**Received**
08/26/24

**Filed**
08/26/24

Sunil S. Patel & Laurie McAnally Patel, et al.,

Petitioners

v.

Commissioner of Internal Revenue

Respondent

Docket No. 24344-17 Document No. 376
Docket No. 11352-18 Document No. 369
Docket No. 25268-18 Document No. 361

# Brief As Amicus Curiae

Certificate of Service

**SERVED 08/26/24**

**Received** 08/22/24

**Lodged** 08/22/24

Sunil S. Patel & Laurie McAnally Patel, et al.,

Petitioners

v.

Commissioner of Internal Revenue

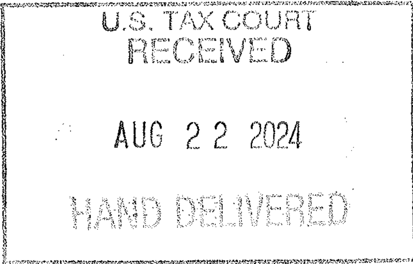
Respondent

Docket No. 24344-17 Document No. 372
Docket No. 11352-18 Document No. 365
Docket No. 25268-18 Document No. 357

# Brief As Amicus Curiae

Certificate of Service

**SERVED 08/23/24**




UNITED STATES TAX COURT

| | | |
|---|---|---|
| SUNIL S. PATEL AND LAURIE MCANALLY PATEL,<br><br>Petitioners,<br><br>v.<br><br>COMMISSIONER OF INTERNAL REVENUE,<br><br>Respondent. | )<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>) | Docket Nos.: 24344-17, 11352-18, 25268-18<br><br>Judge Courtney D. Jones<br>Paper Filed |

# **BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITIONERS**

Robert J. Kovacev
Samuel A. Lapin
Miller & Chevalier Chartered
900 16th Street NW
Washington, DC 20006
Tel: (202) 626-5800

*Counsel for Chamber of Commerce of the United States of America*

## Corporate Disclosure Statement

Pursuant to Rule 20(c) of the United States Tax Court Rules, amicus curiae Chamber of Commerce of the United States of America states that it does not have a parent corporation and that no publicly held company owns 10% or more of the stock of the amicus.

## Table of Contents

**PAGE**

Corporate Disclosure Statement ........................................................................ i

Interest of *Amicus Curiae* ..............................................................................1

Introduction and Summary of Argument...........................................................3

I. The Codification of the Economic Substance Doctrine in Section 7701(o) Explicitly Retained the Relevance Threshold. ...............................................5

A. Section 7701(o)'s Text Unambiguously Includes a Threshold "Relevance" Inquiry that Must be Addressed before Applying the Economic Substance Doctrine ...........................................................5

B. Statutory History Confirms Congressional Intent to Preserve the "Relevance" Standard as a Threshold Inquiry Before Applying the Economic Substance Doctrine ...........................................................8

C. Respondent's Own Guidance is Consistent with a Threshold Relevancy Requirement ....................................................................12

D. A Threshold Relevancy Requirement is Consistent with Pre-Enactment Economic Substance Jurisprudence..................................13

II. The Relevancy Determination Should Be Guided By The Decades Of Judicial Precedent Interpreting The Economic Substance Doctrine .............15

A. Section 7701(o) is Not Relevant to Transactions Engaging in Activities That Congress has Determined Serve Non-Tax Policy Goals ............................................................17

B. Other Transactions That Courts Have Held to be Not Relevant as to the Economic Substance Doctrine...............................22

1. Transactions to Recognize Economic Gains or Losses for Tax Purposes......................................................... 23

2. Transactions to Facilitate Recognition of Taxable Loss on Liquidation of Subsidiary. .......... 24

3. Tax Elections That Result in Deemed Transactions .......... 26

III. Conclusion .......... 27

## Table of Authorities

**Cases** **Page(s)**

*ADT, LLC v. Richmond*,
18 F.4th 149 (5th Cir. 2021) ........................................................ 6

*Avco Mfg. Corp. v. Commissioner*,
25 T.C. 975 (1956), *aff'd in relevant part*, No. 45633, 1957 WL
10899 (2d Cir. 1957) ........................................................ 25

*Comm'r v. Day & Zimmerman*,
151 F.2d 517 (3d Cir. 1945) ........................................................ 25

*Cottage Savings Association v. Commissioner*,
499 U.S. 554 (1991) ........................................................ 23

*Cross Refined Coal LLC v. Commissioner*,
45 F.4th 150 (D.C. Cir. 2022) ........................................................ 18, 21

*Curry v. Commissioner*,
43 T.C. 667 (1965) ........................................................ 24

*Dover Corp. v. Commissioner*,
122 T.C. 324 (2004) ........................................................ 26

*DTDV, LLC v. Commissioner*,
T.C. Memo. 2018-32 (2018) ........................................................ 16

*Elliott v. Commissioner*,
84 T.C. 227 (1985) ........................................................ 22

*George L. Riggs, Inc. v. Commissioner*,
64 T.C. 474 (1975) ........................................................ 25, 26

