Docket No. 24344-17
11352-18
25268-18

IN THE UNITED STATES TAX COURT

SUNIL S. PATEL & LAURIE MCANALLY PATEL, ET AL.,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

BRIEF OF THE AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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DISCLOSURE STATEMENT

Pursuant to Rule 151.1(c)(1) of the Tax Court Rules of Practice and Procedure, the American College of Tax Counsel (the "College") has no parent corporations, is not a publicly held corporation, and no publicly held corporation owns ten percent or more of the College.

Pursuant to Rule 151.1(c)(3), counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to this brief's preparation or submission.

INTEREST OF *AMICUS CURIAE*

The College respectfully submits this brief as *amicus curiae* in support of Petitioners Sunil S. Patel and Laurie McAnally Patel (the "Petitioners").

The College is a nonprofit professional association of tax lawyers in private practice, in law school teaching positions, and in government, who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession. The purposes of the College are:

- To foster and recognize the excellence of its members and to elevate standards in the practice of the profession of tax law;
- To stimulate development of skills and knowledge through participation in continuing legal education programs and seminars;
- To provide additional mechanisms for input by tax professionals in development of tax laws and policy; and
- To facilitate scholarly discussion and examination of tax policy issues.

The College is composed of approximately 700 Fellows recognized for their outstanding reputations and contributions to the field of tax law and is governed by a Board of Regents consisting of one Regent from each federal judicial circuit, two Regents at large, the Officers of the College, and the Immediate Past President of the College.

This *amicus* brief is submitted by the College's Board of Regents, and does not necessarily reflect the views of all members of the College, including those who are government employees.[1]

The College submits this brief in response to this Court's July 19, 2024 Order (as modified by this Court's August 22, 2024 Order) to address the important issues of: (1) whether section 7701(o) of the Internal Revenue Code (the "Code") requires a threshold relevancy determination; and (2) when the economic substance doctrine may not be "relevant" under section 7701(o).[2] This issue involves an issue of substantial importance to tax administration. The position advocated by the Commissioner in this case represents an unsupported and unwarranted expansion of a provision of the Code that has been in place for more than a decade. Such an expansive reading of section 7701(o) could severely impair ordinary tax planning for small and large taxpayers alike and effectively nullify incentives provided by Congress to undertake specified activities.

[1] Larry A. Campagna, Immediate Past President of the College, and Michael Desmond, Vice President of the College, abstained from the decision of the Board of Regents to prepare and file this brief, and did not participate in the preparation or review of this brief.

[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended and in effect during the tax years at issue (the "Code").

SUMMARY OF THE ARGUMENT

The plain text of the statute, legislative history, cases interpreting the pre-enactment common law doctrine, and published IRS guidance all support that section 7701(o) requires a threshold relevancy determination that is separate from the two-part conjunctive test that evaluates whether a transaction has economic substance. At present, the only case to analyze this issue, the district court in *Liberty Global, Inc. v. United States*, found the relevancy determination "coextensive" with the two-part test.[3] That cannot be. Such an interpretation renders the introductory clauses of section 7701(o)(1) and subparagraph (o)(5)(C) meaningless and, taken to its logical conclusion, could expose all transactions to the economic substance doctrine. Absent this initial relevancy inquiry, no transaction would withstand scrutiny unless taxpayers in all events first turned a blind eye to the tax consequences of their economic decisions.

But the Code is replete with examples in which Congress has explicitly allowed tax benefits to flow from incentivized activities. From investments in education, retirement savings, and opportunity zones, to deductions for home mortgages and charitable contributions, to tax credits — including those for research and development, low-income housing, and alternative energy —

[3] 2023 WL 8062792, at *4 (D. Colo. Oct. 31, 2023), *appeal docketed* No. 23-1410 (10th Cir. Dec. 28, 2023).

Congress regularly and routinely enacts statutes to use the Code to influence taxpayers' behavior ("tax incentive statutes"). Cases interpreting the pre-enactment common law economic substance doctrine and the legislative history tell us that section 7701(o) was never meant to apply in these types of situations. For example, before section 7701(o) was enacted, the Ninth Circuit held that: "[a]bsence of pre-tax profitability does not show 'whether the transaction had economic substance beyond the creation of tax benefits' . . . where Congress has purposely used tax incentives to change investors' conduct."[4] And the legislative history to section 7701(o) identified low-income housing credits, production tax credits, new markets credits, and energy credits, among others, that were not intended to be subject to section 7701(o).[5] Applying the economic substance doctrine to tax incentive statutes would render these incentives ineffective and

[4] *Sacks v. Commissioner,* 69 F.3d 982, 991 (9th Cir. 1995) (internal citation omitted), *rev'g* T.C. Memo. 1992-596, 64 T.C.M. (CCH) 1003 (1992). Although *Sacks* described the inquiry as "a sham question," the court focused on "the subjective aspect of whether the taxpayer intended to do anything other than acquire tax deductions, and the objective aspect of whether the transaction had any economic substance other than creation of tax benefits." 69 F.3d at 987.

[5] H.R. Rep. No. 111-443(I), at 296 (2010); *see also* J. Comm. Tax'n, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE "RECONCILIATION ACT OF 2010," as amended, in combination with the "Patient Protection and Affordable Care Act," (JCX-18-10), at 152 n.344. (Mar. 21, 2010) (providing examples of tax credits that were not intended to be disallowed by section 7701(o) when, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage).

contrary to Congress's goals.[6] Section 7701(o) cannot properly add substantive requirements beyond those already imposed by a tax incentive statute. The College thus urges this Court to recognize the need for a threshold relevancy determination under section 7701(o) and the need to exclude tax incentive statutes from the application of the economic substance doctrine.[7]

BACKGROUND

I. History Of The Economic Substance Doctrine.

Section 7701(o) clarified a longstanding judicial doctrine that courts developed (with significant variability) since the seminal Supreme Court decision in *Gregory v. Helvering*, 293 U.S. 465, 469 (1935) ("[T]he question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.").[8] The doctrine allows courts in certain circumstances to disregard a tax benefit that complies with the literal terms of the Code.

[6] *Sacks,* 69 F.3d at 992 ("If the Commissioner were permitted to deny tax benefits when the investments would not have been made but for the tax advantages, then only those investments would be made which would have been made without the Congressional decision to favor them.").

[7] The College does not take a position on whether this Court should find that section 831(b) is or is not a tax incentive statute. Rather, the College submits that if the Court should find that section 831(b) is a tax incentive statute, the economic substance doctrine is not relevant.

[8] *See Tucker v. Commissioner*, 766 F. App'x 132, 137 (5th Cir. 2019) (explaining that "[t]he doctrine has emerged from the Supreme Court's decision in *Gregory v. Helvering*").

Courts in different jurisdictions disagreed over the test to apply when evaluating economic substance. Still, the judicial consensus was that a court needed to inquire into whether, objectively, the transaction had a meaningful economic effect on the taxpayer (other than tax benefits) and whether, subjectively, there was a substantial nontax business purpose for the transaction.[9] A split among the circuits arose because some courts applied a conjunctive test in which a taxpayer needed to satisfy both prongs to demonstrate economic substance.[10] Others applied a disjunctive test in which satisfying one prong would demonstrate economic substance, and still others applied a flexible test in which the two prongs were merely specific factors to consider in a court's analysis.[11] But the economic substance doctrine always had limits.[12]

[9] *See, e.g.*, *Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. United States*, 568 F.3d 537, 544 (5th Cir. 2009).

