rep. No. 1073, 91st Cong., 2d Sess. 47 (1970) (emphasis added); S. Rep. No. 1080, 91st Cong., 2d Sess., reprinted in 1970 U.S.C.C.A.N. 4188, 4217 (identical language). Several members of Congress pointed out that the tax revisions would simplify tax administration or, as the minority floor manager put it, "permit the administration of the tax deferral system by the Secretary of Commerce **in conjunction with the Secretary of the Treasury** without the need for individual closing agreements." 116 Cong. Rec. 16588, 16592 (1970) (remarks of Rep. Mailliard) (emphasis added); see also 116 Cong. Rec. at 16592 (1970) (remarks of Rep. Lennon); 116 Cong. Rec. 32487, 32498 (1970) (remarks of Sen. Williams). In view of this history, one court has held that the 1970 amendment "merely codifies the previous arrangement for closing agreements." Oglebay Norton Co. v. United States, 610 F.2d 715, 723 (Ct. Cl. 1979) (referring particularly to "qualified withdrawals").[6]

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[6] Relying on section 607(a), the joint submission by MARAD and NOAA completely misreads this history to suggest that **only** they can enter **any** agreements with taxpayers concerning CCF program funds or vessels. Jt. Br. at 30-31. It is true that only MARAD or NOAA can enter CCF agreements with participants, and Treasury has never argued otherwise. They notably fail, however, to cite any authority for the proposition that the 1970 (continued...)

In addition, Congress added to the MMA section 607(l), making Treasury's regulatory power explicit:

> The Secretary of the Treasury and the Secretary [of DOT or Commerce] **shall jointly prescribe all rules and regulations**, not inconsistent with the foregoing provisions of this section, **as may be necessary or appropriate to the determination of tax liability** under this section.

MMA § 607(l) (emphasis added). The formulation in this provision ("all rules and regulations . . . as may be necessary") closely parallels the language granting the Secretary of the Treasury plenary regulatory authority over all of Title 26, the Internal Revenue Code. <u>See</u> IRC § 7805. Thus, even though the 1970 act did not place the CCF program in the Code, MMA section 607(l) nevertheless expressly confers significant tax regulatory authority on Treasury.

This history reflects Congress's intended allocation of responsibilities between the agencies. DOT or Commerce is to negotiate and enter the CCF agreements under section 607(a). As one House member stated, the "agreement which each carrier will enter into with the Secretary of Commerce" will "simply set forth the building program which the carrier hopes to achieve and will provide for the orderly deposit of earnings into the fund." 116 Cong. Rec. at 16592 (remarks of Rep. Mailliard). Treasury, on

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[6](...continued)
Act **withdrew** the pre-existing authority Treasury had to enter closing agreements concerning the **tax implications** of the CCF agreements entered by MARAD or NOAA. Treasury had, and continues to have, independent authority to enter closing agreements with any taxpayer, including participants in the CCF program. <u>See</u> IRC § 7121.

the other hand, is to administer the tax provisions both through its pre-existing administrative authority and the additional regulatory authority granted by section 607(l).

MARAD and NOAA turn this legislative history on its head when they argue that the 1970 act **removed** Treasury's authority over the tax aspects of the CCF program. See Jt. Br. at 28-31. There is simply nothing in the 1970 act or its legislative history to suggest that it was intended to reduce Treasury's powers in any way. In particular, nothing indicates that Treasury had any less authority than it previously had in such areas as conducting examinations, proposing deficiencies, or entering closing agreements with CCF taxpayers. Moreover, this argument is contradicted by section 607(l), which states that Treasury shall have a role in "**all** rules and regulations" that affect "the determination of tax liability." This provision, which clearly **grants** authority, cannot possibly be read as a removal of power from Treasury.

Although it is difficult to cite a single sentence or phrase in section 607 that does not have some effect on "the determination of tax liability" of a CCF program participant, MARAD and Treasury quickly reached an accommodation concerning their respective powers under section 607. See Exhibit 2 (letter dated Mar. 29, 1971, from the Deputy Maritime Administrator for Program Implementation to the Deputy Assistant Secretary for Tax Policy); see also Exhibit 3 (letter dated April 7, 1971, from the Deputy Assistant Secretary for Tax Policy to the Deputy Maritime

Administrator for Program Implementation).[7] Pursuant to this agreement, joint regulations were indeed issued on February 10, 1976. See 41 Fed. Reg. 5812, codified at 26 C.F.R. Part 3 (1995) and 46 C.F.R. Part 391 (1994). MARAD also issued regulations on January 29, 1976, 41 Fed. Reg. 4265, codified at 46 C.F.R. Part 390 (1994), and NOAA issued regulations on September 19, 1974, 39 Fed. Reg. 33675, codified at 50 C.F.R. Part 259 (1994).