*Greenberg Bros. P'ship #4 v. Commissioner*,
111 T.C. 198 (1998) ........................................................ 16

*Gregory v. Helvering*,
293 U.S. 465 (1935) ........................................................ 15

*Hobby v. Commissioner*,
2 T.C. 980 (1943) .......... 24

*Horn v. Commissioner*,
968 F.2d 1229 (D.C. Cir. 1992) .......... 15

*Johnson v. Commissioner*,
152 T.C. 121 (2019) .......... 6

*Sacks v. Commissioner*,
69 F.3d 982 (9th Cir. 1995) .......... 17, 18

*Summa Holdings, Inc. v. Commissioner*,
848 F.3d 779 (6th Cir. 2017) .......... 15

*Sun Properties, Inc. v. United States*,
220 F.2d 171 (5th Cir. 1955) .......... 23, 24

*Tucker v. Commissioner*,
766 Fed. Appx. 132 (5th Cir. 1966) .......... 13

*Wells Fargo & Co. v. Commissioner*,
120 T.C. 69 (2003) .......... 16

*Woods Investment Co. v. Commissioner*,
85 T.C. 274 (1985) .......... 13

**Statutes**

26 U.S.C. § 7701(o) .......... *passim*

26 U.S.C. § 7701(o)(1) .......... 3, 5, 6, 7, 11

26 U.S.C. § 7701(o)(5)(C) .......... 6, 7, 11

I.R.C. § 45C(d)(1)(B) .......... 17

I.R.C. § 45C(d)(B) .......... 18

I.R.C. § 332 .......... 20, 25, 26

I.R.C. § 332(b) .......... 24

I.R.C. § 6418 .......... 11, 18

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), (Mar. 21, 2010) .......... 10, 21

Inflation Reduction Act of 2022, P.L. 117-169, 136 Stat. 2009 (Aug. 16, 2022) .......... 11

Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. § 3501 (2007) (as introduced in the House, Oct. 25, 2007) .......... 10

Title VII, Subtitle A, Section 701, "Clarification of Economic Substance Doctrine," of the CARE Act of 2003, S. 476, reported in S. Rpt. No. 108-11, 108th Cong., 1st Sess. (Feb. 27, 2003) .......... 8

**Rules and Regulations**

Rev. Rul. 2003-125 section 165(g)(3), 2003-2 C.B. 1243 (Dec. 29, 2003) .......... 26

TAX CT. R. 151.1(c)(3) .......... 1

Treas. Reg. § 301.7701-3(g)(1) .......... 26

**Other Authorities**

101 Cong. Rec. S15673 (Oct. 18, 1990) .......... 18

Charlene Luke, *The Relevance Games: Congress's Choices for Economic Substance Gamemakers,* 66 TAX LAW. 551, (2013) .......... 8

H.R. Rep. 99-426 (Dec. 7, 1985) .......... 19

H.R. Rep. No. 108-755 (Oct. 7, 2004) .......... 9

H.R. Rep. No. 109-455 (May 9, 2006) .......... 9

H.R. Rep. No. 111-299(II) (2009) .......... 10

H.R. Rep. No. 111-443(I) (2010) .......... 5 10, 14, 26

*Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties*, LB&I-04-0422-0014 (Apr. 22, 2022) ..... 14, 21

IRS Acquiescence, 1976-2 C.B. 1 (Dec. 31, 1976) ..... 26

IRS Acquiescence, 1986-2 C.B. 1 (Dec. 31, 1986) ..... 13

IRS Action on Decision, 1975 WL 38131 (Sept. 29, 1975) ..... 26

IRS Action on Decision 1986-39 (June 30, 1986) ..... 13

N.Y. STATE BAR ASS'N, TAX SECTION, SUMMARY REPORT ON THE PROVISIONS OF RECENT SENATE BILLS THAT WOULD CODIFY THE ECONOMIC SUBSTANCE DOCTRINE, 3, 8 (May 21, 2003) ..... 9

Notice 2010-62, 2010-40 I.R.B. 411 (Sept. 13, 2010) ..... 12

Notice 2014-58, 2014-44 I.R.B. 746 (Oct. 27, 2014) ..... 12

S. Rep. No. 108-11 (2003) ..... 8

S. Rep. No. 109-336 (Sept. 15, 2006) ..... 10

S. Rep. No. 110-206 (Oct. 25, 2007) ..... 10

## Interest of *Amicus Curiae*[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases, such as this one, that raise issues of concern to the business community.

The Chamber respectfully submits this brief as *amicus curiae* in response to the Court's request for amicus briefs as to whether section 7701(o) of the Internal Revenue Code requires a threshold relevancy determination and, if so, what are the circumstances in which the economic substance doctrine is relevant under that statute.[2] The Chamber's members depend on a predictable and certain application of

---

[1] No counsel for any party authored this brief in whole or in part, and no entity or person, aside from *amicus curiae*, its members, or its counsel made any monetary contribution intended to fund the preparation or submission of this brief. The Chamber has received consent from all parties to file this amicus brief. TAX CT. R. 151.1(c)(3).

