No. __-____

IN THE
Supreme Court of the United States

WFC HOLDINGS CORPORATION,
Petitioner,
v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In 1998, petitioner WFC Holdings Corporation and its subsidiaries entered into a lease restructuring transaction that generated tens of millions of dollars in economic benefits for the company and its shareholders. The government concedes that, under the plain language of the Internal Revenue Code ("Code"), the transaction also entitled petitioner to a tax deduction that reduced its corporate income tax liability by approximately $148 million. The Eighth Circuit nevertheless denied petitioner's claim for the deduction under the judge-made "economic substance doctrine." It held that the transaction's structure was designed to achieve the tax deduction and was not necessary to obtain the non-tax economic benefits. The question presented is:

Whether an objectively profitable transaction can be disregarded for tax purposes under the judge-made economic substance doctrine because it was structured to achieve income tax deductions authorized by the plain language of the Code.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner WFC Holdings Corporation states the following:

WFC Holdings Corporation is incorporated under the laws of Delaware and is a wholly owned subsidiary of Wells Fargo & Company, a publicly held corporation incorporated under the laws of Delaware.

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Petitioner WFC Holdings Corporation ("WFC Holdings"), a wholly owned subsidiary of Wells Fargo & Company (collectively, "Wells Fargo" or "WFC"), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

INTRODUCTION

For more than 75 years, this Court has held that the economic substance doctrine – which developed as a purely judge-created rule with no textual basis in the Internal Revenue Code ("Code") – must be limited to circumstances in which there is "nothing of substance to be realized . . . from [the challenged] transaction beyond a tax deduction." *Knetsch v. United States*, 364 U.S. 361, 366 (1960). If a transaction generates substantial non-tax benefits, it must be respected for tax purposes, meaning that the taxpayer is entitled to any tax benefits that flow from the transaction under the Code. That is true even if the transaction is specifically structured to achieve tax benefits, because, as this Court has repeatedly held, a taxpayer's "legal right . . . to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935).

The decision below violated these longstanding principles by holding that the lease restructuring transaction ("LRT") should be disregarded for tax purposes under the economic substance doctrine even though it was an objectively profitable transaction, wholly apart from tax benefits. The LRT facilitated a *bona fide* transfer of commercial real estate leases from two Wells Fargo bank subsidiaries to Charter Holdings, Inc. ("Charter"), a non-bank subsidiary.

That transfer did not merely shift the leases from one corporate pocket to another. Because banks are subject to stricter federal regulations on holding interests in real estate than non-banks, the transfer of certain of those leases allowed Wells Fargo to earn millions of dollars in additional revenue that would have been impossible without the LRT.

Despite these non-tax benefits, the courts below concluded that the LRT lacked economic substance because Wells Fargo structured the lease transfer as a tax-free exchange under Code § 351, which in turn entitled it to recognize a capital loss deduction under the Code's plain language when it sold the preferred stock it received in the exchange to an unrelated third party. The court below held that Charter's issuance of a new class of preferred stock and Wells Fargo's subsequent arm's-length sale of that stock made the entire transaction lack economic substance despite the profitability of the LRT in the aggregate. The lower courts also held that the lack of non-tax motivation for these other components undermined the transaction's business purpose.

Certiorari is warranted because the decision below exceeds the limits of the economic substance doctrine consistently recognized by this Court. The decision below, if left unreviewed, threatens to turn the economic substance doctrine into an expansive dragnet for the Internal Revenue Service ("IRS") to challenge virtually any tax-efficient business transaction. Tax planning almost invariably involves structuring an economically significant transaction so that the transaction produces both non-tax economic benefits as well as efficient tax results. The Eighth Circuit's rule that a profitable transaction lacks economic sub-

stance if it is also structured to achieve tax benefits threatens tax planning long recognized as legitimate.

Certiorari also is appropriate because the Eighth Circuit's novel rule deepens the growing conflict among the federal circuits over whether a transaction that objectively changes a taxpayer's economic position can nevertheless lack economic substance. The majority of circuits hold, consistent with *Knetsch*, that "a transaction ceases to merit tax respect when it has no economic effects other than the creation of tax benefits." *United Parcel Serv. of Am., Inc. v. Commissioner*, 254 F.3d 1014, 1018 (11th Cir. 2001) ("*UPS*") (internal quotations omitted). However, the Eighth Circuit has joined the Sixth and Tenth Circuits in holding a transaction to lack economic substance even where the transaction was profitable. This Court has not addressed the economic substance doctrine in more than 35 years. In that time, certain lower courts have strayed far from this Court's teachings. The Court's intervention is sorely needed to resolve the confusion illustrated by the decision below.

The proper contours of the economic substance doctrine present a question of national importance that should be addressed promptly by this Court. Clarity and predictability are essential to the sound administration of the tax laws. The Eighth Circuit's expansive decision calls into doubt many forms of tax planning that have long been held legitimate. Congress's recent statutory clarification of the economic substance doctrine, which reaffirms pre-existing standards, only heightens the need for this Court's review. *See* 26 U.S.C. § 7701(*o*)(5)(A).

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-25a) is reported at 728 F.3d 736. The findings of fact, conclusions of law, and order for judgment of the district court (App. 26a-125a) is not reported (but is available at 2011 WL 4583817).

JURISDICTION

The court of appeals entered its judgment on August 22, 2013. A petition for rehearing was denied on October 29, 2013. App. 126a. On January 20, 2014, Justice Alito extended the time for filing a petition for a writ of certiorari to and including February 26, 2014. App. 143a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Code §§ 351, 357, and 358 (1994 & Supp. III 1998)[1] are reproduced at App. 127a-138a.

STATEMENT

1. The LRT was a single integrated transaction involving the transfer of 21 commercial leases from two WFC banking subsidiaries ("the Wells Fargo banks") to Charter Holdings, Inc. ("Charter"), a non-banking subsidiary. The Wells Fargo banks transferred the leases in exchange for shares of Charter preferred stock in a transaction authorized by Code § 351. A § 351 exchange is a common method of transferring property to a corporation without creating a taxable gain or loss under the Code. The transaction had three steps.

First, on December 17, 1998, the Wells Fargo banks transferred to Charter leasehold interests in

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[1] References to Code §§ 351, 357, and 358 are to the version of the United States Code as it existed in 1998.