[10] *See generally* H.R. Rep. No. 111-443(I) at 293 (2010) (describing the three ways the circuits evaluated the economic substance doctrine).

[11] *Id.*

[12] *See e.g.*, *Horn v. Commission*er, 968 F.2d 1229, 1234 (D.C. Cir. 1992) ("Congress undoubtedly has the power to grant beneficial tax treatment to economically meaningless behavior . . . ."); *Sacks*, 69 F.3d at 991–92; *Summa Holdings, Inc. v. Commissioner,* 848 F.3d 779 (6th Cir. 2017) (explaining that the common law "economic-substance principles … d[id] not give the Commissioner purchasing power" to recast transaction); *Cross Refined Coal, LLC v. Commissioner*, 45 F.4th 150, 156–61 (D.C. Cir. 2022) (evaluating the common law economic substance doctrine to address whether a partnership was bona fide and finding that "Congress recognized the environmental benefits of cleaner coal and provided tax incentives that it deemed appropriate as a result") *aff'g* Tax Ct. Docket No. 19502-17, Index No. 177 (Aug. 29, 2019).

II. Clarification Of The Economic Substance Doctrine.

Congress added section 7701(o) — titled "Clarification of the Economic Substance Doctrine" — in 2010.[13] This statute defines the doctrine as a "common law doctrine" under which income tax benefits with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.[14] It also states:

> (1) **Application of doctrine**. In the case of any transaction to which the economic substance doctrine is *relevant*, such transaction shall be treated as having economic substance only if — (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.
>
> . . .
>
> (5) **Definitions and special rules**. For purposes of this subsection—
>
> . . .
>
> (C) **Determination of application of doctrine not affected**. The determination of whether the economic substance doctrine is *relevant* to a transaction shall be made in the same manner as if this subsection had never been enacted.[15]

The enactment of section 7701(o) thus resolved the conflict among the circuit courts regarding how the doctrine should be applied by adopting a two-part conjunctive test. In doing so, Congress left untouched the preexisting judicial rules

[13] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010) (codified at I.R.C. §§ 6662(b)(6), 6662(i), 6664(c)(2), 6664(d)) (the "2010 Act").

[14] I.R.C. § 7701(o)(5)(A).

[15] I.R.C. § 7701(o) (emphasis added).

for when the doctrine comes into play.[16] That is how the IRS has understood section 7701(o), too.[17] And the IRS and Treasury Department have yet to issue proposed or temporary regulations, leaving taxpayers and their advisers to rely on IRS published guidance and public statements.[18]

The 2010 Act also established strict liability accuracy-related penalties attributable to any disallowed tax benefits for a transaction lacking economic substance or failing to meet the requirements of any similar rule of law.[19] The minimum penalty is 20 percent of the underpayment. That penalty is increased to 40 percent if the disallowed benefits were not "adequately disclosed" in the return or in a statement attached to the return.[20] Amendments to section 6664 make clear that the "reasonable cause" exception does not apply to the penalty.[21]

[16] I.R.C. § 7701(o)(5)(C).

[17] *See* IRS Notice 2010-62, 2010–40 I.R.B. 411, 412 (Oct. 4, 2010) ("[S]ection 7701(o)(1) only applies in the case of any transaction to which the economic substance doctrine is relevant. Consistent with these provisions, the IRS will continue to analyze when the economic substance doctrine will apply in the same fashion as it did prior to the enactment of section 7701(o).").

[18] *See infra* note 23 and 92.

[19] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), (b), 124 Stat. 1029, 1068–70 (codified at I.R.C. §§ 6662(b)(6), 6662(i), 6664(c)(2), 6664(d)).

[20] I.R.C. §§ 6662(b)(6), 6662(i).

[21] I.R.C. § 6664(c)(2).

III. This Court's Application Of Section 7701(o).

Since 2010, few cases have addressed section 7701(o) because the IRS has seldom invoked the doctrine. This cautious approach may be a response to the tax community's strong urging that the IRS treat section 7701(o) as a clarification of judicially created law rather than as an expansion of the doctrine's application.[22] Indeed, shortly after the enactment of section 7701(o), the IRS issued guidance that required revenue agents to conduct a multi-step analysis and then seek approval from the Director of Field Operations before raising section 7701(o) on audit.[23] In 2022, however, the IRS curtailed its internal controls by removing the executive

[22] *See, e.g.*, ABA Section of Taxation, Comment Letter on IRS Notice 2010-62, p. 12 (Jan. 18, 2011), https://www.americanbar.org/content/dam/aba/administrative/taxation/migrated/pubpolicy/2011/011811comments.pdf; New York State Bar Association Tax Section, Report on Codification of the Economic Substance Doctrine, p. 1 (Jan. 5, 2011), https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Reports%202011/1228%20Report.pdf.

[23] IRS Dir., LMSB-20-0910-024 (Sept. 14, 2010); IRS Dir., LB&I-4-0711-015 (July 15, 2011). The IRS has had a history of cautiously invoking the economic substance doctrine. *See* Chief Counsel of the Internal Revenue Service Donald L. Korb, Remarks at the 2005 University of Southern California Tax Institute, 57 Major Tax Plan. 10-1 ¶ 1006 (Jan. 23, 2005) (explaining that "the economic substance doctrine should be used only rarely and judiciously"); Chief Counsel of the Internal Revenue Service Donald L. Korb, Remarks at the 2007 University Of Southern California Tax Institute, Korb Provides Reassurance on Application of Economic Substance Doctrine, 2007 TNT 16-65 (explaining that the economic substance doctrine would not be used to challenge "investment solely for purposes of obtaining the [low income housing] credit offered" under the Code or "routine business restructurings," among other things).

approval required before revenue agents could assert the economic substance doctrine.[24]

Few courts have addressed the economic substance doctrine under section 7701(o). Most post-enactment decisions involve transactions that pre-dated the enactment of section 7701(o).[25] Because the statute "is not retroactive," courts have had little reason to consult section 7701(o).[26] Although the question of relevance is a novel question for this Court, this Court has emphasized the "relevant" language in the introductory clause of section 7701(o). In *CNT Investors, LLC v. Commissioner*, citing section 7701(o) and (5)(A), this Court observed that "Congress has mandated that, in applying the 'common law doctrine under which tax benefits * * * with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose' to any transaction to which it is '*relevant'*, the Federal courts use a conjunctive test."[27] And the dissent in *Mazzei v. Commissioner*, after describing the origins of the economic substance doctrine, similarly noted the "relevant" language in the

[24] IRS Mem., LB&I-04-0422-0014 (Apr. 22, 2022).

[25] *See infra* note 63.

[26] *See, e.g., Bank of New York Mellon Corp. v. Commissioner*, 801 F.3d 104, 115 n.7 (2d Cir. 2015) (explaining that the section 7701(o) is not retroactive and was therefore inapplicable).

