UNITED STATES TAX COURT

SUNIL S. PATEL AND LAURIE MCANALLY PATEL,	)	
	)	Docket No. 24344-17,
Petitioners,	)	11352-18, 25268-18
	)	
v.	)	Judge Courtney D. Jones
	)	Paper Filed
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent.	)	

BRIEF OF THE TAX LAW CENTER AT NYU LAW AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Tax Court Rules 151.1(c)(1) and 20(c), amicus curiae The Tax Law Center at NYU Law ("Tax Law Center") states that it is a nonprofit, tax-exempt organization at New York University School of Law.* The Tax Law Center does not have any members who have issued shares or debt securities to the public.

* This brief does not purport to represent the views, if any, of New York University School of Law.

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INTEREST OF AMICUS CURIAE[1]

The Tax Law Center is a nonpartisan, nonprofit center dedicated to improving the integrity of the federal tax system. Its staff comprises tax law experts with experience in tax policymaking, administration, and litigation. The Tax Law Center regularly engages with the public and all branches of government on important tax issues, especially those that could affect the broader tax system.

The Tax Law Center 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 within the meaning of that statute.[2]

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[1] No counsel for any party authored this brief in whole or in part, and no entity or person, aside from amicus curiae and its counsel, made any monetary contribution intended to fund the preparation or submission of this brief. The Tax Law Center 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").

SUMMARY OF ARGUMENT

Section 7701(o) does not require that relevance be determined as a separate "threshold" matter. No such threshold test exists at common law, which was expressly incorporated by the statute.

Under common law, the economic substance doctrine does not operate to deny claimed tax benefits, and therefore is not "relevant," where those benefits are consistent with congressional intent. The statute's reference to relevance, therefore, is nothing more than a convenient shorthand for clarifying that—as was the case prior to codification—consideration of the economic substance doctrine would not result in the denial of tax benefits in every case, including cases which lack economic substance but are nevertheless consistent with congressional intent. The core inquiry that determines whether the economic substance doctrine is relevant and so will operate to have the result of denying claimed tax benefits involves considering both congressional intent and the facts and circumstances of the transaction at issue.

Petitioners and supporting amici make two key errors in in their attempt to impose a threshold relevance test that would put the economic

substance doctrine categorically out of bounds (i.e. prevent courts from even undertaking the doctrine's core inquiry) in many cases.

First, Petitioners and supporting amici assert or imply that a threshold relevance test is necessary for judges to exercise appropriate restraint and to avoid a raft of claimed negative policy outcomes. That proposition in turn rests upon conflating: (1) consideration of the economic substance doctrine (through the core inquiry into both facts and circumstances and congressional intent) and (2) whether the inquiry results in the denial of claimed tax benefits.

Although Petitioners and supporting amici correctly understand that the economic substance doctrine is a tool of statutory interpretation, they fail to acknowledge that such tools are at common law implicitly available to the courts—and explicitly and routinely considered—in very many categories of case where the courts may ultimately decide that a particular tool does not control the result. Appropriately restrained use of the economic substance doctrine to deny claimed benefits and respect for statutory text can be reached under the existing common law approach which requires courts to inquire carefully into both congressional intent (which itself includes consideration of the literal text

of claimed tax benefits as well as other elements of the statutory framework) and facts and circumstances.

Second, Petitioners and supporting amici err in their attempt to read a threshold test into section 7701(o), which is contrary to the best interpretation of the statute. The text of section 7701(o) is clear in adopting the common law doctrine and making changes to or clarifying the common law doctrine in a few discrete ways, primarily by codifying a conjunctive test for economic substance that requires both objective non-tax economic benefits and a subjective non-tax business purpose. Otherwise, the common law is left expressly undisturbed, including with respect to the doctrine's "application" and "relevance." This determination at common law is made on a case-by-case basis after an inquiry into congressional intent and the facts and circumstances of the transaction at issue. Nothing in section 7701(o) suggests that codification added new categorical exclusions from the economic substance doctrine that did not exist at common law.

Congress indeed understood itself to be doing what the statutory text achieves. Calls for a "threshold" test amount to an attempt to create an extra-statutory angel list of tax code provisions that are per se exempt

from the economic substance doctrine. But Congress considered and declined to codify such an angel list, even for tax provisions for which the economic substance doctrine is generally intended not to apply with the effect of denying tax benefits. Congress recognized that the substance of a transaction (or series of transactions, as the case may be) must be considered to confirm it is consistent with the purpose of the claimed tax benefits. Section 7701(o) was enacted to "provide[] a uniform definition of economic substance but does not alter the flexibility of the courts in other respects," including a court's determination as to whether the doctrine should be considered, and whether, based on facts and circumstances and congressional intent, it ultimately operates to deny claimed tax benefits. H.R. Rep. No. 111-443, pt. 1 at 296 (2010).

