No. 19-41

In the Supreme Court of the United States

KEITH A. TUCKER, ET UX., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals properly applied the economic-substance doctrine to disallow claimed tax losses generated by a tax-shelter transaction that used offsetting foreign-currency options to create noneconomic losses.

ADDITIONAL RELATED PROCEEDINGS

United States Tax Court:

Keith A. and Laura B. Tucker v. *Commissioner of Internal Revenue*, No. 12307-04 (Sept. 18, 2017)

Keith A. and Laura B. Tucker v. *Commissioner of Internal Revenue*, No. 12874-05 (Feb. 7, 2006)

United States Court of Federal Claims:

Epsolon, Ltd. v. *United States* (No. 1:05-cv-00999) (stayed pending disposition of this appeal)

United States Court of Appeals (5th Cir.):

Keith A. Tucker; Laura B. Tucker v. *Commissioner of Internal Revenue*, No. 17-60933 (Apr. 3, 2019)

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is not published in the Federal Reporter but is reprinted at 766 Fed. Appx. 132. The memorandum opinion of the Tax Court (Pet. App. 20a-93a) is not published in the United States Tax Court Reports but is reprinted at 114 T.C.M. (CCH) 326.

JURISDICTION

The judgment of the court of appeals was entered on April 3, 2019. The petition for a writ of certiorari was filed on July 2, 2019. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case arises out of petitioner Keith Tucker's[1] participation in a variation of a "now infamous" tax shelter that was "aggressively marketed by law and accounting firms in the late 1990s and early 2000s." *American Boat Co.* v. *United States*, 583 F.3d 471, 473-474 (7th Cir. 2009); see *Kornman & Assocs., Inc.* v. *United States*, 527 F.3d 443, 446 n.2 (5th Cir. 2008). The tax shelter purported to generate tax benefits by creating an artificially high basis in partnership interests or corporate stock, accomplished by transferring gains without offsetting liabilities. See IRS Notice 2000-44, 2000-36 C.B. 255 (IRS Notice). In 2000, the IRS classified that tax shelter as a "listed transaction"—*i.e.*, a transaction that the IRS "ha[d] determined to be a tax avoidance transaction," Treas. Reg. 1.6011-4T(b)(2) (2000)—and warned that penalties would be imposed on those who used or promoted it or "substantially similar" transactions. IRS Notice 256. After petitioner employed a variation of that tax shelter a few months later, the IRS disallowed the tax benefits that the transaction purported to generate. Pet. App. 8a. The Tax Court upheld the disallowance, and the court of appeals affirmed. *Id.* at 19a, 93a.

1. In August 2000, petitioner, who was then CEO of Waddell & Reed Financial, Inc. (Waddell), realized $41,034,873 in income from exercising stock options that he had received from Waddell. Pet. App. 24a-25a. Petitioner then consulted with the accounting firm KPMG

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[1] Laura B. Tucker, Mr. Tucker's wife, is a petitioner because she filed a joint tax return with him. See Pet. App. 1a-2a. Because this case concerns only Mr. Tucker's actions, however, this brief refers to him as "petitioner."

about a plan to "mitigate" the significant income-tax liability that would ordinarily flow from realizing such a large amount of income. *Id.* at 4a; see *id.* at 3a-4a. Petitioner considered several tax strategies that did not come to fruition. See *id.* at 26a-29a. But by late 2000, KPMG developed "a customized tax solution to mitigate [petitioner's] 2000 income tax by the end of the year," which KPMG called the "FX transaction." *Id.* at 29a.

a. The FX transaction had two parts: (1) the "loss component," which generated an artificial loss; and (2) the "basis component," which artificially inflated petitioner's basis in the stock of an S corporation so that he could use the loss immediately. Pet. App. 33a. Although the two components differed somewhat, they both used paired foreign-currency options with closely aligned strike prices, designed so that the options were offsetting, to generate huge paper gains and paper losses. See *id.* at 2a, 20a; see also C.A. ROA 7004, 7009. The claimed tax benefits were then generated by separating the options' offsetting paper gains and losses and recognizing only the desired portion for U.S. tax purposes. See Pet. App. 53a-54a, 59a-60a.

