Rodriguez v. FDIC: The Supreme Court's Federal Common Law Hostility & Its Effects on the Economic Substance Doctrine

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ABSTRACT

On February 25, 2020, the U.S. Supreme Court in Rodriguez v. FDIC unanimously ruled that there should be no federal common law, including in the area of taxation, except in extraordinary circumstances. Some commentators have raised the concern that this hostility to federal common law may eventually extend to the judicial economic substance doctrine. The economic substance doctrine was codified in 2010; however, Congress made it clear that the new statute would not eliminate the judicial version of the doctrine. Although a case directly addressing the codified version of the economic substance doctrine has yet to be litigated, courts have continued to invoke the judicial doctrine in cases post-codification. In this article, we: (1) provide an overview of federal common law; (2) describe the judicial economic substance doctrine; (3) discuss the tension between the economic substance doctrine and textualism; (4) provide an overview of the Rodriguez case; (5) discuss how the U.S. Supreme Court's hostility to federal common law in Rodriguez may eventually curtail the judicial economic substance doctrine; and (6) provide an example of how such a curtailment could potentially affect a current issue in Internal Revenue Service ("Service") enforcement—syndicated conservation easement transactions.

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INTRODUCTION

In 1981, the U.S. Supreme Court declared that "Federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision."[1] Written in such clear and direct language, it would be difficult to construe this statement as anything other than the Supreme Court's unequivocal disapproval of general federal common law. Despite this declaration, lower federal courts continued crafting federal common law in numerous legal fields. In tax law, doctrines developed through federal common law, known as the substance-over-form doctrines, have become one of the government's most important tools for combating tax evasion. Notwithstanding the substance-over-form doctrines' importance, the Supreme Court has not ruled on the scope, nor even the permissibility, of the doctrines in nearly fifty years. Nevertheless, in early 2020, the Supreme Court reiterated its 1981 sentiment that federal courts do not possess the power to develop and apply common law doctrines.

[1] Milwaukee v. Illinois, 451 U.S. 304, 312 (1981).

On February 25, 2020, the U.S. Supreme Court in *Rodriguez v. FDIC*[2] unanimously ruled that there should be no federal common law, including in the area of taxation, except in extraordinary circumstances.[3] Some commentators have raised the concern that this hostility to federal common law may eventually extend to the judicial economic substance doctrine.[4] The economic substance doctrine was codified in 2010; however, Congress made it clear that the new statute would not eliminate the judicial version of the doctrine.[5] Although a case directly addressing the codified version of the economic substance doctrine has yet to be litigated, courts have continued to invoke the judicial doctrine in cases post-codification.[6] In this article, we: (1) provide an overview of federal common law; (2) describe the judicial economic substance doctrine; (3) discuss the tension between the economic substance doctrine and textualism; (4) provide an overview of the *Rodriguez* case; (5) discuss how the U.S. Supreme Court's hostility to federal common law in *Rodriguez* may eventually curtail the judicial economic substance doctrine; and (6) provide an example of how such a curtailment could potentially affect a current issue in Internal Revenue Service ("Service") enforcement—syndicated conservation easement transactions.[7]

I. FEDERAL COMMON LAW

The scope of federal common law has never been clear. Notwithstanding an immense catalogue of academia attempting to clarify the elusive concept,[8] no unified definition of federal common law exists.[9] And despite the

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[2] 140 S. Ct. 713 (2020)
[3] *See* Rodriguez v. FDIC, 140 S. Ct. 713, 717 (2020).
[4] *See* Reuven S. Avi-Yonah, *Rodriguez, Tucker, and the Dangers of Textualism*, 167 TAX NOTES FED. 87 (2020).
[5] *See* I.R.C. § 7701(o)(5)(C).
[6] *See, e.g.*, Tucker v. Comm'r, 766 F. App'x. 132 (5th Cir. 2019), *cert. denied*, 140 S. Ct. 378 (2019); Summa Holdings, Inc. v. Comm'r, 848 F.3d 779 (6th Cir. 2017); Bank of N.Y. Mellon Corp. v. Comm'r, 801 F.3d 104 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 1377 (2016).
[7] *See* I.R.S. Notice 2017-10, 2017-4 I.R.B. 544 (Dec. 23, 2016).
[8] *See, e.g.*, Jay Tidmarsh & Brian J. Murray, *A Theory of Federal Common Law*, 100 NW. U. L. REV. 585 (2006) (discussing conflicting definitions of federal common law and the development of federal common law in six specific enclaves); Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883 (1986) (discussing the benefits of a broad view of federal common law); Thomas W. Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1 (1985) (discussing the benefits of a narrow view of federal common law).
[9] *See* RICHARD H. FALLON, JR. ET AL., HART & WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 685 (Robert C. Clark et al. eds., 5th ed. 2003) (defining federal common law as "federal rules of decision whose content cannot be traced by traditional methods of interpretation to federal statutory or constitutional commands"); Field, *supra* note 8, at 890

Supreme Court's well-known decree in *Erie Railroad v. Tompkins* that "[t]here is no federal general common law,"[10] federal common law continues to govern several well-established areas of the law.[11] Unfortunately, the Court has never articulated a specific methodology for determining when federal common law should or should not be developed.[12] In an effort to provide some guidance, legal scholars observe that federal common law has historically developed in two general circumstances.[13] First, the Supreme Court created federal common law in specific areas where federal rules are "necessary to protect uniquely federal interests."[14] Second, the Court created federal common law when it was necessary to effectuate congressional intent.[15]

At the heart of many disputes is the fundamental issue concerning the constitutional legitimacy of federal common law.[16] Critics of federal common law argue that judicial lawmaking is unconstitutional because it violates principles of federalism and separation of powers and raises

("'federal common law' . . . refer[s] to any rule of federal law created by a court . . . when the substance of that rule is not clearly suggested by federal enactments – constitutional or congressional.") (emphasis omitted); Merrill, *supra* note 8, at 5 ("'Federal common law' . . . means any federal rule of decision that is not mandated on the face of some authoritative federal text.") (emphasis omitted).

[10] Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938). Ironically, a case decided the same day as *Erie* held that "federal common law" governed a dispute over the apportionment of an interstate stream. Hinderlinder v. La Plata River & Cherry Creek Ditch Co., 304 U.S. 92, 110 (1938).

[11] These enclaves include: cases affecting the rights and obligations of the United States, *see, e.g.*, Clearfield Trust Co. v. United States, 318 U.S. 363 (1943); interstate disputes, *see, e.g.*, Kansas v. Colorado, 206 U.S. 46 (1907); matters involving Native American tribes, *see, e.g.*, County of Oneida v. Oneida Indian Nation, 470 U.S. 226 (1985); matters involving international relations, *see, e.g.*, Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964); and admiralty disputes, *see, e.g.*, Kossick v. United Fruit Co., 365 U.S. 731 (1961).

[12] ERWIN CHEMERINSKY, FEDERAL JURISDICTION 358 (Erwin Chemerinsky et al. eds., 4th ed. 2003).

[13] *Id.*; *see also* FALLON, *supra* note 9, at 696-98.

[14] Rodriguez v. FDIC, 140 S. Ct. 713, 717 (2020) (citing Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981) (quoting Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 426 (1964))).

[15] *See, e.g.*, Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2672 (1988).

[16] The constitutional legitimacy of federal common law is debated in the colloquy between Professor Martin H. Redish, critiquing the constitutionality of federal common law, and Professor Louise Weinberg, advocating for federal common law. *See generally* Martin H. Redish, *Federal Common Law, Political Legitimacy, and the Interpretative Process: An Institutionalist Perspective*, 83 NW. U. L. REV. 761 (1989); Louise Weinberg, *Federal Common Law*, 83 NW. U. L. REV. 805 (1989); Martin H. Redish, *Federal Common Law and American Political Theory: A Response to Professor Weinberg*, 83 NW. U. L. REV. 853 (1989); Louise Weinberg, *The Curious Notion That the Rules of Decision Act Blocks Supreme Federal Common Law*, 83 NW. U. L. REV. 860 (1989).

jurisprudential concerns.[17] Under the Constitution, separation of powers serves as the foundational bedrock upon which the Founding Fathers built the United States government.[18] In theory, this separation of powers is really quite simple. Congress, elected by the voting public, drafts and passes laws;[19] the executive branch enforces those laws;[20] and the judiciary ensures that the other branches faithfully comply with the Constitution.[21] Judicial federal common lawmaking is strange when viewed against these constitutional checks and balances. The Constitution's express delegation of lawmaking authority to the legislative branch leads some commentators to classify most forms of federal common lawmaking as unconstitutional.[22] The Constitution's principles of federalism add an additional layer of complexity as the lawmaking power is split between the federal and state governments.[23] Overall, federal power is limited[24] and states are the primary lawmaking

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[17] *See, e.g.*, United States v. Standard Oil Co., 332 U.S. 301, 316-17 (1947) (recognizing that permitting judges to make laws "would be intruding within a field properly within Congress' control," and consequently refusing to create federal common law).

[18] *See, e.g.*, Clinton v. Jones, 520 U.S. 681, 699 (1997) ("The doctrine of separation of powers is concerned with the allocation of official power among the three co-equal branches of our Government. The Framers 'built into the tripartite Federal Government . . . a self-executing safeguard against the encroachment or aggrandizement of one branch at the expense of the other.'" (quoting Buckley v. Valeo, 424 U.S. 1, 122 (1976))); *see also* THE FEDERALIST NO. 51, at 349 (James Madison) (Jacob E. Cooke ed., 1961) ("the great security against a gradual concentration of the several powers in the same department, consists in giving to those who administer each department the necessary constitutional means, and personal motives, to resist encroachments of the others."); Charles Pinckney, *Observations on the Plan of Government Submitted to the Federal Convention*, *in* 3 THE RECORDS OF THE FEDERAL CONVENTION OF 1787 106, 108 (Max Farrand ed., 1911) ("In a government, where the liberties of the people are to be preserved, and the laws well administered, the executive, legislative and judicial, should ever be separate and distinct, and consist of parts, mutually forming a check upon each other.").

[19] *See* U.S. CONST. art. I.

[20] *See* U.S. CONST. art. II.

[21] *See* U.S. CONST. art. III.

[22] *See, e.g.*, Linda D. Jellum, *Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation is Unconstitutional*, 70 U. MIAMI L. REV. 152 (2015); Martin H. Redish, *Federal Common Law, Political Legitimacy, and the Interpretive Process: An Institutionalist Perspective*, 83 NW. U. L. REV. 761 (1989).

[23] *See* THE FEDERALIST NO. 45, at 313 (James Madison) (Jacob E. Cooke ed., 1961) (stating that "[t]he powers delegated by the proposed Constitution to the Federal Government, are few and defined. Those which are to remain in the State Governments are numerous and indefinite.").

[24] The Constitution reserves exclusive lawmaking authority to the federal government in certain substantive areas determined to be of a considerable national concern to the federal government. *See, e.g.*, U.S. CONST. art. I, § 8, cl. 3 (delegating the regulation of interstate commerce to the federal government via the commerce clause); U.S. CONST. art. II, § 2, cl. 2 (permitting the federal government to conduct foreign relations via the foreign relations power).

authorities.[25] The discretionary power of the federal courts to create federal common law "to protect uniquely federal interest,"[26] creates the potential for displacement of state authority, thus undercutting federalism. Finally, federal common law reignites age-old concerns about judicial activism and overreach.[27]

Federal common law exists to some degree in most areas of the law, including tax law. Federal tax law is primarily statute based and decision-makers often resolve controversies by carefully applying the Internal Revenue Code[28] and Treasury Regulations to the transaction in question. Nevertheless, tax law is notoriously complex,[29] and some taxpayers play on the Code's complexity to inflate their tax benefits in ways Congress did not intend. To combat this problem and protect the integrity of the tax system, courts developed a body of federal common law known as the substance-over-form or anti-abuse doctrines.[30] These doctrines permit judges to look

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[25] *See* U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.").

[26] Rodriguez v. FDIC, 140 S. Ct. 713, 717 (2020) (citing Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981) (quoting Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 426 (1964))).