21 commercial leases with a present value liability of $425 million, and government securities worth $429 million. App. 51a. In exchange, Charter transferred to the two banks 4,000 shares of its preferred stock worth $4 million, the net fair market value of the assets and liabilities transferred. *Id.*[2] This exchange transferred to Charter the entire trade or business of managing the leases. App. 52a.

Second, on the same day, in compliance with federal banking regulations, WFC purchased the 4,000 shares of Charter preferred stock from the Wells Fargo banks for their $4 million fair market value. App. 53a.

Third, on February 26, 1999, WFC sold the same 4,000 shares of preferred stock to Lehman Brothers ("Lehman") in an arm's-length transaction for its then fair market value of approximately $3.75 million. *Id.* The preferred stock entitled Lehman to a cumulative annual dividend of 6.625% and had a liquidation value of $1,000 per share. App. 55a.

2. In March 2003, WFC filed a timely tax-refund claim for the 1996 tax year in which it sought to carry back $235 million of the capital loss realized from the LRT, resulting in a tax refund of $82 million. App. 30a. In April 2007, the IRS denied the refund claim and WFC brought this refund action in district court. *Id.* After a bench trial, the district court issued findings of fact and conclusions of law.

a. The district court found that the LRT occurred against the backdrop of WFC's efforts to mitigate its

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[2] In preparation for the exchange, Charter authorized issuance of 20,000 shares of Series A Preferred Stock, and WFC purchased 16,000 shares for $16 million in addition to making an $83 million contribution to Charter's common capital. App. 51a.

losses on commercial real estate leases resulting from the acquisition of First Interstate Bancorp in a hostile takeover in 1996. App. 30a-31a. The two companies' overlapping geographical footprints left WFC with a large number of leases that were no longer needed for its banking operations. App. 32a. Many of these leases were "underwater," *i.e.*, WFC's rental payments exceeded its income from subleases. *Id.*

WFC's loss-mitigation efforts were hampered by regulations on its banking subsidiaries promulgated by the Office of the Comptroller of the Currency ("OCC") under the National Bank Act ("NBA"). App. 56a. Under the NBA, federally chartered banks are permitted to hold real estate – including commercial leases – only for banking or other limited purposes. *Id.* A commercial lease no longer used for banking purposes is considered "other real estate owned" ("ORE"). *Id.* ORE also includes leased properties that a bank only partially uses for banking functions. App. 58a. A property is certainly ORE when bank occupancy is below 15%. Properties with occupancy between 15% and 50-60% are at risk of being deemed ORE by the OCC, depending on the facts and circumstances. *Id.*[3]

Under OCC mandatory disposition requirements, a bank ordinarily must dispose of an ORE lease within five years, either by a complete assignment or by a sublease of the entire premises for a period coter-

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[3] The record indicates that WFC occupancy of eight of the 21 leases (comprising more than $305 million of the liabilities transferred in the LRT) was below 15% and thus clearly ORE. Another seven leases ($75 million of the transferred liabilities) were less than 60% occupied and thus at risk of ORE status. *See* A458-58.1, A459.12-459.13, A486-87, A500-01, A514-15, A528-29, A542-43, A556-57, A570-71, A697.

minous with the master lease term. App. 56a (citing 12 C.F.R. § 34.82(a)). The OCC may extend the disposition period by another five years (but no further), if it finds that "'(1) the [bank] has made a good faith attempt to dispose of the real estate within the five-year period, or (2) disposal within the five-year period would be detrimental to the [bank].'" App. 56a-57a (quoting 12 U.S.C. § 29). "Violating OCC regulations can result in serious consequences, including public and private reprimands, monetary fines, moratoriums or delays by the OCC in approving new mergers and acquisitions, as well as reputational harm." App. 59a-60a; *see* 12 U.S.C. § 1818(i)(2); 12 C.F.R. § 109.103.

OCC regulations hampered WFC's ability to obtain loss-mitigating sublease rent on ORE properties in several ways. First, many subtenants insisted that WFC grant them sublease extension options so that they would not be forced to move soon after settling into a property. That made it difficult for WFC to sublease properties with a short remaining term (or "lease tail") because the necessary sublease extension option would extend beyond the five-year mandatory disposition period. App. 60a. Second, in some cases, WFC's master lease term extended beyond the mandatory disposition period. *Id.* To terminate the lease before the disposition period, WFC would be required to pay future rent on the remaining master lease term but could not collect *any* loss-mitigating sublease rent during that period. *Id.* Third, some of WFC's leases contained lengthy extension options at significantly discounted rent. *See*, *e.g.*, App. 81a. But because these extensions would run well beyond the mandatory disposition period, WFC could not exercise these lucrative options. *Id.*

In contrast to federally chartered banks, non-banking subsidiaries are regulated by the Federal Reserve (the "Fed") pursuant to the Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841, 1844, and "Regulation Y," 12 C.F.R. pt. 225. The Fed, unlike the OCC, does not mandate disposition of ORE leases; it merely provides that they "be administered in an economically sensible manner." App. 57a. Thus, transferring leases from a banking subsidiary to a non-banking subsidiary would bring them under the Fed's more permissive regulatory regime. App. 42a-43a.

b. The district court found that the lease transfer effectuated by the LRT achieved this regulatory benefit, resulting in millions of dollars in profits for WFC. Like the parties, the court focused on the lease of the Garland building, which accounted for $193 million (nearly one-half) of the liabilities transferred in the LRT. *See* App. 80a-84a; A575. The Garland lease "had a large profit potential" that "WFC could best access . . . by removing the building from OCC oversight." App. 103a. The Garland property was entirely unoccupied by WFC (and thus clearly ORE), and WFC had to dispose of the property by 2001, or at the latest 2006, if it could obtain the maximum five-year extension from the OCC. App. 80a-81a. Because the Garland lease extended to 2009, if WFC had been forced to terminate the lease in 2001, it "would have been obligated to pay $90 million in future rent on the master lease without being able to collect any loss-mitigating sublease rent." App. 60a.[4]

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[4] The record indicates that, because the Garland lease was not terminated, Charter was able to capture sublease revenue of more than $20 million during the eight-year period from 2001 to 2009. *See* A576-77, A1548.3, A1792-96.