Congress next revisited the CCF program as part of the comprehensive Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085. Section 607 of the MMA was essentially copied and inserted into the Internal Revenue Code, excepting only sections 607(a), (j), (k), and (l). See Tax Reform Act of 1986, § 261, 100 Stat. at 2208. The express purpose of this change in the CCF program was to "coordinate" the application of the Code and section 607. Id., § 261(a), 100 Stat. at 2208. The reason only some provisions were copied over and inserted is apparent from the legislative history: the parts incorporated into the Code are the portions of section 607 that are "tax provisions," i.e., those that have tax consequences. As the House report states:

> The **tax provisions** relating to capital construction funds are recodified as part of the Internal Revenue Code.

H.R. Rep. No. 426, 99th Cong., 1st Sess. 192 (1985) (emphasis added). Similarly, a letter from the Chairman of the House Ways

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[7] The effect of these letters is discussed below in connection with Treasury's argument that it retains at least joint authority over all regulations that affect tax liability determinations.

and Means Committee to the Chairman of the House Merchant Marine and Fisheries Committee states:

> A new section 7518 has been added to the Internal Revenue Code to reflect **those provisions** of the Capital Construction Fund **that have direct tax policy or tax administration effect.**

H.R. Rep. No. 426, 99th Cong., 1st Sess. 194 (1985) (emphasis added). In addition, certain minor conforming amendments were made in section 607 itself in order to "harmonize" it with the new Code section 7518. H.R. Rep. No. 426, 99th Cong., 1st Sess. 194 (1985). Thus, for example, DOT and Commerce are now required to provide annual reports to Treasury in order to facilitate the administration of the tax aspects of the CCF program. See MMA § 607(m). These reports provide Treasury and the IRS with an inventory of taxpayers who have entered CCF agreements and the amounts deposited and withdrawn annually.

It is impossible to review this history and conclude that the "tax provisions" of the CCF program -- i.e., those portions that were inserted into the Internal Revenue Code in 1986 -- are now to be administered by any agency other than Treasury. The only provisions that remain exclusively within the jurisdiction of MARAD or NOAA are: section 607(a), which grants the power to enter into and negotiate the terms of CCF agreements; section 607(j), which sets forth certain 1970-vintage transition rules; and section 607(m), which requires reports to

Treasury.[8] The tax provisions themselves have all been expressly moved to the jurisdiction of Treasury, making them subject to Treasury's general powers to administer and regulate under them, except where that authority is expressly granted to DOT or Commerce.

### D. The MARAD/NOAA position would mean that the addition of section 7518 to the Code is a nullity.

The fundamental flaw of the joint brief by NOAA and MARAD is that it never comes to grips with the meaning of the 1986 Tax Reform Act. Their memorandum discusses at length what they believe section 261 of the 1986 act did not do -- i.e., that it did not permanently commit jurisdiction over the tax aspects of the CCF program to Treasury. See Jt. Br. at 44-51. But their only statement of what section 261 affirmatively did is that it "confirmed" the primary authority of DOT and Commerce over the CCF program. See Jt. Br. at 46.

This theory is belied by a simple question: if that's all the 1986 Tax Reform Act did, why was it necessary? Section 607(b) through (i) of the MMA, as modified by the 1986 act, is repeated in sections 7518(a) through (h) of the Code virtually verbatim. The act also modified section 607 by adding paragraph (m), which imposes on DOT and Commerce the duty to make reports to Treasury. Interpreting these changes as an increase in DOT's

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[8] Section 607(k) of the MMA, which sets forth certain definitions, is incorporated by reference in Code section 7518(i).

or Commerce's powers, or even as a "confirmation" of them, is perverse reasoning.

On the other hand, the conclusion that the 1986 act increased Treasury's jurisdiction is inescapable. Prior to the 1986 act, Treasury already had the "exclusive" powers that MARAD and NOAA claim belong to Treasury under the CCF program, see Jt. Br. at 26. Likewise, since 1970 Treasury and IRS already had the power (under MMA § 607(l)) to issue "joint regulations" with DOT or Commerce on matters that affect "the determination of tax liability." If the 1986 act did anything, therefore, it must have increased Treasury's authority. It placed the "tax provisions" in the Code, making them entirely subject to Treasury's general regulatory and administrative powers over Title 26 (except where that authority is expressly granted to another agency), and, as noted, imposed an additional requirement on DOT and Commerce to report to Treasury. See MMA § 607(m). The MARAD/NOAA view, by contrast, would essentially render the 1986 change a nullity, or at best a meaningless gesture by Congress.

NOAA and MARAD virtually ignore Treasury's general authority to interpret the tax laws (e.g., under IRC § 7801) and to issue regulations under them (pursuant to IRC § 7805). See Jt. Br. at 48, 50. Their sole argument in support of ignoring these provisions is that Treasury's power does not extend to MMA section 607(a), and that they alone can enter "CCF agreements specifying terms and conditions." Id. But Treasury has never

claimed that power. Rather, the omission of section 607(a) from section 7518 means that Commerce or DOT negotiate and administer the CCF agreements, while Treasury has the authority to make any determinations regarding the tax effects of those agreements. This is the only conclusion that can logically be drawn from the plain meaning of the statutory scheme and the legislative history reviewed above.