[27] *See, e.g.*, Textile Workers Union of Am. v. Lincoln Mills of Ala., 353 U.S. 448, 465 (1957) (Frankfurter, J., dissenting) (raising jurisprudential concerns relating to potential "judicial inventiveness" in making federal common law). For additional information regarding the origin, meaning, and development of judicial activism, see generally Craig Green, *An Intellectual History of Judicial Activism*, 85 EMORY L.J. 1195 (2009); Keenan D. Kmiec, *The Origin and Current Meaning of "Judicial Activism,"* 92 CALIF. L. REV. 1441 (2004).

[28] Hereinafter "the Code." References to the Code are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

[29] *See, e.g.*, Learned Hand, *Thomas Walter Swan*, 57 YALE L. J. 167, 169 (1947) (commenting on the complexity of income tax provisions, Judge Learned Hand described the Code's text to, "merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness.").

[30] The substance-over-form doctrine is a general common law doctrine under which a court has the power to recharacterize a transaction in accordance with its true substance if the taxpayer's charactherization "would completely thwart the Congressional policy to tax transactional realities rather than verbal labels." Crenshaw v. United States, 450 F.2d 472, 477-78 (5th Cir. 1971). Other, more specific, anti-abuse doctrines have emerged from the general substance-over-form doctrine. *See, e.g.*, Associated Wholesale Grocers, Inc. v. United States, 972 F.2d 1517, 1521 (10th Cir. 1991) ("The step-transaction doctrine developed as part of the broader tax concept that substance should prevail over form."); Bail Bonds by Marvin Nelson, Inc. v. Comm'r, 820 F.2d 1543, 1549 (9th Cir. 1987) ("The

beyond codified text and alter the tax treatment of a transaction which complies with the Code's written terms but not its intended purpose.[31] The substance-over-form doctrines are now one of the government's most important tools for combating tax evasion and attacking corporate tax shelters. Unfortunately, the last forty years yielded no explicit Supreme Court guidance on the doctrines' applicability. Nevertheless, the lower courts dramatically evolved and expanded the doctrines, and cannot agree on the scope of anti-abuse doctrines, when they apply, or how to apply them.[32] The result is an imprecise body of federal tax common law.

II. THE ECONOMIC SUBSTANCE DOCTRINE

The economic substance doctrine is one of the most prominent substance-over-form doctrines developed through federal tax common law.[33] When applied, the doctrine allows the government to disallow tax benefits from transactions satisfying the formal requirements of the Code but lacking non-tax related economic substance.[34] Under the doctrine, a claimed

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economic substance factor involves a broader examination of whether the substance of a transaction reflects its form, and whether from an objective standpoint the transaction was likely to produce economic benefits aside from a tax deduction.").

[31] *See* U.S. DEP'T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS AND LEGISLATIVE PROPOSALS 46-58 (1999) (discussing judicial responses to tax shelters and noting that "[j]udicial anti-avoidance doctrines have been useful in curbing tax avoidance behavior.").

[32] Numerous common law doctrines have emerged in tax law's jurisprudence; however, judges do not always explicitly name which doctrine he or she is invoking, and, in many cases, the doctrines overlap. This overlap has caused confusion for practitioners, courts, and federal agencies attempting to clarify the proper scope of the anti-abuse doctrines. *See* H.R. REP. NO. 108-126, at 44 (2003) ("The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, invocation of these doctrines can be seen as at odds with an objective, 'rule-based' system of taxation."); King Enters., Inc. v. United States, 418 F.2d 511, 516 n.6 (Ct. Cl. 1969) ("In coping with this and related problems, courts have enunciated a variety of doctrines, such as step transaction, business purpose, and substance-over-form. Although the various doctrines overlap and it is not always clear in a particular case which one is most appropriate, their common premise is that the substantive realities of a transaction determine its tax consequences.").

[33] Sometimes referred to as "the sham transaction doctrine," the economic substance doctrine has attracted large amounts of scholarly commentary. *See, e.g.*, Rebecca Rosenberg, *Codification of the Economic Substance Doctrine: Agency Response and Certain Other Unforeseen Consequences*, 10 WM. & MARY BUS. L. REV. 199, 202 (2018); Monica D. Armstrong, *OMG! ESD Codified!: The Overreaction to Codification of the Economic Substance Doctrine*, 9 FLA. A&M U. L. REV. 113, 114 (2013); Lee Sheppard, *Economic Substance Abuse*, 89 TAX NOTES 1095 (2000).

[34] *See* I.R.S. v. CM Holdings, Inc., 301 F.3d 96, 102 (3d Cir. 2002) (describing the economic substance doctrine as "the Government's trump card; even if a transaction

deduction may be disallowed if the underlying transaction lacks business purpose or independent economic effect aside from the creation of tax benefits.[35] In other words, the economic substance doctrine allows judges to override the Code's express words and rule in favor of Congressional intent.[36] The courts evaluate a transaction's economic substance by applying an objective analysis of the transaction's actual economic consequences and a subjective analysis of the taxpayer's profit motive in entering into the transaction.[37] The economic substance doctrine's primary intent is to prevent taxpayers from using a transaction serving no economic purpose other than tax savings to claim tax benefits unintended by Congress.[38] Congress codified the economic substance doctrine in 2010, but there is minimal Service guidance on applying the doctrine.[39] Additionally, the Service continues to rely upon the economic substance doctrine in its enforcement actions.[40] This lack of interpretational instruction for the new codified version coupled with the Service's continued use of existing case law means the economic substance doctrine's federal common law evolution remains critical to the doctrine's application.

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complies precisely with all requirements for obtaining a deduction, if it lacks economic substance it 'simply is not recognized for federal taxation purposes.'" (quoting ACM P'ship v. Comm'r, 157 F.3d 231, 261 (3d Cir. 1998))).

[35] *See* United States v. Daugerdas, 759 F. Supp. 2d 461, 466 (S.D.N.Y. 2010).

[36] *See* ACM P'ship v. Comm'r, 73 T.C.M. (CCH) 2189, 2215 (Mar. 5, 1997) (the economic substance doctrine helps courts identify "tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings"), *aff'd*, 157 F.3d 231 (3d Cir. 1998), *cert. denied*, 526 U.S. 1017 (1999).

[37] *See, e.g.*, Illes v. Comm'r, 982 F.2d 163, 165 (6th Cir. 1992) ("To be valid, an asserted deduction must satisfy both components of a two-part test. The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction."). This "two-part test," known as the conjunctive test, was later codified in I.R.C. § 7701(o). *See* discussion *infra* Part II § B.

[38] *See* Horn v. Comm'r, 968 F.2d 1229, 1237 (D.C. Cir. 1992) ("[T]he sham transaction doctrine seeks to identify a certain type of transaction that Congress presumptively would not have intended to accord beneficial tax treatment.").

[39] Since codification, the Executive branch has only issued four documents elaborating on the economic substance doctrine including: two official notices to the public, *see* I.R.S. Notice 2014-58, 2014-44 I.R.B. 746 (Oct. 27, 2014); I.R.S. Notice 2010-62, 2010-40 I.R.B. 411 (Oct. 4, 2010); and two internal letters to Service employees, *see* I.R.S. Treas. Dir. LB&I 1-4-0711-015, IRM 20.1.1, 20.1.5 (July 15, 2011); I.R.S. Treas. Dir. LMSB-20-0910-024, IRM 20.1.1, 20.1.5 (Sept. 14, 2010).

[40] *See* I.R.S. Notice 2010-62, 2010-40 I.R.B. 411 (Oct. 4, 2010) ("The IRS will continue to rely on relevant case law under the common-law economic substance doctrine in applying the two-prong conjunctive test in section 7701(o)(1).").

A. *Federal Common Law Development*

The common law origins of the economic substance doctrine trace back to the 1935 Supreme Court decision *Gregory v. Helvering*.[41] In *Gregory*, the taxpayer fully owned and bcontrolled a corporation. The corporation, in turn, owned appreciated stock the taxpayer wanted to sell for personal profit.[42] If the corporation simply sold the stock and distributed the proceeds to the taxpayer, its single shareholder, the taxpayer would have been subject to two levels of taxation on the transaction's gain: one at the corporate level and another on the dividend at the shareholder level.[43] To avoid this double taxation, the taxpayer formed a new corporation and transferred all the appreciated stock the taxpayer wished to sell from the old corporation to the new corporation in a tax-free reorganization.[44] The new corporation was immediately dissolved and the entity's assets, namely the appreciated stock shares, distributed to the taxpayer upon liquidation.[45] As a result, the taxpayer only paid a single level of tax on the capital gain from the liquidation distribution and paid no further tax from the subsequent sale of the appreciated stock.[46] The reorganization satisfied all legal requirements under the text of the Code; nevertheless, the Supreme Court invalidated the reorganization because the transaction lacked economic substance.[47] The Supreme Court recognized the taxpayer's mechanical compliance with the Code, but emphasized the importance of Congressional intent to avoid absurd and unintended results:

> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of [the Code provision], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its

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[41] 293 U.S. 465 (1935).
[42] *Id*. at 467.
[43] *Id*.
[44] *Id.*
[45] *Id*.
[46] *Id*. (The taxpayer in *Gregory* took the position that the creation of the new corporation and shifting of assets was a "'reorganization' under section 112(g) of the Revenue Act of 1928," resulting in a tax-free distribution of shares to the taxpayer).
[47] *Id*. at 470.

> face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.[48]

From 1935 to 1978, the *Gregory* decision guided tax statute interpretation.[49] The Supreme Court reiterated *Gregory's* statutory interpretation principles in *Knetsch v. United States*, a case similarly involving a taxpayer's straightforward application of the Code's text to reach Congressionally unintended tax benefits.[50] These early economic substance cases focused on the Congressional intent of a tax statute when evaluating the validity of a taxpayer's transaction.[51] But in *Frank Lyon Co. v. United States*, the Court shifted the doctrine's emphasis away from Congressional intent and towards the taxpayer's intent when entering into the transaction.[52]

Frank Lyon involved a dispute about the validity of tax deductions taken after the taxpayer, Frank Lyon, entered into a sale-and-leaseback transaction to secure favorable tax benefits.[53] The transaction involved an agreement in which Frank Lyon obtained a loan to assist a bank in constructing a building when banking regulations prevented the bank from directly financing the building through a conventional mortgage loan.[54] Frank Lyon became the title holder to the building and, after construction was completed, leased the building back to the bank under highly favorable terms.[55] In addition to assisting the bank in obtaining a mortgage, the transaction allowed Frank Lyon to take favorable income tax deductions relating to the building.[56] The

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[48] *Id*.

[49] *See, e.g.*, Higgins v. Smith, 308 U.S. 473, 476-77 (1940); Moline Props., Inc. v. Comm'r, 319 U.S. 436, 439 (1943); Comm'r v. Court Holding Co., 324 U.S. 331, 334 (1945); United States v. Cumberland Pub. Servs. Co., 388 U.S. 451, 453-54 (1950); Goodstein v. Comm'r, 267 F.2d 127 (1st Cir. 1959), *aff'g* 30 T.C. 1178 (1958); Goldstein v. Comm'r, 364 F.2d 734, 741 (2d Cir. 1966); Estate of Franklin v. Comm'r, 544 F.2d 1045, 1046 (9th Cir. 1976).

[50] *See* Knetsch v. United States, 364 U.S. 361, 365-66 (1960) (The Court "examine[d] 'what was done' here, determined "there was nothing of substance to be realized . . . from the transaction beyond a tax deduction," concluded "this [transaction] is a sham," and disallowed the associated deductions (quoting *Gregory*, 293 U.S. at 469)).

[51] *See, e.g.*, *Id*. at 365 (determining that the taxpayer's motive for entering the transaction was irrelevant because, "the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.").

[52] *See* Frank Lyon Co. v. United States, 435 U.S. 561 (1978) (The Supreme Court opinion makes no mention of Congressional intent nor does the opinion cite *Gregory*).

[53] *Id*. For a more detailed explanation of the *Frank Lyon* facts and holding *see* Leandra Lederman, *W(h)ither Economic Substance?*, 95 IOWA L. REV. 389, 409-16 (2010).

[54] *Frank Lyon*, 435 U.S. at 563-64.

[55] *Id*. at 579-80.

