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Nos. 23354-21, 19159-23

IN THE UNITED STATES TAX COURT

NAT S. HARTY & APRIL D. HARTY,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

**BRIEF OF *AMICI CURIAE* THE NATIONAL FOREIGN TRADE
COUNCIL, INC. AND THE CHAMBER OF COMMERCE OF THE
UNITED STATES OF AMERICA**

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Tax Court Rules 20(c) and 151.1(c), *amici curiae* the National Foreign Trade Council, Inc., and the Chamber of Commerce of the United States of America state that neither entity has a parent corporation and that no publicly held company owns 10 percent or more of either entity's stock.

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INTEREST OF THE *AMICI CURIAE*¹

Amicus curiae the National Foreign Trade Council, Inc. (“NFTC”) is the premier business association advancing trade, tax, national security, and supply chain policies that support access to the global marketplace. Founded in 1914, NFTC promotes an open, rules-based global economy on behalf of a diverse membership of U.S.-based businesses, who account for over \$6 trillion in revenue and employ nearly 6 million people in the United States.

Amicus curiae Chamber of Commerce of the United States of America (“Chamber”) is the world’s largest business organization. As the nation’s leading advocate for business, the Chamber represents companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the

¹ No counsel for any party authored this brief in whole or in part, and no person or entity, other than *amici curiae*, their members, and their counsel, made a monetary contribution to the preparation or submission of this brief. Tax Court Rule 151.1(c).

Chamber regularly files *amicus curiae* briefs in cases, like this one, that raise issues of concern to the nation's business community.

Amici curiae respectfully submit this brief to address the economic substance doctrine codified in section 7701(o).² The Commissioner's interpretation of this provision has the potential to destabilize the application of federal tax law, inserting uncertainty into routine transactions Congress never intended to be within the doctrine's sweep. That is especially problematic for fostering cross-border investment, which depends on the predictable application of federal tax law. Whatever the facts and outcome here, *amici* respectfully submit that this Court should not adopt the Commissioner's erroneous interpretation of the law.

ARGUMENT

Section 7701(o) determines that the economic substance doctrine applies only if "relevant." The Commissioner wrongly suggests that there is no threshold relevancy requirement at all in cases like this one that are appealable to the Ninth Circuit. Alternatively, his position is,

² Unless otherwise indicated, all section references are to the Internal Revenue Code, Title 26.

essentially, that the economic substance doctrine is relevant in any case that is comparable in a general way to a case that has applied it before. But that misinterprets this Court's decision in *Patel v. Commissioner*, 165 T.C. No. 10, 2025 WL 3158814 (Nov. 12, 2025). Under the best reading of *Patel*, the economic substance doctrine's threshold relevancy determination ultimately depends on whether the statute granting the tax benefit at issue makes the doctrine relevant.

In this case, the key provision is section 453. What section 453 makes relevant is whether the petitioner made a bona fide installment sale. Putting *that* question before the Court is the proper role for the economic substance doctrine. In contrast, severing the doctrine from statutory interpretation would misapply the doctrine and create unpredictability and unfairness, disrupting legitimate expectations in business and trade and imposing strict liability penalties on behavior that the statutory text did not prohibit.

I. The Economic Substance Doctrine Is Relevant to a Transaction When the Substantive Tax Law Conditions a Tax Benefit on Economic Reality

In *Patel*, this Court “easily conclude[d] that [section 7701(o)] requires a relevancy determination” that is “not coextensive with” the test for determining whether a transaction is economically substantial. 2025 WL 3158814, at *10. *Patel* also provided guidance for applying the threshold relevancy requirement. First, *Patel* stated that the list of transactions in the House Report for the bill that became section 7701(o) is “a nonexhaustive list of transactions to which the [economic substance] doctrine does not apply.” 2025 WL 3158814, at *11. This list of “basic business transactions” includes choices about whether to fund a business with debt or equity, whether to use a foreign or domestic corporation to make a foreign investment, whether to do a corporate reorganization, and whether to use a related-party entity in a transaction (applying the section 482 standard). H.R. Rep. No. 111-443(I), at 228–29 (2010).