Treasury argues only that it has exclusive jurisdiction to interpret, administer, and enforce the **tax** provisions of the program -- i.e., those in section 7518 of the Code -- and then only when such authority is not "expressly" given to DOT or Commerce. This is precisely what sections 7801 and 7805 of the Code say. Thus, the "joint regulation" provisions in both sections 7518 and 607 limit Treasury's powers, meaning that Treasury can take no regulatory action in those specific enumerated areas that is not coordinated with the other agencies. Likewise, the grants of authority in both provisions to the "Secretary" of DOT or Commerce to make certain specific determinations leave the power over those determinations exclusively with those agencies. Treasury agrees that these dozen enumerated provisions expressly limit Treasury's general authority -- but they are the only ones that do so.

E. Treasury's authority over the tax aspect of the program ensures uniform administration of the tax laws.

As the Supreme Court has recognized, sound policy requires that Treasury administer the internal revenue laws in

order to ensure their uniform application. Nat'l Muffler Dealers Assn. v. United States, supra, 440 U.S. at 477. The technical accuracy of tax policy decisions can only be guaranteed if they are made by the "masters of the subject," notably the Assistant Secretary for Tax Policy, the Commissioner, and the IRS. Any other rule is likely to lead to technical errors that have grave potential to affect the tax system adversely. Moreover, to permit federal tax determinations to be made by other agencies would certainly lead to inconsistencies and perpetual tax disputes, critically undermining the integrity of the tax system. This problem becomes especially acute where, as here, the other agencies' mission is not to achieve uniform administration of the tax laws but rather to maximize the utilization of specific tax benefits in order to further the non-tax policy goals of a particular program.

There can be little doubt that specialized expertise is necessary to interpret section 7518. Many of the specific rules in that provision (and in MMA section 607, for that matter) can be understood only by referring to other parts of the Internal Revenue Code. Some of these cross-references simply include or exclude an item under the CCF program from other tax provisions: thus, for example, fund amounts are excluded from the computation of the accumulated earnings tax under Code section 531, while "earnings and profits" are determined under Code section 316 in the normal manner. See IRC § 7518(c)(1)(D) and (E); MMA § 607(e)(1)(D) and (E). But other provisions of the Code that

are cross-referenced require critical tax determinations in themselves, such as the amount of interest that is tax exempt under Code section 103, see IRC § 7518(d)(2)(D) and MMA § 607(e)(2)(D), the amount allowable as a deduction for depreciation under Code section 167, see IRC § 7518(a)(1)(B) and MMA § 607(b)(1)(B), or the amount of the dividends received deduction allowable under Code section 243(a)(1), see IRC § 7518(d)(2)(C) and MMA § 607(e)(2)(C). More importantly, section 7518 includes numerous terms of art and fundamental but frequently complex tax concepts, such as "taxable income," "sale or disposition," "basis," "recapture," and the "tax benefit rule." It is absurd to suggest that anyone other than Treasury, the Commissioner, and the IRS has the expertise to administer this provision.

While Treasury cannot discuss the particular cases cited by MARAD, the very existence of this dispute between the Treasury or IRS and the other agencies clearly proves the importance of this point. The instant disagreement is precisely what happens when an agency that is unfamiliar with tax principles takes it upon itself to make decisions that have profound tax policy consequences.

Congress has been presented with other unfortunate examples of this in recent years. For instance, in response to the savings and loan crisis of the late 1980s, Congress amended section 597 of the Code to address the tax treatment of transactions in which federal financial assistance was provided.

See Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 1401(a)(3), 103 Stat. 183, 548-49. Congress subsequently learned that the Federal Savings and Loan Insurance Corporation ("FSLIC") had advised financial institutions that they could deduct certain losses even if they had been reimbursed by FSLIC for them, and in response Congress had to enact a specific directive that FSLIC assistance would be taken into account in determining the amount of the deductible loss. See Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13224, 107 Stat. 312, 485-86.

Similarly, just this year Congress repealed section 1071 of the Code, see Self-Employment Health Insurance Act of 1995, Pub. L. No. 104-7, § 2 (April 11, 1995), after finding "serious problems in the operation and administration" of that section by the Federal Communications Commission ("FCC"). See H.R. Rep. No. 32, 104th Cong., 1st Sess. 16 (Feb. 14, 1995). Among the problems highlighted by the committee that investigated the issue were that the FCC interpreted the provision inconsistently with the intent of Congress, that the FCC had only vague standards and definitions, and that the "FCC's interpretation and administration of the . . . program has not been supervised by the IRS." Id.