[56] *Id*. at 568 (On its 1969 federal income tax return Frank Lyon " . . . asserted as deductions one month's interest to [the mortgage lender]; one month's depreciation on the building;

question before the Court became whether Frank Lyon was entitled to the claimed tax deductions despite having acted more like a conduit lender than a building lessor.[57] After an extensive factual analysis, the Court decided in the taxpayer's favor and allowed Frank Lyon the claimed deductions.[58] The Court emphasized that the taxpayer "exposed its very business well-being to . . . real and substantial risk"[59] and as a result, the case did not involve "manipulation by a taxpayer through arbitrary labels and dealings that have no economic significance."[60] In reaching its decision, the Supreme Court set forth a general standard to determine when a transaction should be respected for tax purposes:

> Where . . . there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties. Expressed another way, so long as the lessor retains significant and genuine attributes of the traditional lessor status, the form of the transaction adopted by the parties governs for tax purposes.[61]

Lower courts drew on the first sentence of this Supreme Court precedent and created the modern economic substance doctrine, comprised of a business purpose prong and economic substance prong. The business purpose prong focuses on the taxpayer's subjective intent and underlying motivation for entering into the transaction.[62] The economic substance prong focuses on whether the transaction objectively had economic substance aside from the tax benefits.[63] Unfortunately, the Supreme Court never provided

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interest on the construction loan from City Bank; and sums for legal and other expenses incurred in connection with the transaction.").

[57] *Id.* at 568-69; *see also* Michael S. Knoll, *Put-Call Parity and the Law*, 24 CARDOZO L. REV. 61, 79-80 (2002). (explaining that the parties structured the terms of the transaction so that Frank Lyon, although the formal title owner of the building, was in the same economic position as a lender and the bank retained a synthetic ownership interest in the building, equivalent to economic ownership).

[58] *Frank Lyon*, 435 U.S. at 580-81.

[59] *Id*. at 577.

[60] *Id*. at 583.

[61] *Id*. at 583-84.

[62] Joseph Bankman, *The Economic Substance Doctrine*, 74 S. CAL. L. REV. 5, 26-29 (2000) (discussing the subjective business purpose prong).

[63] *Id.* at 12-26 (discussing the objective economic substance prong).

guidance for the scope of the economic substance doctrine and many questions about its application remained. Consequently, multiple versions of the doctrine emerged in lower courts.[64] Some lower courts applied a conjunctive test, permitting tax benefits only if a transaction had both business purpose and economic substance.[65] Other lower courts applied a disjunctive test, permitting tax benefits if a transaction had *either* a business purpose or economic substance.[66] Another set of lower courts, albeit a much smaller group, applied a more flexible test under which the business purpose and economic substance prongs are not separate elements that must be satisfied, but are instead factors to be weighed against the transaction's purported tax benefits.[67] All three approaches reinforce the principle that mere compliance with the Code will not automatically entitle a taxpayer to the associated tax benefits.

Against this backdrop, Congress enacted 26 U.S.C § 7701(o), a "clarification of the economic substance doctrine."[68] The statute sought to provide lower courts clarity by codifying the conjunctive test as the appropriate assessment of economic substance.[69] Unfortunately, the statute

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[64] *See generally*, Yoram Keinan, *The Many Faces of the Economic Substance's Two-Prong Test: Time for Reconciliation?*, 1 N.Y.U. J.L. & BUS. 371 (2005) (discussing lower courts' various interpretations of *Frank Lyon* and subsequent applications of the economic substance doctrine).

[65] *See, e.g.*, Klamath Strategic Inv. Fund v. United States, 568 F.3d 537, 544 (5th Cir. 2009) (explaining that because both prongs are necessary, "a lack of economic substance is sufficient to invalidate the transaction regardless of whether the taxpayer has motives other than tax avoidance."); Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1355 (Fed. Cir. 2006) ("[A] lack of economic substance is sufficient to disqualify the transaction."); Pasternak v. Comm'r, 990 F.2d 893, 902 (6th Cir. 1993) (disallowing tax benefits because the transactions were "devoid of economic substance consonant with their intended tax effects").

[66] *See, e.g.*, IES Industries, Inc. v. United States, 253 F.3d 350, 335 (8th Cir. 2001); Horn v. Comm'r, 968 F.2d 1229, 1234-35 (D.C. Cir. 1992); Rice's Toyota World v. Comm'r, 752 F.2d 89, 91-92 (4th Cir. 1985).

[67] *See, e.g.*, ACM P'ship v. Comm'r, 157 F.3d 231, 247 (3d Cir. 1998) ("these distinct aspects of the economic sham inquiry do not constitute discrete prongs of a rigid 'two-step analysis,' but rather represent related factors both of which inform the analysis of whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes" (quoting Casebeer v. Comm'r, 909 F.2d 1360, 1363 (9th Cir. 1990) (explaining that "the Court's holding in *Frank Lyon* was not intended to outline a rigid two-step analysis," instead, "business purpose and economic substance are simply more precise factors to consider in the application of this court's traditional sham analysis." (quoting Sochin v. Comm'r, 843 F.2d 351, 354 (9th Cir. 1988))).

[68] I.R.C. § 7701(o); Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111- 152, § 1409, 124 Stat. 1029, 1067 (codified at I.R.C. § 7701(o)).

[69] I.R.C. § 7701(o)(1).

leaves many questions regarding the doctrine unanswered, including the important threshold decision of when the doctrine applies.[70]

B. *Codification*

Congress codified the economic substance doctrine in section 7701(o) of the Internal Revenue Code as part of the Health Care and Education Reconciliation Act of 2010.[71] Congress considered codification of the doctrine prior to 2010,[72] but faced opposition from The Bush White House, the Treasury Department, and practitioners.[73] Ultimately, supporters won by framing codification as a way to provide a uniform test for economic substance and deter tax avoidance.[74]

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[70] *See* 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.").

[71] Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029, 1067-70 (codified at I.R.C. §§ 6662(b)(6), (i), 6662A(e)(2)(B), 6664(c)(2), (d)(2), 6676(c), 7701(o)).

[72] *See, e.g.*, S. 2242, 110th Cong. §§ 511-513 (2007); S. 1321, 109th Cong. §§ 801–802 (2006); S. 476, 108th Cong. §§ 701, 704, 717 (2003); H.R. 5095, 107th Cong. §§ 101, 104 (2002); H.R. 2255, 106th Cong. §§ 3-4 (1999).

[73] *See, e.g.*, OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATION POLICY: H.R. 2419 - FOOD AND ENERGY SECURITY ACT OF 2007, at 2 (2007) ("[T]he Administration opposes the provision to codify the 'economic substance' doctrine and urges Congress to eliminate this provision from the final legislation. The economic substance doctrine is a judicial rule that is best left for the courts to apply in appropriate cases."); Crystal Tandon, *Economic Substance Codification Would Create More Problems than It Solves, Says Korb*, 118 TAX NOTES 777, 777 (2008) (reporting IRS Chief Counsel Donald Korb called codification "'a solution in search of a problem'" and questioning "'what [economic substance codification] would add'" to the IRS's tax enforcement capabilities); Dennis J. Ventry Jr., *Save the Economic Substance Doctrine from Congress*, 118 TAX NOTES 1405, 1410 (2008) (describing Treasury's support of a common law doctrine because "a judicially controlled doctrine provides judges the tools they need to protect the revenue"); ANDREW P SOLOMON ET AL., N.Y. STATE BAR ASS'N TAX SECTION SUMMARY REPORT ON THE PROVISIONS OF RECENT SENATE BILLS THAT WOULD CODIFY THE ECONOMIC SUBSTANCE DOCTRINE 3 (May 21, 2003) (questioning whether "codifying the 'economic substance' doctrine will be an effective vehicle to combat the tax shelter problem" and arguing that codification "will have unwarranted and unintended effects on legitimate transactions").

[74] *See, e.g.*, H.R. REP. NO. 111-443, at 295 (2010) (explaining, despite prior success using the common law doctrine in tax avoidance litigation, "it is still desirable to provide greater clarity and uniformity in the application of the economic substance doctrine in order to improve its effectiveness at deterring unintended consequences."); Ventry, *supra* note 73, at 1410 (reporting Senator Chuck Grassley explaining " 'I'm not doing this to raise taxes,' but rather to clarify the definition for taxpayers and the courts."). An additional factor that likely influenced some members of Congress to support codification of the economic substance doctrine was an expected increase in revenue to partially offset the costs of the Affordable Care Act. *See* JOINT COMM. ON TAXATION, 111TH CONG., JCX-17-10, ESTIMATED REVENUE EFFECTS OF THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 4872, THE "RECONCILIATION ACT OF 2010," AS AMENDED, IN COMBINATION WITH THE REVENUE

Section 7701(o) defines the economic substance doctrine as "the common law doctrine under which tax benefits under subtitle A [income taxes] with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose."[75] The statute provides that:

> [i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.[76]

Thus, section 7701(o)(1) codified the conjunctive test and clarified that both the "objective" and "subjective" prongs of the test are required for a transaction to have economic substance.[77]

Although codification ended some uncertainty in lower courts by requiring use of the conjunctive test,[78] codification did nothing to resolve many other important inconsistencies surrounding the doctrine. Section 7701(o) does not address specifics regarding what qualifies as a "meaningful change" in the taxpayer's "economic position;" what constitutes a "substantial" non-tax "purpose;" and whether the doctrine is "relevant" to a

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EFFECTS OF H.R. 3590, THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT ('PPACA')," AS PASSED BY THE SENATE, AND SCHEDULED FOR CONSIDERATION BY THE HOUSE COMMITTEE ON RULES ON MARCH 20, 2010, at 3 (Comm. Print 2010) (estimating revenue increase of $1.8 billion over five years and $4.5 billion over ten years).

[75] I.R.C. § 7701(o)(5)(A).

[76] I.R.C. § 7701(o)(1) (The requirement of clause (A) are sometimes referred to as the "objective" or "economic substance" test, and the requirement of clause (B) are sometimes referred to as the "subjective" or "business purpose" test).

[77] A flexible version of the economic substance analysis may still be permissible under section 7701(o), if taxpayers must satisfy both the objective and the subjective analyses in order to meet such flexible test.

[78] Rarely would a court's economic substance analysis under the conjunctive test or the disjunctive test lead to different results concerning the validity of the disputed transaction. Consequently, Congress' focus on codifying the conjunctive test, while not resolving other important inconsistencies, remains unclear. *See* Martin J. McMahon, Jr., *Living with (and Dying by) the Codified Economic Substance Doctrine*, 10 (Univ. of Fl. Legal Studies, Working Paper No. 2010-13) ("[N]one of the courts applying the disjunctive test ever upheld the tax benefits of a transaction on the grounds that one of the two prongs but not the other had been satisfied; where one has been found absent, the other has also been found lacking, and when one has been found present, the other has also been found to be present.").

transaction.[79] Thus, despite the Joint Committee on Taxation's recognition that "the application of the economic substance doctrine among the courts varies considerably,"[80] utilizing this unclear federal common law is necessary to determine the appropriate scope of the statute. This is a perplexing approach to a statute purportedly offering a "clarification" of existing law.[81]

Perhaps Congress intentionally left these statutory ambiguities for the Treasury Department to clarify through the agency's authority to issue regulations and guidance on Code provisions.[82] However, an important problem with the Treasury's regulatory authority over section 7701(o) is that Congress explicitly granted courts the power to determine "whether the economic substance doctrine is relevant to a transaction."[83] Thus, the preliminary question of relevance is left to the courts, as are any other aspects of the doctrine which are neither constrained by statutory language nor addressed by agency guidance.[84]

The problems with case law's continued influence over the economic substance doctrine are compounded by the Treasury Department's reluctance to issue guidance on the statute. In the ten years since codification, Treasury has only issued four documents interpreting section 7701(o): two public notices and two internal letters to Service employees.[85] None of these

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[79] *See* I.R.C. § 7701(o).

[80] STAFF OF J. COMM. ON TAXATION, 109TH CONG., JCS-02-05, OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 20 (Comm. Print 2005) ("Under current law, the application of the economic substance doctrine among the courts varies considerably, with one recent court even questioning the viability of the doctrine altogether. The lack of clarity undermines the prophylactic effect of the doctrine and produces unfairness. The potential unfairness is compounded by the recent increase in penalties in the event the IRS finds and challenges a tax shelter transaction and the taxpayer loses in court").

[81] *See* I.R.C. § 7701(o) (titled "Clarification of economic substance doctrine").

[82] *See* I.R.C. § 7805(a) (granting the Treasury Department the authority to issue all "needful rules and regulations for the enforcement of" the Code).

[83] 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").