In order to eliminate economic risk, both components of the transaction were structured so that the potential for economic profit and loss was capped. See Pet. App. 30a. Although investment advisors told petitioner that he had a potential return of $800,000 and a 40% chance of earning a profit, summaries provided to him showed that he faced a 60% chance of losing the funds expended on the transaction. *Ibid.*; C.A. ROA 7015, 7022. Ultimately, the transaction resulted in a $695,000 net loss for petitioner, without regard to tax

benefits. Pet. App. 30a. But petitioner claimed substantial tax savings, including approximately $15 million in 2000, the year in suit. *Id.* at 2a.

b. The FX transaction operated through three newly created entities: (1) Sligo (2000) Company, Inc. (Sligo), a Delaware corporation of which petitioner was the sole shareholder and which elected S-corporation status, see 26 U.S.C. 1361-1379; (2) Sligo (2000), LLC (Sligo LLC), a Delaware LLC of which petitioner was the sole member; and (3) Epsolon, Ltd. (Epsolon), a corporation organized under the laws of the Republic of Ireland and initially owned by Cumberdale Investment, Ltd. (Cumberdale), an Irish corporation in which petitioner held no interest. Pet. App. 4a, 32a. In December 2000, Sligo purchased 99% of Epsolon's shares from Cumberdale for $10,000. *Ibid.* Epsolon was used to generate the loss component of the transaction, while Sligo LLC was used for the basis-inflation component. *Id.* at 33a.

i. The loss component was premised on a prearranged entity reclassification scheme that purported to split the paper gains and losses from option spread positions, so that Epsolon's losses passed to Sligo (and then to petitioner), but its gains did not. See Pet. App. 5a; C.A. ROA 4253-4262. Specifically, after petitioner, through Sligo, had acquired 99% of Epsolon, Epsolon became a "controlled foreign corporation" (CFC) for U.S. federal tax purposes, see 26 U.S.C. 951-965, but it retained CFC status for only nine days. Pet. App. 4a-5a, 7a. After those nine days elapsed, Epsolon elected partnership classification for U.S. tax purposes. *Id.* at 5a-6a; see C.A. ROA 1548-1549.

While Epsolon was still a CFC, petitioner (through Sligo) made $1,514,700 in capital contributions to Epsolon. Pet. App. 5a. Next, Epsolon bought from and sold

to Lehman Brothers (Lehman) eight foreign-currency option contracts tied to the U.S. dollar and the euro. C.A. ROA 1550-1552. Each contract was accompanied by an offsetting contract, so that each pair of options created a "spread" position. Pet. App. 5a. Although the premiums were almost entirely offsetting, Epsolon was the net seller of its options, receiving a net premium of $1,458,999 from Lehman. *Id.* at 5a-6a; C.A. ROA 1550-1554, 7001. Reflecting the parties' understanding that the offsetting nature of the options meant that neither party would ever have to pay the huge potential payoff amounts listed for each option, Lehman required Epsolon to post only a $1,448,986 margin. Pet. App. 34a.

The next steps were designed to separate the paper gains from the losses. On December 21, 2000, Epsolon, still a CFC, disposed of four options and realized a paper gain of $51,260,455. Pet. App. 6a. It then used those gains to acquire new options, with the same expiration date, but tied to the U.S. dollar/deutschmark exchange rate. *Ibid.*; see C.A. ROA 1554-1556. Because an irrevocable exchange rate had been established between the euro and the European currencies it replaced, the deutschmark options effectively replaced the euro options that were closed out the same day with equivalent positions. See C.A. ROA 6990, 8834.

On December 27, 2000, Epsolon made a "check-the-box" election, changing its status to a partnership for U.S. tax purposes. Pet. App. 6a. When a corporation (including a CFC) changes its classification to a partnership, it is deemed to distribute its assets and liabilities to its shareholders in a liquidation under 26 U.S.C. 332. See Treas. Reg. 301.7701-3(g)(1)(ii) (2000). The shareholders are then deemed to contribute all of the former CFC's assets and liabilities to the partnership,

a new entity for federal tax purposes. See 26 U.S.C. 721. As a result, 99% of Epsolon's assets and liabilities were distributed to Sligo in the deemed liquidation, and Sligo received a carryover basis in its share of Epsolon's assets, preserving the loss in the remaining options. Pet. App. 7a; see 26 U.S.C. 334(b)(1). Petitioner calculated Sligo's adjusted basis in the Epsolon partnership as the difference between Sligo's basis in the long options and its liability on the short options. Pet. App. 56a.