None of these excluded transactions is explicitly listed in section 7701(o). But neither is there any suggestion in *Patel* that such exclusions should be treated as isolated historical accidents. Instead, *Patel* rightly refers to these transactions as excluded because *all* transactions are

presumptively excluded from application of the economic substance doctrine *unless* a statutory provision makes the doctrine relevant. And the specified transactions facially present as choices that Congress has not tied to the occurrence of some economically substantial event. *See* H.R. Rep. No. 111-443(I), at 228 (2010).

To move the economic substance doctrine from presumptively irrelevant to relevant under section 7701(o), *Patel* directs “courts to the existing application of the doctrine.” 2025 WL 3158814, at *11; *see also* I.R.C. § 7701(o)(5)(C) (“The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted”). Under the Commissioner’s interpretation in this case, that inquiry would be limited to something like ascertaining whether *any* insurance cases have applied the economic substance doctrine. But that is not what *Patel* did. Instead, this Court *started* its analysis with a more specific inquiry, identifying “cases involving insurance transactions and, in particular, captive insurance transactions.” 2025 WL 3158814, at *11. It then continued to zoom in until it found *Malone & Hyde, Inc., & Subs. v. Commissioner*, 62 F.3d 835 (6th Cir. 1995), concluding that this was “the closest case.” *Id.*

The *Patel* Court determined that the economic substance doctrine was relevant in *Malone & Hyde*, quoting the Sixth Circuit’s explanation that so-called insurance payments to a subsidiary that is “a sham corporation” are expenses that “do not constitute bona fide business expenses, entitling the taxpayer to a deduction under § 162(a).” 2025 WL 3158814, at *12 (quoting *Malone & Hyde, Inc., & Subs.*, 62 F.3d at 840). That is the reason the economic substance doctrine was relevant to the captive insurance transactions at issue—the applicable substantive tax law conditioned the tax benefits sought on the existence of true (that is, economically substantive) insurance. Thus, *Patel*’s discussion of *Malone & Hyde* revealed that well-reasoned economic substance cases focus on whether the applicable tax law is best understood to require an economically real occurrence as a condition of the tax benefit sought.

II. The Tax Code Often Does Not Condition a Tax Benefit on Economic Reality

The presumption under section 7701(o) that the economic substance doctrine is not relevant is not irrebuttable. The Sixth Circuit aptly summarized how the Supreme Court and this Court use the economic substance doctrine to interpret the meaning of tax laws:

A corporation that shuffles shares from one entity to another in order to avoid capital gains tax may not obtain the tax benefits that come with a genuine corporate “reorganization.” *Gregory v. Helvering*, 293 U.S. 465, 468–69 (1935); *Minn. Tea Co. v. Helvering*, 302 U.S. 609, 612–13 (1938). A taxpayer is not “indebted”—and thus not entitled to deduct his interest payments—when the “loan” has no business function other than enabling those deductions and does not create a true obligation to pay interest. *Knetsch v. United States*, 364 U.S. 361, 365–66 (1960). And when a family sets up an ordinary corporation owned by Roth IRAs and pays the corporation fees for sham “services” that it never performed, the Commissioner may rightly refuse to recognize the Roth IRA’s gains as investment earnings and may reclassify them as contributions. *See Repetto v. Comm’r*, 103 T.C.M. (CCH) 1895, at *9 (2012).

Summa Holdings, Inc. v. Commissioner, 848 F.3d 779, 785–86 (6th Cir. 2017).³

³ Tenth Circuit Judge Eid interprets this caselaw in the same way and explains that the economic substance doctrine applies when “statutory language . . . explicitly incorporate[s] a term related to economic reality or the taxpayer’s economic motive.” *Liberty Glob., Inc. v. United States*, 174 F.4th 1208, 1228 (10th Cir. 2026) (Eid, J. dissenting). If the majority opinion in *Liberty Global* can be read to support the district court’s determination in *Liberty Global* that section 7701(o) requires no threshold relevancy determination, it contradicts *Patel*. And this Court should not follow it here because this case is not appealable to the Tenth Circuit. *See Golsen v. Commissioner*, 54 T.C. 742, 757 (1970).