[27] 144 T.C. 161, 197 n.38 (2015) (emphasis added) (explaining that section 7701(o) does not apply because transactions at issue occurred before the enactment of section 7701(o)).

introductory clause of section 7701(o). The dissent described this language as a "warn[ing]" to the Court that the doctrine "isn't always relevant."[28]

ARGUMENT

I. Section 7701(o) Requires A Threshold Relevancy Determination.

Section 7701(o) requires a threshold relevancy determination before applying the economic substance doctrine. This is supported by the plain text of section 7701(o), the legislative history for section 7701(o), cases interpreting the pre-enactment common law doctrine, and IRS guidance.

Section 7701(o) plainly states that "the common law doctrine under which [income] tax benefits . . . with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose,"[29] applies only when it "is relevant."[30] And the determination of whether the economic substance doctrine is "relevant" to a transaction "shall be made in the same manner as if this subsection had never been enacted."[31] A plain reading of

[28] *Mazzei v. Commissioner*, 150 T.C. 138, 196 (2018) (Holmes, J., joined by Foley & Buch, JJ., dissenting), *rev'd*, 998 F.3d 1041 (9th Cir. 2021). In a recent decision by the Court, *Parkway Gravel, Inc. v. Commissioner*, the Court noted, but did not apply, section 7701(o) because neither the IRS nor the petitioner chose to put forth any arguments under section 7701(o). T.C. Memo. 2024-59 (May 21, 2024). Rather, the Court rejected the IRS argument that either the common law "conduit" doctrine or the "sham transaction" doctrine should apply to recharacterize the transactions.

[29] I.R.C. § 7701(o)(5)(A).

[30] I.R.C. § 7701(o)(1).

[31] I.R.C. § 7701(o)(5)(C) (emphasis added).

section 7701(o) thus requires a threshold relevancy determination, which is confirmed by the statute's legislative history, cases interpreting the pre-enactment common law doctrine, and IRS guidance.

A. The Traditional Tools Of Statutory Interpretation Provide That Section 7701(o) Includes A Threshold Relevancy Determination.

The tools of statutory construction confirm that there is a threshold relevancy determination. In the tax law, as in every other statute-based regime, "courts must presume that a legislature says in a statute what it means and means in a statute what it says there."[32] The "ordinary meaning of [statutory] language accurately expresses the legislative purpose."[33] The "best way" to effectuate Congress's nuanced policy judgments is to apply each provision as its text requires.[34] As this Court recently explained in *Varian Med. Sys. v. Commissioner*, "[i]t is after all 'the sole function of the courts — at least where the disposition

[32] *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992) (describing that rule as the "one, cardinal canon"). The tools of statutory interpretation are well-known and commonly applied. *See* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS (2012).

[33] *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 175–76 (2009) (quoting *Engine Mfrs. Assn. v. S. Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252 (2004)).

[34] *Summa Holdings*, 848 F.3d at 789–90.

required by the text is not absurd —'. . . to enforce [plain statutory text] according to its terms."[35]

The first place to begin the interpretation of the statute is "with the statutory text."[36] Section 7701(o)(1) provides that "[i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if" the two-part conjunctive test is met. The introductory clause in section 7701(o)(1) thus begins with a reference to the transaction. A transaction at issue is limited to any transaction to which the economic substance doctrine "is relevant." Only if the economic substance doctrine is determined to be relevant is "*such transaction*" evaluated under the two-part conjunctive test.[37] In this context, "such" functions as a demonstrative adjective, or a "pointing word."[38] Everything before the word "such" is thus defining the kind of transaction that is subject to the two-part conjunctive test in (A) and (B) of section 7701(o)(1). "[S]uch transaction" thus refers to a transaction

[35] No. 8435-23, 2024 BL 297457, at *8 (T.C. Aug. 26, 2024) (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,* 530 U.S. 1, 6 (2000)) (internal quotations omitted).
[36] *BNSF Ry. Co. v. Loos*, 586 U.S. 310, 315 (2019); *NPR Invs., LLC v. United States*, 740 F.3d 998, 1007 (5th Cir. 2014) (interpreting the Code and stating "[t]he language of the statute is our guidepost.").
[37] I.R.C. § 7701(o)(1).
[38] Bryan A. Garner, GARNER'S MODERN ENGLISH USAGE, 873 (4th ed. 2016) ("Such is properly used as an adjective when reference has previously been made to a category of people or things: hence such means 'of that kind' . . . .").

for which the relevancy determination *has already been made*. That is the natural and plain reading of section 7701(o)(1).

That threshold relevancy determination is made mandatory by section 7701(o)(5)(C). Section 7701(o)(5)(C) provides a "special rule[]" that "the determination of whether the economic substance doctrine is *relevant* to a transaction *shall be made* in the same manner as if this subsection had never been enacted."[39] This mandates a determination of relevance by stating that such a "determination . . . shall be made."[40] As courts have held repeatedly, "shall" "indicates a mandatory intent."[41] And that "determination" is distinct from the two-part conjunctive determination in section 7701(o)(1).[42]

Unlike section 7701(o)(1), which specifies the two-part test to evaluate whether a transaction has economic substance, section 7701(o)(5)(C) tells courts to

[39] (Emphasis added).

[40] *Id.*

[41] *Nat'l R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 109 (2002) ("'[S]hall' makes the act of filing a charge within the specified time period mandatory."); *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) ("The mandatory 'shall' … normally creates an obligation impervious to judicial discretion."); *see generally Matter of Brown*, 960 F.3d 711, 716 (5th Cir. 2020) ("'Shall' is a mandatory word indicating a command.").

[42] It is also telling that Congress could have, but did not, require that section 7701(o) apply to "all transactions." *See*, *e.g.*, *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024) (explaining that the absence of a deferential standard from 5 U.S.C. § 706 is "telling"). "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank*, 503 U.S. at 253–54 (1992).

determine relevancy as they had done before. Together, the text and the structure of these provisions establish that Congress mandated that a court *first* determine whether an economic substance inquiry is warranted, *before* delving into the two-part test for determining if a transaction has economic substance. The relevancy determination in section 7701(o)(1) and (5)(C) thus cannot be interpreted as synonymous with the two-part conjunctive test in 7701(o)(1)(A) and (B).[43]

This interpretation also avoids rendering any part of the statute superfluous. It is "a cardinal principle of statutory construction that [courts] must give effect, if possible, to every clause and word of a statute."[44] By limiting the application of the economic substance doctrine to only those transactions to which it is relevant, it follows that there are some categories of transactions to which the economic substance doctrine under section 7701(o) is *not* relevant. Any other interpretation

[43] To be sure, section 7701(o)(1) provides that the two-part conjunctive test applies to "such transaction." "[S]uch transaction" is "any transaction to which the economic substance doctrine is relevant." I.R.C. § 7701(o)(1). It follows then that the relevancy determination must come before the determination of whether the transaction lacks economic substance under a plain reading of the statute. A contrary interpretation would lead to serious practical difficulties. It would require taxpayers to defend a transaction through an exam, audit, and litigation, coupled with an either 20- or 40-percent strict liability penalty, including for transactions to which Congress did not intend the economic substance doctrine to apply.