The LRT also enabled WFC to exercise in 2009 a 10-year lease extension option on the property at a fixed annual rental rate of $13.4 million, well below the 2009 rental rate of $29 million. App. 81a. The court found that exercising this lease extension option "subsequently generated millions of dollars in profit," relying on trial testimony estimating $31.8 million in profits from the Garland property for the period of 2010-2019 alone. App. 84a (citing A1871-72 (reproduced at App. 139a-140a)). The trial court also recognized that Charter's remaining lease extension options through 2039 (at the same fixed rental rate) and its option to purchase the property outright "did have some value in 1998, and that moving that particular property into a non-banking subsidiary outside the OCC's regulatory jurisdiction enhanced WFC's ability to maximize its profits from those options." App. 123a.

c. Like every other court to consider a similar transaction, the district court agreed that WFC was entitled to the claimed tax deduction under the Code's plain language. App. 86a-87a (citing *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1348-52 (Fed. Cir. 2006); *Black & Decker Corp. v. United States*, 436 F.3d 431, 438-40 (4th Cir. 2006)). Under Code § 351(a), a taxpayer may exchange property for stock in a corporation without recognizing any taxable gain, provided that the taxpayer controls the corporation after the exchange. Code § 358(a)(1) provides that the tax basis of the stock received by the taxpayer is equal to the taxpayer's basis in the property exchanged for that stock.[5] Generally, if the

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[5] Tax basis is "[t]he value assigned to a taxpayer's investment in property and used primarily for computing gain or loss from a transfer of the property." App. 4a n.2 (citation omitted); *see* 26 U.S.C. § 1001(a).

corporation assumes liabilities of the taxpayer, the tax basis of the stock is reduced by the amount of liabilities assumed. *See* 26 U.S.C. § 358(d)(1). But, in § 358(d)(2), Congress created an exception to this rule when the corporation assumes liabilities that, if paid by the taxpayer, would have given rise to a tax deduction. *See* App. 85a-86a (explaining statutory framework).

Applying that framework here, the Wells Fargo banks' tax basis in the Charter stock under Code § 358(a) was equal to their tax basis in the property they exchanged for it, *i.e.*, the $427 million basis in the government securities plus the basis in the underwater leases (which was zero). Under § 358(d), that basis was not reduced by Charter's assumption of the Wells Fargo banks' liabilities associated with the leases because payment of those liabilities would have given rise to a tax deduction under Code § 162(a)(3). Thus, the $425 million in lease liabilities assumed by Charter reduced the market value of the Wells Fargo banks' Charter stock, but, under § 358(d), did not reduce their tax basis in the stock. When Wells Fargo then sold the Charter preferred stock to Lehman for $3.75 million, it was entitled under the Code to recognize a capital loss of $423 million (the stock's tax basis of $427 million less $3.75 million). *See* App. 86a.

d. The district court nevertheless departed from the Code's plain text and concluded that the LRT should be disregarded under the economic substance doctrine. The court considered whether the LRT (1) had a business purpose, *i.e.*, was "'motivated by any economic purpose outside of tax considerations,'" and (2) had economic substance, *i.e.*, whether any "'real potential for profit exists.'" App. 89a (quoting

IES Indus., Inc. v. United States, 253 F.3d 350, 353 (8th Cir. 2001)).

With respect to business purpose, the district court focused on a business plan developed by WFC executives in consultation with WFC's tax advisor, KPMG. *See* App. 36a-50a, 91a-94a. The final draft of that document set forth three reasons for the LRT: (1) relaxing OCC regulatory restrictions on the ORE leases would allow WFC to better manage the transferred leases; (2) the LRT would help prevent bank customers from leveraging their depositor or borrower relationship to obtain preferential lease terms; and (3) consolidating the leases in a new subsidiary would streamline decision-making and incentivize key managers of the leased properties. App. 43a-44a.

The district court concluded that "the LRT was a tax-driven transaction, designed and sold by an accounting firm and developed by WFC's tax department" in conjunction with other business executives. App. 94a. The court then rejected two of WFC's proffered business justifications for the LRT – more effectively dealing with good bank customers and incentivizing managers responsible for the leases – because it found that WFC had not consistently implemented them after the LRT. App. 104a-116a. With respect to WFC's regulatory rationale, the court acknowledged that the LRT resulted in a genuine regulatory change that generated profits for WFC. App. 102a-103a. But the court found that this rationale could not "fully explain" the structure of the LRT, including why Charter issued a new class of preferred stock and why WFC then sold that stock to Lehman. App. 96a-97a.

The district court also concluded that the LRT lacked economic substance. First, the court opined

that the last two steps of LRT – "the stock sale from the transferring banks to WFC and from WFC to Lehman" – "had no non-tax economic value to WFC, and yet increased transaction costs." App. 117a. Second, the court reasoned that the LRT was not profitable unless WFC's profit from the lease transfer exceeded the amount of its claimed capital loss of $423 million. App. 118a.

Finally, the district court explained why it did not attempt to quantify the profits WFC actually realized from the LRT. The court recognized that the LRT had generated tens of millions of dollars in pre-tax profits, *see supra* pp. 8-9, but nevertheless declined to quantify these profits because "[t]he Court cannot isolate one part, or even a few parts, of one step of a large, complex transaction and find that its profit potential imbues the entire transaction with substance which is otherwise lacking." App. 124a.

3. The Eighth Circuit affirmed. Because the government abandoned its argument that petitioner's capital loss deductions were contrary to the Code's plain language, the court of appeals considered only whether the LRT was properly disregarded for tax purposes under the economic substance doctrine. App. 11a-14a.

Beginning with economic substance, the Eighth Circuit summarized WFC's contention that the district court's own findings showed that the LRT was profitable and thus possessed economic substance as a single integrated transaction.[6] App. 15a-16a. The court did not question that contention but agreed

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[6] The Eighth Circuit noted, but did not adopt, the district court's reasoning that, because WFC claimed a capital loss of $423 million, its profit from the LRT had to exceed that amount. App. 15a.

with the government that the profitability of the LRT was irrelevant because WFC could have achieved the lease transfer without also structuring it to obtain a tax deduction. App. 17a. The court reasoned that "the creation and sale to Lehman Brothers of the Charter stock were crucial steps of the LRT/stock transaction that had no practical economic effect on WFC's ability to remove the Garland property from OCC oversight and develop its profit potential." *Id.* The court accordingly concluded that "[v]iewing 'the transaction as a whole' the LRT/stock transaction did not create 'a real potential for profit.'" App. 18a (quoting *IES*, 253 F.3d at 353, 356).