The majority opinion in *Liberty Global*, moreover, provides no guidance on how section 7701(o)’s relevancy requirement (assuming the majority accepts there is such a requirement) should be applied. It simply

Yet the doctrine often ends up irrelevant because the tax code frequently provides tax benefits for transactions that do not change a taxpayer's economic position apart from tax effects and have no substantial non-tax purpose. *See* I.R.C. § 7701(o). Whether such transactions are “all form and no substance,” *Summa Holdings, Inc.*, 848 F.3d at 786, or whether their substance is simply non-economic, the Code does not care.

Sometimes, Congress straightforwardly advances non-economic policy goals through tax code provisions. Case in point, is section 45V, which grants tax credits for the production of clean hydrogen. Nothing in the statutory text suggests that this tax benefit is withheld if the taxpayer produces clean hydrogen solely for tax benefits and does not improve his economic position other than through those tax benefits. Instead, the statute seeks to improve environmental conditions by inducing behavior precisely for the sake of tax benefits.

says that the economic substance doctrine is relevant because the tax benefit there at issue was “not intended by Congress.” *Liberty Global*, 174 F.4th at 1213 n.6. The best evidence of whether Congress intends to make the economic substance relevant is the statutory text that it enacts.

On many other occasions, Congress incentivizes taxpayers to act specifically to improve their own economic well-being, perhaps on the assumption that economically flourishing individuals and entities tend to promote the flourishing of those around them. For example, as the Sixth Circuit noted, individual retirement accounts “are designed for tax-reduction purposes” and do not require non-tax effects or purposes. *Summa Holdings, Inc.*, 848 F.3d at 786. Similarly, “[t]he Code authorizes companies to create [domestic international sales corporations] as shell corporations that can receive commissions and pay dividends that have no economic substance at all.” *Id.*

The tax code also gives an eligible taxpayer the ability to elect to be classified for federal tax purposes, as a corporation, a partnership, or an entity disregarded as separate from its owner. Businesses commonly make this election based on tax efficiency. Provided the business itself is genuine, the economic substance doctrine has no relevance to these classification elections. *See Dover Corp. & Subs. v. Commissioner*, 122 T.C. 324, 353 n.19 (2004) (explaining that certain entity classification “check-the-box regulations” do not “require that the taxpayer have a business purpose for . . . any election under those regulations”). Such

entity classification elections do not impact a business's non-tax economic position and commonly lack substantial non-tax purposes. Nevertheless, the IRS has recognized this and has not (yet) attempted to apply the economic substance doctrine to inherently tax-driven elections. *See, e.g.,* Rev. Rul. 2003-125, 2003-2 C.B. 1243 (Dec. 29, 2003) (determining that a taxpayer may change entity election from a corporation to a disregarded entity for the purpose of triggering recognition of a worthless security deduction under section 165(g)(3)).

A particularly significant election that the economic substance doctrine should not be allowed to interfere with is the section 338 election. This election allows for the recharacterization of stock purchases as asset purchases for federal tax purposes. Because the election is available only to corporate purchasers, non-corporate purchasers commonly incorporate and capitalize a wholly-owned subsidiary as part of the acquisition transaction. This reduces inefficiencies and allows the parties to share the tax benefits associated with an asset purchase. Here again, the IRS has (so far) not interfered with such elections. *See* I.R.S. Field Service Advisory 200122007, 2001 WL 587796 (Feb. 13, 2001).

Most salient for this case, the economic substance doctrine is also not relevant to bona fide dispositions of property even when the disposition's sole effect and purpose is tax recognition of gain or loss. In *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554 (1991), a savings and loan association disposed of mortgages that had declined in value by exchanging them for similar mortgages with the same current value. *Id.* at 557–58. This generated a large loss for federal income tax purposes. *Id.* at 558. Other savings and loan associations executed similar transactions, and it was recognized that these transactions “would generate tax losses but that [the transactions] would not substantially affect the economic position of the transacting S & L’s.” *Id.* at 557.