[44] *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (quoting *United States v. Menasche*, 348 U.S. 528, 538–39 (1955) (internal quotation marks omitted)).

renders the use of the term "relevant" meaningless,[45] and effectively strikes the following language from the statute:

> (1) Application of doctrine. ~~In the case of any transaction to which the economic substance doctrine is relevant, such~~ [A] transaction shall be treated as having economic substance only if — (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.
>
> ...
>
> (5) Definitions and special rules. For purposes of this subsection—
>
> ...
>
> ~~(C) Determination of application of doctrine not affected. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.~~

Such an interpretation would broaden the application of the economic substance doctrine and penalize taxpayers for transactions that Congress sought to incentivize. Section 6662(b)(6) and (i) impose strict liability penalties (20 or 40 percent) for transactions that lack economic substance under section 7701(o). Although section 7701(o) unambiguously requires a threshold relevancy determination, the rule of lenity further supports that interpretation. That rule provides that statutes imposing penalties are to be "construed strictly" against the

[45] SCALIA & GARNER, *supra,* at 174 ("If possible, every word and every provision is to be given effect. . . . None should be ignored. None should needlessly be given an interpretation that causes it to duplicate another provision or to have no consequence.").

government and in favor of taxpayers.[46] Because sections 6662(b)(6) and (i) subject taxpayers to harsh strict liability penalties, section 7701(o) should not be interpreted as applying without a threshold relevancy determination.[47]

Yet that is how the District Court of Colorado interpretated section 7701(o)(1) in *Liberty Global, Inc. v. United States*,[48] which currently is on appeal to the Tenth Circuit.[49] There, the district court reasoned that the statute's introductory clause is "coextensive with the statute's test for economic substance."[50] In doing so, the district court did not address section 7701(o)(5)(C)'s instruction that the determination of "relevan[ce]" is made as if section 7701(o) "had never been enacted." By adopting a rule that the economic substance

[46] *Bittner v. United States*, 598 U.S. 85, 101 (2023) (holding that the rule of lenity required interpreting the non-willful FBAR penalty in 31 U.S.C. § 5314 to apply per-report as opposed to per-bank account) (*quoting Commissioner v. Acker*, 361 U.S. 87 , 91 (1959)); *Rand v. Commissioner,* 141 T.C. 376, 393 (2013) (finding that the rule of lenity supported that there is no penalty on the refunds resulting from overstated earned income credits, additional child tax credits, or recovery rebate credits); *United States v. Thompson/Center Arms Co*., 504 U. S. 505 , 517–518 (1992) (applying the rule of lenity in a civil action to interpret an ambiguous tax statute that could impose criminal sanctions against a corporation); *Mohamed v. Commissioner*, 106 T.C.M. (CCH) 537, 543 (2013) ("The rule of lenity is an interpretive canon that may be expressed as follows: 'Ambiguity in a statute defining a crime or imposing a penalty should be resolved in the defendant's favor.'") quoting SCALIA & GARNER, *supra*, at 296.

[47] *Mohamed*, 106 T.C.M. (CCH) at 543 ("Any inclination that we might have to read section 6651(f) expansively must give way to the rule of lenity.").

[48] 2023 WL 8062792, at *4 (D. Colo. 2023).

[49] *Liberty Global, Inc. v. United States*, No. 23-1410 (10th Cir. Dec. 28, 2023).

[50] *Id.*

doctrine "applies when a transaction lacks economic substance," the court engaged in circular reasoning, as it ignored the statute's plain text, which provides that the doctrine is not always relevant.

The district court acknowledged that its interpretation presented the "risk of tautology." Nevertheless, that is what the court established. The district court made Congress's mandate to conduct a relevance inquiry ("shall be made") and its direction for how to do so ("in the same manner as if [section 7701(o)] had never been enacted") the same as the two-part conjunctive test in section 7701(o)(1). This renders section 7701(o)(5)(C) superfluous.[51] The district court did not grapple with this implication, nor did it discuss (let alone cite) section 7701(o)(5)(C) in its analysis.

As between an interpretation that gives effect to the introductory clause of section 7701(o)(1) and to its "special rule[]" in (o)(5)(C) and an interpretation that would render both superfluous, as taken by the district court in *Liberty Global*, coupled with a broader application of 20- to 40-percent strict liability penalties, this Court should find that section 7701(o) requires a threshold relevancy determination that is *separate* from the two-part conjunctive test.

[51] *Williams*, 529 U.S. at 404 (quoting *United States v. Menasche*, 348 U.S. 528, 538–39 (1955) (internal quotation marks omitted)) (explaining that it is "a cardinal principle of statutory construction that [courts] must give effect, if possible, to every clause and word of a statute.").

B. The Legislative History Of Section 7701(o) Confirms That There Is A Threshold Relevancy Requirement.

The Fifth Circuit, to which an appeal in this case would lie, does not resort to legislative history except to resolve statutory ambiguity.[52] As the plain meaning of section 7701(o)(1) and (5)(C) can only be interpreted as requiring a threshold relevancy determination, there is no need to resort to legislative history. That said, the legislative history to section 7701(o), such as it is,[53] confirms that the plain meaning was intended.

For more than ten years, Congress considered roughly 70 bills to clarify the economic substance doctrine.[54] Early versions of the proposed legislation did not include any language that would have restricted the application of the conjunctive

[52] *United States v. Kay*, 359 F.3d 738, 743 (5th Cir. 2004) ("If, after application of these principles of statutory construction, we conclude that the statute is ambiguous, we may turn to legislative history.").

[53] Due to the process through which it was enacted, there are no congressional reports approved by the tax-writing committees that accompanied the 2010 Act. However, in the years preceding enactment, including during the 111th Congress, committee reports from the House Committee on Ways and Means and the Senate Committee on Finance, and technical explanations prepared by the staff of the Joint Committee on Taxation, provide insight into what Congress intended when it enacted section 7701(o).

[54] *See* Charlene Luke, THE RELEVANCE GAMES: CONGRESS'S CHOICES FOR ECONOMIC SUBSTANCE GAMEMAKERS, 66 TAX LAW. 551, 553, 562–63 (2013); *see also* ABA Section of Taxation, Comment Letter on IRS Notice 2010-62, Appendix A (Jan. 18, 2011), https://ataxingmatter.blogs.com/files/aba-economic-substance.-comments-on-notice-2010-62.pdf.

test to transactions that were "relevant."[55] Commentators, including the American Bar Association, raised concerns that the lack of guardrails might allow the two-part conjunctive test to apply to transactions that had never been subject to the economic substance doctrine.[56]

In response, beginning in 2004, Congress modified the proposed legislative text to specify that the conjunctive test only applies to "a case in which a court determines that the economic substance doctrine is relevant[.]"[57] In 2007, Congress further strengthened the threshold relevancy requirement by limiting the conjunctive test to "any transaction to which the economic substance doctrine is relevant" and including a "special rule[]" that "[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same

[55] *See, e.g.*, S. Rep. No. 108-11, 108th Cong., 1st Sess., Title VII, Subtitle A, Section 701, "Clarification of Economic Substance Doctrine," of the CARE Act of 2003, (Feb. 27, 2003). But even with respect to those earlier versions, individual legislators suggested that tax credits, such as low-income housing tax credits and historical rehabilitation credits, as well as new market tax credits "would not be adversely affected" by enacting economic substance legislation. 9150 Cong. Rec. S5191 (daily ed. May 11, 2004) (cosponsor of JUMPSTART OUR BUSINESS STRENGTH (JOBS) ACT, S. 1637, 108th Cong. (2003)).