[2] Unless otherwise indicated, all textual references to "section" herein are references to sections of the Internal Revenue Code of 1986, as amended ("Code").

tax laws to plan their business operations in both the short and long terms. An interpretation of the codified economic substance doctrine that, contrary to the statutory text and legislative history, does not include a relevancy requirement would excessively broaden the doctrine's scope and upend reliance on the tax treatment of otherwise routine business transactions. Such an interpretation would create uncertainty and confusion for companies' ordinary business planning and risks. It would also undermine the effectiveness of tax incentives that Congress intended to encourage certain activities—often ones that would not otherwise be profitable to serve public policy goals.

## Introduction and Summary of Argument

The economic substance doctrine is a judicially developed tool under which the federal income tax consequences of a transaction flowing from a literal application of the Code and its associated regulations may be altered for transactions that lack any economic substance apart from perceived tax benefits. Absent appropriate safeguards, application of the economic substance doctrine could cause the operation of the federal tax laws to be wholly uncertain and unpredictable. The courts, however, narrowed the contexts in which the doctrine was applied and thereby avoided such wholesale uncertainty. In so doing, the courts prevented an overly aggressive application of the doctrine by the Internal Revenue Service (the "IRS").

When Congress codified this common law doctrine in section 7701(o) of the Code, it explicitly incorporated the historic "relevance" standard into the text of the statute. Section 7701(o) applies only "[i]n the case of any transaction to which the economic substance doctrine is *relevant*." 26 U.S.C. § 7701(o)(1) (emphasis added).

To read the "relevance" standard out of the governing law would violate congressional intent and contradict decades of judicial precedent. Predictable application of the federal tax law is critical to both large and small businesses. The relevancy threshold prevents the destabilization of the application of the federal tax law, allowing routine transactions contemplated by Congress to avoid the sweep of

the economic substance doctrine, and the uncertainty that accompanies it. For these reasons, the Chamber urges the Court to determine that section 7701(o) does require a threshold relevancy determination.

Further, the relevancy determination should be guided by the decades of judicial precedent interpreting the economic substance doctrine. For example, the doctrine has always been limited to assessing the results of certain types of transactions resulting in tax outcomes that clearly subvert the public policy underlying the Code. When the taxpayer makes an election or otherwise engages in a transaction clearly contemplated by the Code, or claims a tax credit or deduction designed to incentivize taxpayers to engage in an activity Congress intended to encourage, the economic substance doctrine is not relevant.

# Argument

## I. The Codification of the Economic Substance Doctrine in Section 7701(o) Explicitly Retained the Relevance Threshold.

### A. Section 7701(o)'s Text Unambiguously Includes a Threshold "Relevance" Inquiry that Must be Addressed before Applying the Economic Substance Doctrine.

Prior to the enactment of section 7701(o), the economic substance doctrine was a limited common law judicial doctrine that courts applied to "den[y] tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax." H.R. Rep. No. 111-443(I), at 292 (2010). In 2010, Congress codified specific aspects of the economic substance doctrine in section 7701(o) of the Code. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, Title I, § 1409 (2010). Congress clarified in section 7701(o)(1) that the two historical prongs of the economic substance doctrine: (1) objective economic effect and (2) subjective non-tax business purpose—apply conjunctively.

The opening clause of section 7701(o)(1) expressly cabins the scope of the doctrine, stating that the test only applies "[i]n the case of any transaction to which the economic substance doctrine is *relevant*." (emphasis added). In a standalone paragraph designated a "special rule," the statute further specifies that "[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." Section 7701(o)(5)(C). Through this "special rule," Congress preserved the judiciary's precedents and role in determining when an economic substance analysis is required.

The unambiguous statutory text of section 7701(o)(1), which explicitly provides that the test is only applied "[i]n the case of any transaction to which the economic substance doctrine is relevant," indicates that the economic substance doctrine does not apply to all transactions, and that the Court must therefore first determine whether the doctrine is relevant to the transaction before proceeding with an economic substance inquiry.

It is a fundamental rule of statutory construction that courts must give effect to each word in the statutory text. *ADT, LLC v. Richmond*, 18 F.4th 149 (5th Cir. 2021) ("Wherever possible, we must read statutes to give effect to their every word." (citing *Corley v. United States*, 556 U.S. 303, 314 (2009)); *Johnson v. Comm'r*, 152 T.C. 121, 125 (2019) ("When construing a statute, however, it is our duty to give effect, if possible, to every clause and word so as to avoid rendering any part of the statute meaningless surplusage." (internal quotations omitted)). The only reasonable interpretation of section 7701(o) that does not render statutory language meaningless is to read it to require a threshold relevancy determination *before* applying the economic substance doctrine. Under an interpretation that no relevancy threshold

exists, the entire clause could be deleted from section 7701(o)(1) without affecting the purported meaning, as illustrated here.

> (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.

Not only would such an interpretation read this text out of the statute, it would also eliminate the special rule in section 7701(o)(5)(C), addressing how to apply the relevance standard.