But the Supreme Court declined the government's invitation to apply the economic substance doctrine to invalidate the disposition. The Court explained that “there is no contention that the transactions in this case were not conducted at arm's length, or that Cottage Savings retained *de facto* ownership of the participation interests it traded to the four reciprocating S & L's.” *Id.* at 568. In other words, because the dispositions of property were bona fide dispositions and not shams, the economic substance doctrine had no role to play.

The government argued for a requirement that the exchanged properties “differ in economic substance” imbedded within the meaning of “disposition of property” in section 1001(a). *Cottage Sav. Ass’n*, 499 U.S. at 562. The Supreme Court concluded that this reading of the statute was unsupported, unworkable, and “incompatible with the structure of the Code.” *Id.* at 565–66. Relevant authorities revealed that a disposition occurs if “the property entitlements are not identical.” *Id.* at 565. The structural issue is that section 1001 provides that gain or loss “shall be recognized” unless a “nonrecognition provision[] applies.” *Id.* at 566. And one of the nonrecognition provisions withholds gain or loss recognition on certain “like kind” exchanges “of properties that would appear to be economic substitutes,” which makes no sense if exchanges of economic substitutes are not dispositions of property in the first place. *See id.*

These examples are by no means the only instances where tax laws confer a benefit without requiring economic substance,⁴ or requiring it

⁴ An important line of cases recognizes that the economic substance doctrine does not apply to transactions undertaken to allow a shareholder to recognize loss on the subsequent liquidation of a subsidiary under

only in a limited way. The takeaway is that a transaction's economic substance is relevant when the tax laws Congress has enacted make it relevant. Tax laws often do not make economic substance relevant, or they make it relevant only in limited respects.

III. Existing Applications of the Economic Substance Doctrine in the Installment Sale Context Reveal That Section 453 Simply Requires a Bona Fide Installment Sale

The tax code allows taxpayers to structure a sale as an installment sale purely to reduce taxes as long as it is bona fide. It thus assigns economic substance only that limited role. The analysis in this context mirrors the Supreme Court's analysis in *Cottage Savings*. Section 453, like section 1001(a), requires "a disposition of property." Nothing suggests that this term has a different meaning for section 453 purposes than for section 1001(a) purposes. Thus, a section 453 disposition occurs if the property transferred is "not identical" to the property received. *See Cottage Sav. Ass'n*, 499 U.S. at 565. Section 453 also requires that "at least 1 payment is to be received after the close of the taxable year in

section 331. *See, e.g., Granite Tr. Co. v. United States*, 238 F.2d 670 (1st Cir. 1956).

which the disposition occurs.” I.R.C. § 453(b)(1). And the statute imposes certain limitations on use of the installment sale method, some of which are discussed below.

In the 1970s and 1980s, the IRS litigated a series of cases involving the use of intermediaries to qualify for installment sale tax treatment under section 453. Those cases (like this one) involved transfers by taxpayers of property to an intermediary in exchange for installment payments and a resale of the property by the intermediary. The rule that emerged is that use of an intermediary does not thwart installment-sale treatment unless the taxpayer controls the proceeds from the intermediary’s sale of the property “or possess[es] the economic benefit therefrom.” *Roberts v. Commissioner*, 643 F.2d 654, 656 (9th Cir. 1981) (quoting *Rushing v. Commissioner*, 441 F.2d 593, 598 (5th Cir. 1971)). *Rushing*, a seminal case in this line, explained that “a taxpayer may, if he chooses, reap the tax advantages of the installment sales provision if he actually carries through an installment sale, even though this method was used at his insistence and was designed for the purpose of minimizing his tax.” 441 F.2d at 598.