[56] ABA Section of Taxation Comment Letter on S.476 – Proposed Codification Of The Economic Substance Doctrine, 5 (Apr. 24, 2003) (expressing concern that the legislation without a threshold relevance test "may be read as implying that the economic substance doctrine applies to every transaction"). The comment letter noted that "a number of IRC provisions require a business purpose or profit motive but do not expressly require economic substance." *Id.* at 6.

[57] *See, e.g.*, H.R. Rep. No. 108-755, at 666 (Oct. 7, 2004) (Conf. Rep.); H.R. Rep. No. 109-455, at 222 (May 9, 2006) (Conf. Rep.); S. Rep. No. 109-336, at 138–39 (Sept. 15, 2006) (Conf. Rep.).

manner as if this subsection [section 7701(o)] had never been enacted."[58] "[T]he provision does not change current law standards in determining whether to utilize an economic substance analysis."[59] This revised language, which was eventually enacted, reflects a deliberate choice by Congress to adopt a threshold relevancy test rooted in the pre-enactment common law economic substance doctrine that is separate from the two-part conjunctive test.

And, as discussed *infra* at II.B, Congressional reports accompanying the enactment of the economic substance doctrine explained that section 7701(o) was not intended to alter the tax treatment of transactions that had been respected under longstanding judicial and administrative practice.[60] The Joint Committee on Taxation also explained that the economic substance doctrine under section 7701(o) does not apply if a taxpayer's eligibility for tax benefits is consistent with

[58] *See* Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. § 3501 (2007).

[59] H.R. Rep. No. 111-443(I) at 295–96, n.124 ("If the tax benefits are clearly consistent with all applicable provisions of the Code and the purposes of such provisions, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this provision.").

[60] *Id*. at 296; JCX-18-10, at 152–53; *see also* S. Rep. No. 110-206, at 92–93 (2007); H.R. Rep. No. 111-299(II), at 291 (2009). As examples of transactions outside the scope of the conjunctive test, each report listed the choice to capitalize a business enterprise with debt or equity, the choice to utilize a foreign corporation for a foreign investment, the choice to enter into a corporate organization or reorganization, and the choice to transact with a related party. JCX-18-10, at 152–53. The committee reports uniformly explain that these examples are "illustrative and not exclusive." *Id*. at 152.

the Congressional purpose.[61] The evolution of the proposed text, along with its legislative history, demonstrates that Congress intended to give effect to the "relevance" language added to section 7701(o)(1) and 7701(o)(5)(C) in determining whether to apply the two-part conjunctive test.

C. Cases Interpreting the Pre-Enactment Common Law Economic Substance Doctrine Support A Threshold Relevancy Requirement.

Section 7701(o)(5)(C) provides that "[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if [section 7701(o)] had never been enacted." Although the cases interpreting the pre-enactment common law economic substance doctrine did not use a "relevance" label, courts recognized that the economic substance doctrine did not apply to every transaction.[62] This includes courts evaluating transactions post-enactment under the common law economic substance doctrine.[63]

[61] JCX-18-10, *supra*, at 152 n.344.

[62] *See Cross Refined Coal,* 45 F.4th at 160–61 (taxpayer can take advantage of tax credits designed by Congress); *Sacks*, 69 F.3d at 991–92 (same); *John Kelley Co. v. Commissioner,* 326 U.S. 521 (1946) (rejecting application of *Gregory v Helvering* to decisions to capitalize with debt versus equity).

[63] As section 7701(o) applies to transactions entered into after March 30, 2010, Pub. L. No. 111-152, § 1409(a), courts continued to evaluate transactions under pre-enactment case law post-enactment of section 7701(o). *See, e.g., Daichman v. Commissioner,* 120 T.C.M. (CCH) 176 n.12 (2020) (explaining that section 7701(o) was not applicable to the case).

For instance, in *Summa Holdings, Inc. v. Commissioner* the Sixth Circuit considered the tax benefits achieved by using Roth IRAs and "domestic international sales corporations" ("DISCs").[64] A family contributed the maximum amount allowed to two Roth IRAs, which invested in a DISC.[65] Over several years, the DISC made dividends to the Roth IRAs, where the money could grow (and eventually be withdrawn) tax-free.[66] The Commissioner asked the court to set aside this arrangement, claiming it was just a scheme "to sidestep the contribution limits on Roth IRAs."[67]

The Sixth Circuit evaluated the pre-enactment common law economic substance doctrine and disagreed, explaining that "the Code authorizes DISC commissions and dividends, regardless of whether they have economic substance, in order to reduce the tax burden of exporters."[68] And as to Roth IRAs, "the Code authorizes investors to avoid significant taxes on capital gains and dividends by using their Roth IRAs in all manner of tax-avoiding ways[.]"[69] The Sixth Circuit explained that Roth IRAs and DISCs are "designed for tax-reduction purposes"

[64] 848 F.3d at 781–82.

[65] *Id.* at 783.

[66] *Id.* at 784.

[67] *Id.* at 784–85.

[68] *Id.* at 789. The transactions occurred before the effective date of section 7701(o). *See id.* at 784–85 ("Congress has codified this principle for transactions after 2010, 26 U.S.C. § 7701(o)").

[69] *Id.* at 789.

and “have no economic substance at all”— so “economic-substance principles . . . do not give the Commissioner purchasing power here.”[70]

Similarly, in *Horn v. Commissioner* the D.C. Circuit evaluated whether “Congress intended to authorize a deduction for losses incurred by certain taxpayers who engaged in transactions of a type designed to secure tax benefits while avoiding any economic risk.”[71] It held that Congress did. The D.C. Circuit found that the losses incurred by the taxpayers were allowable under section 108 of the Tax Reform Act of 1984 (as amended), which (1) allowed “any loss” from trading straddles if “incurred in a trade or business”; and (2) treated “any loss incurred by a commodities dealer in the trading of commodities . . . as a loss incurred in a trade or business.”[72] The D.C. Circuit found that the plain meaning of the statute authorized the claimed deductions and that the IRS’s position took the sham transaction doctrine “too far.”[73]

[70] *Id*. at 786.

[71] *Horn*, 968 F.2d at 1230–31 (“More specifically, we must decide whether section 108 of the Tax Reform Act of 1984, as amended, permits commodities dealers to deduct losses incurred in the disposition of the legs of straddle transactions, even if the taxpayer’s pattern of trading reveals that the transactions were designed only to produce tax benefits.”).

[72] *Id*. at 1234–35 (citation omitted); *see* 26 U.S.C. § 1092.

[73] *Horn*, 968 F.2d at 1237 (describing the sham transaction doctrine as “(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?”).

The D.C. Circuit explained that "Congress undoubtedly has the power to grant beneficial tax treatment to economically meaningless behavior . . . ."[74] It further explained that "[a]lthough useful in determining congressional intent and in avoiding results unintended by tax code provisions, the doctrine cannot trump the plainly expressed intent of the legislature."[75] In doing so, the D.C. Circuit rejected the economic substance-based reasoning that other courts had employed to "read [section 108(b)] completely out of existence."[76] Reading the provision as a whole made clear that Congress authorized the transaction at issue.[77] Although it found an inquiry into the legislative history "superfluous," the court nevertheless found that the legislative history confirmed its reading of the statute.[78]

And this Court too has explained that certain transactions require no economic substance because the statutes are designed to incentivize taxpayer behavior. For example, in *Skripak v. Commissioner* the taxpayers participated in a

[74] *Id.* at 1236 ("Congress has the power to authorize these transactions, whether or not they are economic shams.").