On December 28, 2000, after Epsolon elected partnership status, it disposed of the offsetting "loss leg[]" of the European currency options. Pet. App. 53a; see *id.* at 7a. As a result, it claimed a $39,584,511 loss for 2000, of which Sligo reported a 99% share of the losses, or $39,188,666. *Ibid.* Sligo's loss then passed through to petitioner, who reported a $39,188,666 loss as a deduction on his 2000 tax form. *Ibid.* Yet petitioner suffered no corresponding economic loss, due to the offsetting gain that he did not recognize for U.S. tax purposes. See *id.* at 6a-7a.

ii. Because Sligo was an S corporation, its income and losses passed through to petitioner as its sole shareholder, but he could use Sligo's losses only to the extent of his stock basis. See 26 U.S.C. 1366(a) and (d). The basis-inflation component of the FX transaction was designed to artificially inflate petitioner's basis in Sligo's stock, thereby enabling him to offset his substantial income from other sources immediately. See Pet. App. 7a.

To increase his basis, petitioner acquired, through Sligo LLC, additional offsetting foreign-currency options, this time based on the U.S. dollar/Japanese yen exchange rate. Pet. App. 7a. On December 26, 2000, petitioner contributed the yen options to Sligo by transferring his ownership of Sligo LLC to Sligo. *Ibid.* He

claimed that doing so increased his basis in his Sligo stock by $51 million, which, combined with $2,024,700 in purported cash contributions to Sligo, gave him a total basis of $53,024,700. *Id.* at 7a, 59a-60a. Petitioner did not, however, correspondingly decrease his basis as a result of the premium for the sold yen option. *Id.* at 7a. He asserted that his obligation to fulfill that option was "contingent" on whether the option was "in the money" at expiration, and that such a contingent liability did not reduce his basis under 26 U.S.C. 358(a) and (d). C.A. ROA 9738.

c. For 2000, the year in suit, petitioner reported more than $44 million in wages and salaries, including $41,034,873 in gains from his Waddell stock options. Pet. App. 8a. He reported the $39,188,666 Epsolon loss as a deduction. *Ibid.* In 2001, petitioner took another $13 million deduction, which reflected Sligo's share of Epsolon's losses from the disposition of the remaining foreign-currency options, for a total of more than $52 million in reported losses from the FX transaction. *Ibid.*

2. The Commissioner disallowed petitioner's claimed $39,188,666 loss deduction, which gave rise to a tax deficiency of $15,518,704. Pet. App. 8a.

Petitioner challenged the deficiency in the Tax Court. Pet. App. 20a-93a. Because tax benefits from similar basis-inflation schemes had by that time been disallowed in numerous cases, petitioner conceded before trial that the basis-inflation component of the FX transaction was invalid. *Id.* at 7a, 20a. But petitioner continued to defend the transaction's loss component, contending that he was entitled to deduct the loss purportedly flowing from Epsolon to the extent of his actual basis in Sligo (which he alleged was $2,024,700) and

to carry forward the remaining losses under 26 U.S.C. 1366(d)(2). Pet. App. 20a-21a. Despite the offsetting nature of Epsolon's options, petitioner argued that the FX transaction technically complied with statutory and regulatory provisions and that his attempt to use the loss without recognizing the offsetting gains should be respected. *Id.* at 20a. The Commissioner contended that the underlying option transactions lacked economic substance and therefore should be disregarded for federal tax purposes. *Id.* at 51a-52a.

3. The Tax Court determined that petitioner's transaction lacked economic substance and should be disregarded. Pet. App. 20a-93a. The court explained that the economic-substance doctrine "permits a court to disregard a transaction—even one that formally complies with the [Internal Revenue] Code—for Federal income tax purposes if it has no effect other than on income tax loss." *Id.* at 65a. The court found that the two-part FX transaction, in which each component used offsetting foreign-currency options to generate the claimed tax benefits, was designed only to create huge artificial losses and to enable petitioner to report those losses on his income-tax returns. *Id.* at 79a-80a. The Tax Court conducted both an objective and a subjective inquiry, concluding that the transaction lacked objective economic substance and that petitioner did not have a subjectively genuine business purpose or any motivation other than tax avoidance. *Id.* at 80a, 83a.