Turning to the business-purpose inquiry, the Eighth Circuit observed that, "[g]iven our conclusion that the LRT/stock transaction had no real potential for profit, WFC faces an uphill battle to establish that it had a subjective intent to treat the LRT/stock transfer as a money-making transaction." App. 19a (citation omitted). The court first agreed with the district court that the regulatory benefits of transferring the leases to a non-bank subsidiary were "not the business purpose for the LRT/stock transfer as a whole," because not all of the leases transferred were ORE and regulatory benefits did not justify the transfer of Charter preferred stock. App. 22a. The court also adopted the district court's reasons for rejecting WFC's two remaining business purposes for the LRT. App. 22a-24a.

REASONS FOR GRANTING THE PETITION

Under the economic substance doctrine, as interpreted by this Court since *Gregory v. Helvering*, 293 U.S. 465 (1935), a transaction lacks economic substance only if it has no meaningful economic effects on the taxpayer apart from creating tax benefits. The decision below eviscerates that principle by holding that a highly profitable transaction lacked economic substance. Certiorari is warranted because that decision disregards this Court's longstanding precedents, deepens a mature conflict among the federal circuits, and implicates a question of critical importance to American taxpayers and the national economy.

I. THIS COURT SHOULD GRANT CERTIORARI TO REAFFIRM THE LIMITS OF THE ECONOMIC SUBSTANCE DOCTRINE

A. The Decision Below Contravenes This Court's Long-Established Principle That A Transaction With Meaningful Economic Effects Apart From Tax Benefits Cannot Be Disregarded For Tax Purposes

This Court has for more than 75 years held that the economic substance doctrine applies only where "there was nothing of substance to be realized by [the taxpayer] from th[e] transaction beyond a tax deduction." *Knetsch v. United States*, 364 U.S. 361, 366 (1960). That venerable principle dates back to this Court's seminal economic substance case, *Gregory v. Helvering*, 293 U.S. 465 (1935). There, the Court disregarded Gregory's attempted corporate "reorganization," in which she created a new wholly owned corporation (Averill), transferred securities held by another wholly owned corporation (United) to Averill, and then immediately dissolved Averill, causing the

securities to be distributed to her. The "reorganization" was "without substance," the Court held, not because Gregory had an "ulterior purpose" to avoid taxes (such a purpose is legitimate, *see infra* Part I.B), but because the transaction had no real-world consequences except to avoid taxes. 293 U.S. at 467, 469.[7] It was a "pure paper shuffle, having no potential consequences for the business in which the corporations engaged." *Yosha v. Commissioner*, 861 F.2d 494, 497-98 (7th Cir. 1988) (Posner, J.).

Since *Gregory*, this Court has consistently held that, where a transaction has any meaningful effect on the taxpayer's economic position, the taxpayer is entitled to any tax benefits provided for under the Code's literal terms. *See*, *e.g.*, *Helvering v. Minnesota Tea Co.*, 296 U.S. 378, 385 (1935) (tax-free reorganization was not a "sham" – "a mere device intended to obscure the character of the transaction" – but was a "bona fide business move"); *John Kelley Co. v. Commissioner*, 326 U.S. 521, 525 (1946) (refusing to apply economic substance doctrine where "[t]here is not present . . . the wholly useless temporary compliance with statutory literalness . . . condemned as futile . . . in *Gregory*"); *United States v. Cumberland Pub. Serv. Co.*, 338 U.S. 451, 454 (1950) (corporation entitled to tax benefits where sale was "made by its stockholders following a genuine liquidation and dissolution").

For example, in *United States v. Consumer Life Insurance Co.*, 430 U.S. 725 (1977), an insurer engaged

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[7] Under the Code, the transfer to Averill qualified as a tax-free reorganization, while the transfer from Averill to Gregory qualified as a tax-free liquidation. *Gregory*, 293 U.S. at 468-69. This Court held Gregory liable for the "much larger tax" she would have paid had United distributed the securities directly to her as a dividend. *Id.* at 467.

in reinsurance treaties with other insurance companies that altered its mix of insurance reserves in a way that qualified it for the favorable tax treatment reserved for life insurance companies. *Id.* at 727-28. The Court honored these transactions and upheld the favorable tax treatment because the treaties "served valid and substantial nontax purposes" and shifted actual economic risks, even though they were also designed to qualify the taxpayer for favorable tax treatment under the Code. *Id.* at 738-39.

Similarly, in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), this Court's last decision on the economic substance doctrine, the Court upheld tax deductions associated with a sale-leaseback transaction that had real economic effects. Taxpayer Frank Lyon Company bought a bank building from a banking company, Worthen, and then leased it back to Worthen. Worthen's lease payments to Frank Lyon equaled Frank Lyon's loan payments to the finance companies from which it had borrowed money to buy the building. *Id.* at 566. Although Frank Lyon's cash flow netted out to zero in early years, Frank Lyon remained liable on its loans and bore the risk of the residual value of the building after the lease to Worthen expired. *Id.* at 577-79. Further, the sale to Frank Lyon was necessitated by banking regulations that prevented Worthen itself from obtaining financing. *Id.* at 564. This Court held that Frank Lyon was entitled to deductions for depreciation, interest, and other expenses associated with ownership of the building. *Id.* at 568, 584. The economic substance doctrine was satisfied, it held, because there was "a genuine multiple-party transaction with economic substance which [was] compelled or encouraged by business or regulatory realities . . . [and] imbued with

tax-independent considerations," as distinguished from "manipulation by a taxpayer through arbitrary labels and dealings that have no economic significance." *Id.* at 583-84.

By contrast, this Court has disregarded the tax consequences of transactions under the economic substance doctrine only when a transaction had no meaningful economic effects apart from tax benefits, as was the case in *Gregory*. For example, in *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945), the corporate taxpayer sought to avoid paying taxes on the proceeds of the sale of a building (its sole asset) by distributing the building to its shareholders in a complete liquidation. *Id.* at 332-33. The corporation first declared a "liquidating dividend," distributing the building to its two shareholders. *Id.* at 333. The shareholders held the building for a mere three days before selling it to the purchaser on terms the purchaser had arranged with the corporation prior to the liquidation. *Id.* This Court held that the corporation had to pay taxes as if it had sold the building directly to the purchaser, disregarding the liquidation and the shareholder's fleeting possession of the building as "mere formalisms, which exist[ed] solely to alter tax liabilities." *Id.* at 334.