[75] *Id.* at 1231.

[76] *Id.* at 1234 ("However, after reading the statute and the legislative history, we began with the question, 'If section 108(b) does not authorize the deduction claimed here, what is its purpose?'").

[77] *Id.* at 1236 (explaining that "the language of section 108(a)—providing that the deduction shall be allowed if the transaction was in a trade or business *or* engaged in for profit—coupled with the irrebuttable presumption of section 108(b), makes it clear that that is exactly what Congress intended to do").

[78] *Id.* at 1235 (analyzing the Conference Committee Report accompanying the 1986 legislation).

book contribution program under which individuals purchased portions of a book publisher's excess inventory and, after holding the books for more than six months (the then long-term capital gains holding period), contributed them to various public libraries.[79] The book contribution program was carried out with the assistance of a corporation, which located the individual donors and the donee libraries, purchased the books from the publisher, and resold them to the donors. The taxpayers claimed charitable contribution deductions equal to the publisher's "catalog retail list price," which was significantly higher than what they paid for the books.[80] The Commissioner denied their charitable contribution deductions, arguing that the transaction lacked economic substance.[81]

This Court rejected the Commissioner's arguments.[82] This Court explained that "the deduction for charitable contributions provided by section 170 is a legislative subsidy for purely personal (as opposed to business) expenses of a taxpayer. Accordingly, doctrines such as business purpose and an objective of economic profit are of little, if any, significance in determining whether petitioners

[79] 84 T.C. 285, 293–97 (1985).
[80] *Id.*
[81] *Id.* at 314–15.
[82] *Id.* at 315, 319–20.

have made charitable gifts."[83] Only after reaching that conclusion did the Court also find that the transactions had economic substance.

More recently, in *Cross Refined Coal, LLC v. Commissioner,* this Court held in a bench opinion that the economic substance doctrine could not negate the validity of transactions undertaken to claim a tax credit.[84] Specifically, the Court examined whether Cross Refined Coal, LLC was a bona fide partnership and whether its partners were entitled to claim losses and section 45 credits.[85] The Commissioner argued that the partnership was formed primarily to monetize refined coal tax credits.[86] The Court disagreed. In its analysis, the Court addressed the common law economic substance doctrine and emphasized that Congress explicitly created the section 45 tax credits to incentivize the production of refined coal, an activity that would otherwise be uneconomical.[87] As this Court explained, "Without the credits, the refined coal activity was a losing proposition; but that fact cannot mean that the activity, undertaken by someone who gains by claiming the

[83] *Id.* (citations omitted); *see also RERI Holdings I, LLC v. Commissioner*, T.C. Memo. 2014-99, 107 T.C.M. (CCH) 1488, 1493 (2014) ("Also, if we were to find that the transaction by which RERI acquired and then donated the successor member interest to the University had no nontax business purpose, again: So what? Have we not said sufficiently that gifts to charity need have no economic substance beyond the mere fact of the gift?").
[84] Tax Ct. Docket No. 19502-17, Index No. 177 (Aug. 29, 2019).
[85] *Id*. at 36.
[86] *Id.* at 63.
[87] The Tax Court did not discuss section 7701(o).

credits, lacks economic substance; rather, that fact is the reason for the credits."[88] Consequently, this Court concluded that the economic substance doctrine did not apply to tax incentive statutes like section 45.[89]

The D.C. Circuit affirmed, holding that "Taxpayers that structure their dealings to receive tax benefits afforded by statute are entitled to those benefits, no matter their subjective motivations. Otherwise, the sham-partnership doctrine, like the more general economic-substance doctrine, would allow the Commissioner 'to place labels on transactions to avoid textual consequences he doesn't like.'"[90]

And as discussed *infra* at II.B, Congress routinely uses tax law to further policies and encourage behaviors that might otherwise be uneconomic. Cases interpreting the pre-enactment economic substance doctrine establish that statutes that are intended to induce taxpayers' behavior, such as tax credits, are not subject to the economic substance doctrine.[91]

[88] *Id*. at 54.

[89] *Id.*

[90] *Cross Refined Coal*, 45 F.4th at 156 (quoting *Summa Holdings,* 848 F.3d at 787).

[91] *See, e.g.*, *Sacks*, 69 F.3d at 992 (explaining that "[a] tax advantage such as Congress awarded for alternative energy investments is intended to induce investments which otherwise would not have been made"); *see also* Hale E. Sheppard, Tax Incentives, Economic Substance, and Partnership Validity: New Case Undercuts IRS Attacks, Corporate Taxation, 50 WGL-CTAX 03, 4, 2023 WL 2330058, at *3 (2023) ("Congress often inserts itself, creating incentives, such as tax credits and deductions, to encourage parties to place money where they otherwise would not") (citing cases).

D. IRS Guidance Also Supports A Threshold Relevancy Requirement.

Additionally, the IRS has recognized Congress's intent that section 7701(o) only applies where it is "relevant." In Notice 2010-62, the IRS provided that:

> [S]ection 7701(o)(1) only applies in the case of any transaction to which the economic substance doctrine is *relevant*. Consistent with these provisions, the IRS will continue to analyze when the economic substance doctrine will apply in the same fashion as it did prior to the enactment of section 7701(o). If authorities, prior to the enactment of section 7701(o), provided that the economic substance doctrine was not relevant to whether certain tax benefits are allowable, the IRS will continue to take the position that the economic substance doctrine is not relevant to whether those tax benefits are allowable.[92]

Notice 2010-62 thus interpreted section 7701(o)(1) and (c)(5) as requiring a threshold relevancy determination.

Although the IRS's position in a notice is not binding on this Court, it reflects the understanding of the agency charged with applying section 7701(o), immediately following its enactment. As the Supreme Court recently explained in *Loper Bright,* "respect" — indeed, "great respect" — is "especially warranted" when an "Executive Branch interpretation was issued roughly contemporaneously with enactment of the statute and remained consistent over time."[93] The

[92] IRS Notice 2010-62 at 5 (emphasis added); *see also* IRS Notice 2014-58, 2014-44 I.R.B. 746 (Oct. 27, 2014) (observing that determination of whether economic substance doctrine is relevant is considered on case-by-case basis).

[93] 144 S. Ct. at 2283 (quoting *Edwards' Lessee v. Darby*, 12 Wheat. 206, 210 (1827)).

Commissioner now seeks to broaden the application of section 7701(o). This new and inconsistent interpretation of section 7701(o) should not be considered more persuasive.[94] And as discussed further *infra* at II.B, the Internal Revenue Manual continues to recognize that section 7701(o) does not apply to all transactions, thereby mandating a threshold relevancy determination.[95]

II. The Economic Substance Doctrine Is Not Relevant To Tax Incentive Statutes.[96]

Section 7701(o)(5)(C), titled "Determination Of Application Of Doctrine Not Affected," states "[t]he *determination* of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted." Accordingly, a review of cases interpreting the pre-enactment common law economic substance doctrine and the legislative

[94] *Bittner*, 598 U.S. at 97 n.5 ("[W]hen the government (or any litigant) speaks out of both sides of its mouth, no one should be surprised if its latest utterance isn't the most convincing one. This is no new principle in the law any more than it is in life. In *Skidmore*, this Court noted that the persuasiveness of an agency's interpretation of the law may be undermined by its inconsistency 'with earlier [agency] pronouncements.' 323 U.S. at 140.").