4. The court of appeals affirmed. Pet. App. 1a-19a.

a. The court of appeals concluded that the economic-substance doctrine applied to the FX transaction. Pet. App. 10a-14a. It explained that, under that doctrine, "taxpayers have the right to decrease or avoid taxes by legally permissible means," but "transactions which do

not vary control or change the flow of economic benefits are to be dismissed from consideration." *Id.* at 9a (citation omitted). The court further explained that the doctrine applies to transactions that technically comply with the tax laws, observing that this Court had previously applied the doctrine to technically compliant transactions. *Id.* at 11a. The court of appeals further observed that, although "the FX Transaction was consistent with the Code's language, it looked like 'the whole undertaking was in fact an elaborate and devious' path to avoid tax consequences." *Ibid.* (quoting *Gregory* v. *Helvering*, 293 U.S. 465, 470 (1935)) (brackets and ellipses omitted). The court thus held that the Tax Court had appropriately applied the economic-substance doctrine to assess whether the FX transaction had any motive or substance apart from its tax consequences. *Id.* at 13a.

The court of appeals acknowledged that, in arguing to the contrary, petitioner had "rel[ied] heavily" on the Sixth Circuit's decision in *Summa Holdings, Inc.* v. *Commissioner*, 848 F.3d 779 (2017). Pet. App. 13a. It noted that, in the Sixth Circuit's view, that case had not involved "a labeling-game sham" that "defied economic reality," but rather "Code-compliant, tax-advantaged transactions" that fell "on the legitimate side of the line." *Id.* at 13a-14a (quoting *Summa Holdings*, 848 F.3d at 786, 788). The court here determined that in this case, by contrast, "even under *Summa Holdings*, it was appropriate for the tax court to apply the economic substance doctrine to determine whether the transactions defied economic reality." *Id.* at 14a (citation and internal quotation marks omitted).

b. The court of appeals further held that the FX transaction lacked substance under the economic-

substance doctrine. Pet. App. 15a-19a. It explained that "the economic substance doctrine effectively has two prongs," both of which the taxpayer must satisfy: "an objective economic prong and a subjective business purpose prong." *Id.* at 15a-16a. The court determined that the transaction at issue here "failed the objective economic prong because there was no reasonable possibility of profit and there was no actual economic effect." *Id.* at 18a-19a. The court accordingly found it unnecessary to reach the subjective prong. *Id.* at 19a.

ARGUMENT

Petitioner contends (Pet. 13-33) that the economic-substance doctrine "is only a tool for interpreting the meaning of ambiguous text," Pet. 13, and that the court of appeals therefore should not have applied the doctrine to the transaction at issue here. The court below correctly rejected that contention; determined that the FX transaction lacked economic substance; and held that petitioner therefore could not lawfully claim losses based on that transaction to offset his substantial income from other sources. The decision below does not conflict with any decision of this Court or of any other court of appeals. And in light of Congress's codification of the economic-substance doctrine in 2010, this case—which involves the 2000 tax year—would be a poor vehicle in which to reconsider the contours of that doctrine. Further review is not warranted.

1. The court of appeals properly applied the economic-substance doctrine to the transaction at issue here. Contrary to petitioner's contention (Pet. 23-31), the economic-substance doctrine is not a canon for construing ambiguous statutory terms. Rather, this Court has long applied the doctrine to reflect the understanding that Congress does not intend sham transactions to

produce tax benefits *even if* the transactions technically comply with the statutory and regulatory provisions that authorize such benefits. The economic-substance doctrine thus addresses the endless possible ways to cobble together Code-compliant maneuvers to confer tax benefits without real economic consequences.