ARGUMENT

I. Codification of the Economic Substance Doctrine Did Not Introduce a Separate "Threshold" Test for Relevance.

A. The text of section 7701(o) instructs that relevance is determined according to existing common law.

When Congress codified the economic substance doctrine in 2010, it expressly left undisturbed existing judicial standards for whether and when to employ the doctrine. Section 7701(o) provides that the codified doctrine is "relevant" to "any transaction" as follows:

(o) CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE

(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—

(A) ECONOMIC SUBSTANCE DOCTRINE

The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) EXCEPTION FOR PERSONAL TRANSACTIONS OF INDIVIDUALS

In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(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.

(D) TRANSACTION

> The term "transaction" includes a series of transactions.

I.R.C. § 7701(o) (emphasis added).

The plain language of the text is clear that, other than where it explicitly states otherwise,[3] the "economic substance doctrine" refers to existing common law doctrine. I.R.C. § 7701(o)(5)(A). The statute further states that whether the economic substance doctrine is relevant to a transaction is determined "in the same manner as if this subsection had never been enacted," i.e., as under the existing common law doctrine. I.R.C. § 7701(o)(5)(C).

In this context, a "relevant" transaction simply means a transaction for which failing the two-pronged test for economic substance will result in the denial of tax benefits—and so explicitly recognizes that not all cases in which the doctrine is considered will result in denial of tax benefits, including where the two-pronged test is not met. As explained

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[3] The text of section 7701(o) provides that the statute modifies or clarifies the economic substance doctrine in the following respects: it requires a two-pronged, conjunctive test for economic substance (§ 7701(o)(1)); it requires special rules for determining profit potential (§ 7701(o)(2)); it treats state and local tax effects the same as Federal tax effects (§ 7701(o)(3)); it does not allow financial accounting benefits to be considered a business purpose if the origin of those benefits is reduction of Federal income tax (§ 7701(o)(4)); it applies to individuals only in the case of certain transactions (§ 7701(o)(5)(B)); and it can apply to a transaction or series of transactions (§ 7701(o)(5)(D)).

infra, determining relevance at common law involves considering both congressional intent of the claimed tax benefits and the facts and circumstances of the transaction giving rise to the claimed tax benefits. The common law does not lay out rules for categorically and wholesale exempting entire categories of transactions from this inquiry. Of course, as with any other area of common law, at the level of specific transactions on which courts have previously opined, precedent may control.

Thus, while the statute recognizes the common law reality that the economic substance doctrine will not apply with the effect of denying tax benefits in each and every case in which it is considered, it remains up to the courts—under existing judicial precedent—to ultimately decide whether a given transaction is required to pass the now-statutory test for economic substance. *See* I.R.C. § 7701(o)(1); I.R.C. § 7701(o)(5)(C).

Given that the statutory test so explicitly delineates what it changes—and does not change—with respect to existing common law, it would be especially odd to read it as adding major new categorical exemptions not found at common law, and particularly when the text is also entirely silent on what the content or boundaries of these new exemptions might be.

B. Congress understood that the IRS and courts would need to consider the facts and circumstances to determine whether the economic substance doctrine is relevant, even where the underlying tax benefit is generally intended to be outside the scope of the doctrine.

The text of section 7701(o) is clear that codification of the economic substance doctrine did not affect its relevance and thus application under the common law. This plain meaning is confirmed by the legislative history. Congress explained its understanding of relevance under the common law and therefore the meaning of relevance under section 7701(o) as follows:

> The provision provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if the provision had never been enacted. Thus, the provision does not change current law standards in determining when to utilize an economic substance analysis. 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. H.R. Rep. No. 111-443, pt. 1, at 296 n.124 (2010).

Congress's understanding of the common law, therefore, was that the economic substance doctrine would not be used to deny tax benefits—i.e., not be relevant—where the claimed tax benefits were consistent with

the purpose of the underlying statute, even if the transaction was entered into solely for tax purposes or lacked economic substance. Notably, Congress did not say that the economic substance doctrine would not *apply* in such a case, but rather that it would not be the basis for disallowance of tax benefits. This language suggests Congress's understanding that courts must engage with the facts and circumstances as well as congressional intent behind the claimed tax benefits before making a determination as to whether the economic substance doctrine is relevant.