[95] IRM. 4.46.4.12.9; *see also* IRM Exhibit 4.46.4-4, Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties.

[96] Of course, a court might determine there are additional situations in which section 7701(o) is not relevant. *See* H.R. Rep. No. 111-443 at 296; JCX-18-10, at 152–53 (explaining that the economic substance doctrine was not relevant to basic business transactions where the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages). *See, e.g., Dover Corp. v. Commissioner*, 122 T.C. 324, 351, 353 n.19 (2004) (the entity classification regulations do not require "that the taxpayer have a business purpose for such an election or, indeed, for any election under those regulations").

history reveals how section 7701(o) was intended to apply. Such guidance shows that the economic substance doctrine was not meant to be applied to tax incentive statutes.[97]

Tax incentive statutes are used by Congress to further policies and encourage behaviors that might otherwise be uneconomic. Such tax-based incentives presuppose that taxpayers often make choices based on their tax consequences.[98] Thus, it would be counterintuitive to apply, or for Congress to have intended to apply, section 7701(o), a transaction-restrictive doctrine, to statutes intended to induce a taxpayer's behavior.[99]

[97] *Altria Grp., Inc. v. United States*, 694 F. Supp. 2d 259, 284 (S.D.N.Y. 2010), *aff'd*, 658 F.3d 276 (2d Cir. 2011) (explaining that "the economic substance doctrine simply has no application if it is clear that a claimed deduction is within the intent of a provision of the Code.").

[98] *See*, *e.g.*, Stanley S. Surrey, Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures, 83 HARV. L. REV. 705, 705 (1970) ("[T]he present federal income tax is replete with tax incentive provisions. Some were adopted to assist particular industries, business activities, or financial transactions. Others were adopted to encourage nonbusiness activities considered socially useful, such as contributions to charity."); *see also* Martin J. McMahon, ECONOMIC SUBSTANCE, PURPOSIVE ACTIVITY, AND CORPORATE TAX SHELTERS, 94 Tax Notes 1017, 1019 (2002) ("the code abounds with provisions that . . . are *intended* to influence economic behavior").

[99] *See, e.g.*, Hale E. Sheppard, *supra,* at 3 ("Congress often inserts itself, creating incentives, such as tax credits and deductions, to encourage parties to place money where they otherwise would not") (collecting cases); *see also* Leandra Lederman, W(H)ITHER ECONOMIC SUBSTANCE?, 95 IOWA L. REV. 389, 396 (2010) (citing Joseph Bankman, The Economic Substance Doctrine, 74 S. CAL. L. REV. 5, 13 (2000) ("Taking the government up on proffered tax benefits is, by definition, not abusive.")).

A. Cases Interpreting The Pre-Enactment Common Law Economic Substance Doctrine Show That Courts Did Not Apply The Economic Substance Doctrine To Tax Incentive Statutes.

As discussed *supra* at I.C, cases interpreting the pre-enactment common law economic substance doctrine require a threshold relevancy determination. Such case law is replete with examples of courts rejecting the application of the economic substance doctrine in cases involving tax incentive statutes.[100] Courts have routinely recognized that the doctrine is irrelevant where Congress intended to provide taxpayers with incentives under the Code.[101]

As Petitioners highlighted in their seriatim reply brief, *Sacks v. Commissioner* is the paramount case illustrating this principle.[102] In *Sacks*, the taxpayer challenged the IRS's disallowance of depreciation deductions and

[100] *See*, *e.g.*, *Cross Refined Coal,* 45 F.4th at 160–61 (explaining when Congress creates a tax credit to encourage an otherwise uneconomical activity, the economic substance of that activity should be evaluated by including the tax incentive); *Salem Fin., Inc. v. United States*, 786 F.3d 932, 950 (Fed. Cir. 2015) ("Indeed, Congress often provides tax benefits to encourage socially beneficial activity that would not be pursued absent tax advantages.").

[101] *See Altria Grp.*, 694 F. Supp. 2d at 284 (explaining that when a claimed deduction is within the intent of a provision of the Code, the economic substance doctrine does not apply); *Skripak,* 84 T.C. at 319 ("Consequently, a taxpayer's desire to avoid or eliminate taxes by contributing cash or property to charities cannot be used as a basis for disallowing the deduction for that charitable contribution.").

[102] *See* Pet'rs' Seriatim Reply Br. 9 ("*Sacks* confirms the common sense that Congress adopts policy-based inducement statutes to incentivize citizens to take action they would not take without the incentive."). Petitioners also cite to *Cross Refined Coal* and *Summa Holdings* discussed *infra* at I.C.

investment tax credits claimed on solar water heaters. The Tax Court, holding for the IRS, held that the taxpayer's sale-leaseback of solar water heaters was a sham.[103] The Ninth Circuit disagreed, reversing and remanding. The Ninth Circuit recognized that Congress specifically intended to provide tax incentives to promote environmental benefits, *i.e.*, the use of alternative energy. The Ninth Circuit stated "[i]f the government treats tax-advantaged transactions as shams unless they make economic sense on a pre-tax basis, then it takes away with the executive hand what it gives with the legislative."[104] The Ninth Circuit concluded that:

> If the Commissioner were permitted to deny tax benefits when the investments would not have been made but for the tax advantages, then only those investments would be made which would have been made without the Congressional decision to favor them. The tax credits were intended to generate investments in alternative energy technologies that would not otherwise be made because of their low profitability. . . . Yet, the Commissioner in this case at bar proposes to use the reason Congress created the tax benefits as a ground for denying them. That violates the principle that statutes ought to be construed in light of their purpose.[105]

Similar to the Ninth Circuit in *Sacks*, this Court reviewed several cases related to transactions involving charitable donations, each time rejecting the

[103] *Sacks v. Commissioner*, T.C. Memo. 1992-596, 64 T.C.M. (CCH) 1003 (1992), *rev'd*, 69 F.3d at 982 (9th Cir. 1995).

[104] *Sacks v. Commissioner*, 69 F.3d at 992 (9th Cir. 1995), *rev'g* T.C. Memo. 1992-596, 64 T.C.M. (CCH) 1003 (1992).