The Ninth Circuit (where an appeal in this case would lie) reached the same conclusion in *Roberts*. The court explained that installment-sale treatment is not permitted if the taxpayer's transfer of property to an intermediary is "a sham transfer" that allows the taxpayer "to secure the control and benefit of the proceeds of the sale on the market as if he had himself sold it directly to the ultimate purchasers." *Roberts*, 643 F.2d at 656–67. The Ninth Circuit did not care that the purpose of the sale to the intermediary was tax reduction: "So long as the trust had real substance as an independent entity, it is of no consequence that Taxpayer's election to take in installments (and to forego the balance of the benefits of sale) was wholly voluntary on his part and done with income tax advantages in mind." *Id.* at 657.

Relying on *Roberts*, the Ninth Circuit later upheld a district court's determination that married taxpayers "were entitled to report income on a sale of stock to a corporation under the installment sales method, even though [the husband] effectively controlled the corporation and the corporation used the stock to pay off a loan he had guaranteed." *Stewart v. United States*, 739 F.2d 411, 412 (9th Cir. 1984) (per curiam). The court concluded that the loan guarantee discharge benefit the taxpayer got

from the intermediary's sale to a third party "did not show that he effectively controlled the bank's decision to sell the securities or its use of the proceeds." *Id.* at 416. And the Ninth Circuit noted that the tax benefit from "structuring the transaction in this particular manner" was unproblematic because taxpayers are "not required to structure transactions so as to maximize taxes." *Id.*

Congress' reaction to the *Rushing* and *Roberts* line of cases shows approval of the control and enjoyment test. In 1980, Congress amended section 453 to disallow installment-sale treatment for certain transactions involving related intermediaries. *See* Installment Sales Revision Act of 1980, Pub. L. 96-471 (HR 6883), § 2, 94 Stat. 2247. Congress had reason to know of the control and enjoyment test used in the *Rushing-Roberts* cases to determine whether a sale to an intermediary qualified as an installment sale, and the Senate Report on the bill engaged with *Rushing* and other caselaw. S. Rep. 96-1000, at 12–14 (1980), *reprinted in* 1980 U.S.C.C.A.N. 4696, 4707–708. Both at this time and in later amending acts, Congress could have changed section 453 to adopt a different standard, or it could have disallowed installment-sale treatment for all transactions involving intermediaries. By choosing

not to amend the statute in either of those ways (or one similar), it left in place the control and enjoyment test of the *Rushing* and *Roberts* line.

Unlike in *Cottage Savings*, the parties here dispute whether the taxpayer's disposition of property to S. Crow Collateral Corporation ("SCCC") was a real disposition. The Commissioner contends that taxpayers' sale to SCCC was not bona fide and that taxpayers just sold the properties directly to the ultimate buyers. Petitioners dispute that. Whether the sale to SCCC was a true sale and whether the loan petitioners obtained was a real loan are fact-intensive issues on which *amici* take no position.

But the Commissioner's discussion of the relevancy requirement (Resp. Br. 94–100) is troubling. It starts by avoiding the most relevant statutory language: section 7701(o)(1). That provision is what this Court relied on first to "easily conclude" that the threshold relevancy requirement is "not coextensive with" the two-part economic substance test. *Patel*, 2025 WL 3158814, at *10. The Commissioner's brief instead quotes section 7701(o)(5)(C), which points to caselaw for the content of

the relevancy requirement.⁵ Resp. Br. 94. The Commissioner then posits that “[i]n the Ninth Circuit, to which these cases would be appealed, economic substance cases do not contain any, let alone a uniform, analysis to determine whether the doctrine is ‘relevant’ to the transaction before applying the two-factor test.” *Id.* The Commissioner seems to be saying that the separate relevancy requirement this Court saw “right there, on [section 7701’s] face,” is eliminated where circuit precedent does not discuss relevance. *See Patel*, 2025 WL 3158814, at *10.

That is wrong. The point of looking to caselaw for the content of the relevancy requirement is to discern whether the transaction at issue is the type of transaction to which the economic substance doctrine is applied. It does not require courts to have articulated a relevancy test.⁶

⁵ That provision also “expressly directs [courts] to make the determination (whether the doctrine is relevant).” *See Patel*, 2025 WL 3158814, at *10. But the Commissioner appears to ignore this fact.