a. In its foundational decision in *Gregory* v. *Helvering*, 293 U.S. 465 (1935), the Court disregarded a transaction that was "conducted according to the terms of" the relevant statutory provision. *Id.* at 470. The taxpayer in *Gregory* had created a corporation for the sole purpose of transferring valuable stock to herself at the capital-gains tax rate, rather than at the higher ordinary-income tax rate. *Id.* at 467. This Court disregarded the corporation for purposes of calculating her tax liability, explaining that, although "a new and valid corporation was created," it "was nothing more than a contrivance" designed to transfer property at a reduced rate. *Id.* at 469. The Court cautioned that permitting the taxpayer to obtain tax benefits in that situation would "exalt artifice above reality and * * * deprive the statutory provision in question of all serious purpose." *Id.* at 470; see *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945) (explaining that the ability to disallow "mere formalisms, which exist solely to alter tax liabilities," is critical to "the effective administration of the tax policies of Congress").

In *Knetsch* v. *United States*, 364 U.S. 361 (1960), the Court similarly disallowed interest-expense deductions generated by a transaction that, in form, complied with the relevant law. *Id.* at 365-366. The Court explained that a claimed tax benefit may be disallowed, even if the transaction complies with the technical tax laws, if "there was nothing of substance to be realized by [the

taxpayer] from th[e] transaction beyond a tax deduction." *Id.* at 366.

Finally, in *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978), the Court reiterated that, "[i]n applying th[e] doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." *Id.* at 573. In that case, the Court required that the government respect a transaction that had "economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." *Id.* at 583-584. But the Court emphasized that it was "not condoning manipulation by a taxpayer through arbitrary labels and dealings that have no economic significance." *Id.* at 583.

This Court's decision in *Cottage Savings Ass'n* v. *Commissioner*, 499 U.S. 554 (1991), on which petitioner relies (Pet. 28), is not to the contrary. There, the Court addressed whether an exchange of one set of mortgages on single-family homes for another set of mortgages on other single-family homes was a "disposition of property" giving rise to a loss under 26 U.S.C. 1001(a) and Treas. Reg. 1.1001-1(a) (1990), which require that properties exchanged be materially different. The Court determined that a loss could be recognized because the two groups of mortgages exchanged were "'materially different'" and "legally distinct entitlements." *Cottage Savings*, 499 U.S. at 566. In so holding, the Court defined "'materially different'" for purposes of Section 1001(a) to mean that the exchanged properties "embody legally distinct entitlements," not that they "differ in economic substance." *Id.* at 562, 566. But in assessing

the meaning of that particular statutory provision, the Court did not jettison the longstanding economic-substance doctrine. Indeed, the transaction likely complied with that doctrine, as "[t]he taxpayer in *Cottage Savings* had an economically substantive investment in assets which it had acquired a number of years earlier in the course of its ordinary business operations and which had declined in actual economic value by over $2 million." *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 251 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999).

b. Congress has since confirmed that the economic-substance doctrine encompasses sham tax-avoidance transactions that otherwise comply with the Code. In 2010, it defined the "'economic substance doctrine'" as "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." 26 U.S.C. 7701(*o*)(5)(A). That definition reflects the well-established understanding that the economic-substance doctrine is a background substantive doctrine that applies to all of the income-tax provisions in Title 26, Subtitle A, not a canon of construction used only to interpret ambiguous statutory terms. See *Summa Holdings, Inc.* v. *Commissioner*, 848 F.3d 779, 785 (6th Cir. 2017) (explaining that "Congress has codified th[e] principle" that courts should "look[] to the economic realities of the business deal").

Section 7701(*o*) as a whole makes clear, moreover, that a transaction must have economic substance in order to support a claim for tax benefits provided in other parts of the Code. Under that provision, a transaction will 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." 26 U.S.C. 7701(*o*)(1). That language, which focuses on economic substance *apart from* compliance with the Code, is inconsistent with petitioner's view of the economic-substance doctrine as merely a tool for interpreting ambiguous Code provisions. The legislative history of Section 7701(*o*) confirms Congress's understanding that the economic-substance doctrine addresses transactions that satisfy the technical requirements of the tax laws. See H.R. Rep. No. 443, 111th Cong., 2d Sess. 295 (2010) (House Report) (explaining that, because a "strictly rule-based tax system cannot efficiently prescribe the appropriate outcome of every conceivable transaction that might be devised, * * * courts have long recognized the need to supplement tax rules with anti-tax-avoidance standards, such as the economic substance doctrine, in order to assure the Congressional purpose is achieved").

