No. 10-1047

In the Supreme Court of the United States

CARLOS E. SALA AND TINA ZANZOLINI-SALA,
PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals applied the correct standard of review in determining that petitioners' transaction lacked economic substance and that petitioners therefore were not entitled to deduct the artificial tax losses generated by that transaction.

2. Whether the court of appeals applied the correct substantive standard in determining that petitioners' transaction lacked economic substance.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-14) is reported at 613 F.3d 1249. The opinion of the district court (Pet. App. 15-88) is reported at 552 F. Supp. 2d 1167.

JURISDICTION

The judgment of the court of appeals was entered on July 23, 2010. A petition for rehearing was denied on November 19, 2010 (Pet. App. 95-96). The petition for a writ of certiorari was filed on February 17, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On August 13, 2000, the Internal Revenue Service (IRS) issued Notice 2000-44, 2000-2 C.B. 255. Notice 2000-44 stated that transactions involving the transfer of property and offsetting contingent liabilities to a partnership, followed by the taxpayer's exit from the partnership to achieve a non-economic loss, do not give rise to an allowable tax deduction. See Pet. App. 5 n.2. One of the examples described in the notice involved a transfer of largely offsetting long and short option contracts. See *id.* at 70. The notice informed taxpayers that the IRS would challenge deductions based on such transactions and would seek penalties against taxpayers who claimed them. See *id.* at 5 n.2.

More than three months later, petitioner Carlos E. Sala participated in the sort of offsetting-option transaction described in Notice 2000-44, one designed to generate an artificial tax loss large enough to eliminate over $60 million of taxable income that he had realized in 2000. Pet. App. 2, 4. At the time of the transaction, Sala had actual knowledge of Notice 2000-44. Gov't C.A. App. 536-544, 553-555. Sala's year-end transaction, which involved a partnership that existed for only a few weeks, was characterized by the shelter promoter as a "test period" for a legitimate investment program that commenced in January 2001. Pet. App. 2, 4. Participants were required to invest an amount equal to a percentage of the desired tax loss. *Id.* at 4; Gov't C.A. App. 522.

In October and November 2000, Sala deposited approximately $8,925,000 in a trading account. In late November, the investment manager used approximately $728,000 to acquire on Sala's behalf a combination of 24 long (purchased) and short (sold) option positions in foreign currency. The $728,000 represented the net of the

aggregate purchase price of the long options (about $60.99 million) and the aggregate sales proceeds of the short options (about $60.26 million). Pet. App. 6.

On November 28, 2000, Sala transferred his trading account to Solid Currencies, Inc. (Solid), a newly formed, wholly owned S corporation, which in turn transferred the account to a partnership called Deerhurst Investors, GP (Deerhurst GP). Pet. App. 6, 17. Deerhurst GP closed out the offsetting option positions in December 2000 and liquidated before December 31. The liquidating distribution to Solid consisted of approximately $8 million in cash and two foreign currency contracts with a market value of less than $1 million. Solid sold the contracts before the end of 2000. *Id.* at 6-7.

Although Solid derived a small profit (approximately $100,000 before fees) from its participation in Deerhurst GP, Solid claimed a tax loss of more than $60 million. Pet. App. 7. In asserting that loss, Solid took the position that had already been repudiated by the IRS in Notice 2000-44. Purporting to apply the rule of *Helmer* v. *Commissioner*, 34 T.C.M. (CCH) 727 (1975), that a partnership's assumption of a partner's contingent liability is not treated as an assumption of a liability when calculating the partner's basis in the partnership, Solid disregarded the short options in calculating its adjusted basis in Deerhurst GP. See Pet. App. 6. Thus, Solid calculated its basis in the partnership as approximately $69 million (consisting of the approximately $61 million in long options plus the approximately $8 million cash balance in the trading account). See *id.* at 7; 26 U.S.C. 705, 722. Because Solid received $8 million in cash along with the two foreign currency contracts on liquidation of the partnership, Solid calculated its basis in those contracts as approximately $61 million (its purported $69

million partnership basis less the $8 million cash distribution). See Pet. App. 7; 26 U.S.C. 732(b). And, because Solid sold the foreign currency contracts for less than $1 million, it calculated a tax loss on the sale of $60,250,065.94. Pet. App. 7. That loss was wholly artificial, however, as Solid incurred no actual economic harm but instead profited from participating in Deerhurst GP. *Ibid.* Because Solid was an S corporation, the asserted tax loss passed through to petitioners. See 26 U.S.C. 1361 *et seq.*