Similarly, in *Knetsch*, this Court disregarded a complex set of transactions that created a tax deduction under the Code but placed the taxpayer in essentially the same economic position in which he started. Knetsch bought a set of annuity bonds from an insurance company and funded the purchase by selling nonrecourse notes back to the same insurance company. 364 U.S. at 362-63. Although Knetsch bought millions of dollars in bonds and sold millions of dollars in notes, the transactions effectively offset

such that at maturity his bonds net of the notes would be worth only $1,000. *Id.* at 363. Even that tiny gain was erased by losses Knetsch incurred from paying higher interest rates on money he borrowed than the rate he earned on the annuities he purchased with the borrowed funds. *Id.* It thus was "patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction." *Id.* at 366.

Under this Court's precedents, the LRT clearly has economic substance. The LRT bears no resemblance to the economically empty transactions dismissed as shams, such as the creation of a paper corporation that was immediately dissolved (*Gregory*) or the economically offsetting transactions designed to produce a tax deduction (*Knetsch*). The LRT relieved onerous regulatory constraints on the taxpayer's business and generated millions of dollars in pre-tax profits (even accounting for transaction costs). *See supra* p. 8. This genuine non-tax impact is at least as great as the economic impact found sufficient in *Frank Lyon*. In fact, this Court has previously honored tax benefits generated by the transfer of a business from a banking subsidiary to a non-banking subsidiary that freed the business from banking regulations.[8] The

[8] In *Commissioner v. First Security Bank of Utah, N.A.*, 405 U.S. 394 (1972), a banking company transferred the premiums it received procuring life insurance for its bank customers from a bank subsidiary to a newly organized subsidiary that had a lower tax rate as a life insurance company. *Id.* at 398-99. This Court refused to reallocate the income to the banking subsidiary under the assignment-of-income doctrine and Code § 482 because banking regulations would have prevented the bank subsidiary from retaining the premiums. *Id.* at 405; *see also supra* p. 16 (explaining that the lease transaction in *Frank Lyon* had economic substance in part because Worthen was precluded by banking regulations from obtaining financing).

Eighth Circuit's refusal to honor the LRT despite its demonstrated non-tax economic benefits clearly exceeded the limited scope of the economic substance doctrine articulated by this Court.

B. The Decision Below Contravenes Taxpayers' Long-Recognized Right To Structure Business Transactions To Be Tax Efficient

The Eighth Circuit did not question that the transfer of at least some of the underwater leases to Charter generated significant profits. Instead, the court agreed with the government that the profitability of the lease transfer was insufficient under the economic substance doctrine because other, tax-planning components of the LRT were not necessary to achieve that profit: "the creation and sale to Lehman Brothers of the Charter stock were crucial steps of the LRT/stock transaction that had no practical economic effect on WFC's ability to remove the Garland property from OCC oversight and develop its profit potential." App. 17a; *see also* App. 22a (noting that WFC's business purpose of achieving regulatory change did not explain these transaction steps). Put differently, the court concluded the LRT lacked economic substance because WFC "could have obtained that profit potential by 'simply transferr[ing] the leases to a non-banking subsidiary'" "without engaging in the three-step LRT/Stock transaction." App. 17a (citation omitted).

The Eighth Circuit's reasoning is inconsistent with a second fundamental principle long recognized by this Court: that taxpayers are permitted to structure their business transactions to achieve efficient tax results. "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law

permits, cannot be doubted." *Gregory*, 293 U.S. at 469. Accordingly, an objectively profitable transaction cannot lack economic substance merely because certain aspects of its structure are intended specifically to obtain tax benefits in addition to non-tax profits. The law has long recognized that taxpayers may arrange an economically beneficial transaction to achieve tax benefits as well.

Consumer Life illustrates this rule. Consumer Life was an insurance company that sold both life insurance and accident and health insurance ("A&H") policies. To obtain "preferential tax treatment" as a life insurance company, Consumer Life entered into a set of highly "complicated" reinsurance treaties designed to keep its life insurance reserves above the 50% threshold necessary to be considered a life insurance company under the Code. 430 U.S. at 727-28, 734. The reinsurance arrangement transferred the "unearned premium reserve[s]" for Consumer Life's A&H policies (but not its life insurance reserves) to American Bankers, while nonetheless "retain[ing] the lion's share of the risk." *Id.* at 733-34. "Consumer Life paid over the A&H premiums when they were received," but American Bankers immediately returned 50% of the premiums as a "ceding commission." *Id.* at 734. American Bankers also paid 47% of the remaining 50% (less any amount paid to satisfy claims) at the end of each quarter as an "experience refund." *Id.* The arrangement thus effectively permitted Consumer Life to transfer its unearned A&H premium reserves to American Bankers for a 3% fee. *Id.*

This Court rejected the government's argument that the reinsurance arrangement lacked economic substance because transferring unearned premium

reserves off of Consumer Life's books had "valid and substantial nontax purposes" germane to the company's business. *Id.* at 738-39 & nn.16-17. Critically, however, this Court did not require that those "nontax purposes" explain every aspect of the challenged reinsurance treaties. To the contrary, the Court acknowledged that those purposes could not explain the "specific terms of the treaties," which the Court recognized were likely motivated by "[t]ax considerations." *Id.* at 739. Nor, critically, could non-tax considerations explain why Consumer Life transferred only its A&H reserves – and not its life insurance reserves – to American Bankers. The *only* reason for that feature of the treaties was Consumer Life's intent to take advantage of the "preferential tax treatment" afforded to qualifying life insurance companies. *Id.* But these tax-motivated features did not "vitiate an otherwise substantial transaction." *Id.*[9]

The LRT had economic substance under the holding and logic of *Consumer Life*. As was true there, the transfer of the leases from WFC's banking subsidiaries to Charter had "valid and substantial nontax purposes." Indeed, the transfer of certain of those leases generated millions of dollars in economic returns that would not have been possible but for the transfer. And, while the transaction was also structured so the lease transfer would also permit WFC to obtain a corporate tax deduction, consistent with the

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[9] *See also Knetsch*, 364 U.S. at 365 ("We put aside a finding by the District Court that Knetsch's 'only motive . . . was to attempt to secure an interest deduction.'"); *Frank Lyon*, 435 U.S. at 580 ("The fact that favorable tax consequences were taken into account by Lyon on entering into the transaction is no reason for disallowing those consequences. We cannot ignore the reality that the tax laws affect the shape of nearly every business transaction.") (footnote omitted).