2. Petitioner asserts (Pet. 13-23) that the courts of appeals are split about the proper scope of the economic-substance doctrine. But the decision below is consistent with decisions of other courts that have considered similar tax-shelter schemes, and with other courts' general conception of the economic-substance doctrine.

a. The courts of appeals that have addressed similar transactions using offsetting options have reached results consistent with the decision below. Petitioner identifies no decision in which any court has upheld claimed tax benefits from a transaction similar to the

one at issue here, in which a taxpayer acquired offsetting pairs of options and structured the transaction so that only the portion yielding a tax benefit was claimed.

Several other courts of appeals have addressed similar transactions in which offsetting foreign-currency options were used to generate tax benefits, but the taxpayer experienced no real risk of economic loss or opportunity for economic gain. Like the court below, those courts have applied the economic-substance doctrine to disallow the claimed tax benefits. See, *e.g.*, *Blum* v. *Commissioner*, 737 F.3d 1303, 1313 (10th Cir. 2013); *Sala* v. *United States*, 613 F.3d 1249, 1253 (10th Cir. 2010), cert. denied, 565 U.S. 814 (2011); *Stobie Creek Invs. LLC* v. *United States*, 608 F.3d 1366, 1376 (Fed. Cir. 2010); *Jade Trading, LLC ex rel. Ervin* v. *United States*, 598 F.3d 1372, 1374 (Fed. Cir. 2010); *Cemco Investors, LLC* v. *United States*, 515 F.3d 749, 751 (7th Cir.), cert. denied, 555 U.S. 823 (2008). More generally, courts have consistently treated the fact that a loss is fictional—*i.e.*, that the taxpayer has not actually suffered an economic harm comparable to the claimed tax loss—as one of the most compelling indicators that a transaction lacks economic substance. See, *e.g.*, *Crispin* v. *Commissioner*, 708 F.3d 507, 516 (3d Cir.), cert. denied, 571 U.S. 1094 (2013); *Stobie Creek*, 608 F.3d at 1377; *Keeler* v. *Commissioner*, 243 F.3d 1212 (10th Cir. 2001).

b. Petitioner contends (Pet. 13-23) that review is warranted because courts of appeals purportedly have expressed conflicting theoretical understandings of the relationship between the economic-substance doctrine and the Code provisions that specify the prerequisites for various tax benefits. In this case, the Fifth Circuit

applied the economic-substance doctrine notwithstanding its recognition that the transactions at issue technically complied with the Code. Petitioner contends, however, that other courts of appeals have viewed the economic-substance doctrine as relevant only for interpreting ambiguous tax rules. No such conflict exists, and any disagreement at the margins of the economic-substance doctrine is not implicated here.

The courts of appeals have consistently applied the economic-substance doctrine to disallow claimed tax benefits from tax shelters that meet literal statutory and regulatory requirements, but that create artificial tax benefits that are inconsistent with economic realities. Those courts have distinguished between designing "a real transaction in a particular way to provide a tax benefit (which is legitimate), and creating a transaction, without a business purpose, in order to create a tax benefit (which is illegitimate)." *Coltec Indus., Inc.* v. *United States*, 454 F.3d 1340, 1357 (Fed. Cir. 2006), cert. denied, 549 U.S. 1206 (2007). Indeed, they have emphasized that the entire purpose of the economic-substance doctrine and related doctrines is to address transactions that comply with the "literal terms of the tax code" but are orchestrated tax-avoidance schemes without independent economic consequences. *Id.* at 1352.