[84] In the ten years since codification, the Treasury Department has issued very little regulatory guidance regarding section 7701(o). *See* STAFF OF J. COMM. ON TAX'N, 111TH CONG., JCX-18-10, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE RECONCILIATION ACT OF 2010, AS AMENDED, IN COMBINATION WITH THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (Comm. Print 2010) (discussing the treatment of foreign tax credits in relation to the economic substance doctrine). *See also* H.R. Rep. No. 111-443(I), at 293 (2010) (describing various circuit's interpretations of the economic substance doctrine before codification); Erik M. Jensen, *Sometimes Unguided (or Maybe Misguided) Economic Substance Guidance*, 32 J. TAX'N INVS. 27, 29 (2016) (the conjunctive test "requirement might not provide for complete consistency among circuit courts, but it is a step in the right direction").

[85] These documents include two official notices to the public, *see* I.R.S. Notice 2014-58, 2014-44 I.R.B. 746 (Oct. 27, 2014); I.R.S. Notice 2010-62, 2010-40 I.R.B. 411 (Oct. 4,

documents carry the same binding effect as Treasury Regulations.[86] One of these documents, Notice 2010-62, states "[t]he IRS will continue to rely on relevant case law under the common-law economic substance doctrine in applying the two-prong conjunctive test in section 7701(o)(1)."[87] Furthermore, the notice recognizes the "relevance" of the economic substance doctrine is an issue reserved to the courts by the statute.[88] Consistent with the lack of regulatory authority regarding relevance, "the Treasury Department and the IRS do not intend to issue general administrative guidance regarding the types of transactions to which the economic substance doctrine either does or does not apply."[89] Instead, the notice explains the Service will analyze a transaction's relevance by examining case law, which the agency anticipates will "continue to develop."[90] However, in the decade since codification and the notice's issuance, there is still no post-codification case law interpreting section 7701(o). As a result, the future applicability of the economic substance doctrine, guided by case law which has yet to emerge, remains unclear. This uncertainty is magnified by the lack of recent Supreme Court guidance on the proper scope of the doctrine. But when viewed in light of the Supreme

2010); and two internal letters to IRS employees, *see* I.R.S. Treas. Dir. LB&I 1-4-0711-015, IRM 20.1.1, 20.1.5 (July 15, 2011); I.R.S. Treas. Dir. LMSB-20-0910-024, IRM 20.1.1, 20.1.5 (Sept. 14, 2010).

[86] IRS notices do not carry the same weight nor go through the same rigorous notice and comment review as Treasury Regulations. *See, e.g.*, Stobie Creek Invs. v. U.S., 82 Fed. Cl. 636, 671 (Fed. Cl. 2008) ("As a general proposition, IRS notices are press releases stating the IRS's position on a particular issue and informing the public of its intentions; such notices do not constitute legal authority . . . IRS notices are not promulgated pursuant to a notice-and-comment period, the process which gives regulations their legal authority and entitles them to *Chevron* deference") *aff'd*, 608 F.3d 1366 (Fed. Cir. 2010); Pritired 1, LLC v. U.S., 816 F. Supp. 2d 693, 728 (S.D. Iowa 2011) (reasoning that "[a] notice is akin to a 'revenue ruling' and is an interpretation of the law offered by the IRS. While not binding precedent, revenue rulings—and notices—are entitled to 'some weight,' because the IRS 'consider[s] them authoritative and binding'") (citations omitted).

[87] I.R.S. Notice 2010-62, 2010-40 I.R.B. 411 (Oct. 4, 2010).

[88] *Id.* at 411-12 ("Section 7701(o)(5)(C) states the determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if section 7701(o) had never been enacted [by continuing to defer to common law].").

[89] *See also id.* at 412 ("The IRS will not issue a private letter ruling or determination letter . . . regarding whether the economic substance doctrine is relevant to any transaction or whether any transaction complies with the requirments of section 7701(o)"); *see* also I.R.S. Notice 2014-58, 2014-44 I.R.B. 746 (Oct. 27, 2014) (stating that "[w]hether the economic substance doctrine is relevant . . . will be considered on a case-by case basis, depending on the facts and circumstances of each individual case." This language presumably refers to whether or not the Service may raise the economic substance doctrine as an issue in audit or litigation).

[90] I.R.S. Notice 2010-62, 2010-40 I.R.B. 412 (Oct. 4, 2010).

Court's increasing use of textualism[91] and recent hostility towards federal common law[92] a clearer, albeit far more limited, application of the economic substance doctrine emerges.[93]

III. FEDERAL TAX COMMON LAW AND THE TENSION WITH TEXTUALISM

The resurgence of textualism in Supreme Court jurisprudence has led courts and commentators to doubt the continuing legitimacy of tax law's substance-over-form doctrines.[94] Dissecting this argument begins with a baseline understanding of a much larger debate in the legal community regarding the proper method of statutory interpretation.[95] This broader statutory interpretation debate focuses on two methodological theories: textualism and purposivism.[96] Textualism "refers to a formalist method of

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[91] *See, e.g.*, John F. Manning, *The New Purposivism*, 2011 SUP. CT. REV. 113, 123-29 (2011) (explaining the rise of "modern textualism" since 1987 and its influence on purposivist judges).

[92] *See* Rodriguez v. FDIC, 140 S. Ct. 713, 717 (2020).

[93] *See infra* Part III and Part IV.

[94] *See, e.g.*, Coltec Indus., Inc. v. U.S., 62 Fed. Cl. 716, 756 (Fed. Cl. 2004), *vacated and remanded*, 454 F.3d 1340 (Fed. Cir. 2006) ("[T]he use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers."); Linda D. Jellum, *Codifying and "Miscodifying" Judicial Anti-Abuse Tax Doctrines*, 33 VA. TAX REV. 579, 589-90 (2014) (exploring textualists' criticisms of judicial anti-abuse doctrines); Amandeep S. Grewal, *Economic Substance and the Supreme Court*, 116 TAX NOTES 969, 970 (2007) ("[T]he Court should affirm its prior holdings and instruct the lower courts that the casual disregard of statutory language in favor of judicial tests is inappropriate."); Brian Galle, *Interpretative Theory and Tax Shelter Regulation*, 26 VA. TAX REV. 357, 369 (2006) ("[A]s textualism has become more prevalent over the past two decades, the [economic substance] doctrine has been subjected to ever-increasing skepticism from textualist-minded courts."); Noel B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 20-26 (2004) (observing the prevalence of textualism in modern tax scholarship and its challenge to substance-over-form doctrines); Allen D. Madison, *The Tension Between Textualism and Substance-over-Form Doctrines in Tax Law*, 43 SANTA CLARA L. REV. 699, 702 (2003) ("Th[is] article concludes from this analysis that the substance-over-form doctrines discussed here are no longer appropriate in tax cases."); John F. Coverdale, *Text as Limit: A Plea for a Decent Respect for the Tax Code*, 71 TUL. L. REV. 1501 (1997) (arguing in favor of textualist interpretation of tax statutes).

[95] Additional interpretive methods of statutory interpretation have been put forward; however, a discussion of those methods is beyond the scope of this paper. *See, e.g.*, Peter L. Strauss, *The Common Law and Statutes*, 70 U. COLO. L. REV. 225, 227 (1999) (discussing "intentionalism"); Steven D. Smith, *The Pursuit of Pragmatism*, 100 YALE L. J. 409 (1990) (discussing legal pragmatism); Richard A. Posner, *Statutory Interpretation—In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 817-18 (1983) (discussing "imaginative reconstruction").

[96] For the sake of brevity and clarity, the vast literature and nuanced arguments surrounding the statutory interpretation debate cannot be done justice in this Article. For additional materials, *see, e.g.*, Anita S. Krishnakumar, *Backdoor Purposivism*, 69 DUKE L.J. 1275 (2020); WILLIAM N. ESKRIDGE, JR. ET AL., CASES AND MATERIALS ON LEGISLATION AND REGULATION: STATUTES AND THE CREATION OF PUBLIC POLICY 405-580 (6th ed. 2020); John F. Manning, *What Divides Textualists from Purposivists?*, 106 COLUM. L. REV. 70, 76-77

statutory interpretation that regards the enacted text of a statute as the primary source of statutory meaning."[97] Textualism prioritizes the enacted text of a statute as the most legitimate source of the law because the codified words are a product of the constitutionally mandated process of bicameralism and presentment.[98] For this reason, many textualists refuse to consider legislative intent or other external evidence of statutory purpose to glean statutory meaning.[99] A contrasting method of statutory interpretation, known as purposivism, looks beyond the confines of codified text and focuses on the law's underlying meaning or the policy objectives Congress sought to further when enacting a statute.[100] A purposivist legal analysis may utilize "extrinsic interpretive aids, including legislative history," to derive legislative purpose and statutory meaning.[101]

Despite textualism and purposivism's apparent conflict, their differences are less stark than their dichotomous portrayal suggests.[102] In modern practice, few judges are dogmatically textualist or purposivism-based, and most take a more nuanced approach to statutory interpretation.[103] "The most

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(2006); Philip P. Frickey, *Interpretive-Regime Change*, 38 LOY. L.A. L. REV. 1971, 1971 (2005); Caleb Nelson, *What Is Textualism?*, 91 VA. L. REV. 347, 372 (2005); Cass R. Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885, 917-19 (2003); ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW (Amy Gutmann ed., 1997); William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621, 623 (1990).

[97] Anita S. Krishnakumar, *Backdoor Purposivism*, 69 DUKE L.J. 1275, 1281 (2020).

[98] U.S. CONST. art. I, § 7, cls. 1-3; *see* INS v. Chadha, 462 U.S. 919, 946 (1983).

[99] *See* ANTONIN SCALIA, *Common-Law Courts in a Civil-Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws*, *in* A MATTER OF INTERPRETATION 3, 22 (Amy Gutmann ed., 1997) ("The text is the law, and it is the text that must be observed.").

[100] *See* Abbe R. Gluck, *The States as Laboratories of Statutory Interpretation: Methodological Consensus and the New Modified Textualism*, 119 YALE L.J. 1750, 1764 (2010).

[101] *Id.*

[102] *E.g.*, John F. Manning, *Inside Congress's Mind*, 115 COLUM. L. REV. 1911, 1925 (2015) (arguing that leading purposivists and textualists "have more in common than many may realize"); *see also* Jonathan R. Siegel, *The Inexorable Radicalization of Textualism*, 158 U. PA. L. REV. 117, 119, 128-30 (2009) ("The latest move in the interpretation wars, however, is to declare something of a truce. Textualism, intentionalism, and purposivism are either not all that different or at least not different in the way people usually think.").