IRS efforts to apply the internal revenue laws fairly and uniformly are severely disrupted whenever non-tax specialists in the United States Government make decisions that have direct tax policy effects. To permit MARAD or NOAA to make federal tax

determinations or to issue regulations that directly affect income tax liabilities in connection with the CCF program, without the tax policy guidance of specialists in those subjects, would only lead to more such disagreements and result in uneven application of the internal revenue laws between participants and non-participants in the program. Such a chaotic result cannot have been intended by Congress and should not be sanctioned by the Attorney General.

Of course, Treasury and the IRS recognize the crucial role that both MARAD and NOAA play in the sound administration of the CCF program. In the spirit of accommodation, Treasury previously offered to issue joint regulations with MARAD and NOAA on any issue affecting tax liability under the program, in order to end the long bureaucratic wrangling over jurisdiction and provide needed guidance to taxpayers and IRS agents. But those agencies have rejected Treasury's offer, insisting instead on their own exclusive power over all aspects of the program.

As demonstrated above, MARAD's and NOAA's claim to exclusive jurisdiction over the CCF program is clearly incorrect. Nevertheless, Treasury acknowledges the significant oversight responsibility that those agencies have regarding aspects of the CCF program within their commercial shipping and fisheries expertise. Treasury and IRS will continue to consult with MARAD and NOAA and will draw on their expertise in enforcing the tax features of the program. Similarly, we would expect those agencies to defer to Treasury and the IRS with respect to all

matters involving tax policy, enforcement, and administration. For the CCF program to work as Congress intended, MARAD and NOAA must work cooperatively with Treasury and the IRS in this manner.

## II. ALTERNATIVELY, TREASURY HAS JOINT JURISDICTION OVER TAX REGULATIONS UNDER THE CCF PROGRAM.

In the alternative, even if Treasury's authority over all tax aspects of the CCF program is not exclusive, Treasury at least has "joint" authority with DOT or Commerce to issue any regulations under the program that affect the determination of tax liabilities. Indeed, Treasury would have such power even under the pre-1986 regime outlined in MMA section 607; the 1986 insertion of section 7518 in the Code additionally confirms Treasury's role. Moreover, even if tax regulations under the CCF program must be coordinated jointly with DOT or Commerce, Treasury still retains exclusive power under section 7801 of the Code to enforce and administer the provisions of section 7518 on a taxpayer-by-taxpayer or issue-by-issue basis. Again, these conclusions follow from analysis of the relevant statutory provisions and a survey of the history of the program.

### A. Section 607(l) of the MMA grants Treasury joint authority over tax regulations.

Section 607(l) of the MMA expressly grants Treasury, in conjunction with DOT or Commerce, such regulatory authority "as may be necessary or appropriate to the determination of tax liability under" section 607. As noted above, virtually every single sentence or phrase in section 607 -- with the exception of

paragraphs (a), (j), (k), (l), and (m), which were not carried over into Code section 7518 -- ultimately has some impact on "the determination of tax liability" of a participant in the CCF program. Hence, even if section 7518 had never been inserted into the Code, Treasury would have at least joint authority with Commerce and DOT to issue any regulations that influence "tax liability" -- in effect, over all the tax implications of the program -- pursuant to section 607(l).

In opposition to this argument, MARAD and NOAA cite the 1971 letter agreement between MARAD and Treasury and the historical practice under it. Jt. Br. at 31-33. In the initial letter, MARAD's counsel recounted the agencies' agreement as follows:

> First, with respect to those policy issues which section 607 specifies to be the responsibility of the Secretary of Commerce, the Maritime Administration will adopt such rules as it believes are necessary to carry out the purposes of the Merchant Marine Act, 1936, as amended. The fact that the resolution of such policy issues produces tax consequences will not, by that fact alone, confer joint jurisdiction upon the Department of the Treasury.

_See_ Exhibit 2 (letter dated Mar. 29, 1971, from the Deputy Maritime Administrator for Program Implementation to the Deputy Assistant Secretary for Tax Policy). MARAD and NOAA now contend that this language "confirmed" the "limited extent of IRS/Treasury authority over the CCF program." Jt. Br. at 31.

Careful reading of the quoted language confirms just the opposite, however. Treasury agreed that its authority to

issue tax regulations under the program was limited **only** "with respect to those policy issues which section 607 **specifies** to be the responsibility of the Secretary of Commerce" -- in other words, only with respect to the five particular items enumerated in section 607 as the exclusive responsibility of Commerce. None of those issues is in dispute here. As the quoted language indicates, the mere fact that those five specified areas may ultimately have tax consequences does not automatically confer regulatory power on Treasury. The clear implication is that any other provision that does have tax consequences must still fall within Treasury's joint jurisdiction under section 607(l).