For example, several courts of appeals have recently upheld the disallowance of foreign tax credits under the economic-substance doctrine, even though the transactions literally complied with foreign-tax-credit provisions. See *Santander Holdings USA, Inc.* v. *United States*, 844 F.3d 15 (1st Cir. 2016), cert. denied, 136 S. Ct. 2295 (2017); *Bank of N.Y. Mellon Corp.* v. *Commissioner*, 801 F.3d 104 (2d Cir. 2015), cert. denied, 136 S. Ct. 1377

(2016); *Salem Fin., Inc.* v. *United States*, 786 F.3d 932 (Fed. Cir. 2015), cert. denied, 136 S. Ct. 1366 (2016). Other courts of appeals have done the same for a variety of transactions that technically complied with the Code. See, *e.g.*, *WFC Holdings Corp.* v. *United States*, 728 F.3d 736, 746 (8th Cir. 2013), cert. denied, 573 U.S. 904 (2014); *Southgate Master Fund, LLC ex rel. Montgomery Capital Advisors, LLC* v. *United States*, 659 F.3d 466, 479 (5th Cir. 2011); *Sala*, 613 F.3d at 1253 (10th Cir.); *Dow Chem. Co.* v. *United States*, 435 F.3d 594, 599 (6th Cir. 2006), cert. denied, 549 U.S. 1205 (2007); *Winn-Dixie Stores, Inc.* v. *Commissioner*, 254 F.3d 1313, 1315-1316 (11th Cir. 2001) (per curiam); *ACM P'ship*, 157 F.3d at 261 (3d Cir.).

Petitioner asserts (Pet. 14-17) that the Sixth Circuit in *Summa Holdings*, *supra*, and the D.C. Circuit in *Horn* v. *Commissioner*, 968 F.2d 1229 (1992), disapproved such applications of the economic-substance doctrine. That assertion is mistaken. Those two decisions, which involved distinct doctrines or specific exceptions that are inapplicable here, do not support the sweeping proposition that the economic-substance doctrine applies only "when the text itself requires reference to economic substance." Pet. 13.

In *Summa Holdings*, the Sixth Circuit applied the distinct, though related, substance-over-form doctrine. 848 F.3d at 784; see *Rogers* v. *United States*, 281 F.3d 1108, 1113-1118 (10th Cir. 2002) (explaining the differences between the doctrines). The court held that the substance-over-form doctrine did not allow the Commissioner to nullify transactions merely because "the purpose of the transactions was to sidestep the contribution limits on Roth IRAs and lower the tax obligations of the" taxpayer's family. *Summa Holdings*,

848 F.3d at 784-785. But the court repeatedly distinguished the economic-substance doctrine, explaining that "[a] focus on the economic substance of the transaction is just what the Code contemplates and just what the Commissioner and courts may consider." *Id.* at 785; see *ibid.* (explaining that "the Commissioner [can] recharacterize the economic substance of a transaction—to honor the fiscal realities of what taxpayers have done over the form in which they have done it"); *ibid.* (stating that transactions can be "disregard[ed]" under the "'sham' transaction doctrine"—*i.e.*, the economic-substance doctrine—and that Congress "codified this principle for transactions after 2010").

Petitioner's claim of a circuit conflict is also inconsistent with other Sixth Circuit decisions issued both before and after *Summa Holdings*. In an earlier decision, the Sixth Circuit had explained that the economic-substance doctrine applies "even if a transaction is in 'formal compliance with Code provisions.'" *Dow*, 435 F.3d at 599 (quoting *American Elec. Power Co.* v. *United States*, 326 F.3d 737, 741 (6th Cir. 2003)). The panel in *Summa Holdings* lacked authority to overrule that decision. Since *Summa Holdings*, the Sixth Circuit has reiterated that, "[w]hile taxpayers are free to arrange their affairs to minimize taxes, they must do so in real ways—ways that give a transaction economic teeth." *Billy F. Hawk, Jr., GST Non-Exempt Marital Trust* v. *Commissioner*, 924 F.3d 821, 825 (2019) (citing *Gregory*, 293 U.S. at 469, and *Summa Holdings*, 848 F.3d at 787), petition for cert. pending, No. 19-200 (filed Aug. 13, 2019). And while "the distinction between transactions that obscure economic reality and Code-compliant, tax-advantaged transactions may be difficult to identify in some cases," *Summa Holdings*,

848 F.3d at 788, the transaction at issue here falls in the former category "even under *Summa Holdings*." Pet. App. 14a.