[103] *See, e.g.*, Abbe R. Gluck, *Justice Scalia's Unfinished Business in Statutory Interpretation: Where Textualism's Formalism Gave Up*, 92 NOTRE DAME L. REV. 2053, 2057-58 (2017) ("Thanks to the great intellectual efforts of textualists, purposivists, and pragmatists over the past three decades, a basic equilibrium has emerged. All sides have significantly moderated and largely have converged on a middle-ground, text-focused position that . . . includes recourse to broader context, including, in disciplined fashion . . . legislative materials." (footnote omitted)); William N. Eskridge Jr., *Textualism, the Unknown Ideal?*, 96 MICH L. REV. 1509, 1557 (1998) ("All major theories of statutory interpretation consider the statutory text primary. The plain meaning of a text, as applied to a set of facts, is the focal point for attention whether one is a textualist, intentionalist, or pragmatic interpreter of statutes.").

salient remaining difference between the two interpretive approaches appears to be that purposivists are willing to reject a statute's seemingly plain meaning" when conflicting evidence of purpose strongly suggests a different meaning.[104]

With that background in mind, the controversy surrounding tax law's substance-over-form doctrines is perhaps best understood as a microcosm of the much larger statutory interpretation debate. Tax law's anti-abuse doctrines developed, in large part, during the "heyday of purposivism" and this interpretive influence is evident in the language of early holdings.[105] For example, in *Gregory v. Helvering,* the Supreme Court invalidated a taxpayer's transaction involving a mechanical application of the Code to derive tax benefits.[106] The Court reasoned that the transaction was not "the thing which the statute intended"[107] in repudiating the trial court's determination that a "statute so meticulously drafted must be interpreted as a literal expression of the taxing policy."[108] As a result, modern cases implementing the anti-abuse doctrines utilize a similar line of reasoning, which often advances a version of tax law that conflicts with a literal reading of the Code.[109] Underlying all of the judicially created anti-abuse doctrines is the general principle that proper application of the Code requires looking beyond the form of a transaction to determine whether its substance aligns with the law's purpose.[110]

Textualists critique the anti-abuse doctrines as an illegitimate form of lawmaking and a violation of separation of powers principles.[111] Textualism argues that the judiciary is bound by the codified words in the Code; if a transaction complies with the text of the law then that transaction should be

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[104] Krishnakumar, *supra* note 96, 1283-84.
[105] Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 STAN. L. REV. 195, 205-06 (2020).
[106] *See* Gregory v. Helvering, 293 U.S. 465, 469-70 (1935).
[107] *Id.* at 469.
[108] Gregory v. Comm'r, 27 B.T.A. 223, 225 (1932).
[109] *See, e.g.*, Coltec Indus., Inc. v. U. S., 454 F.3d 1340, 1354 (Fed. Cir. 2006) ("[T]he economic substance doctrine is merely a judicial tool for effectuating the underlying Congressional purpose that, despite literal compliance with the statute, tax benefits not be afforded based on transactions lacking in economic substance."); IRS v. CM Holdings, Inc., 301 F.3d 96, 102 (3d Cir. 2002) ("[E]ven if a transaction complies precisely with all requirements for obtaining a deduction, if it lacks economic substance it 'simply is not recognized for federal taxation purposes, for better or for worse.'" (quoting ACM P'ship v. Comm'r, 157 F.3d 231, 261 (3d Cir. 1998)).
[110] This treatment can be traced back to the very beginning of the economic substance doctrine. *See, e.g.*, Comm'r v. Court Holding Co., 324 U.S. 331, 334 (1945) (asserting that a straight-forward application of the Code to allow unintended tax benefits "would seriously impair the effective administration of the tax policies of Congress.").
[111] *See* Choi, *supra* note 105, at 197.

upheld despite perceived inconsistencies with the law's spirit or Congress's intent.[112] To that end, tax law's substance-over-form doctrines may be viewed as an improper mechanism for elevating what the judiciary believes is Congress' intent over a taxpayer's literal compliance with the text of the Code.[113] In contrast, purposivism argues that strict textualism legitimizes tax evasive sham transactions and undermines the integrity the Code.[114] In turn, some commentators blame textualism for "the recent proliferation of tax shelters."[115]

Textualism has been on the rise since the end of the twentieth century when the Supreme Court began to read statutes in a narrower, more text-focused manner, frequently bypassing a legislative history analysis.[116] Federal judges have shown an increasing preference towards textualism, heavily influencing the jurisprudence of federal courts.[117] The judicial shift towards textual-focused statutory analysis has caused textualism to gain traction amongst scholars and practitioners.[118] Specifically, some commentators argue that textualism is incompatible with tax's substance-over-form doctrines and consequently, the judge-made doctrines should be abolished.[119] The perceived tension between textualism and the anti-abuse

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[112] *See* Jellum, *supra* note 94, at 590.

[113] *See, e.g.*, Coltec Indus., 62 Fed. Cl. at 756 ("[T]he use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers.").

[114] *See* Jellum, *supra* note 94, at 590.

[115] Cunningham & Repetti, *supra* note 94, at 2.

[116] *See* Manning, *supra* note 96, at 79-80.

[117] In a recent example of a Supreme Court decision heavily influenced by a textualist method of interpretation, the Court wrote: "When the express terms of a statute give us one answer and extratextual considerations suggest another, it's no contest. Only the written word is the law. . . ". Bostock v. Clayton County, 140 S. Ct. 1731, 1737 (2020). Lower courts have been slower to adopt the Supreme Court's move towards a textualist method of statutory interpretation. Overall, appellate courts, and especially district courts, still use a more purposivist method of statutory interpretation than the Supreme Court. *See, e.g.*, Aaron-Andrew P. Bruhl, *Statutory Interpretation and the Rest of the Iceberg: Divergences Between the Lower Federal Courts and the Supreme Court*, 68 DUKE L.J. 1, 58 (2018) (noting that "the increase [in judicial textualism] was larger for the courts of appeals than for the district courts"); Abbe R. Gluck & Richard A. Posner, *Statutory Interpretation on the Bench: A Survey of Forty-Two Judges on the Federal Courts of Appeals*, 131 HARV. L. REV. 1298, 1310 (2018) (surveying appellate judges and noting that "[e]ven the text-centric judges described themselves in such terms as 'textualist-pragmatist' or 'textualist-contextualist'").

[118] *See, e.g.*, Eskridge, *supra* note 96, at 624 ("The new textualism is the most interesting development in the Court's legisprudence (the jurisprudence of legislation) in the 1980s and is well worth understanding."); John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 9 (2001) ("In recent years, the textualists' legislative process critique has palpably affected Supreme Court decisionmaking.").

[119] *See, e.g.*, BORIS I. BITTIKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS § 1.04 (West 2019) (discussing the economic substance doctrine and noting, "the insistence of more than a few tax practitioners that the judge-made doctrine was illegitimate and had

doctrines is exemplified in the Supreme Court's 2001 decision *Gitlitz v. Commissioner*.[120] Written in almost entirely textualist terms, the Court controversially held that a single transaction entitled stockholders to two separate tax benefits: an increase in tax basis and an exemption from income tax.[121] In coming to this decision, the Court refused to apply a judicially created anti-abuse doctrine preventing taxpayers from obtaining two redundant tax benefits from a single transaction.[122] Justice Thomas, writing for an 8-1 majority, acknowledged that the Court's holding resulted in a "double windfall" for the taxpayers that raised public policy concerns.[123] However, the Court declined to analyze any policy concerns articulating that "[b]ecause the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern."[124] For textualist-leaning Justices like Thomas, looking beyond the words of a statute that contains unambiguous[125] text may lead judges to utilize legislative history to impose their individual policy preferences. Rather, courts should interpret statutes utilizing the text's plain language and if that interpretation produces an absurd result then it is up to Congress to amend the statute.[126] Setting aside the merits of either form of statutory interpretation, the judicial trend toward textualism represents a threat to existing tax anti-abuse doctrines, a key barrier to abusive tax schemes.

IV. THE *RODRIGUEZ* CASE

In the recent Supreme Court decision *Rodriguez v. FDIC* the Court unanimously chastised an appellate court's application of federal tax common law in holding that state law determines the ownership of a tax refund paid to an affiliated group.[127]

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never actually been applied by the Supreme Court to deny a taxpayer any tax benefits"); Madison, *supra* note 94, at 702 ("The article concludes from this analysis that the substance-over-form doctrines discussed here are no longer appropriate in tax cases").

[120] *See* Gitlitz v. Comm'r, 531 U.S. 206, 222 (2001).

[121] *See id*. at 219-220.

[122] This anti-abuse doctrine is sometimes referred to as the "*Ilfeld* rule." *See* Charles Ilfeld Co. v. Hernandez, 292 U.S. 62, 68 (1934) ("In the absence of a provision of the [applicable act] definitely requiring [a double deduction], a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers.").

[123] *Gitzlitz*, 531 U.S. at 219-220.

[124] *Id.* at 220.

[125] Note that although the majority deemed the text of the statute in *Gitlitz* unambiguous, Justice Bryer's dissent argues that the statute's text was ambiguous. *See id.*, at 220-224.

[126] In response to *Gitlitz*, Congress did amend the contested statute and added I.R.C § 1366(a) specifically to reverse the impact of the Supreme Court's holding. *See* H.R. REP. NO. 251, at 14, 52 (2001) *as reprinted in* 2002 U.S.C.C.A.N 20.

[127] *See* Rodriguez v. FDIC, 140 S. Ct. 713, 718 (2020).

A. Rodriguez *Legal Background Information*

Congress permits an affiliated group of corporations to file a consolidated federal tax return,[128] and the Service issues any refund as a single payment to the group's designated agent.[129] Once a refund is issued, the tax regulations provide minimal guidance as to how the affiliated group should distribute that refund among themselves.[130] To fill the gap, affiliated groups often draft tax allocation agreements, which specify how the group allocates tax liabilities and distributes refunds among members.[131] Absent a clear tax allocation agreement, an affiliated group may turn to the courts to resolve a refund dispute.[132] Prior to the Supreme Court's *Rodriguez* decision, a circuit split existed regarding how to properly resolve the refund distribution question. Some federal circuits turned to state law to resolve the distribution question.[133] Other circuits utilized a federal common law doctrine, known as the *Bob Richards* rule.[134] In circuits applying the doctrine, the *Bob Richards* rule created a presumption that, absent an unambiguous tax allocation agreement,[135] "a tax refund due from a joint return generally belongs to the company responsible for the losses that form the basis of the refund."[136]

B. Rodriguez *Facts*

Beginning in 2004, United Western Bancorp, Inc. ("UWBI") and one of its subsidiary corporations, United Western Bank ("Bank"), filed an annual

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[128] I.R.C. § 1501.
[129] *See* Treas. Reg. § 1.1502-77(d)(5).
[130] *Rodriguez*, 140 S. Ct. at 716.
[131] *See id.*
[132] *See id.*
[133] *See, e.g.*, FDIC v. AmFin Financial Corp., 757 F.3d 530, 536 (6th Cir. 2014).
[134] *See, e.g.*, Rodriguez v. FDIC (*In re* United Western Bancorp, Inc.), 914 F.3d 1262, 1270 (10th Cir. 2019); Capital Bancshares, Inc. v. FDIC, 957 F.2d 203, 208 (5th Cir. 1992); *see* U.S. v. Revco D.S., Inc. (*In re* Revco D.S. Inc.), 111 B.R. 631, 637 (Bankr. N.D. Ohio 1990).
[135] The *Bob Richards* rule, in its original conception, only applied in situations where no tax allocation agreement existed between affiliated group members, *see* Western Dealer Mgmt., Inc. v. Eng. (*In re* Bob Richards Chrysler-Plymouth Corp.), 473 F.2d 262, 265 (1973). Over time, some courts developed a more expansive version of the *Bob Richards* rule and applied the doctrine even when a tax allocation agreement existed but did not unambiguously prescribe a different result. *See, e.g.*, Zucker v. FDIC (*In re* BankUnited Fin. Corp.), 727 F.3d 1100, 1108 (11th Cir. 2013); *see* Cohen v. UN-Ltd. Holdings, Inc. (*In re* Nelco Ltd), 264 B.R. 790, 809 (Bankr. E.D. Va. 1999).
[136] In re United Western Bancorp, Inc., 914 F.3d at 1264 (quoting Barnes v. Harris, 783 F.3d 1185, 1195 (10th Cir. 2015)).

consolidated federal tax return.[137] In 2008, the companies entered into a tax allocation agreement.[138] In 2010, the Bank suffered a large net operating loss, became insolvent, and entered receivership in January of 2011.[139] In response to the Bank's 2010 net operating losses, UWBI filed an associated refund request of over $4 million on behalf of the affiliated group in 2011.[140] Unfortunately, because the Bank was UWBI's principal source of income, the Bank's receivership resulted in UWBI's insolvency and subsequent bankruptcy filing.[141] In 2015, the Service issued UWBI, the group's designated agent, a $4,081,334.67 tax refund in response to the Bank's 2010 net operating loss.[142]

A dispute arose between the Bank's receiver, the Federal Deposit Insurance Corporation ("FDIC"), and UWBI's bankruptcy trustee, Simon Rodriguez.[143] The disagreement concerned conflicting interpretations of the tax allocation agreement and, subsequently, the proper ownership of the refund.[144] The Tenth Circuit applied an expansive version of the *Bob Richards* rule and directed the refund to the FDIC.[145] The Supreme Court granted certiorari not to determine which party would receive the tax refund, but rather how lower courts should resolve the dispute.[146] In other words, the narrow question addressed was whether federal common law, guided by the *Bob Richards* rule, or applicable state law determines the ownership of a federal tax refund paid to an affiliated group.