This understanding is even clearer from Congress's discussion of so-called "basic business transactions that, under longstanding judicial and administrative practice are respected, [even though] the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages." H.R. Rep. 111-443, pt. 1 at 296 (2010). While Congress did not intend for the doctrine to be relevant to such transactions, it also acknowledged that "[a]s under present law, whether a particular transaction meets the requirements for specific treatment under these provisions can be a question of facts and circumstances." *Id.*; *see also* Staff of 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," at 152-53, n. 344 (Comm. Print 2010) ("[F]or example, it is not intended that a tax credit 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") (emphasis added). Indeed, Congress considered and declined to codify an angel list or safe harbor, likely because "including enumerated statutory exceptions would merely provide determined tax avoiders with new building blocks for shelters." *See* Charlene D. Luke, *The Relevance Games: Congress's Choices for Economic Substance Gamemakers*, 66 TAX LAW. 551, 569-70 (2013) (reviewing the legislative history of section 7701(o) and prior draft versions).

II. The Application of the Economic Substance Doctrine at Common Law Involves an Inquiry into the Facts and Circumstances to Determine Whether the Claimed Tax Benefits Under a Given Transaction are Consistent with Congressional Intent.

Since the doctrine was introduced nearly ninety years ago in *Gregory v. Helvering*, transactions have been tested for economic substance to determine "whether what was done, apart from tax motive,

was the thing which the statute intended." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935); *see also Klamath Strategic Investment Fund v. United States*, 568 F.3d 537, 543 (5th Cir. 2009) ("The economic substance doctrine allows courts to enforce the legislative purpose of the Code by preventing taxpayers from reaping tax benefits from transactions lacking in economic reality"); *Bank of N.Y. Mellon Corp. v. Comm'r*, 801 F.3d 104, 113 (2d Cir. 2015), *cert. denied* 136 S.Ct. 1377 (2016) ("The economic substance doctrine exists to provide courts a 'second look' to ensure that particular uses of tax benefits comply with Congress's purpose in creating that benefit"); *Coltec Industries, Inc. v. United States*, 454 F.3d 1340, 1353-54 (Fed. Cir. 2006) ("The economic substance doctrine represents a judicial effort to enforce the statutory purpose of the tax code. From its inception, the economic substance doctrine has been used to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit. In this regard, the economic substance doctrine is not unlike other canons of construction that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute"); *ACM P'ship v. Comm'r*, T.C. Memo.

1997-115, 1997 WL 93314, at *36 (1997), *aff'd* 157 F.3d 231 (3d Cir. 1998) ("The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings").

Because the economic substance doctrine is used to effectuate congressional intent, it follows that the doctrine is not relevant and therefore is not used to disallow a tax benefit that may lack economic substance but is nevertheless consistent with congressional intent. As the Commissioner explains in his briefing, whether the tax benefits claimed under a given transaction (or series of transactions, see section 7701(o)(5)(D)) are consistent with congressional intent requires an inquiry into the facts and circumstances. Simultaneous Sur-Reply Brief for Respondent at 8-13. This inquiry may overlap with the test for economic substance. *See United States v. Liberty Global, Inc.*, No. 1:20-cv-03501-RBJ, 2023 WL 8062792, at *5 (D. Colo. Oct. 31, 2023).

Nothing in the text of section 7701(o) "require[s] a threshold relevancy determination *before* applying the economic substance doctrine." Brief for The Chamber of Commerce of the United States of

America as Amicus Curiae Supporting Petitioners at 6 (emphasis in original). Not only is such a separate test contrary to judicial precedent—and would thus read out of the statute the definition of relevance under section 7701(o)(5)(C)—it also is not necessary to give meaning to the statutory relevancy requirement. Courts can and have found the economic substance and related doctrines to be not relevant to a given transaction after engaging with the facts and congressional intent behind the claimed benefits. *E.g.*, *Mazzei v. Comm'r*, 998 F.3d 1041, 1044, 1060 (9th Cir. 2021), *rev'g* 150 T.C. 138 (2018) (engaging in a thorough analysis of congressional intent and the facts before following other circuits in declining to apply substance-over-form principles to the use of DISCs and FSCs to avoid Roth IRA contribution limits) ("This is a case in which the details matter a great deal, and so we first set forth the complex legal backdrop and then explain the specific facts of this case").

The few courts that have considered section 7701(o) have held that the question of relevance cannot be divorced from the overall analysis. In *Liberty Global*, currently on appeal to the 10th Circuit, the district court held that "there is no 'threshold' inquiry separate from the statutory factors [of objective economic substance and subjective business

purpose]," not because the economic substance doctrine is always relevant, but because an analysis of the facts and circumstances is necessary to determine "whether a transaction's benefits violate the legislative intent." *See United States v. Liberty Global, Inc.*, No. 1:20-cv-03501-RBJ, 2023 WL 8062792, at *5 (D. Colo. Oct. 31, 2023) (citing *Blum v. Commissioner*, 737 F.3d 1303 (10th Cir. 2013). Accordingly, the district court rejected the taxpayer's contention that relevance be determined based on the underlying statutes alone without an inquiry into the facts and circumstances. *See id.* at 7-8.