Section 7701(o)(5)(C) directs courts to determine whether the economic substance doctrine is relevant to a transaction "in the same manner as if this subsection [section 7701(o)] had never been enacted." Reading the relevancy threshold out of section 7701(o) would make it impossible to follow the directive in section 7701(o)(5)(C) that relevance is determined as if section 7701(o) "had never been enacted." Congress spoke clearly. The statute expressly contains the relevancy threshold requirement and that it should be applied consistent with decades of judicial precedent.

### B. Statutory History Confirms Congressional Intent to Preserve the "Relevance" Standard as a Threshold Inquiry Before Applying the Economic Substance Doctrine.

Section 7701(o)'s reference to "relevance" in two separate locations was not a mere rhetorical flourish. The statutory history establishes that Congress added the "relevance" language specifically to prevent the IRS and the courts from applying the subjective and objective tests to transactions that had never been subject to the economic substance doctrine. Congress clearly intended to preserve longstanding judicial precedent on the threshold question of when to examine a transaction at all.

From 1999 through 2010, Congress considered at least 70 different bills to codify the economic substance doctrine. *See* Charlene Luke, *The Relevance Games: Congress's Choices for Economic Substance Gamemakers*, 66 TAX LAW. 551, 562-63 (2013). Early versions of the proposed legislation lacked any statutory language restricting application of the conjunctive test to transactions which were "relevant." *See, e.g.*, Title VII, Subtitle A, Section 701, "Clarification of Economic Substance Doctrine," of the CARE Act of 2003, S. 476, reported in S. Rpt. No. 108-11, 108th Cong., 1st Sess. (Feb. 27, 2003). A committee report issued in connection with a 2003 proposal briefly observed that "[t]he bill does not change current law standards used by courts in determining when to utilize an economic substance analysis," S. Rep. No. 108-11, at 79 (2003), but the text of the bill did not expressly provide for this result.

Commentators responded vociferously to the absence of guardrails within the legislative text that would prevent the conjunctive test from being applied indiscriminately to transactions that had never been subject to the economic substance doctrine. The Tax Section of the American Bar Association expressed concern that the legislation, without a threshold relevance test, "may be read as implying that the economic substance doctrine applies to every transaction." AM. BAR ASS'N, COMMENTS ON THE PROPOSED CODIFICATION OF THE ECONOMIC SUBSTANCE DOCTRINE, 5 (Apr. 24, 2003). The Tax Section of the New York State Bar Association identified an extensive list of routine transactions that might not satisfy the conjunctive test, but which had long been considered outside the scope of the doctrine by the IRS and the courts, including transactions undertaken to recognize *bona fide* economic gain or loss, transactions to recapitalize a corporation with debt rather than equity, and decisions to undertake investments that would not be profitable without a federal tax credit incentive. *See* N.Y. STATE BAR ASS'N, TAX SECTION, SUMMARY REPORT ON THE PROVISIONS OF RECENT SENATE BILLS THAT WOULD CODIFY THE ECONOMIC SUBSTANCE DOCTRINE, 3, 8 (May 21, 2003).

And Congress responded. In the face of this public feedback, 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[.]" *See, e.g.*, H.R. Rep. No. 108-755, at 666 (Oct. 7, 2004); H.R. Rep. No.

109-455, at 222 (May 9, 2006); S. Rep. No. 109-336, at 138-39 (Sept. 15, 2006). In 2007, Congress further strengthened the relevance standard by: (i) proposing to limit the conjunctive test to "any transaction to which the economic substance doctrine is relevant" and (ii) proposing to include a "special rule" that "[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 [section 7701(o)] had never been enacted." *See* Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. § 3501 (2007) (as introduced in the House, Oct. 25, 2007).

The addition of the "special rule" in the proposed legislative text was accompanied by a substantial expansion of the discussion of "relevance" in formal legislative history. Starting with a Senate Finance Committee Report published in October 2007, every congressional report addressing the proposed codification of the economic substance doctrine added the following explanation:

> The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages.

S. Rep. No. 110-206, at 92-93 (Oct. 25, 2007); H.R. Rep. No. 111-299(II), at 291 (2009); H.R. Rep. No. 111-443(I), at 296 (2010); 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 152-53 (Mar. 21, 2010). 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 stated that these examples are "illustrative and not exclusive." Id. at 152.

The evolution of the proposed text, along with the accompanying legislative history, demonstrates that Congress intended for the IRS and the judiciary to give effect to the language on "relevance" added to sections 7701(o)(1) and 7701(o)(5)(C) in determining whether to utilize the statute's conjunctive test.

Subsequent Congresses have enacted statutes that reflect an understanding that Congress included a threshold relevancy test in section 7701(o). The transferability provisions of the recently-enacted Inflation Reduction Act of 2022, P.L. 117-169, 136 Stat. 2009 (Aug. 16, 2022), are one example. *See* Section 6418. Under the terms of section 6418, certain tax credits may be purchased from the taxpayer engaging in qualifying activity by an unrelated taxpayer not engaging in any such activity. By definition, the purchaser of a transferable credit does so for tax reasons: to obtain a tax credit to offset against its tax liability. The statute does not contain any provision expressly exempting the purchase of a transferable credit from

section 7701(o). Yet Congress obviously intended the transfer of credits to occur without requiring an independent non-tax business purpose or non-tax economic effect. The very nature of a transferable credit is the transfer of the tax benefit in sale without any non-tax effects or purpose in doing so. If section 7701(o) applied to every single transaction, the economic substance doctrine would frustrate congressional intent and render the transferability provisions a dead letter because *by definition* no such sale would ever satisfy the economic substance test. Congress itself thus interprets section 7701(o) to include a meaningful threshold relevancy requirement.