The agencies' actual practice under this agreement further demonstrates that Treasury had at least such joint power over tax aspects of the CCF program. The joint regulations illustrate this shared authority, see 26 C.F.R. Part 3 (1995); 46 C.F.R. Part 391 (1994), as do the existing DOT and Commerce regulations, which generally defer to the joint regulations on tax issues. See 46 C.F.R. Part 390 (1994) (MARAD regulations); 50 C.F.R. Part 259 (1994) (NOAA). Rather than "confirming" that Treasury's powers were "limited," the letter agreement and the subsequent practice under it the really show the **absence** of limitations on Treasury's joint responsibility to issue regulations with respect to the determination of tax liabilities.

The 1986 enactment of section 7518 of the Code also confirms that Treasury plays at least a shared role in promulgating tax regulations under the CCF program. As explained

previously, the insertion of section 7518 into the Code makes that provision expressly subject to Treasury's plenary regulatory authority under Code section 7805. Congress's intent in placing the "tax provisions" of the CCF program within the ambit of this general power can only have been to ensure that Treasury performs at least some part of the regulatory function.

B. Joint authority is not limited to the specified "joint regulation" areas.

MARAD and NOAA also argue that Treasury's authority to prescribe regulations is **limited** to those seven specific places in both statutes (MMA § 607 and IRC § 7518) that call for "joint regulations." See Jt. Br. at 24 n.7 and 27. At the same time, they base their own claim of exclusive regulatory power over the program on the provision of section 607(a) that states:

> The deposits in the fund, and all withdrawals from the fund, whether qualified or nonqualified, shall be subject to such conditions and requirements as the Secretary [of Commerce or DOT] may by regulations prescribe or are set forth in such agreement.

MMA § 607(a); see also Jt. Br. at 23-27. Then, from the fact that section 607(a) was not incorporated into section 7518 of the Code, they deduce that all remaining regulatory power over the CCF program lies in their agencies except for the specific items carved out for "joint regulations." Id.; see also Jt. Br. at 48. Again, this argument is unsupportable textually and inconsistent with the history of the CCF program.

First, the plain meaning of the 1970 statute contradicts this argument. There is no language in section 607

that even implies Treasury's power is limited to the seven areas in which Congress ordered "joint regulations." Congress cannot possibly have thought that the enumerated "joint" areas were the only ones that affected the determination of tax liability, for plainly there are many other rules set forth throughout the text of section 607 that have profound tax effects. A much more logical interpretation is that Congress intended to give Treasury at least shared authority over **every** aspect of the CCF program that affects "the determination of tax liability," see MMA § 607(l), and that Congress merely noted certain specific topics as being particularly appropriate for "joint regulations" with DOT or Commerce.

Further, close reading of section 607(a) demonstrates that Congress did not bestow on MARAD and NOAA the sweeping powers they now claim. MARAD of course has general powers to administer the MMA and "to adopt all necessary rules and regulations to carry out the powers, duties and functions" vested in the agency by that act. See MMA § 204(b), 46 U.S.C. App. § 1114(b) (1995). Nevertheless, section 607(a) merely provides DOT or Commerce with the power to enter agreements and to prescribe the terms and conditions of those agreements, such as the program objectives, the timing of deposits, the amounts to be deposited, etc. See 116 Cong. Rec. at 16592 (remarks of Rep. Mailliard) (CCF agreement will "simply set forth the building program which the carrier hopes to achieve and will provide for the orderly deposit of earnings into the fund").

Clearly Congress intended the negotiation and administration of CCF agreements to be an autonomous function of the program that is conducted exclusively by DOT or Commerce. But section 607(a) does not remotely indicate that the power of DOT or Commerce to prescribe "conditions and requirements" for entering agreements was intended to "trump" the authority provided in section 607(l) of the same statute to prescribe all tax regulations jointly. To adopt the MARAD/NOAA view of the 1970 act, however, would require assuming such schizophrenic behavior by Congress.

The second fundamental error in the MARAD/NOAA argument that 607(a) confers exclusive powers on them is that it ignores subsequent history. The argument would mean that the existing joint regulations, which address many subjects beyond the seven enumerated items, were both unauthorized by section 607 and in conflict with the agencies' 1971 agreement.[9]

Further, the MARAD/NOAA argument again implies that the 1986 Tax Reform Act's insertion of section 7518 into the Code was a nugatory act of absolutely no consequence or effect. To the contrary, it is difficult to read the 1986 act as anything other than a grant of exclusive authority over the "tax provisions" of

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[9] While the second substantive paragraph of the 1971 letter agreement discusses how Treasury and MARAD were to share responsibility over the seven "joint regulation" issues listed in section 607, it is silent as to any limitations on Treasury's authority to promulgate other tax regulations. <u>See</u> Letter from Roy G. Bowman, Deputy Maritime Administrator for Program Implementation, to John S. Nolan, Deputy Assistant Secretary for Tax Policy (Mar. 29, 1971).

section 7518 to Treasury and the IRS. See, e.g., H.R. Rep. No. 426, 99th Cong., 1st Sess. 194 (1985) (expressly describing section 7518 as all the provisions from section 607 "that have direct tax policy or tax administration effect"). But section 607(l) remained in the MMA even after 1986, and certainly Congress was aware that the authority it had granted only sixteen years earlier in that provision required "joint regulations" on all tax issues.