A. There are no "categorical exceptions" to the economic substance doctrine.

Courts have held that there are no tax benefits which are per se exempt from the economic substance doctrine. *Bank of N.Y. Mellon Corp.*, 801 F.3d at 113-14 (rejecting taxpayer argument that the doctrine never applies to foreign tax credits and observing that section 7701(o) "codified the two-part economic substance test used in many Circuits, including ours, and affirmed decades of judge-made law from around the country on economic substance. It did not create categorical exceptions to the doctrine"); *see also Salem Financial, Inc. v. United States*, 786 F.3d 932, 942 (Fed. Cir. 2015) ("[the taxpayer's] argument that the inquiry begins

and ends with the Code and regulations, if accepted, would largely eviscerate the common-law economic substance doctrine…. 'Even the smartest drafters of legislation and regulation cannot be expected to anticipate every device'") (quoting *ASA Investerings P'ship v. Comm'r*, 201 F.3d 505, 512 (D.C. Cir. 2000)); *Historic Boardwalk Hall, LLC v. Comm'r*, 694 F.3d 425, 432 (3rd Cir. 2012) (observing that the economic substance doctrine under section 7701(o) is not intended to disallow rehabilitation tax credits but only where the taxpayer invested in a historic rehabilitation project "both in form and substance").

Courts inquire into the facts and circumstances to determine the applicability of the economic substance doctrine in each case, even where the congressional intent behind the claimed tax benefit is for taxpayers to engage in tax-motivated activities. For example, in *Alternative Carbon*, the Federal Circuit rejected the taxpayer's argument that the economic substance doctrine could never be relevant in the case of energy credits, which, by congressional design, may not require economic substance beyond the tax benefit. *See Alt. Carbon Res., LLC v. United States*, 939 F.3d 1320, 1331 (Fed. Cir. 2019). The court noted that, under its precedent, otherwise unprofitable transactions entered into for the

purpose of tax credits "'demand[] careful review under the economic substance doctrine[.]'" *Id.* (quoting *Salem Fin., Inc. v. United States*, 786 F.3d 932, 950 (Fed. Cir. 2015)). The court thus examined both the underlying transaction that gave rise to the taxpayer's claim and the legislative history of the alternative fuel credit under section 6426 in determining that the economic substance doctrine was "indisputably relevant." *Id.* The court applied the economic substance doctrine—and ultimately disallowed the credit—because the taxpayer did not, *in fact*, sell fuel for use within the meaning of the statute, but rather arranged for its disposal in exchange for a nominal fee. *Id.* at 1329; *see also Alt. Carbon Res., LLC*, 138 Fed. Cl. 548, 557 (2018) ("while plaintiff is correct that it need not show that its business model was profitable absent the alternative fuel mixture payments, plaintiff cannot escape the requirement that its business model must substantively align with Congressional intent") (quoting *Alt. Carbon Res., LLC*, 137 Fed. Cl. 1, 26 (2018)); *Chemoil Corp. v. United States*, No. 19-CV-6314, 2023 WL 6257928, at *5-6 (S.D.N.Y. Sept. 26, 2023) (citing *Alternative Carbon*, 939 F.3d 1320, in applying the economic substance doctrine to fuel credits).

Reflecting the flexibility that courts have in applying the economic substance doctrine, the determination of relevance may require a more or less extensive inquiry into the facts and circumstances, depending on the purpose of the tax provisions giving rise to the claimed benefits. *Summa Holdings* is one example of such a case where the court held that substance-over-form principals were not relevant based mostly on the congressional intent of the tax provisions used to generate benefits (DISCs and Roth IRAs). *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779, 786 (6th Cir. 2017). However, *Summa Holdings* does not stand for the proposition that the economic substance doctrine is never relevant in the case of DISCs and Roth IRAs; the court still made a factual finding that the taxpayers actually used the tax provisions for their "congressionally sanctioned purposes." *See id.* at 782, 786. Even amicus curiae Chamber of Commerce—which argues for a threshold relevance test—agrees that the application of the doctrine requires some kind of inquiry into the transaction itself to determine relevance. *See* Brief for The Chamber of Commerce of the United States of America as Amicus Curiae Supporting Petitioners at 20 ("[T]he taxpayer must actually engage in the relevant qualifying activity to receive the tax benefit").

September 6, 2024

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CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of September 2024, a true and correct copy of the foregoing was served on counsel for Petitioners and Respondent via electronic mail to the following email addresses and that both parties consented in writing to service via electronic mail pursuant to Tax Court Rule 21(b)(2)(A):

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