On their joint federal tax return for 2000, petitioners reported a total loss of approximately $60.45 million as having been passed through from Solid. Pet. App. 7. The claimed loss offset almost all of petitioners' income for 2000, so they reported an adjusted gross income of only $26,381. *Ibid.* Consequently, notwithstanding Sala's receipt of $60 million in income (primarily from the exercise of stock options) in 2000, petitioners reported that they owed no federal income taxes for that year. *Id.* at 4, 7.

In November 2003, petitioners filed an amended return for 2000, forgoing the $60.45 million pass-through loss from Solid and paying approximately $26 million in taxes, interest, and penalties. In September 2004, however, they filed a second amended return for 2000, reclaiming the pass-through loss and demanding a refund of $23,727,630. Pet. App. 8.

2. After the IRS denied their refund claim, petitioners filed this refund suit in the United States District Court for the District of Colorado. After a bench trial, the court entered judgment in favor of petitioners. Pet. App. 15-88.

As relevant here, the district court rejected the government's argument that the transaction at the end of

2000 giving rise to Solid's claimed loss (the Deerhurst GP transaction) lacked economic substance and therefore must be disregarded for Federal income tax purposes. Pet. App. 37-52. As a threshold matter, the court rejected the government's argument that its analysis should be limited to the Deerhurst GP transaction. *Id.* at 24, 26-27. Instead, the court found that the "transaction" giving rise to the claimed loss—and therefore the transaction to be analyzed—was not merely the Deerhurst GP transaction but the entire "Deerhurst Program," which also included the legitimate, follow-on investment program that commenced in January 2001 and continued for several years thereafter. *Id.* at 23-31.

Consistent with its threshold determination regarding the scope of the loss-generating transaction, the district court evaluated whether the transaction possessed economic substance by comparing the magnitude of the claimed loss ($60 million) to the profits that Sala's $9 million investment potentially could have earned over the five-year term of the follow-on investment program. See Pet. App. 41 (stating that "Sala's $9 million had the potential to exceed—albeit by a slender margin—the $60,449,984 claimed loss within the five years and two months dedicated to the combined Deerhurst Program"). Based on that analysis, the court concluded that the overall program "possessed economic substance." *Id.* at 42. The court further concluded that the government had failed "to show by a preponderance of the evidence that there was no business purpose to Sala's actions other than tax avoidance." *Id.* at 43; see *id.* at 42-52. In making the "business purpose" determination, the court examined each component of the Deerhurst Program individually, as well as the program in its entirety. See *ibid.* After finding that each component and

the program as a whole had a business purpose other than the creation of tax losses, the court held that "Sala's investment in the Deerhurst Program was not a sham transaction." *Id.* at 52.[1]

3. The court of appeals reversed. Pet. App. 1-14. The court noted at the outset that "[t]he ultimate determination of whether a transaction lacks economic substance is a question of law" that is subject to de novo appellate review. *Id.* at 8 (citation omitted). Before undertaking that analysis, however, the court of appeals rejected the district court's ruling that "the entire Deerhurst Program, from 2000 onward, should be reviewed as a single transaction." *Id.* at 9. Instead, the court ruled that "[b]ecause the only transaction that relates to the $60 million tax loss Sala seeks to claim is his participation in Deerhurst GP, * * * circuit precedent dictates that [the court] not consider any of the post-2000 Deerhurst transactions." *Id.* at 9-10.

Turning to the merits, the court of appeals explained that, under the economic-substance doctrine, transactions "lacking an appreciable effect, other than tax reduction, on a taxpayer's beneficial interest will not be recognized for tax purposes." Pet. App. 10 (citation omitted). The court further explained that the existence of "some profit potential does not necessarily compel the conclusion the transaction has economic substance." *Ibid.* Applying those and other "well-established standards," the court held that the Deerhurst GP transaction lacked economic substance. *Id.* at 11.

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[1] The district court also rejected the government's other arguments against recognition of petitioners' claimed loss, including the contention that the loss was nondeductible under 26 U.S.C. 165(c)(2). In rejecting that argument, the court concluded that Sala had a profit motive for participating in the Deerhurst Program as a whole. Pet. App. 52-58.