### C. Respondent's Own Guidance is Consistent with a Threshold Relevancy Requirement.

Shortly after the economic substance doctrine was codified, the IRS acknowledged the threshold relevance test and announced that "[i]f 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." Notice 2010-62, 2010-40 I.R.B. 411 (Sept. 13, 2010); *see also* 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). While 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 that the best interpretation of the statute required a threshold relevance determination.

### D. A Threshold Relevancy Requirement is Consistent with Pre-Enactment Economic Substance Jurisprudence.

While the threshold relevancy requirement has been given many names over the years, it has always been present in the common law economic substance jurisprudence. Courts have discussed whether the realization of tax benefits of a transaction is inconsistent with express congressional purpose or whether the tax benefit at issue is already restricted by a detailed statutory or regulatory scheme. *See Tucker v. Comm'r*, 766 Fed. Appx. 132, 139 (5th Cir. 1966) (affirming the Tax Court's determination that "Congress 'neither contemplated nor intended to encourage this type of mechanical manipulation of the rules' that permits Mr. Tucker to avoid recognizing a $51 million gain"); *Woods Investment Co. v. Comm'r*, 85 T.C. 274, 278-281 (1985) (rejecting basis adjustment that the IRS asserted to prevent "what [the IRS] perceives to be a 'double deduction,'" because "[t]he consolidated return regulations promulgated pursuant to section 1502 provide a detailed and comprehensive set of rules for adjusting the basis of a subsidiary's stock held by a parent corporation" and "judicial interference … is not warranted to alter" the result under those regulations); IRS Action on Decision 1986-39 (June 30, 1986) (announcing that IRS would refrain from asserting the position in litigation until it revised the applicable regulations), IRS Acquiescence, 1986-2 C.B. 1 (Dec. 31,

1986). Section 7701(o)'s relevancy threshold codifies this jurisprudential recognition of the limitations of the economic substance doctrine.

Courts have permitted tax benefits for many types of transactions, even if the taxpayer lacked subjective business purpose, the transaction lacked objective economic effect, or both. Such decisions can only be explained by the existence of a threshold determination of whether the doctrine is relevant, however that threshold test is labeled. In addition to the illustrative list of "basic business transactions" in the legislative history, courts have permitted tax benefits from many different types of transactions, including those described below, regardless of whether the transactions met the objective or subjective tests of the economic substance doctrine.

And for many transactions clearly outside the scope of the doctrine, often based on judicial decisions rendered decades earlier, the government has simply refrained from asserting the doctrine in the first instance. *See, e.g., Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties*, LB&I-04-0422-0014 (Apr. 22, 2022); *LB&I Directive for Industry Directors, Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties*, LB&I-4-0711-015 (July 15, 2011).

When Congress decided to codify the economic substance doctrine, it specifically invoked the decades of jurisprudence governing which transactions it should be applied to. *See* H.R. Rep. No. 111-443(I), at 295-96 (citing to historical

case law illustrating courts' approach to relevance of the economic substance doctrine, particularly with respect to certain basic business transactions). Although the plain meaning of the text is dispositive here, courts can and should look to this interpretative history to direct their application of the relevancy requirement.

## II. The Relevancy Determination Should Be Guided By The Decades Of Judicial Precedent Interpreting The Economic Substance Doctrine.

The economic substance doctrine was never intended to give the Service a blank check to upend tax benefits that Congress intended taxpayers to enjoy. Rather, it is a stopgap to ensure against tax outcomes that Congress never intended. In laying the doctrine's foundations, the Supreme Court made clear that "the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935).

That being the case, it is clear that the doctrine *cannot* be relevant to transactions producing tax effects that Congress *did* intend. *See Horn v. Comm'r*, 968 F.2d 1229, 1231 (D.C. Cir. 1992) ("Although 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."); *Summa Holdings, Inc. v. Comm'r*, 848 F.3d 779, 789 (6th Cir. 2017) (rejecting economic substance challenge to taxpayer's use of Domestic International Sales Corporation (DISC) because "the Code authorizes DISC commissions and dividends, regardless of whether they have economic substance, in order to reduce the tax burden of

exporters"); *DTDV, LLC v. Comm'r*, T.C. Memo. 2018-32, at *39 (2018) ("In applying the economic substance doctrine, the relevant substantive question is whether the taxpayer had a purpose other than obtaining tax benefits *manifestly inconsistent with congressional intent*" (emphasis added)).