The only possible reconciliation of these conflicting provisions is to interpret the 1986 act as a confirmation or increase in Treasury's role. Clearly Congress deliberately placed section 7518 in the Code in order to make all of the "tax provisions" expressly subject to Treasury's general powers to enforce and promulgate regulations. If the 1986 act is to mean anything, it can only mean that Congress intended to expand Treasury's authority, not to reduce it. The MARAD/NOAA contention that they have exclusive regulatory power except where the statutes specifically require joint regulations, while erroneous even before 1986, is completely untenable after 1986.

C. Treasury has independent enforcement powers over the CCF program.

MARAD and NOAA essentially argue that they are entitled to administer the CCF program without **any** guidance or intervention by Treasury or the IRS, even administratively or on a taxpayer-by-taxpayer basis. This argument, which is couched in terms of whether MARAD or NOAA actions "estop" or are "binding"

on Treasury or the IRS, see Jt. Br. at 36-44, is unsupportable, however, because Treasury has independent enforcement authority over the CCF program.

MARAD's and NOAA's claim is fundamentally inconsistent with Code section 7801. As previously noted, that section grants the Secretary of the Treasury exclusive authority over "administration and enforcement" of all provisions in the Code, including section 7518. The addition of section 7518 to the Code makes it clear that the CCF program is subject to Treasury's independent authority to make income tax examinations and assessments unfettered by the views of any other agency, for that authority is limited only in those areas where "administration and enforcement" powers are expressly granted to someone other than the Secretary of the Treasury. See IRC § 7801(a). MARAD and NOAA conspicuously fail to cite a single such grant of "administration and enforcement" authority in section 7518, or even in section 607(a). Indeed, Congress has pointedly never given any tax enforcement powers to either agency. Clearly, even if Treasury's power to issue regulations is jointly shared with DOT or Commerce, Treasury's powers to administer and enforce Code section 7518 on a taxpayer-by-taxpayer or issue-by-issue basis are entirely unencumbered by any provision of either the Code or the MMA.

It is true that section 607(a) gives DOT or Commerce the exclusive power to enter CCF agreements, and that section 7518 explicitly refers to such agreements. Cf. Jt. Br. at 25.

It is also true that, to qualify for tax deferral benefits, all deposits or withdrawals must be made "pursuant to" or "in accordance with the terms of" a bona fide agreement. E.g., MMA §§ 607(d)(2), 607(f)(1); IRC §§ 7518(c)(2), 7518(e)(1). But the converse statement is not true, and one of the gravest errors in the MARAD/NOAA submission is their failure to perceive this analytical distinction. See, e.g., Jt. Br. at 33-36. The mere fact that a deposit or withdrawal is made "pursuant to" or "in accordance with the terms of" an agreement does **not** automatically qualify it for the tax benefits outlined in section 7518; those tax benefits are still contingent upon the deposits complying with the other statutory requirements that are set forth. In other words, a CCF agreement is a necessary, but far from sufficient, condition for obtaining those tax benefits.

This logical error permeates the MARAD/NOAA argument. For example, MARAD claims that "the determination as to whether a party meets the statutory requirements of the CCF" is "exclusively" within its jurisdiction. Jt. Br., App. 6 (letter dated May 12, 1994, from the Secretary of Transportation to the Secretary of the Treasury). This claim is based in part on one provision of the joint regulations which, in the MARAD/NOAA view, "delegates to the Secretary of Transportation or Commerce the authority to disallow a deposit." See Jt. Br. at 33-34; 26 C.F.R. § 3.3(h) (1995); 46 C.F.R. § 391.3(h) (1994). The effect of this provision, they claim, is that Treasury ceded to MARAD or NOAA the "final word" as to the tax treatment of a deposit, so

that what MARAD or NOAA endorse in a CCF agreement is "binding" on the IRS.

Quite simply, the regulation in question does no such thing. It states in full:

> **(h) Presumption of validity of deposits.** All amounts deposited in the fund shall be presumed to have been deposited **pursuant to an agreement** unless, after an examination of the facts upon the request of the Commissioner of Internal Revenue or his delegate, the Secretary of Commerce determines otherwise. The Commissioner or his delegate will request such a determination where there is a substantial question as to whether a deposit is made **in accordance with an agreement.** (Emphasis added.)