Code, those tax-structuring features should not have led the courts below to "vitiate an otherwise substantial transaction."

The Eighth Circuit's comment that WFC could have transferred the leases to Charter without the tax-advantageous LRT structure further highlights its departure from this Court's decisions. Even assuming the Eighth Circuit's premise were true (though it cited nothing in the record), the economic substance of a transaction does not depend on "whether alternative routes may have offered better or worse tax consequences." *Boulware v. United States*, 552 U.S. 421, 429 n.7 (2008); *see also Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148 (1974) (referring to "the established tax principle that a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred"). Indeed, faced with a choice between transactions with "better or worse tax consequences," *Gregory*'s venerable holding entitles taxpayers to pick the one with the *better* consequences.[10]

The Eighth Circuit's holding effectively nullifies taxpayers' right to engage in tax planning because a tax-efficient transaction almost invariably has features that are not necessary to achieve the economic

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[10] The Eighth Circuit's holding that WFC's arm's-length sale of Charter preferred stock to Lehman lacked economic substance also contradicts the holding of *Cottage Savings Association v. Commissioner*, 499 U.S. 554 (1991), that a sale or exchange gives rise to recognition of a gain or loss as long as it involves a material change in "legal entitlements," even if the properties exchanged do not "differ in economic substance." *Id.* at 562, 565. The sale to Lehman, in which WFC exchanged dividend-paying securities for cash, clearly satisfies the *Cottage Savings* test.

benefits generated by the transaction. As the Eleventh Circuit has noted, to require a "tax-independent reason for a taxpayer to choose between" different ways of structuring a transaction "would prohibit tax-planning." *United Parcel Serv. of Am., Inc. v. Commissioner*, 254 F.3d 1014, 1019 (11th Cir. 2001) ("*UPS*"); *see also infra* Part III.B. This Court should intervene to vindicate this core principle of its economic substance jurisprudence.

II. THE DECISION BELOW DEEPENS A CIRCUIT CONFLICT REGARDING WHETHER A TRANSACTION WITH MEANINGFUL NON-TAX ECONOMIC EFFECTS HAS ECONOMIC SUBSTANCE

Consistent with this Court's precedents, the majority of federal circuits to reach the issue, including the Second, Third, Fourth, Ninth, and Eleventh Circuits, have held that the central test under the economic substance doctrine is "whether the transaction had any practical economic effects other than the creation of income tax losses." *Sochin v. Commissioner*, 843 F.2d 351, 354 (9th Cir. 1988).[11] Under that standard, the LRT clearly had economic substance: the transfer of leases to Charter had significant "practical

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[11] *See also Jacobson v. Commissioner*, 915 F.2d 832, 837 (2d Cir. 1990) (same); *In re CM Holdings, Inc.*, 301 F.3d 96, 102 (3d Cir. 2002) ("[W]here a transaction objectively affects the taxpayer's net economic position, legal relations, or non-tax business interests, it will not be disregarded merely because it was motivated by tax considerations.") (internal quotations omitted); *Friedman v. Commissioner*, 869 F.2d 785, 792 (4th Cir. 1989) ("A 'sham' transaction is one that has no economic effect other than the creation of tax losses."); *UPS,* 254 F.3d at 1018 (economic substance doctrine applies only if the transaction has "no economic effects other than the creation of tax benefits"*)* (internal quotations omitted).

economic effects" and in fact generated significant non-tax profits for the company and its shareholders.

Several decisions exemplify the application of this test. First, in *UPS*, the Eleventh Circuit found that a complex transaction in which the company restructured its lucrative excess-value parcel insurance business had economic substance. Before the restructuring, UPS collected excess-value charges from the customer and paid any liability for losses if they occurred. After the restructuring, UPS paid the excess-value charges it collected to an insurance company, which in turn entered into a reinsurance agreement with an overseas UPS affiliate that was not subject to U.S. income taxation. The Eleventh Circuit found that the transaction had "real economic effects" because UPS no longer stood to benefit from the "stream of income it had earlier reaped from excess-value charges." 254 F.3d at 1019. The court thus found that the transaction warranted respect under the tax laws, even though it was designed to shelter the excess-value charges from U.S. taxation. *Id.* at 1020.

Second, *Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006), considered a contingent liability transaction similar in structure to the LRT, but it involved health insurance liabilities rather than real estate leases. The district court granted summary judgment to the taxpayer. In vacating that ruling, the Fourth Circuit held that the relevant legal question was whether, apart from tax benefits, there was "economically substantial value to Taxpayer in transferring its contingent liability" to the subsidiary. *Id.* at 442. If there was, then the transaction had economic substance. Because the court concluded that there was a genuine issue of fact as

to that question, it remanded the case for trial. *Id.*; *see also Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1358 (Fed. Cir. 2006) (addressing a similar contingent liability transaction and holding that economic substance of the liability transfer was dispositive).

In contrast to the foregoing cases, the decision below accelerates a growing lower court trend of finding a transaction to lack economic substance even where the evidence establishes that the transaction was profitable. For example, in *Sala v. United States*, 613 F.3d 1249 (10th Cir. 2010), the trial court upheld loss deductions based on the taxpayer's option transactions with a partnership, which the court found had the potential to generate pre-tax profits of $550,000 and generated an actual pre-tax profit of $90,000. *Id.* at 1251, 1254. The Tenth Circuit did not disturb these findings but nevertheless reversed the trial court. Rather than evaluating whether the challenged transactions actually changed the taxpayer's economic position (they clearly did), the court instead reasoned that the tax loss recognized in the transaction was "artificial" and that in any case the transaction's expected tax benefit of $24 million "dwarf[ed]" the $550,000 in potential profits from the transaction. *Id.* at 1253, 1254.