Courts divine congressional intent for this purpose by applying fundamental tools of statutory interpretation. First, the ordinary meaning of the text controls. If the text is unambiguous, that is the end of the inquiry. *Wells Fargo & Co. v. Comm'r*, 120 T.C. 69, 89 (2003) ("Where Congress has expressed its will in reasonably plain terms, those terms must ordinarily be regarded as conclusive."). If there is ambiguity in the statutory text, the Court should consider the provision in its statutory context, and then resort to legislative history. *See, e.g.*, *Greenberg Bros. P'ship #4 v. Comm'r*, 111 T.C. 198, 203 (1998) ("If a statute is silent or ambiguous, we turn to legislative history to ascertain congressional intent.").

Few if any sections of the Code explicitly state that a transaction is or is not relevant for purposes of section 7701(o). Therefore, the Court should review the pertinent statute in light of the statutory context, legislative history, and judicial precedents. If the transaction falls into the conduct contemplated by congressional intent as determined by applying these tools, section 7701(o) is not relevant.

Considered in this light, the Court must consider the relevance of section 7701(o) on a statute-by-statute basis, engaging in the statutory analysis set forth above. There are certain guideposts that can assist the Court's analysis, however.

**A. Section 7701(o) is Not Relevant to Transactions Engaging in Activities That Congress Has Determined Serve Non-Tax Policy Goals.**

First, section 7701(o) is not relevant to transactions that involve engaging in an activity that Congress intended to incentivize regardless of the potential for profit or a non-tax business purpose. Congress often uses tax credits or deductions to incentivize activity precisely *because* there is no reasonable potential for profit in engaging in that activity.

For example, the orphan drug credit in section 45C encourages research into treatments of certain diseases or conditions "for which there is no reasonable expectation that the cost of developing and making available in the United States a drug for such disease or condition will be recovered from sales in the United States of such drug." Section 45C(d)(1)(B). If the economic substance doctrine were "relevant" to these types of tax incentives, the doctrine would frustrate, rather than further, congressional intent. "If 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." *Sacks v. Comm'r*, 69 F.3d 982, 992 (9th Cir. 1995).

Pre-codification economic substance jurisprudence confirms this principle. "Absence 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." *Sacks*, 69 F.3d at 991 (quoting *Casebeer v. Comm'r*, 909 F.2d 1360, 1365 (9th Cir. 1990) (internal quotations omitted)); *see also Cross Refined Coal LLC v. Comm'r*, 45 F.4th 150, 158 (D.C. Cir. 2022) ("[T]axpayers may legitimately conduct business activity that Congress has deliberately made profitable through statutory tax incentives—and may do so with no hope of a pre-tax profit.")

The transfer of credits pursuant to section 6418, discussed in Part II supra, is an illustrative example of a transaction that by necessity cannot be relevant to section 7701(o). If a transaction involving the sale of tax credits had to comply with the non-tax business purpose and non-tax economic effect prongs of section 7701(o), there could almost never be a sale of credits that would pass muster. Yet Congress clearly intended to incentivize such sales to take place. Accordingly, section 7701(o) cannot be relevant in analyzing a transfer pursuant to section 6418.

Many other tax incentives are likewise driven by congressional policy to encourage the underlying activity regardless of the potential for profit or the motivation of the taxpayer. Sometimes Congress says as much in the statutory text, *see, e.g.*, Section 45C(d)(B), or in legislative history. *See, e.g.*, 101 Cong. Rec.

S15673 (Oct. 18, 1990) (explaining the extension of the predecessor to the section 45K nonconventional fuel production credit was based, in part, on the Congress's belief "that a significant capacity for production of gas from tight formations can be developed *given a sufficient after-tax rate of return*." (emphasis added)); H.R. Rep. 99-426, at 220 (Dec. 7, 1985) (explaining that Congress enacted the business energy tax credits now codified in section 48 to "stimulate the development and business application of a broad variety of energy sources" that, "because of price and other advantages of fossil fuel using systems, were not experiencing widespread application").

Other times, Congress' policy can be inferred from the structure and purpose of the credit or deduction. For example, the general business credit under section 38 and the investment credit under section 46 and their component parts are express incentives tied to entering into certain transactions or increasing or reducing certain activities. Similarly, deductions allowed in sections 179C and 179D, for investments in certain oil refineries and energy efficient commercial buildings, respectively, provide tax benefits to encourage taxpayers to invest in energy conservation efforts. These provisions reflect a congressional determination that taxpayers required additional incentive to engage in those activities beyond whatever non-tax profit potential there may be. The economic substance doctrine cannot be relevant to

transactions entered into pursuant to these and similar tax incentives without frustrating congressional intent to promote the activity.

While transactions involving tax incentives may present the most straightforward relevancy determinations, the economic substance doctrine is not relevant to any transaction that is consistent with congressional purpose behind the applicable provision of the Code. For example, in *Granite Trust Co. v. United States*, the First Circuit declined to apply the economic substance doctrine to disallow a taxpayer's recognition of losses following a partial liquidation under a predecessor to section 332. 238 F.2d 670 (1st Cir. 1956). The court found that legislative history "seems inescapably to reflect a legislative understanding . . . that taxpayers can, by taking appropriate steps, render the subsection applicable or inapplicable as they choose." *Id.* at 676.