In support of its economic-substance holding, the court of appeals found "[m]ost compelling" the fact that "the claimed loss generated by the program was structured from the outset to be a complete fiction." Pet. App. 11. The court rejected petitioners' reliance on *Helmer* and the technical application of the partnership basis rules, noting that petitioners' argument "does not * * * address the claimed loss's absence of economic reality," which is "the hallmark of a transaction lacking economic substance." *Ibid.*

The court of appeals also found significant "[t]he pre-determined nature of the Deerhurst GP stage" of the Deerhurst Program. Pet. App. 12. The court explained that, because petitioners could achieve the tax loss they desired only if Deerhurst GP was liquidated before the end of 2000, "liquidation was set to occur irrespective of any profits or losses, and would have happened even if market conditions indicated it would be more profitable not to dispose of the long and short options at that point." *Ibid.* The "pre-determined nature of the liquidation," the court reasoned, "indicates a lack of economic substance." *Ibid.*

Next, the court of appeals noted that any potential profit from the Deerhurst GP transaction was "negligible in comparison to the $24 million tax benefit which would not have been achieved but for th[e] pre-determined" steps of the transaction. Pet. App. 13. "The existence of some potential profit is insufficient," the court reasoned, "to impute substance into an otherwise sham transaction where a common-sense examination of the evidence as a whole indicates the transaction lacked economic substance." *Ibid.* (internal quotation marks and citation omitted).

Finally, the court of appeals observed that the district court's finding—made in rejecting the government's alternative argument based on 26 U.S.C. 165(c)(2)—that Sala participated in the overall Deerhurst program with a profit motive did not call for a different result. Pet. App. 13-14 & n.4. The court explained that it had "never held that the mere presence of an individual's profit objective will require us to recognize for tax purposes a transaction which lacks economic substance." *Id.* at 13 (internal quotation marks and citation omitted). In any event, the court of appeals added, the district court's profit-motive finding was "based on its consideration of the five-year Deerhurst Program as a whole," whereas "only the Deerhurst GP phase is relevant to the economic substance analysis." *Id.* at 13-14.[2]

4. Petitioners filed a petition for rehearing and suggestion for rehearing en banc. Pet. App. 95. The court of appeals added to its opinion a footnote addressing statutory interest, see *id.* at 14 n.5, while otherwise denying the request for panel rehearing. *Id.* at 95-96. The court also denied the request for en banc review. *Id.* at 96.

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[2] In light of its ruling that the Deerhurst GP transaction lacked economic substance, the court of appeals did not address the government's other arguments. Pet. App. 14. Those arguments included contentions that petitioners' loss was not deductible under Section 165(c)(2) because Sala did not have a primary profit motive for participating in the Deerhurst GP transaction (Gov't C.A. Br. 57-59); that the non-economic nature of the loss rendered it nondeductible under Section 165(a) (*id.* at 60-63); that the loss was eliminated by Treas. Reg. § 1.752-6 (Gov't C.A. Br. 63-88); and that the government was at least entitled to a new trial in light of the post-trial recantation of testimony by one of petitioners' leading witnesses (*id.* at 89-97).

ARGUMENT

The decision of the court of appeals is correct, and it does not conflict with any decision of this Court or another court of appeals. The petition for a writ of certiorari should be denied.

1. Petitioners contend (Pet. 8-16) that the court of appeals should have applied clear-error rather than de novo review to the district court's determination that the transaction giving rise to their claimed $60 million tax loss had economic substance. That argument lacks merit.

As the court of appeals explained, although a district court's findings of fact underlying an economic-substance determination are reviewed for clear error, the "ultimate determination of whether a transaction lacks economic substance is a question of law" and is therefore subject to de novo review. Pet. App. 8. That conclusion is supported by this Court's precedents. In *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978), the Court held that the taxpayer was entitled to deductions for depreciation and interest based on a sale-leaseback arrangement, rejecting the government's contention that the arrangement lacked economic substance. In describing the appropriate standard of review, the Court explained that "[t]he general characterization of a transaction for tax purposes is a question of law subject to review," whereas "[t]he particular facts from which the characterization is to be made are not so subject." *Id.* at 581 n.16. Similarly in *Knetsch* v. *United States*, 364 U.S. 361 (1960), the case that petitioners identify as giving rise to the economic-substance doctrine (Pet. 19), the Court described the district court's finding that the transaction at issue was a sham as a "conclusion of law." 364 U.S. at 365.