This language plainly delegates to the Secretary of Commerce or Transportation the authority to determine whether a deposit has been made "pursuant to" or "in accordance with" an agreement under section 607(a) -- **and no more.** DOT or Commerce must determine, for example, whether the amount of a deposit is appropriate for accomplishing the program objectives set forth in the agreement, whether a deposit is timely, and whether a deposit is of a type of property that may properly be deposited. But there is nothing in the regulation to indicate that DOT or Commerce may decide whether a deposit is otherwise deductible under the statute, nor, more importantly, does it demonstrate that the Commissioner is "bound" by the opinion of DOT or Commerce on that issue. Indeed, this regulation is further proof of the correctness of Treasury's position that the procedural aspects of the CCF program (entering and managing agreements)

were reserved to DOT or Commerce, and that while Treasury shares the tax regulatory aspects, it alone has exclusive ultimate authority to enforce and administer the tax implications of a CCF agreement.

MARAD and NOAA also base their "binding contract" argument on another provision of MARAD's regulations and on general principles of contract interpretation. _See_ Jt. Br. at 40-44. In the standard form of CCF contract, MARAD "agrees that the federal income tax benefits provided in [section 607] . . . **shall** be available" to the contracting party. Jt. Br. at 40; _see_ 46 C.F.R. § 390, App. II, Article 15 (1994) (emphasis added). This statement should not be construed as a guarantee of those tax benefits, but rather as an acknowledgement that the tax benefits may be available to the contracting party if all applicable requirements in section 607 (and section 7518) are satisfied. It is not possible for DOT or Commerce to assure taxpayers of specific tax benefits in advance, because it may be determined until years later during an audit that the deposit is not in compliance with those statutory requirements. If this statement is construed as a "guarantee," however, such a guarantee is simply not within MARAD's authority to make. It follows that the common defense to a "binding contract" or estoppel claim against the Government -- that the action upon which the estoppel is based was _ultra vires_ -- may continue to be available to the Government should such a claim ever be asserted by an aggrieved taxpayer in the appropriate forum. Of course,

such a claim is not yet ripe for decision, and OLC need not make any such determination here.

The fundamental logical error at the heart of the MARAD/NOAA argument is easily illustrated with an example.[10] Suppose that a participant entered a CCF agreement with MARAD or NOAA, the terms of which allow amounts to be deposited that turn out to be in excess of the ceilings prescribed in section 607(b) and section 7518(a). Suppose further that, during a later IRS audit, it is found that the participant in fact made deposits in excess of the taxable income from a qualifying vessel operating in the foreign or domestic commerce of the United States, and that the participant excluded such amounts from taxable income or claimed a deduction for them on its annual income tax return.[11] MARAD and NOAA would apparently argue that the CCF agreement "binds" the IRS and that the excess amounts must still be treated as qualifying deposits eligible for tax deferment. In their view, the effect of their exclusive power to prescribe the "conditions and requirements" of an agreement is that the IRS is precluded from administratively reviewing the tax consequences of such "conditions and requirements." Jt. Br. at 39-44.

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[10] Notwithstanding MARAD's insistence on discussing this issue in the context of a particular taxpayer, see Jt. Br. at 33-35, we again note that Treasury is prohibited by law from discussing any specific taxpayer and stress that this example is strictly hypothetical.

[11] Although hypothetical, this example is not far-fetched. The deposit ceilings are related to several tax amounts (such as taxable income or tax depreciation related to a particular vessel) that may not be finally determined for several years after a taxable year closes.

In other words, according to MARAD and NOAA, the IRS -- the agency charged with administering the federal income tax laws in Title 26 of the United States Code -- is powerless to stop even a clear violation of those laws. To endorse this conclusion means not only that DOT or Commerce can unilaterally override any IRS administrative action to disallow improperly claimed tax benefits. Ultimately, it also means that DOT or Commerce can by contract grant tax benefits in excess of the limitations Congress itself has imposed. Treasury submits that such a view is self-evidently wrong and should not be endorsed by OLC.

D. <u>This allocation of authority is the correct policy conclusion.</u>

Sound policy requires that Treasury have at least joint regulatory authority, with DOT and Commerce, over all aspects of the CCF program that influence "the determination of tax liability." This reading of section 607(l) is consistent with the rest of the statutory scheme and with the history of the program. Moreover, any other interpretation would mean that Treasury lacks authority to interpret and issue regulations under section 7518 of its own statute, notwithstanding section 7805's express grant of such authority. It is difficult to imagine any result that is more improbable, or one that would lead to more fruitless tax disputes.

MARAD and NOAA perhaps do not appreciate how extraordinary it is for Congress to impose any restrictions on Treasury's authority to regulate under the internal revenue laws.

withdrawals). Treasury, on the other hand, retains the final word with respect to any determination that may affect tax liability, whether made administratively or through regulations, unless that authority is expressly granted to another agency.

Alternatively, OLC should rule that regulatory authority over all matters that affect the determination of tax liability under the CCF program is jointly shared by Treasury and IRS with MARAD or NOAA. In so ruling, OLC should carefully note that Treasury and the IRS retain their exclusive and unfettered authority to make administrative determinations concerning the tax implications of the program.