[105] *Id.* (citing *Cabell v. Markham*, 148 F.2d 737 (2d Cir. 1945) (L. Hand, J.)).

application of the economic substance doctrine to section 170.[106] For instance, in *Hunter v. Commissioner*, as part of a tax reduction program, petitioners purchased limited edition art prints at retail-discounted prices and subsequently donated the prints to charitable institutions.[107] Following the donation of the prints to charitable institutions, the petitioners took a tax deduction equal to the prints' retail (versus discounted) values. In challenging the deduction, the IRS contended that petitioners' "purported purchase" and subsequent donations of the prints were devoid of economic substance and thus could not give rise to a charitable contribution deduction.[108] The Court, concluding that a taxpayer's desire to avoid or eliminate taxes by contributing cash or property to charities cannot be used as a basis for disallowing the corresponding deduction, stated:

> We shall repeat what we stated in *Skripak v. Commissioner* . . . Respondent's seeming obsession with the mechanics of these transactions as shams appears to be caused by the admitted tax-avoidance motivation of the various petitioners. However, as stated above, the deduction for charitable contributions was intended to provide a tax incentive for taxpayers to support charities.[109]

[106] *See*, *e.g.*, *Skripak,* 84 T.C. 285, discussed *infra* at I.C; *Weintrob v. Commissioner*, T.C. Memo. 1990-513, 60 T.C.M. (CCH) 895 (1990); *RERI Holdings I*, T.C. Memo. 2014-99, discussed *infra* at I.C.

[107] T.C. Memo. 1986-308, 51 T.C.M. (CCH) 1533 (1986).

[108] *Id*. at 1535.

[109] *Id*. at 1536 (citing *Skripak*, 84 T.C. at 319).

Accordingly, the Court held that petitioners were entitled to a charitable contribution deduction for the donation of the art prints.

Just a few years later, the Court again rejected the IRS's assertion of the doctrine in a similar case. In *Weitz v. Commissioner*, petitioners had invested in a pool of funds, which were then used to purchase and hold medical equipment purchased in bankruptcy auctions.[110] The equipment was later donated to a charitable institution, and the petitioners then took a deduction for their respective share, based on the equipment's fair market value at the time of the contribution (versus the auction price). The IRS argued that the entire series of transactions used to effectuate the deduction lacked economic substance. The Court, quoting *Gregory v. Helvering*, stated that the "fundamental inquiry is 'whether what was done, apart from the tax motive, was the thing which the statute intended.'"[111] The Court followed by stating:

> As we recently noted in *Skripak v. Commissioner*. . . section 170 allows a deduction from tax with respect to donations to charitable institutions even when the donation is carefully contrived to comply with the requirements of the applicable rules and regulations. Petitioners' actions have been planned and executed to assure that their donation of medical equipment . . . would come within the definition of a deductible charitable contribution and all of the steps necessary to accomplish that goal have been effectuated. Petitioners cannot be penalized for being careful.[112]

[110] T.C. Memo. 1989-99, 56 T.C.M. (CCH) 1422 (1989).

[111] *Id*. at 1426, (citing *Gregory v. Helvering*, 293 U.S. at 469).

[112] *Weitz*, 56 T.C.M. (CCH) at 1428.

The Court ultimately concluded, just as it did in *Skripak* and *Hunter*, that petitioners were entitled to claim a charitable deduction, as the transaction giving rise to the deduction aligned with the underlying objective of the statute — to encourage charitable giving.

As is apparent from the case law in this section and in I. *infra*, taxpayers should be entitled to tax benefits specifically afforded by statute, irrespective of their subjective motivations.[113] As discussed below, applying the doctrine to these statutes would be at odds with Congress's intent, and also fundamentally allow the IRS to disallow transactions after-the-fact.[114]

B. Legislative History and IRS Guidance Also Show That Congress Did Not Intend Section 7701(o) To Apply To Tax Incentive Statutes.

The legislative history of section 7701(o) confirms that Congress did not intend for the economic substance doctrine to apply to tax incentive statutes.[115] The legislative history states:

[113] *Cross Refined Coal*, 45 F.4th at 156–57; *see also Mill Road 36 Henry, LLC v. Commissioner*, T.C. Memo 2023-129 at *28 ("Congress long ago decided to incentivize charitable contributions by allowing a deduction for those contributions, and it would be perverse indeed to deny a deduction to a donor simply because he had responded to the incentive.").

[114] *See*, *e.g.*, *id.*, quoting *Summa Holdings*, 848 F.3d at 787 ("Otherwise, the sham-partnership doctrine, like the more general economic-substance doctrine, would allow the Commissioner 'to place labels on transactions to avoid textual consequences he doesn't like.'").

[115] *See*, *e.g.*, Hale E. Sheppard, *supra*, at * 5 ("Congress left no doubt when it enacted Section 7701(o) back in 2010 that the economic substance doctrine should

> If the tax benefits are clearly consistent with all applicable provisions of the Code and the purposes of such provisions, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this provision.[116]

Further, the Joint Committee's Technical Explanation accompanying the enactment of section 7701(o) states "[i]f the realization of the tax benefits is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate, it is not intended that such benefits be disallowed."[117] The Technical Explanation goes on to provide specific examples: "for example, it is not intended that a tax credit (*e.g.*, section 42 (low-income housing credit), section 45 (production tax credit), section 45D (new markets tax credit), section 47 (rehabilitation credit), section 48 (energy credit), etc.) be disallowed in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage."[118]

Additionally, the IRS has recognized Congress's intent regarding section 7701(o)'s applicability in its own internal and published guidance. The Internal Revenue Manual (the "IRM") discusses the economic substance doctrine and

not apply where taxpayers engage in transactions in conformity with a specific tax incentive.").

[116] H.R. Rep. No. 111-443, at 296; *see also* note 96.

[117] JCX-18-10, *supra*, at 152 n.344.

[118] *Id.*

provides examples of facts and circumstances that might indicate that the doctrine might apply (e.g., if the transaction is "pre-packaged" or "highly structured").[119] Immediately following such facts and circumstances, however, the IRM states "[n]otwithstanding [the] existence of the above facts and circumstances, the economic substance doctrine may not be appropriate if the transaction that generates targeted tax incentives is, in form and substance, consistent with Congressional intent in providing the incentives."[120] This same statement is also found verbatim in an LB&I memorandum issued by the IRS in 2022.[121] The IRS's statements regarding Congress's intent — and its guidelines interpreting same — clearly acknowledge its understanding that the economic substance doctrine is not relevant in all cases.[122]

C. If Section 831(b) Is A Tax Incentive Statute, Section 7701(o) Should Not Apply.

As cases interpreting the pre-enactment common law economic substance doctrine, legislative history, and IRS guidance make clear, if the determination of whether the economic substance doctrine is relevant is to be made as if section 7701(o) was never enacted, then the doctrine should not apply to tax

[119] IRM 4.46.4.12.9 (Sept. 6, 2023); *see also* IRM Exhibit 4.46.4-4, Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties.
[120] *Id.*
[121] IRS Mem., LB&I-04-0422-0014 (April 22, 2022).
[122] *See supra* note 94.

incentive statutes. Petitioners argue section 831(b) was intended as a tax incentive statute — that Congress specially intended, via section 831(b), to encourage long-term capital growth and increase retained earnings — in a deliberate endeavor to strengthen small businesses.[123] Consequently, should the Court find that section 831(b) is a tax incentive statute, the economic substance doctrine should not be applied in this case.

[123] Pet'rs' Opening Br. 174.

CONCLUSION

The College respectfully requests that the Court determine that a relevancy determination must be made as a threshold matter before the economic substance doctrine can be applied and that, should the Court determine section 831(b) is a tax incentive statute, the Court decline to apply section 7701(o) to the transactions at issue.

Respectfully submitted,

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This is to certify that a copy of the foregoing paper was served on counsel for Petitioners and on counsel for Respondent by sending the same on September 6, 2024, via FedEx delivery addressed as follows:

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