Applying de novo review to the economic-substance determination is also consistent with the standard of review applicable to similar "mixed" questions of law and fact. For example, de novo review applies to the "ultimate determinations of reasonable suspicion and probable cause," even though clear-error review applies to the "determination of historical facts" underlying those ultimate determinations. *Ornelas* v. *United States*, 517 U.S. 690, 696-697 (1996). More deferential review of "mixed" questions is warranted only where "the district court is better positioned than the appellate court to decide the issue in question or * * * probing appellate scrutiny will not contribute to the clarity of legal doctrine." *Salve Regina Coll.* v. *Russell*, 499 U.S. 225, 233 (1991) (internal quotation marks and citation omitted).

As petitioners explain (Pet. 8-10 & nn.4-9), the courts of appeals are divided on what standard of review applies to an economic-substance determination. Consistent with *Frank Lyon*, several circuits, including the court below, apply de novo review. See, *e.g.*, Pet. App. 8; *Jade Trading, LLC* v. *United States*, 598 F.3d 1372, 1376 (Fed. Cir. 2010); *Dow Chem. Co.* v. *United States*, 435 F.3d 594, 599 & n.8 (6th Cir. 2006), cert. denied, 549 U.S. 1205 (2007). Some other circuits, however, have held (with minimal analysis and without considering *Frank Lyon*) that clear-error review applies. See, *e.g.*, *Nicole Rose Corp.* v. *Commissioner*, 320 F.3d 282, 284 (2d Cir. 2002); *ASA Investerings P'ship* v. *Commissioner*, 201 F.3d 505, 511 (D.C. Cir.), cert. denied, 526 U.S. 871 (2000); *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 245 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999); *Rice's Toyota World, Inc.* v. *Commissioner*, 752

F.2d 89, 92 (4th Cir. 1985). And some circuits have conflicting precedent on the issue. See Pet. 10 & nn.6-9.[3]

For several reasons, however, this case would not be an appropriate vehicle to resolve the disagreement among the courts of appeals. First, petitioners did not properly preserve their current contention that clear-error review applies. Rather, petitioners acknowledged in the court of appeals that "[t]he district court's ultimate characterization of transactions as having economic substance is subject to *de novo* review." Pet. C.A. Br. 11. Although petitioners followed that statement with views on why a clearly-erroneous standard of review would be appropriate, their brief to the panel did not contest the application of de novo review. *Id*. at 12. And in their petition for rehearing and suggestion for rehearing en banc—their opportunity to urge en banc consideration of the standard-of-review issue—petitioners cited *Frank Lyon* and stated that "the panel correctly held that the *de novo* standard of review applies to the ultimate characterization of a transaction as a sham." Pet. for Reh'g 11.

Second, even if clear-error review generally applied to a district court's economic-substance determination, that standard would not apply under the circumstances of this case because the district court never determined whether the relevant transaction—the Deerhurst GP transaction—possessed economic substance. Instead, in making its economic-substance determination, the district court considered the entire five-year Deerhurst Program. Pet. App. 23-31, 39-42. The court of appeals, however, concluded that focusing on the entire Deer-

[3] Unlike petitioners, the government would include the Seventh Circuit in this last category. See *Coleman* v. *Commissioner*, 16 F.3d 821, 825 (1994) (citing *Frank Lyon*, 435 U.S. at 581 n.16).

hurst Program was legal error and that the relevant transaction was the discrete, loss-generating Deerhurst GP transaction that began and ended in the latter part of 2000. *Id.* at 9-10. The district court never determined whether that discrete transaction possessed economic substance, and it would be pointless for an appellate court to review for clear error the (irrelevant) economic-substance determination that the district court did make.[4]

Finally, the result in this case would be the same even if the district court had made a finding that the Deerhurst GP transaction, considered alone, possessed economic substance and that finding were reviewed for clear error. As the court of appeals explained, "[i]t is clear the transaction was designed primarily to create a reportable tax loss that would almost entirely offset Sala's 2000 income with little actual economic risk," and "the generated loss was designed to be entirely artificial." Pet. App. 11. The transaction's lack of economic