To be sure, even in these cases the taxpayer must actually engage in the relevant qualifying activity to receive the tax benefit. As a rule, this would have real-world economic effects that would satisfy the non-tax economic effect prong of section 7701(o). But if the economic substance doctrine were relevant to these types of transactions, the taxpayer would also have to demonstrate that it entered into the transaction for a reason that had nothing to do with the tax incentive – a result that would entirely defeat the purpose of the incentive. The IRS has recognized this and issued a directive that "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" even if the facts and circumstances indicate that the transaction has "no credible business purpose apart from federal tax benefits" or "no meaningful potential for profit apart from tax benefit," among other factors. *Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties*, LB&I-04-0422-0014 (Apr. 22, 2022).

The economic substance inquiry is not relevant in these cases. There is no other way to reconcile section 7701(o) with congressional intent to incentivize taxpayers to engage in activity that they otherwise would not. *See, e.g., Cross Refined Coal*, 45 F.4th at 158 (respecting the transaction because the taxpayer engaged in activity that "Congress specifically sought to encourage")*; 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.334 (Mar. 21, 2010) (explaining that "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.").

Of course, incorporating a transaction as to which the doctrine is not relevant into a larger transaction does not immunize the transaction as a whole from application of the economic substance doctrine. *See, e.g.*, *Elliott v. Comm'r*, 84 T.C. 227, 237-38 (1985) (applying economic substance principals to deny the taxpayer's investment tax credit based on an examination of the transaction as a whole). And the IRSis free to examine whether the taxpayer actually engaged in the incentivized activity and otherwise meets the statutory prerequisites for the tax benefit. But when a taxpayer engages in an activity Congress sought to incentivize, the IRS cannot use section 7701(o) to disallow the resulting credit or deduction even if the taxpayer engaged in the activity solely because of the tax incentive and without any prospect of non-tax profit.

### B. Other Transactions That Courts have Held to be Not Relevant as to the Economic Substance Doctrine.

Courts have determined other categories of transactions are not relevant for purposes of the economic substance doctrine, including, but not limited to, transactions to recognize economic gains or losses for tax purposes, transactions to facilitate recognition of taxable loss on liquidation of a subsidiary, and tax elections that result in deemed transactions.

### 1. Transactions to Recognize Economic Gains or Losses for Tax Purposes.

Courts have not applied the economic substance doctrine to the federal tax benefit of transactions undertaken for the purpose of recognizing taxable gains and losses, provided the item of income or loss reflected economic reality (no artificial or duplicated losses) and the item was properly attributable to the taxpayer, rather than a third party. In the leading case, *Cottage Savings Association v. Commissioner*, 499 U.S. 554 (1991), mortgage interests held by a financial institution had declined in value during the savings and loan crisis. Solely for the purpose of recognizing an economic loss for tax purposes, the taxpayer exchanged its interest in a group of residential mortgages for an equivalent interest in a group of "substantially identical" mortgages held by other lenders. Although the taxpayer lacked a non-tax business purpose for the exchange, and the exchange did not "substantially affect the economic position" of the taxpayer, the Supreme Court rejected the government's application of "economic substance" principles and permitted the deduction for the *bona fide* losses sustained by the taxpayer. *Id.* at 557, 567-68.

Similarly, taxpayers need not demonstrate a non-tax business purpose to realize income or gain from the sale of property. In *Sun Properties, Inc. v. United States*, 220 F.2d 171 (5th Cir. 1955), the Court of Appeals for the Fifth Circuit determined that a sale of property to a corporation by its sole shareholder was a sale, rather than a contribution to capital. Although the taxpayer undertook the sale solely

for tax purposes, the Court of Appeals concluded that finding a non-tax business purpose was unnecessary, stating that "[n]o cases require that a sale have any business purpose beyond that of realizing a capital gain." 220 F.2d. at 174-75. *See also Curry v. Commissioner*, 43 T.C. 667, 695 (1965) ("[T]he mere desire to sell, even if the sole purpose was to realize capital gains, should be a sufficient business purpose."); *Hobby v. Comm'r*, 2 T.C. 980, 985 (1943) ("The primary purpose to realize the gain was a legitimate business purpose, even though it also had a collateral favorable tax effect.").

#### 2. Transactions to Facilitate Recognition of Taxable Loss on Liquidation of Subsidiary.

Consistent with the general treatment of transactions to recognize gains and losses, courts have not applied the economic substance doctrine to the federal tax benefit of corporate liquidations undertaken for the purpose of recognizing taxable losses, as long as the losses reflect economic reality and are properly attributable to the taxpayer.