In *Dow Chemical Co. v. United States*, 435 F.3d 594 (6th Cir. 2006), the trial court found that Dow's purchase of a corporate-owned life insurance ("COLI") plan on the lives of its key executives was reasonably anticipated to generate a pre-tax profit, based on its finding that Dow planned to fund the COLI plan for a seven-year period. *Id.* at 597-98. The Sixth Circuit did not disturb the lower court's factual findings but nevertheless reversed, relying on

a novel rule – purportedly derived from *Knetsch* – that "[c]ourts may consider future profits contingent on some future taxpayer action, but only when that action is consistent with the taxpayer's actual past conduct." *Id.* at 601. As Judge Ryan explained in dissent, "there is no such precedential rule of law and no warrant for creating one in this case." *Id.* at 605.

Certiorari is necessary to prevent inconsistent application of the economic substance doctrine and establish a uniform national standard. The conflicting opinions among the federal circuits on the question presented create a significant risk that similarly situated taxpayers in different jurisdictions will receive different tax treatment based on nothing more than where the taxpayer happens to reside or be headquartered.[12] For example, had Wells Fargo been headquartered in the Fourth Circuit, it would have prevailed under the rule set forth in *Black & Decker* because WFC derived economic value in transferring the leases to Charter. The Court should intervene in this case to reestablish the principle it adopted more than 75 years ago: a transaction lacks economic substance only if it has no objective, real-world effects other than creating tax benefits.

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[12] Tax Court decisions are reviewed by the federal circuit in which an individual taxpayer resides or a corporation has its "principal place of business." 26 U.S.C. § 7482(b)(1)(A)-(B).

III. THE CASE PRESENTS AN ISSUE OF EXCEPTIONAL IMPORTANCE WARRANTING THE COURT'S REVIEW

A. The Decision Below Creates A Malleable, Unworkable, And Arbitrary Rule That Will Create Widespread Uncertainty In The Tax Law

The implications of the Eighth Circuit's test cannot be overstated. If a profitable transaction can be disregarded for tax purposes on the ground that certain aspects of its structure were designed solely to make it tax-efficient, then *all* tax planning is subject to potential IRS challenge in the Eighth Circuit. That is because "any transaction that involves any tax planning at all has one or more aspects or elements that are tax motivated and serve no nontax purposes." John F. Prusiecki, Coltec: *A Case of Misdirected Analysis of Economic Substance*, 112 Tax Notes 524, 527 (Aug. 7, 2006). Moreover, the Eighth Circuit's rule is infinitely malleable because identification of the relevant "components" or features of a transaction requiring economic justification is essentially arbitrary and can easily be manipulated to change the outcome of the economic substance inquiry.[13]

The decision below thus gives courts essentially unbridled latitude to disregard structured business

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[13] *See* David P. Hariton, *The Frame Game: How Defining the "Transaction" Decides the Case*, 63 Tax Law. 1, 1 (2009) ("[A]ny tax-motivated financial structure can be made to look like a tax shelter by defining the transaction as consisting solely of the relevant tax-motivated structuring steps (rather than of the broader business objective or operations to which those steps are applied)."); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5, 15 (2000) ("In theory, by expanding or contracting the number of related events, a decisionmaker could reach virtually any result it wanted under the doctrine.").

transactions under the amorphous economic substance test. That is the culmination of a trend in the lower courts that urgently requires this Court's intervention. Nearly 15 years ago, the Treasury Department reported to Congress that, because the application of economic substance principles "is inherently subjective and courts have applied them unevenly, a great deal of uncertainty exists as to when and to what extent these standards apply, how they apply, and how taxpayers may rebut their assertions." Dep't of the Treasury, *The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals* 94 (July 1999), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/ctswhite.pdf.

The situation has not improved since 1999. As the Second Circuit recently observed, "[s]ince *Gregory*, the economic substance doctrine 'has been applied differently from circuit to circuit and sometimes inconsistently within circuits.'" *United States v. Coplan*, 703 F.3d 46, 91 (2d Cir. 2012) (citation omitted), *cert. denied*, 134 S. Ct. 71 (2013). Lower courts have effectively turned the economic substance doctrine into a "smell test": "If the scheme in question smells bad, the intent to avoid taxes defines the result as we do not want the taxpayer to 'put one over.'" *ACM P'ship v. Commissioner*, 157 F.3d 231, 265 (3d Cir. 1998) (McKee, J., dissenting).[14] But this Court has repeatedly held that the economic substance doctrine

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[14] *See also*, *e.g.*, Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 4.3.1 & n.8 (2013) (calling the economic substance and related doctrines "exquisitely uncertain") (internal quotations omitted); Karen C. Burke, *Reframing Economic Substance*, 31 Va. Tax Rev. 271, 274 (2011) (noting that "it is often impossible to predict how another court would handle a nearly identical or closely similar case").

cannot be used to avoid tax consequences that appear odd or unintended.[15] This case illustrates the dangers of using the economic substance doctrine to correct perceived congressional oversights: shortly after the LRT, Congress added subsection (h) to Code § 358 to prevent certain abusive transactions but *preserved* deductions for the very kind of transaction the lower court found to lack economic substance.[16] The expansion of the economic substance doctrine by the lower courts into an all-purpose anti-loophole rule is an unwarranted departure from the limited doctrine this Court sanctioned starting with *Gregory*, and it calls for this Court's intervention.

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[15] *See Cumberland*, 338 U.S. at 455 (refusing to apply the economic substance doctrine because any "oddities in tax consequences" were "inherent in the present tax pattern" mandated by Congress); *cf. Gitlitz v. Commissioner*, 531 U.S. 206, 219-20 (2001) ("policy concern" that statute results in "double windfall" for taxpayers was irrelevant "[b]ecause the Code's plain text permits the taxpayers here to receive these benefits"); *Hanover Bank v. Commissioner*, 369 U.S. 672, 682, 688 (1962) ("the Government now urges this Court to do what the legislative branch . . . failed to do or elected not to do"; "[t]his, of course, is not within our province").

[16] Specifically, in 2000, Congress added Code § 358(h) to provide that the basis of property subject to § 358(a)(1) must be reduced by the amount of any liabilities assumed in the transfer under certain circumstances, but it specifically exempted transactions where "the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the exchange." 26 U.S.C. § 358(h)(1), (2)(A). Here, the government has stipulated that the LRT would satisfy this exception. App. 52a.