C. Rodriguez *Holding*

On February 25, 2020, the Court unanimously rejected lower courts' application of the *Bob Richards* rule.[147] In evaluating the validity of the *Bob Richards* rule, Justice Gorsuch's opinion emphasized that federal judges should not create federal common law except in extremely limited circumstances:

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[137] In re United Western Bancorp, Inc, 914 F.3d at 1264.
[138] *Id.*
[139] *Id.* at 1266.
[140] *Id.* Pursuant to I.R.C. § 172(b)(1)(A)(i), corporations may carryback net operating losses for up to two tax years. As a result, UWBI's refund request was made to recover a portion of the taxes paid by the Bank during the 2008 tax year.
[141] *Id.* UWBI initially filed for Chapter 11 bankruptcy on March 2, 2012 and later converted the bankruptcy case to a Chapter 7 proceeding on April 15, 2013.
[142] *Id.* at 1267.
[143] *Id.* at 1266-67.
[144] Rodriguez v. FDIC, 140 S. Ct. 713, 716 (2020).
[145] *Id.* at 716-17.
[146] *Id.* at 718.
[147] *Id.*

> Judicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government's "legislative Powers" in Congress and reserves most other regulatory authority to the States. See *Art. I, §1*; *Amdt. 10*. As this Court has put it, there is "no federal general common law." *Erie R. Co. v. Tompkins, 304 U. S. 64, 78, 58 S. Ct. 817, 82 L. Ed. 1188 (1938)*. Instead, only limited areas exist in which federal judges may appropriately craft the rule of decision. *Sosa v. Alvarez-Machain, 542 U. S. 692, 729, 124 S. Ct. 2739, 159 L. Ed. 2d 718 (2004)*. These areas have included admiralty disputes and certain controversies between States. See, *e.g., Norfolk Southern R. Co. v. James N. Kirby, Pty Ltd., 543 U. S. 14, 23, 125 S. Ct. 385, 160 L. Ed. 2d 283 (2004)*; *Hinderlider v. La Plata River & Cherry Creek Ditch Co., 304 U. S. 92, 110, 58 S. Ct. 803, 82 L. Ed. 1202 (1938)*. In contexts like these, federal common law often plays an important role. But before federal judges may claim a new area for common lawmaking, strict conditions must be satisfied. The Sixth Circuit correctly identified one of the most basic: In the absence of congressional authorization, common lawmaking must be "'necessary to protect uniquely federal interests.'" *Texas Industries, Inc. v. Radcliff Materials, Inc., 451 U. S. 630, 640, 101 S. Ct. 2061, 68 L. Ed. 2d 500 (1981)* (quoting *Banco Nacional de Cuba v. Sabbatino, 376 U. S. 398, 426, 84 S. Ct. 923, 11 L. Ed. 2d 804 (1964))*.[148]

Specifically, the Court reasoned that the *Bob Richards* rule did not meet threshold conditions judges must satisfy to craft federal common law because there is no "uniquely federal interest" in the federal government determining how an affiliated group distributes tax refunds among its members.[149] Rather, state law is the appropriate avenue to determine the *Rodriguez* refund dispute issue because state law is the traditional means of handling controversies involving corporate property rights.[150] As a result, the creation of the *Bob Richards* rule was outside the scope of a federal judge's common lawmaking authority thus invalidating the doctrine.

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[148] *Id*. at 717.
[149] *Id*.
[150] *Id*.

V. ANALYSIS: THE ROAD AHEAD

A. Rodriguez *and the Threat to Federal Taxation Common Law*

Although *Rodriguez* addressed the narrow issue of whether federal common law or state law determines the ownership of a tax refund paid to an affiliated group, the decision raises broader questions regarding the continued validity of numerous common law tax doctrines. The unanimous decision serves as a pointed reminder that lower courts' federal common lawmaking is falling out of favor with the Supreme Court. "We took this case," Gorsuch explains, "to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking."[151] Moreover, the demise of the *Bob Richards* rule, the Court warns, is a "cautionary tale."[152]

The *Rodriguez* decision emphasizes the Court's alignment with the pervasive critique that most federal common lawmaking constitutes an improper judicial overreach which violates foundational separation of powers principles.[153] But the impact of this decision is not entirely straightforward. Judge-made rules abound across federal tax law.[154] There is little indication in *Rodriguez* that the Justices intended to overturn these decades-old anti-abuse doctrines; however, the line between legitimate and illegitimate federal common lawmaking remains unclear. *Rodriguez* therefore reinforces the uncertainty of the term "federal common law" and the imprecision around its boundaries.

Federal judges' increasing preference towards textualism coupled with *Rodriguez's* hostility towards judge-made law raises legitimate concerns regarding the continued validity of the substance-over-form tax doctrines. Historically, textualists rejected the anti-abuse doctrines as an illegitimate form of federal common lawmaking. Although the Supreme Court has not recently passed judgement on the anti-abuse doctrines,[155] one can infer how

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[151] *Id*. at 718.
[152] *Id.*
[153] *See id*. at 717 ("Judicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government's 'legislative Powers' in Congress and reserves most other regulatory authority to the States.").
[154] *See e.g.*, True v. U.S., 190 F.3d 1165, 1173 (10th Cir. 1999) (discussing the substance-over-form doctrine); Comm'r v. Clark, 489 U.S. 726, 736 (1989) (discussing the step transaction doctrine); Estate of Franklin v. Comm'r, 544 F.2d 1045, 1046 (9th Cir. 1976) (discussing the sham transaction doctrine).
[155] The last case the Supreme Court decided involving a substance-over-form doctrine was *Frank Lyon* in 1978. Frank Lyon Co. v. United States, 435 U.S. 561, 572 (1978). The court reviewed *Cottage Savings* in 1991 but did not address the substance-over-form issues discussed in the lower courts. *See* Cottage Sav. Ass'n v. Comm'r, 499 U.S. 554, 567 (1991).

the Court might decide. In light of the Court's recent trend of resolving tax cases using textualist interpretation methods,[156] it is doubtful the Court would permit the judicially created doctrines to stand.

B. *Impact on the Economic Substance Doctrine*

Various commentators argue that the economic substance doctrine is an invalid exercise of judicial federal common lawmaking,[157] a critique which has continued post-codification.[158] The Supreme Court has not opined on the scope of the economic substance doctrine for decades. Since then, economic substance cases in the lower courts have proliferated without developing any single articulable standard. Variance in lower courts' application of the doctrine has led circuits to recognize that the economic substance doctrine "is not a model of clarity."[159] Significant disagreement surrounding the fundamental role and the limits of the economic substance doctrine remain. Notably, the Treasury Department has recognized that the doctrine "is inherently subjective" and is applied "unevenly."[160] As a result, the Department has acknowledged, "a great deal of uncertainty exists as to when and to what extent [it] appl[ies], how [it] appl[ies], and how taxpayers may rebut [it]."[161]

Although the partial codification of the economic substance doctrine resolved some ambiguity, it did not help the rampant uncertainty surrounding the doctrine's scope. While the codified "clarification" of the economic substance doctrine was intended to make the content[162] of the doctrine more uniform, the statute does not resolve courts' conflicting views on the scope and limits of the economic substance doctrine.[163] Section 7701(o) does nothing to address the courts' most important threshold question—when

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[156] *See, e.g.*, Gitlitz v. Comm'r, 531 U.S. 206, 220 (2001) ("Because the Code's plain text permits the taxpayers here to receive these benefits, we need not address this policy concern.").

[157] *See, e.g.*, Grewal, *supra* note 94, at 970 (asserting that the economic substance doctrine is invalid under Supreme Court case law and the statutory interpretation methods the Court uses).

[158] *See, e.g.*, Jasper L. Cummings, *The Supreme Court's Economic Substance Doctrine Opinion*, 149 TAX NOTES 1295, 1295–97 (2015) (arguing that, even after the enactment of section 7701(o), the economic substance doctrine is invalid).

[159] United States v. Coplan, 703 F.3d 46, 91 (2d Cir. 2012).

[160] *See* U.S. DEP'T OF THE TREASURY, *supra* note 31, at 94.

[161] *Id.*

[162] Requiring use of the conjunctive test and resolving the circuit split debate regarding the proper economic substance test to apply.

[163] *See* Rebecca Rosenberg, *Codification of the Economic Substance Doctrine: Substantitve Impact and Unintended Consequences*, 15 HASTINGS BUS. L.J. 55, 111-12 (2019) (stating that § 7701(o) does not preclude differing applications of the economic substance doctrine by courts); *see also* discussion *supra* Part V § C.

does the economic substance doctrine apply? The statute explicitly provides that the doctrine is applicable only when the economic substance doctrine is "relevant" to a transaction.[164] Section 7701(o)(5)(c) simply directs courts to determine relevance "in the same manner as if [the statute] had never been enacted."[165] Thus, in cases involving the proper scope of the economic substance doctrine, the doctrine's relevance and subsequent application depends entirely on judicially developed case law— a perplexing approach for a statute purportedly offering a "clarification" of existing law. Furthermore, because the United States' judicial system of stare decisis dictates that the Supreme Court's case law controls all courts beneath it, analyzing how the current Supreme Court may resolve when the economic substance doctrine applies is of paramount importance. Given the *Rodriguez* decision's reprimand of lower courts' creation of federal common law, it's plausible to surmise the Court would hold that the federal common law, upon which the economic substance doctrine was built, is beyond the "limited areas . . . in which federal judges may appropriately craft the rule of decision."[166] If this happens, and the Supreme Court strikes down lower courts' current federal common law application of the economic substance doctrine, the Court would be free to construct its own interpretation of when section 7701(o) should be applied. Current Supreme Court precedent, utilizing textualism in tax cases, indicates the Court would impose a much narrower application of the economic substance doctrine than the majority of lower courts currently use.

C. *Impact on When the Economic Substance Doctrine is "Relevant"*

Practitioners and legal scholars raise concerns that inconsistent case law creates unclear guidance surrounding when courts should use the economic substance doctrine.[167] Most lower courts adopt a broad application of the economic substance doctrine and disregard "mere compliance with the code"[168] when determining whether a transaction qualifies for a tax

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[164] I.R.C. § 7701(o)(1).
[165] I.R.C. § 7701(o)(5)(C).
[166] Rodriguez v. FDIC, 140 S. Ct. 713, 718 (2020).
[167] *See e.g.*, Tucker v. Comm'r, 2019 U.S. 766 F. App'x 132 (5th Cir. 2019), *petition for cert. filed*, 2019 U.S. S. Ct. Briefs LEXIS *2411* *27-28 (U.S. Jul. 24, 2019) (No. 19-41), *cert. denied*, 140 U.S. 378 (2019); David P. Blair, *Are Plain Meaning Cases on a Collision Course with the Economic Substance Doctrine?*, 5 J. TAX'N FIN. PRODS. 7, 9 (2005).
[168] Stauffer's Est. v. Comm'r, 403 F.2d 611, 621 (9th Cir. 1968).

deduction or other benefit.[169] Under this approach, "economic substance is a *prerequisite* to the application of any Code provisions allowing deductions,"[170] with some situations carved out by statute.[171] Furthermore, even when courts recognize a taxpayer "complied with each and every of the relevant requirements imposed by the Code,"[172] tax benefits are frequently denied for lack of economic substance.

Despite most lower courts' broad application of the economic substance doctrine,[173] a narrower approach aligns more closely with recent Supreme Court jurisprudence. Specifically, lower courts' broad conception of the economic substance doctrine conflicts with fundamental separation of powers principles and a modern textualist approach to statutory interpretation.[174] In fact, a careful review of Supreme Court case law reveals that the Court has never applied the economic substance doctrine to deny taxpayers benefits from Code-compliant transactions in the same broad manner as lower courts. Instead, the Court examines economic substance principles consistent with the governing statute to determine whether a transaction falls within the text of the statute.[175] If faced with a case concerning the scope of the economic substance doctrine, the Supreme Court would likely reject lower courts' sweeping application of the doctrine and

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[169] *See, e.g.,* Coltec Indus. v. United States, 62 Fed. Cl. 716, 756 (Fed. Cl. 2004); IRS v. Cm Holdings, 301 F.3d 96, 102 (3d Cir. 2002); Compaq Computer Corp. v. Comm'r, 113 T.C. 214, 223-24 (1999).

[170] Lerman v. Comm'r, 939 F.2d 44, 52 (3d Cir. 1991).

[171] *See* I.R.C. § 7701(o)(5)(B).

[172] H.J. Heinz Co. v. United States, 76 Fed. Cl. 570, 592 (Fed. Cl. 2007).