The D.C. Circuit's decision in *Horn* likewise does not support petitioner's view that the economic-substance doctrine is inapplicable to transactions that technically comply with Code requirements. In *Horn*, the D.C. Circuit construed Section 108 of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 630. See 968 F.2d at 1230. The first subsection of Section 108 permitted a deduction for a loss from a certain type of straddle transaction "if and only if the transaction is entered into for profit or in a trade or business." *Id.* at 1238. The court viewed that requirement as "closely track[ing] the sham transaction doctrine." *Ibid.* The second subsection of Section 108, however, "irrebuttably presume[d] that straddle trades made by commodities dealers are made in a trade or business." *Ibid.* The court inferred from that provision that Congress intended to permit deductions for straddle trades by commodities dealers, regardless of the profit potential of any particular trade. *Id.* at 1238-1239. The D.C. Circuit concluded that disregarding such trades under the economic-substance doctrine would subvert that intended treatment of a narrow class of transactions and would "read [the second subsection] completely out of existence." *Id.* at 1234; see *id.* at 1236, 1238-1240.

The court in *Horn* did not suggest that the only function of the economic-substance doctrine is to aid in construing ambiguous statutory terms. To the contrary, it recognized that the doctrine can bar tax benefits even where the taxpayer acts within "the letter of the tax code." 968 F.2d at 1236 (citing *Gregory*, 293 U.S. at 465). The court held only that, where Congress had

mandated that certain trades would receive a particular tax treatment regardless of their economic effect, the economic-substance doctrine should not be applied in a way that would subvert that specific legislative determination. See *ibid.* ("The sham transaction doctrine is an important judicial device for preventing the misuse of the tax code; but the doctrine cannot be used to preempt congressional intent.").

Petitioner does not identify any statutory provision that, like the provision at issue in *Horn*, reflects Congress's intent to convey the benefits petitioner claimed here through the FX transaction. To the extent he suggests (Pet. 2-3, 17 n.7, 26) that the application of the economic-substance doctrine would thwart Congress's specific intention to grant a tax benefit in this case, that is incorrect. As the decision below explained, Congress did not intend to authorize the tax benefits claimed here when it enacted, for example, the 30-day CFC rule or the check-the-box regulation at issue. See Pet. App. 14a. Rather, this case involves the classic type of contrivance that this Court and the courts of appeals have repeatedly rejected under the economic-substance doctrine. Nothing in *Summa Holdings* or *Horn* is to the contrary.

3. In any event, this case would be a poor vehicle for this Court to reconsider "the fundamental role and limits of the economic substance doctrine," as petitioner advocates (Pet. 31). This case involves an income-tax return for the 2000 tax year and is governed by Code provisions applicable at the time. See Pet. App. 2a. But Congress has since clarified its understanding of the economic-substance doctrine.

In 2010, Congress added Section 7701(*o*) to the Code as a prospective "codification of economic substance

doctrine and penalties." Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, Tit. I, § 1409(a), 124 Stat. 1067 (capitalization and emphasis omitted). As described above, see pp. 13-14, *supra*, that codification confirmed that Congress views the economic-substance doctrine as a "common law doctrine" that disallows "tax benefits" otherwise available under the terms of the Code "if the transaction does not have economic substance or lacks a business purpose." 26 U.S.C. 7701(*o*)(5)(A); see Pet. App. 9a. The 2010 amendment also dispelled some confusion in the lower courts about the doctrine's application, see Pet. App. 66a n.11, by requiring both an objective and a subjective inquiry. See 26 U.S.C. 7701(*o*)(1).

Petitioner asserts (Pet. 32-33) that the 2010 amendment is irrelevant because, in his view, it does not clarify whether the economic-substance doctrine applies in the absence of statutory or regulatory ambiguities. But that assertion misreads Section 7701(*o*)(5)(C). Congress declined to provide guidance on "[t]he determination of whether the economic substance doctrine is relevant" based on the specific transaction at issue and the purpose of the governing tax provision. 26 U.S.C. 7701(*o*)(5)(C); see House Report 296 & n.124. Congress did not leave open the question whether the doctrine applies as a background substantive rule throughout the Code; indeed, the 2010 amendment rests on that premise. See 26 U.S.C. 7701(*o*)(1) and (5)(A). And in all events, given that Congress has amended the Code to codify the economic-substance doctrine, it would make little sense to fundamentally reconsider that doctrine in a case where Congress's most recent guidance does not formally control.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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