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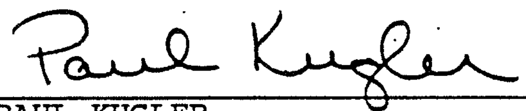

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**Internal Revenue Service**
# memorandum

CC:EL:D-4281-95
Br4:DSquires

date: JUL 27 1995

to: Assistant Chief Counsel (Passthroughs & Special Industries)
CC:DOM:P&SI

from: Acting Chief, Branch 4 (Disclosure Litigation) CC:EL:D

subject: Interagency Jurisdictional Dispute

This responds to your request for an opinion regarding the disclosure of information by the Tax Legislative Counsel to the Office of Legal Counsel in its brief addressing a jurisdictional dispute between the Departments of Transportation and Commerce and the Department of the Treasury and Internal Revenue Service.

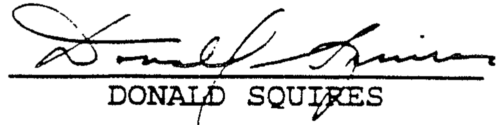
We understand the information at issue relates to a case under audit by the IRS involving the Capital Construction Fund Program, which provides tax deferrals under section 7518 of the Internal Revenue Code. Any information coming from the IRS or the Department of the Treasury concerning this case would constitute return information as defined by section 6103(b)(2) of the Code, as it would relate to "the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense . . . ." This would include even the acknowledgment of any tax status of the taxpayer mentioned by the Departments of Transportation and Commerce in their brief to the Office of Legal Counsel.

Returns and return information may not be disclosed except as specifically authorized by the Internal Revenue Code. I.R.C. § 6103(a). Apart from a few Code provisions not applicable here, return information may be disclosed to the Department of Justice only pursuant to sections 6103(h)(2) and 6103(i) of the Code, relating to the prosecution of tax cases and non-tax criminal cases, respectively. There is no provision in the Code for disclosure of return information to the Office of Legal Counsel for the purpose you describe. Moreover, it does not make any difference for these purposes that the substantive issue under audit might become the subject of litigation. Nor is it relevant that the Departments of Transportation and Commerce have already disclosed information regarding this case. Of course, the IRS

**EXHIBIT 1**

and Department of the Treasury are always free to publicly discuss tax issues in the abstract so long as the facts of particular cases are not included in such public discussions.

Please call me at 622-4570 with any further questions on this matter.



DONALD SQUIRES

March 29, 1971

Mr. John S. Nolan
Deputy Assistant Secretary for
Tax Policy
Department of the Treasury
Washington, D. C. 20220

Dear Mr. Nolan:

I believe it would be helpful to review our telephone conversation of Friday, March 26, so that our respective staffs will have a clear understanding of the working relationship between the Department of Commerce and the Department of the Treasury in carrying out their responsibilities under section 607 of the Merchant Marine Act, 1936, as amended by the Merchant Marine Act of 1970.

First, with respect to those policy issues which section 607 specifies to be the responsibility of the Secretary of Commerce, the Maritime Administration will adopt such rules as it believes are necessary to carry out the purposes of the Merchant Marine Act 1936, as amended. The fact that the resolution of such policy issues produces tax consequences will not, by that fact alone, confer joint jurisdiction upon the Department of the Treasury. The Maritime Administration values very highly the advice and guidance of the Treasury and the Internal Revenue Service and every attempt will be made to consult with personnel of those departments prior to the promulgation of any regulations under section 607 having tax consequences.

Second, with respect to policy issues arising under those portions of section 607 which specifically confer joint jurisdiction on both the Treasury Department and the Commerce Department, the two Departments will consult on such issues to the end that Joint Regulations satisfactory to both Departments can be promulgated. Such regulations should not, of course, disturb the decisions made by the Department of Commerce under the preceding paragraph.

EXHIBIT 2

I want to thank you for the assistance you and your staff have already given the Maritime Administration in this matter and I look forward to a pleasant working association with you and your staff.

Sincerely yours,

(Sgd) Roy G. Bowman

ROY G. BOWMAN
Deputy Maritime Administrator
for Program Implementation

cc:
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J. Lynn
M. Rouvelas
R. Sharood
R. Casey
L. Woodworth

RGBowman/mj

ASSISTANT SECRETARY

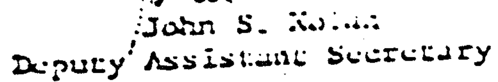
THE DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 7, 1971

Dear Mr. Bowman:

Thank you for your letter of March 29, 1971. We agree with your statement of the working relationship between the Department of Commerce and the Department of the Treasury in implementing the amendments to section 807 of the Merchant Marine Act, 1936, by the Merchant Marine Act of 1970.

Sincerely yours,



John S. Nolan
Deputy Assistant Secretary

Mr. Roy G. Bowman
Deputy Maritime Administrator
for Program Implementation
Office of the Assistant Secretary
of Commerce
Department of Commerce
Washington, D.C. 20230

EXHIBIT 3