⁶ Recognizing that courts did not use “the term ‘relevant’ in analyzing whether to apply the economic substance doctrine in a particular case” but “either applied the doctrine or did not,” Judge Eid drew a principle of relevance out of the caselaw: “the best reading of these pre-codification cases is that the economic substance doctrine is relevant when the favorable tax treatment provided by another provision’s text turns on ‘objective economic realities of a transaction’ or the taxpayer’s economic motive.” *Liberty Global*, 174 F.4th at 1228 (Eid, J., dissenting).

Take *Patel*, for example. Its discussion of *Malone & Hyde* revealed that the economic substance doctrine was relevant in the context there at issue because section 162(a) makes nontax business effect and purpose relevant to the deductibility of expenses characterized as insurance payments. *Patel*, 2025 WL 3158814, at *12–13. Where cases discussing the transaction at issue (or one materially similar) do not apply the economic substance doctrine, the doctrine is not relevant.⁷

When the Commissioner purports to apply *Patel*, he zooms all the way out to contend that the economic substance doctrine is relevant here because the economic substance doctrine has been applied to real estate transactions, debt, and installment sales. Resp. Br. 98. That is not what this Court did in *Patel*. Rather, this Court identified cases involving the particular transaction at issue (captive insurance transactions) and zoomed in on “the closest case.” *Patel*, 2025 WL 3158814, at *11. The

⁷ On the other hand, it makes no sense for Congress to be taken to have required a separate relevancy test which it then effectively eliminated by incorporating caselaw that negates the relevancy test. Moreover, even if the Commissioner were correct that the Ninth Circuit is likely to collapse section 7701(o)’s threshold relevancy requirement into the two-part economic substance test, this Court is bound by *Patel* until it does. See *Golsen*, 54 T.C. at 757.

Commissioner gets closer to the mark when he picks out a case he contends is “particularly analogous,” *ACM P’ship v. Commissioner*, 157 F.3d 231 (3d Cir. 1998). Yet the highly complex transaction at issue in *ACM Partnership* bears little resemblance to the installment sales at issue here. *Patel* does not suggest that, whenever any court has ever applied the economic substance doctrine to a transaction involving a particular statute, the economic substance doctrine is then relevant to all transactions involving the same statute.

The transaction at issue here is an installment sale involving an intermediary. Thus, the closest cases are those in the *Rushing-Roberts*, section 453 intermediary line. Those cases show that economic substance is relevant in this context only in that a true sale is required. Under these closest cases, the sale to the intermediary is a true sale as long as the taxpayer does not control and enjoy the funds the intermediary receives in the subsequent sale. And the fact that the intermediary was used to gain a tax benefit is irrelevant. These are the principles that should guide this Court’s relevancy inquiry.

IV. The Strict-Liability Economic Substance Doctrine Penalty Highlights the Importance of a Robust and Clear Relevancy Requirement

Certainty in the law is a key reason for the success of the United States economy. As tax consequences are a key consideration in business decisions, certainty in tax law is particularly critical. *United States v. Generes*, 405 U.S. 93, 105 (1972) (explaining that “in tax law . . . certainty is desirable”); *Sidell v. Commissioner*, 225 F.3d 103, 111 (1st Cir. 2000) (“The tax code is an intricate web and demands clear rules so that it may be administered with as little uncertainty as possible.”).

The tax code attempts to promote certainty by using “language, lots of language, with nearly mathematic precision.” *Summa Holdings*, 848 F.3d at 789; *id.* (questioning, regarding the tax code, whether “there any other title of the United States Code that has devoted more carefully drawn words to reducing its purpose to text”). Robustly and correctly construed, section 7701(o)(1)’s threshold relevancy requirement reduces the uncertainty that comes with the economic substance doctrine.