[173] It should be noted that some lower courts have rejected the majority's broad application of the economic substance doctrine. *See, e.g.*, Horn v. Comm'r, 968 F.2d 1229, 1234 (D.C. Cir. 1992). These courts have applied the doctrine in a narrower sense as a "judicial device[] for divining and effectuating congressional intent, not for supplanting it." *Id*.

[174] *See* Cunningham & Repetti, *supra* note 94 at 4-6. (suggesting that courts would not have developed the economic substance doctrine if they had been using the textualist method of statutory interpretation).

[175] *See* Boulware v. United States, 552 U.S. 421, 430-31 (2008) (recognizing that "economic substance remains the right touchstone," to characterize corporate distributions but rejecting an extra-statutory intent requirement); Neb. Dep't of Revenue v. Loewenstein, 513 U.S. 123, 133-34 (1994) (dismissing taxpayer's reliance on the economic substance analysis in *Frank Lyon's* economic substance analysis because the statutes at issue were dissimilar); Cottage Sav. Ass'n v. Comm'r, 499 U.S. 554, 562 (1991) (rejecting government's argument that the taxpayer must meet the economic substance requirement, because the statute at issue "embodies a much less demanding and less complex test"); Frank Lyon Co. v. United States, 435 U.S. 561, 583-84 (1978) (examining economic substance principles consistent with Section 167(a) requirements); United States v. Consumer Life Ins. Co., 430 U.S. 725, 740-41 (1977) (rejecting the government's economic substance argument that had no statutory basis); Knetsch v. United States, 364 U.S. 361, 365 (1960) (examining a transaction to see whether it produced indebtedness under Section 163); Gregory v. Helvering, 293 U.S. 465, 470 (1935) (focusing on the "statutory provision in question" to determine if a transaction qualified for tax benefits).

adopt a narrower set of circumstances under which section 7701(o) is "relevant."

Recall, the economic substance doctrine was originally developed during a time when courts prioritized legislative purpose rather than simply giving effect to a statute's plain meaning.[176] However that purposivism era has largely passed, and the Court now emphasizes the primacy of codified text when interpreting statutes,[177] including the Code.[178] Yet despite the Court's repeated admonition that the text is the law, lower courts continue to apply the economic substance doctrine broadly and disregard Code-compliant transactions that violate the judiciary's determination of a statute's unstated purpose.[179]

When interpreting tax statutes, the Supreme Court follows the "firmly established principle of statutory interpretation that 'the words of statutes – including revenue acts – should be interpreted where possible in their ordinary, everyday senses.'[180] Furthermore, the Court has "stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous then, the first canon is also the last: 'judicial inquiry is complete.'"[181] Thus, the Court "enforce[s] plain and unambiguous statutory language according to its terms,"[182] and refuses "to rescue Congress from its drafting errors, and to provide for what [the Court] might think . . . is the preferred result."[183] As a result, the Supreme Court would likely find that a broad application of the economic substance doctrine improperly bypasses statutory text in favor of Congressional purpose despite the Court's holding that, "[t]he best evidence of [statutory] purpose *is* the statutory text."[184]

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[176] *See, e.g.*, Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 412 n.29 (1971).
[177] *See, e.g.*, Baker Botts L.L.P. v. ASARCO LLC, 576 U.S. 121, 135 (2015) ("Our job is to follow the text even if doing so will supposedly 'undercut a basic objective of the statute.'" (citation omitted)).
[178] *See* Gitlitz v. Comm'r, 531 U.S. 206, 220 (2001) ("Because the Code's plain text permits the taxpayer here to receive these benefits, we need not address this policy concern.").
[179] *See, e.g.*, Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1343 (Fed. Cir. 2006) (finding that despite extensive statutory analysis showing that the taxpayer had complied with the Code, the court disregarded the taxpayer's transaction under the economic substance doctrine).
[180] Hanover Bank v. Comm'r, 369 U.S. 672, 687 (1962) (quoting Crane v. Comm'r, 331 U.S. 1, 6 (1947)).
[181] *See* Barnhart v. Sigmon Coal Co., 534 U.S. 438, 461–462 (2002) (citations omitted) (quoting Conn. Nat. Bank v. Germain, 503 U.S. 249, 253-54 (1992)).
[182] Hardt v. Reliance Standard Life Ins. Co., 560 U.S. 242, 251 (2010).
[183] Lamie v. U.S. Tr., 540 U.S. 526, 542 (2004) (alteration in original) (citation omitted) (quoting United States v. Granderson, 511 U.S. 39, 68 (1994) (concurring opinion)).
[184] W. Va. Univ. Hosps., Inc., v. Casey, 499 U.S. 83, 98 (1991) (emphasis added).

Consequently, the broad application of the economic substance doctrine is an unparalleled departure from the Supreme Court's prevailing method of statutory interpretation. Lower courts reason that a broad economic substance application is necessary to uphold Congressional purpose;[185] however, the Supreme Court has rejected this notion of tax exceptionalism[186] and maintained that tax law is subject to the same interpretive standards as other areas of the law.[187]

Furthermore, commentators have pointed out that elevating a search for Congressional purpose over text is particularly difficult when it comes to tax law.[188] A broad application of the economic substance doctrine operates under the false presumption that Congress' overriding purpose for enacting tax laws is tax maximization.[189] However, it is well known that the federal income tax system contains provisions expressly designed to alter taxpayers' behavior.[190] The Code reflects countless tradeoffs that serve many non-tax purposes, such as incentivizing particular kinds of economic activity and providing benefits to certain types of people.[191] As a result, a textualist critique of the anti-abuse doctrines finds it improper for the judiciary to extract Congressional intent from a statute whose words embody a nuanced approach to lawmaking devoid of a singular purpose.[192] Indeed, the Court would likely follow its own guidance that, "[i]n the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by

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[185] That lower courts freely disregard tax statutes (but usually pay heed to nontax statutes) may be due to a phenomenon aptly described as tax myopia. *See* Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up to Be Tax Lawyers*, 13 VA. TAX REV. 517, 518 (1994) ("Tax law too often is mistakenly viewed by lawyers, judges, and law professors as a self-contained body of law . . . this misperception has impaired the development of tax law by shielding it from other areas of law that should inform the tax debate").

[186] Tax exceptionalism means that tax statutes should be interpreted differently from other statutes due to their unique characteristics. Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1541-42, 1559-63 (2006) (defining tax exceptionalism and disagreeing with those scholars who argue that tax interpretation is unique).

[187] *See* Mayo Found. for Medical Educ. & Rsch. v. United States, 562 U.S. 44, 55-56 (2011) (holding that the Chevron doctrine applies in the tax context just as it does elsewhere).

[188] *See, e.g.*, Lederman, *supra* note 53, at 389; David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1631–32 (1999).

[189] *See* Summa Holdings, Inc. v. Comm'r, 848 F.3d 779, 787-88; *cf.* CTS Corp. v. Waldburger, 573 U.S. 1, 12 (2014) ("[N]o legislation pursues its purposes at all costs." (citation omitted)).

[190] *See* Lederman, *supra* note 53, at 389, 394-98.

[191] *See, e.g.*, I.R.C. § 42 (granting tax credit for construction or rehabilitation of affordable housing); I.R.C. §§ 219, 408, 408A (granting deductions for IRA and Roth IRA contributions to encourage retirement savings).

[192] *See, e.g.*, Elizabeth Garrett, *Remarks on Anti-Abuse Rules*, 74 TAXES 197, 199 (1996) ("The language of the statute is the law, and if it is clear, in most cases it should be applied by the Service and by the courts.").

implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out."[193] Prioritizing judicially-made doctrines over clear statutory text is unlikely to go over well with the Court who, just this year, unanimously held that, "[j]udicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government's 'legislative Powers' in Congress . . . "[194] Completely overriding Code-compliant tax benefits with the judicially-constructed economic substance doctrine is likely the type of judicial overreach the *Rodriguez* court warned against.[195] Additionally, the Supreme Court would likely reject lower courts' broad application of the economic substance doctrine that, as one appellate judge noted, operates merely as a "smell test," allowing judges to impose their own subjective feelings to disallow tax benefits that Congress permits.[196] Rather, emphasizing codified statutory text places an "objective constraint on [the judiciary's] conduct."[197]

Existing tax law may lend additional support to the idea that judges should apply economic substance principles only to the extent that such an analysis is required by a statute's codified text because Congress *does* explicitly include a taxpayer's motive for entering into a transaction in some statutes.[198] Thus, if Congress does not explicitly codify taxpayer intent as

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[193] Gould v. Gould, 245 U.S. 151, 153 (1917).

[194] Rodriguez v. FDIC, 140 S. Ct. 713, 718 (2020).

[195] *Id*. at 718 ("We took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hands at common lawmaking. *Bob Richards* made the mistake of moving too quickly past important threshold questions at the heart of our separation of powers.").

[196] *See* ACM P'ship v. Comm'r, 157 F.3d 231, 265 (3d Cir. 1998) (McKee, J. dissenting) ("I can't help but suspect that the majority's conclusion [is] something akin to 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.'").

[197] Alex Kozinski, *What I Ate for Breakfast and Other Mysteries of Judicial Decision Making*, 26 LOY. L.A. L. REV. 993, 996 (1993) ("Language has meaning. This doesn't mean every word is as precisely defined as every other word, or that words always have a single, immutable meaning. What it does mean is that language used in statutes, regulations, contracts and the Constitution place an objective constraint on our conduct.").

[198] *See e.g.*, I.R.C § 162(a) (restricting deductions to those made in the carrying on of a trade or business); I.R.C. § 170(f)(9) (denying charitable deductions that are made to avoid application of I.R.C. § 162(e)); I.R.C. § 269 (denying tax benefits gained through the acquisition of a corporation, in which "the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax"); I.R.C. § 269A (concerning personal service corporations that are formed for the purpose of tax avoidance); I.R.C. § 269B(b) (granting the Treasury Secretary authority to "prescribe such regulations as may be necessary to prevent avoidance or evasion of Federal income tax through the use of stapled entities"); I.R.C. § 306(b)(4) (excepting transactions from the operation of 306(a) in which the taxpayer is not motivated to avoid tax); I.R.C. § 355(a)(1)(D) (taxpayers cannot keep stock in an I.R.C. § 355 transaction unless it was held "not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax"); I.R.C. § 357(b)(1)

relevant to a Code provision, then the Supreme Court is likely to adhere to its own precedent and recognize its "judicial function to apply statutes on the basis of what Congress has written, not what Congress might have written."[199] The Supreme Court does not permit the inference of legislative purpose by ignoring the agreed upon language of the codified text.[200] As such, the Supreme Court is unlikely to approve of lower courts' dismissal of Code-compliant transactions in favor of an unstated and judicially-inferred legislative purpose.[201] Instead, the Supreme Court takes a more straight-forward approach, "enforce[ing] plain and unambiguous statutory language according to its terms,"[202] and recognizes the judiciary "must determine intent from the statute before [the Court]."[203] The Supreme Court has repeatedly warned, "the fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning."[204] Moreover, as the interpreter of laws the Court routinely refuses "to rescue Congress from its drafting errors, and

(excepting tax avoidance plans from the operation of 357(a)); I.R.C. § 467(b)(2) (requiring "constant rental accrual in case of certain tax avoidance transactions"); I.R.C. § 532 (taxing corporations "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders"); I.R.C. § 845(a) (granting the Treasury Secretary authority to recharacterize a reinsurance agreement entailing tax avoidance or evasion); I.R.C. § 877 (addressing expatriations undertaken to avoid tax); I.R.C. § 1272(a)(2)(E)(ii) (excluding a loan from I.R.C. § 1272(a)(2)(E)(i) "if the loan has as 1 of its principal purposes the avoidance of any Federal tax").

[199] United States v. Great N. Ry. Co., 343 U.S. 562, 575 (1952).

[200] *See e.g.*, United States v. Bitty, 208 U.S. 393, 401 (1908) ("All will admit that full effect must be given to the intention of Congress as gathered from the words of the statute."); United States v. Goldenberg, 168 U.S. 95, 102-103 (1897) ("The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used"); Aldridge v. Williams, 44 U.S. 9, 24 (1845) ("In expounding this law, the judgment of the court cannot, in any degree, be influenced by the construction placed upon it by individual members of Congress in the debate which took place on its passage, nor by the motives or reasons assigned by them for supporting or opposing amendments that were offered. The law as it passed is the will of the majority of both houses, and the only mode in which that will is spoken is in the act itself.")