B. The Decision Below And The Confusion In The Lower Courts Hamper Business Planning And Deter Economically Beneficial Activity

The uncertainty created by the Eighth Circuit's expansive and amorphous standard, combined with the disarray in other circuits, threatens to discourage profitable business investment. It is well-established that legal uncertainty has a "deterrent effect . . . on investment" because "[e]vents that threaten to reverse the profitability rankings of irreversible projects . . . tend to reduce the current propensity to invest." Ben S. Bernanke, *Irreversibility, Uncertainty, and Cyclical Investment*, 98 Q.J. Econ. 85, 92-93 (1983). Then-professor Bernanke's lead illustration of this principle is uncertainty over tax outcomes: if a change in the tax laws may alter the relative profitability of a firm's investment options, the firm may defer investment until there is clarity. *See id.* at 93. Similarly, uncertainty over whether firms will be able to obtain tax benefits clearly provided for under the Code may cause them to defer investment decisions.[17] Clarity regarding the scope of the economic substance doctrine thus is necessary to reduce uncertainty and spur critical business investment. *See Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1193 (2010) (businesses find predictability "valuable [when] making business and investment decisions").

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[17] *See* Testimony of Alan Greenspan Before the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) ("Just as price stability facilitates economic decisionmaking . . . , some semblance of predictability in the tax code also would facilitate better forward-looking economic decisionmaking by households and businesses."), *available at* http://www.federalreserve.gov/Boarddocs/Testimony/2005/20050303/default.htm.

The uncertainty created by the decision below is enhanced, because it calls into doubt the proper tax treatment of many kinds of transactions that have long been accepted as legitimate. For example, it has long been accepted that a taxpayer need not have a tax-independent reason for choosing between the use of debt or equity to infuse capital into a corporation, even though this choice can result in significant tax benefits. *See*, *e.g.*, *John Kelley*, 326 U.S. at 525-26. But, under the Eighth Circuit's flawed rule, a taxpayer may be required to point to some economic rationale for incurring additional costs to finance even an economically substantive transaction with equity rather than debt (or vice versa). *See* App. 17a (holding profits from LRT insufficient because WFC "could have obtained that profit potential . . . without accepting the administrative burdens and transaction costs of creating a new class of stock and subsequently selling it") (internal quotations omitted). The decision below increases the risk that taxpayers will be impeded from employing commonplace strategies for achieving tax efficiencies when capitalizing a business, and thus effectively reduces the expected post-tax rate of return on capital investment – an activity essential to economic growth.[18]

The deterrent impact of the uncertainty and unpredictability created by the decision below also is magnified by the harsh, strict-liability penalties imposed on transactions lacking economic substance. Where a tax deduction is based on a transaction that

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[18] Likewise, an arm's-length stock sale to a third party has never been held to lack economic substance, even if intended to trigger a capital loss, yet the court below suggested that WFC's sale of Charter stock to Lehman lacked economic substance because it was designed to realize a tax loss. *See* App. 17a-18a.

is found to lack economic substance, the taxpayer may be liable for a penalty equal to 20% of the claimed deduction. *See* 26 U.S.C. §§ 6662(b)(2), (6), 6676. If the transaction lacking economic substance results in a valuation overstatement, the penalty can be as high as 40%. *See id.* § 6662(b)(3), (e)(1), (h); *United States v. Woods*, 134 S. Ct. 557, 565 (2013). A "smell test" combined with severe strict-liability penalties will give the IRS unfettered discretion, chill legitimate tax-reduction strategies, and thus deprive businesses of critical investment capital and depressing economic growth.

C. The Question Presented Is A Matter Of Recurring Importance, And This Case Is An Ideal Vehicle To Resolve It

The recurring nature of the question presented further heightens the need for this Court's review. In a recent presentation, Assistant Attorney General Kathryn Keneally reported that the Department of Justice's Tax Division maintains a "significant" inventory of pending cases raising economic substance issues. Erin McManus, *Keneally Says DOJ Keeping Quiet On New Lists of Foreign Bank Accounts*, Bloomberg BNA Daily Tax Rep. (Nov. 6, 2013). Keneally also stated that "100 percent" of those cases "arose prior to the enactment of the economic substance statute." *Id.* The current inventory of cases involves "more than a billion dollars" in disputed taxes.[19] This Court's clarification of the limits of the economic substance doctrine after more than 35 years without addressing the issue is essential to guide the proper resolution of these cases. *See also*

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[19] U.S. Dep't of Justice, Tax Division, *FY 2014 Congressional Budget* 7 (Mar. 28, 2013), *available at* http://www.justice.gov/jmd/2014justification/pdf/tax-justification.pdf.

Woods, 134 S. Ct. at 562 n.1 (declining to address the economic substance doctrine).

Moreover, the importance of review in this case is heightened by Congress's 2010 statutory clarification of the economic substance doctrine in Code § 7701(*o*), which applies only to transactions occurring after March 30, 2010.[20] While the statute was intended to adopt a "conjunctive" test, rather than the "disjunctive" test adopted by some circuits, it was not intended to abrogate this Court's longstanding decisions.[21] Moreover, the statute does not answer the question presented in this case, thus properly leaving its resolution in this Court's hands.[22] This Court's review of the question presented thus would also provide helpful guidance to lower courts regarding the proper economic substance standard for future transactions.

Finally, this case presents an appealing vehicle for reaffirming the proper boundaries of the economic substance doctrine because of the strong evidence credited by the lower courts of significant profitability resulting from a genuine regulatory change effectuated through the LRT. The district court and

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[20] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(e)(1), 124 Stat. 1029, 1070.

[21] The Eighth Circuit did not decide whether it was adopting a "conjunctive" test, under which both economic substance and business purpose are required, or a "disjunctive" test, under which either is sufficient. App. 12a-13a & n.3. Further, under the new statute, a determination that a transaction has substantial profit "shall be taken into account" under both prongs of the test. 26 U.S.C. § 7701(*o*)(2)(A).

[22] *See*, *e.g.*, IRS Notice 2010-62, at 4 (Oct. 4, 2010) ("The IRS will continue to rely on relevant case law under the common-law economic substance doctrine in applying . . . section 7701(o)(1)."), *available at* http://www.irs.gov/pub/irs-drop/n-10-62.pdf.

the Eighth Circuit did not dispute that evidence, but instead came to the untenable conclusion that even a profitable transaction may lack economic substance due to the fact that the taxpayer took other tax-planning steps. The Court should grant certiorari, reverse the decision below, and reaffirm the limits of the economic substance doctrine.

CONCLUSION

The petition for a writ of certiorari should be granted.

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