The stakes are higher than ever now because the IRS has largely eliminated the internal checks placed on the use of the doctrine that were put in place soon after section 7701(o) was enacted. The IRS’s initial

policy treated the economic substance doctrine as a tool to be used sparingly and not, for example, when transactions involve an arm's length deal, are already subject to detailed statutory or regulatory schemes, are similar to ones courts have upheld by rejecting or not referring to the economic substance doctrine's application, or involve tax credits designed to encourage certain transactions, situations in which another judicial doctrine applies, situations that could be addressed by recharacterizing the transactions, and situations in which an economic substance doctrine argument was not "among the strongest arguments available." IRM 4.46.4-6 (Dec. 2011); IRM 4.46.4-4 (Dec. 2021). That policy also included a robust approval process. *Id.* But the IRS changed that policy in 2022 both by rescinding much of the substantive guidance and by eliminating most of the approval requirements. See I.R.S. LB&I-04-0422-0014, *Interim Guidance Memorandum on Economic Substance Doctrine and Related Penalties* (Apr. 22, 2022). It is no coincidence that cases involving section 7701(o) are multiplying in this Court and others.

Another stakes-raiser is the strict-liability economic substance penalty. When Congress enacted section 7701(o), it also added a new basis for the accuracy-related penalty under section 6662 for

underpayments attributable to “any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law.” I.R.C. § 6662(b)(6). The penalty increases from 20 percent to 40 percent for transactions lacking economic substance that are not adequately disclosed. I.R.C. § 6662(i). The reasonable cause exception that applies to other types of section 6662 penalties is unavailable for penalties triggered by a transaction’s lack of economic substance. I.R.C. § 6664(c)(2). Similarly, the reasonable cause exception normally available for a section 6676 “excessive” refund claim penalty is unavailable when the excessive refund claim “is attributable to any transaction described in section 6662(b)(6)” —that is, to a transaction lacking economic substance under section 7701(o). I.R.C. § 6676(c).

Economic substance penalties raise the stakes of litigation by increasing taxpayers’ potential liability. But they also raise the stakes because the IRS now asserts economic substance penalties in cases that could easily be decided under the plain terms of the tax code. This compels time-consuming and expensive adjudication of the economic substance issue even in such cases. *Patel* is a good example. This Court

had no trouble resolving the merits of the case without any reference to the economic substance doctrine. *Patel*, T.C.M. (RIA) 2024-034 (T.C. 2024). Yet, after that, many hours were spent and much ink was spilled to determine whether the economic substance penalty applied.

The penalty issue is particularly troubling here. The Commissioner appeared to indicate in a motion filed in this case that he plans to use the economic substance penalty as leverage. He explained that, if the Court agrees with its economic substance theory, “taxpayers who have engaged in [what the IRS labels as monetized installment sale transactions] may face a forty percent penalty under § 6662(i) and therefore an enhanced incentive to concede to respondent.” Doc. 158 at ¶ 32.

The implication of this statement is that the IRS will be able to impose economic substance penalties and then drop those penalties in exchange for a concession on the asserted tax deficiency (or that the IRS will use a threat of an economic substance penalty to obtain such concessions). That conflicts with IRS policy. *See, e.g.*, I.R.M. 4.10.6.1.1 (08-25-2025) (“Penalties are not a ‘bargaining point’ in resolving the taxpayer’s other adjustments.”). And such aggressive penalty use heightens legitimate due process concerns. *See FCC v. Fox Television*

Stations, Inc., 567 U.S. 239, 258 (2012) (invalidating civil penalties based on lack of fair notice); *see also* Amicus Curiae Brief of Taxpayers Protection Alliance, Doc. 359 at 5–8 (detailing the due process issue).

All of this makes it imperative that section 7701(o)'s threshold relevancy requirement be interpreted robustly as an antidote to standardlessness and an enhancement of predictability.

CONCLUSION

This Court should apply section 7701(o)'s threshold relevancy requirement by determining whether and to what extent the statute at issue makes economic substance relevant. Here, the statute at issue, section 453, makes economic substance relevant only in that a bona fide sale is required. And “the closest case[s],” *Patel*, 2025 WL 3158814, at *11, confirm that understanding. A correct articulation and application of the relevancy requirement that ties relevance to the meaning of the applicable statute(s) and zeros in on the closest cases will provide critical certainty for businesses. The alternative is a system in which— notwithstanding what the law says—businesses must guess whether the IRS will think that Congress would approve of the transactions they are contemplating.

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