[201] *See* Joseph Isenbergh, *Musings on Form and Substance in Taxation (reviewing Boris I. Bittker, Federal Taxation of Income, Estates, and Gifts (1981))*, 49 U. CHI. L. REV. 859, 879 (1982) ("Hard grappling with the facts of a case and the inner workings of a statute, although both difficult and intellectually admirable, is frequently passed off as a trivial or excessively 'formal' exercise. . . [Instead, a lower court will make] an inquiry about the 'larger' nature of the statute itself. The latter exercise is in fact quite easy, requiring only the assertion of a statutory purpose that encapsulates one's own tastes, either generally or regarding the transaction under scrutiny.").

[202] Hardt v. Reliance Standard Life Ins. Co., 560 U.S. 242, 251 (2010).

[203] Lamie v. U.S. Tr., 540 U.S. 526, 542 (2004).

[204] Lockhart v. United States, 546 U.S. 142, 146 (2005) (unanimous opinion) (quoting Union Bank v. Wolas, 502 U.S. 151, 158 (1991) (unanimous opinion)). *See also* Oncale v. Sundowner Offshore Servs., Inc., 523 U.S. 75, 79 (1998) (unanimous opinion).

to provide for what [the Court] might think . . . is the preferred result."[205] Instead the Court maintains the position that, "[i]f Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent."[206] As a result, the Court would likely hold that the economic substance doctrine should only be applied to statutes when Congress expressly requires that such an inquiry to be made in a particular statute.

D. *Impact on Technical Tax Arrangements*

The Supreme Court's potential adoption of a narrower application of the economic substance doctrine's relevance raises concerns that such a decision may usher in a new wave of tax shelters.[207] Tax shelters often involve the application of clear and unambiguous Code provisions to derive unintended tax benefits.[208] Additionally, tax shelters exploit the judicial shift towards textualism by designing tax advantageous transactions which comply with the text of the Code but generate results neither Congress nor the Treasury considered when drafting the law. Historically, courts used the economic substance doctrine to strike down these types of transactions, even if the taxpayer textually complies with the Code.[209] However, a narrow application of the economic substance doctrine, described *supra* Part V. § C, would prevent courts from bypassing textual compliance and striking down many tax shelters. Therefore, narrowly construing the economic substance doctrine's relevance would permit the creation of tax shelters by utilizing Code provisions that do not specifically address economic substance principles. Ultimately, this could render the economic substance doctrine moot and begin a new wave of tax shelters that judicially created substance-over-form doctrines cannot strike down.

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[205] *Lamie*, 540 U.S. at 542 (alteration in original) (quoting United States v. Granderson, 511 U.S. 39, 68 (1994) (Kennedy, J., concurring)). *See also Oncale*, 523 U.S. at 79 ("[I]t is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed.").

[206] *Lamie*, 540 U.S. at 542.

[207] *See generally*, Cunningham & Repetti, *supra* note 94.

[208] Although the Code does not outline a single definition of the term "tax shelter," the term is generally used to describe a business arrangement where "a signifigant purpose of such . . . arrangement is the avoidance or evasion of Federal income tax." I.R.C. § 6662(d)(2)(C)(ii).

[209] *See, e.g.*, IRS v. CM Holdings, Inc., 301 F.3d. 96, 102 (3d Cir. 2002) ("even if a transaction complies precisely with all requirements for obtaining a deduction, if it lacks economic substance it 'simply is not recognized for federal taxation purposes, for better or for worse.'" (quoting ACM P'ship v. Comm'r, 157 F.3d 231, 261 (3d Cir. 1998)).

E. *An Example of How it Would Affect A Current Enforcement Matter: Conservation Easements*

While it is difficult to anticipate the face of the next wave of tax shelters, the impact of a narrower application of the economic substance doctrine is already being seen in the Service's recent actions against conservation easements. The Service now considers syndicated conservation easements potential transactions for tax abuse and plans to review the validity of conservation easements via the economic substance doctrine. However, as outlined below, if the Supreme Court adopts a narrower application of the economic substance doctrine's relevance, many conservation easement transactions will satisfy the technical requirements of the Code and the Service will no longer be able to use the doctrine to strike down the transactions.

1. The Technical Transaction

In December 2016, the Service issued Notice 2017-10, identifying syndicated conservation easement transactions ("SCETs") as "listed transactions."[210] "Listed transactions," and "substantially similar transactions," are transactions identified by the Service in notice, regulation, or public guidance as displaying characteristics of illegitimate tax avoidance.[211] Taxpayers who participate in listed transactions must disclose their participation in them to the Service.[212] A typical SCET covered by Notice 2017-10 involves a shelter provider advertising investment in a passthrough entity owning or acquiring real property then granting a conservation easement encumbering the property to a tax-exempt entity.[213] The property is often appraised at an inflated value and subsequently, when the easement is donated, the investors claim an inflated charitable contribution deduction.[214] Investors typically receive additional tax benefits from this transaction by utilizing Code provisions allowing the investor to "tack" on to the passthrough entity's holding period in the property and treat

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[210] *See* I.R.S. Notice 2017-10, 2017-4 IRB 544, 1-3.
[211] I.R.C. § 6707A(c)(2); Treas. Reg. § 1.6011-4(b)(2).
[212] A taxpayer's disclosure under I.R.C. § 6011 is made by attaching a Form 8886 "Reportable Transaction Disclosure Statement" to the tax return for each taxable year in which a listed transaction occurred and filing a copy of Form 8886 with the IRS Office of Tax Shelter Analysis. Similarly, a promoter must provide the Service with certain information under I.R.C. § 6112.
[213] I.R.S. Notice 2017-10, *supra* note 210 at 2.
[214] *See id.*

the donated easement as long-term capital gain.[215] In exchange for facilitating this tax optimizing transaction, the SCET provider generally receives a fee, often in the form of an interest in the passthrough entity. Notice 2017-10 asserts that the Service will challenge the tax benefits of these types of SCETs based on various doctrines, including the economic substance doctrine.[216]

2. Is the Transaction Technically Correct?

If structured correctly, the SCET discussed in Notice 2017-10 technically complies with the plain text of the Code. Taxpayers are generally allowed to deduct the value of charitable contributions that they make during a year.[217] The Code allows a taxpayer to deduct a partial interest in property if it constitutes a "qualified conservation contribution."[218] To satisfy the "qualified conservation contribution" definition, a taxpayer must show they (i) donated a qualified real property interest, (ii) to a qualified organization, (iii) exclusively for conservation purposes.[219] A qualified real property interest can include many things, including a conservation easement that grants a perpetual restriction on the use of a piece of real property.[220] Under an SCET, the promoter will generally ensure all of the Code's requisite elements for making a charitable donation are met. As a result, conservation easement donations are not typically challenged for a taxpayer's failure to comply with the Code. Instead, the primary issue the government raises with SCETs as an abusive tax shelter is the questionable appraisal value of the real property and the associated tax benefits.[221] However, many SCETs do in fact comply strictly with the letter of the Code on this issue too. Normally, when a taxpayer claims a charitable deduction on donated property, the taxpayer deducts the fair market value ("FMV")[222] of the property at the time the taxpayer makes the donation.[223] However, Treasury Regulations provide special rules for calculating deductions stemming from conservation easement donations.[224] Generally, the best evidence of FMV is the sale price

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[215] I.R.C. § 170(e)(1); *see also id.* at 3.
[216] I.R.S Notice 2017-10, s*upra* note 210 at 2.
[217] I.R.C. § 170(a)(1); Treas. Reg. 1.170A-1(a).
[218] I.R.C. § 170(f)(3)(B)(iii); Treas. Reg. 1.170A-7(b)(5).
[219] I.R.C. § 170(h)(1).
[220] I.R.C. § 170(h)(2); Treas. Reg. 1.170A-14(a); Treas. Reg. 1.170A-14(b)(2).
[221] I.R.S Notice 2017-10, s*upra* note 210 at 2.
[222] In this context, the term FMV is calculated by determining the price that a willing buyer and willing seller, both having reasonable knowledge of the relevant facts, would agree to pay. *See* Treas. Reg. 1.170A-1(c)(2).
[223] I.R.C. § 170(a)(1); Treas. Reg. 1.170A-1(c)(1).
[224] *See* Treas. Reg. 1.170A-14(b)(2).

of comparable transactions; however, the Service recognizes that "in most instances, there are no substantial record of comparable [easement] sales."[225] Therefore, when determining the appropriate FMV of conservation easements, qualified appraisers take into account both the current use of the property and the property's future potential profitability, known as its highest and best use ("HBU").[226]

In general, a property's HBU is determined by assessing the reasonably probable use of real property that is physically possible, legally permissible, financially feasible, and maximally productive.[227] In other words, a property's HBU is "[t]he highest and most profitable use for which the property is needed or likely to be needed in the reasonably near future."[228] As a result, the HBU can be any realistic potential use of the property.[229] Importantly, conservation easement deduction valuation does not require the property owner to have actually used the property in the HBU assessed manner previously; nor does it require a property owner to have any real plans to use the property in the manner described in the HBU in the future.[230] Consequently, SCET promoters purchase property with no intention of developing the property and utilize high HBU assessments in order to market tax deductions significantly exceeding an investor's initial investment. If a SCET provider properly receives an inflated HBU assessment from a qualified appraiser, then the subsequent charitable deduction is generally compliant with technical Code requirements.

3. Effect on Enforcement Actions

To combat what the Service perceives as improper charitable deductions flowing from high HBU evaluations, the agency plans to utilize the economic substance doctrine and other anti-abuse rules.[231] Unfortunately, if the Supreme Court narrows the scope of the economic substance doctrine to be relevant only when a specific Code provision requires the doctrine, the Service will not be able to use the economic substance doctrine to combat SCETs. As previously discussed, conservation easement deductions generally comply with all technical elements required by the Code.

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[225] INTERNAL REVENUE SERVICE, CONSERVATION EASEMENT AUDIT TECHNIQUES GUIDE 41 (2018).
[226] *See* Stanley Works v. Comm'r, 87 T.C. 389, 400 (1986); Treas. Reg. 1.170A-14(h)(3)(i)-(ii).
[227] Esgar Corp. v. Comm'r, 744 F.3d 648, 659 n.10 (10th Cir. 2014) (citing United States v. 1.604 Acres of Land, 844 F. Supp.2d 668, 679 (E.D. Va. 2011)).
[228] Olsen v. United States, 292 U.S. 246, 255 (1934).
[229] *See* Symington v. Comm'r, 87 T.C. 892, 896 (1986).
[230] *Esgar Corp.*, 744 F.3d at 657.
[231] I.R.S Notice 2017-10, *supra* note 210 at 3.

Furthermore, nowhere in the statutes covering conservation easement deductions does Congress require anything resembling economic substance. As a result, the Supreme Court, utilizing a narrow economic substance doctrine application, would likely decide that the economic substance doctrine is not relevant in determining the validity of a conservation easement evaluation. Although the Service may be able to challenge inflated conservation easement deductions on alternate grounds, the potential narrowing of the economic substance doctrines scope creates broader issues for combating future tax shelters.

V. CONCLUSION

The rise of textualism coupled with the Supreme Court's recent hostility towards federal common lawmaking threatens the future administration of tax law. If the Supreme Court does take a case interpreting the codified economic substance doctrine, the textualist-leaning Court will likely follow its own *Rodriguez* guidance to limit the scope of federal common lawmaking and narrow the applicability of the economic substance doctrine. If this happens the government, left without its most common tool for combating tax evasive transactions, can expect to see a dramatic surge in such transactions. While courts should not take it upon themselves to close loopholes in the Code,[232] Congress can and should amend statutes reflecting poor policy. Both Congress and the Treasury Department must recognize that the Supreme Court's textualist-focused interpretation of statutes is the new judicial norm. As a result, it is no longer acceptable for the legislative and executive branches to assume that the judiciary will impose common law substance-over-form doctrines to sweep away any unintended mess created through poor drafting of legislation or lack of executive regulations. Instead, the legislative and executive branches must recognize their proper roles in American democracy and issue a meaningful "clarification" of the economic substance doctrine.[233]

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[232] *See* Iselin v. United States, 270 U.S. 245, 251 (1926) ("To supply omissions transcends the judicial function.").

[233] Referencing the codified economic substance doctrine, titled "clarification of the economic substance doctrine" *See* I.R.C. § 7701(o).