Under the Code, whether the liquidation of a corporation triggers the recognition of taxable gain or loss by its shareholder(s) depends on mechanical criteria, including whether the shareholder owned at least 80 percent of the voting power and value of the stock of the liquidating corporation at the time specified in the statute. *See* Section 332(b). For decades, courts have respected transactions that reduce a taxpayer's ownership in a subsidiary below that 80 percent threshold,

specifically undertaken to allow a shareholder to recognize loss on the subsequent liquidation of that subsidiary under section 331. In the absence of those preparatory transactions, section 332 would prevent the subsequent liquidation from resulting in the shareholder recognizing loss. *See, e.g.*, *Granite Trust*, 238 F.2d at 670 (respecting disposition of stock, undertaken for sole purpose of ensuring subsequent liquidation resulted in taxable loss, rather than non-recognition treatment under predecessor to section 332); *Comm'r v. Day & Zimmerman*, 151 F.2d 517 (3d Cir. 1945) (same); *cf. Avco Mfg. Corp. v. Comm'r*, 25 T.C. 975, 980 (1956) (allowing recognition of taxable loss, where company undertook transaction that "was prearranged and timed ... for the express purpose of avoiding the nonrecognition provisions of the [predecessor to section 332]"), *aff'd in relevant part*, No. 45633, 1957 WL 10899 (2d Cir. 1957) (approving stipulation of parties that taxpayer recognized loss on liquidation of subsidiary)

These decisions flow from the judicial conclusion that Congress intended the rules for liquidations to be "elective in the sense that with advance planning and properly structured transactions, a corporation should be able to render [the nonrecognition rules of] section 332 applicable or inapplicable." *George L. Riggs, Inc. v. Comm'r*, 64 T.C. 474, 489 (1975) (respecting purchase of stock undertaken to ensure that section 332 prevented recognition of gain on a subsequent liquidation). "It would be a logical inconsistency equivalent to a 'Catch-22' to say that a

corporation has the power to control the application of this section, but that once the corporation formulates the intent to do so … it has … precluded itself from the section." *Id.* at 489-90; *see also* IRS Action on Decision, 1975 WL 38131 (Sept. 29, 1975) (acknowledging that, in the context of the transaction in *George L. Riggs*, "the [Internal Revenue] Service would agree that Code § 332 is elective"); IRS Acquiescence, 1976-2 C.B. 1 (Dec. 31, 1976).

### 3. Tax Elections That Result in Deemed Transactions.

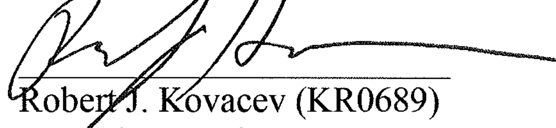
In general, courts and the IRS do not apply the economic substance doctrine to statutory or regulatory elections that result in "deemed" transactions, including deemed corporate liquidations. *See*, *e.g.*, Treas. Reg. § 301.7701-3(g)(1) (prescribing "[d]eemed treatment of elective change" in entity classification). For example, the IRS ruled that a taxpayer may validly elect to change the federal income tax classification of an entity from a corporation to a disregarded entity, for the sole purpose of triggering recognition of a worthless security deduction under section 165(g)(3). Rev. Rul. 2003-125, 2003-2 C.B. 1243 (Dec. 29, 2003). The election results in a deemed liquidation of the corporation for federal income tax purposes, with no consequence other than tax effects, and represents another example of a transaction that has not been subject to the economic substance doctrine where the choice between alternatives is "largely or entirely based on comparative tax advantages." *See* H.R. Rep. No. 111-443(I), at 295-96; *see also Dover Corp. v.*

*Comm'r*, 122 T.C. 324, 351 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").

**III. Conclusion.**

Congress preserved the "relevance" threshold when it codified the economic substance doctrine, ensuring that taxpayers retained the ability to undertake certain types of transactions on the basis of comparative tax advantages. Ignoring the "relevance" threshold in section 7701(o) would frustrate congressional intent to use tax credits or deductions as an incentive for taxpayers to engage in activities that would not be profitable independent of the tax benefit. It would also inject uncertainty into countless routine transactions, including anodyne sales of property and ordinary course tax elections. The Chamber urges the Court to apply the guideposts discussed above in determining the scope of relevance of section 7701(o).

Respectfully Submitted,



Robert J. Kovacev (KR0689)
Samuel A. Lapin (LS0521)
Miller & Chevalier Chartered
900 16th Street NW
Washington, DC 20006
Tel: (202) 626-5800

*Counsel for Chamber of Commerce of the United States of America*

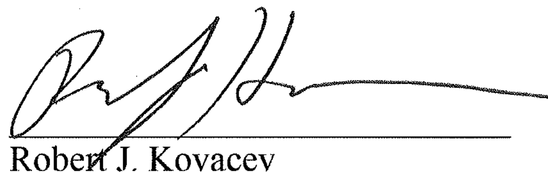
## CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing paper was served on Petitioners and on counsel for Respondent both by electronic mail and by sending the same on August 22, 2024, via FedEx overnight delivery addressed as follows:

David D. Aughtry
Chamberlain Hrdlicka
191 Peachtree Street, N.E., Forty-Sixth Floor
Atlanta, Georgia 30303

Sebastian Voth
Special Trial Attorney
(Strategic Litigation)
24000 Avila Road, Suite 4404
Chet Holifield Building
Mail Stop 8800
Laguna Niguel, CA 92677

Dated: August 22, 2024



Robert J. Kovacev