[4] The court of appeals stated that the district court also found that each phase of the Deerhurst Program independently had economic substance. Pet. App. 10. That is not, however, what the district court concluded. The district court analyzed each phase of the Deerhurst Program independently only in determining whether Sala subjectively had a business purpose. See *id.* at 42-51. In analyzing whether Sala's activities, considered objectively, had economic substance, the district court only considered the entire Deerhurst Program (including both the Deerhurst GP transaction and the five-year investment program that followed). See *id.* at 39-42. That frame of reference is clearly reflected in the court's conclusion that "Sala's $9 million had the potential to exceed—albeit by a slender margin—the $60,449,984 claimed loss *within the five years and two months dedicated to the combined Deerhurst Program*." *Id.* at 41 (emphasis added). As the court of appeals observed, when the analysis is properly limited to the one-month Deerhurst GP transaction, any potential economic gain was dwarfed by the claimed tax benefit. See *id.* at 12-13 & n.3.

reality is confirmed by the predetermined nature of the putative investment decisions and their timing. Sala knew before investing that the Deerhurst GP partnership would dispose of the offsetting options positions and liquidate before the end of 2000, regardless of whether those actions made economic sense, because the actions were necessary to generate the tax loss that Sala desired. *Id.* at 12. Finally, "[a]ny anticipated economic benefit from participating in Deerhurst GP partnership for a few weeks, and then quickly liquidating the partnership before year's end," was "negligible in comparison to the $24 million tax benefit which would not have been achieved but for this predetermined course of action." *Id.* at 13. "[A] common-sense examination of the evidence as a whole" clearly establishes that the Deerhurst GP transaction lacked economic substance. *Ibid.* (quoting *Keeler* v. *Commissioner*, 243 F.3d 1212, 1219 (10th Cir. 2001) (internal quotation marks omitted)).

Every court of appeals that has considered a similar scheme involving one of the abusive tax shelters described in Notice 2000-44 has agreed with the court below that such transactions lack economic substance. See *Stobie Creek Invs. LLC* v. *United States*, 608 F.3d 1366, 1375-1380 (Fed. Cir. 2010); *Jade Trading,* 598 F.3d at 1376-1378; *Klamath Strategic Inv. Fund* v. *United States*, 568 F.3d 537, 543-545 (5th Cir. 2009); *New Phoenix Sunrise Corp.* v. *Commissioner*, No. 09-2354, 2010 WL 4807077, at *4-*6 (6th Cir. Nov. 18, 2010) (unpublished); see also *Cemco Investors, LLC* v. *United States*, 515 F.3d 749, 751, 752 (7th Cir.) (disallowing loss on the basis of 26 C.F.R. 1.752-6, but noting that the offsetting-options shelter at issue "seems to lack economic substance" and that "all [Section 1.752-6] does is instantiate the pre-existing norm that transactions with no eco-

nomic substance don't reduce people's taxes"), cert. denied, 129 S. Ct. 131 (2008); *Kornman & Assocs., Inc. v. United States*, 527 F.3d 443, 462 (5th Cir. 2008) (King, J., concurring) (opining that the transactions at issue in that case—the short-sale variant of the tax shelters described in Notice 2000-44—"have absolutely no economic substance"). Because the result would be the same regardless of the standard of review, this case is not an appropriate one in which to address the standard-of-review issue.[5]

2. Petitioners also contend (Pet. 16-22) that the court of appeals erroneously held that courts may disallow tax benefits from transactions that otherwise have economic substance if the courts conclude that the tax benefits are too large. The court of appeals, however, articulated no such holding. Instead, the court correctly stated and applied the standard for determining whether a transaction has economic substance, and its resolution of that issue does not warrant this Court's review.

The court of appeals stated that a transaction lacks economic substance if it has no "appreciable effect, other than tax reduction, on a taxpayer's beneficial interest." Pet. App. 10. That statement of the applicable standard is correct and is derived directly from this Court's decision in *Knetsch*, which disregarded a taxpayer's transaction with an insurance company on the ground that the transaction "did not appreciably affect [the taxpayer's] beneficial interest except to reduce his tax." 364 U.S. at 366 (internal quotation marks and citation omitted); see

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[5] The standard-of-review issue was also presented in the petitions for writs of certiorari in *Dow Chemical Co.* v. *United States*, 549 U.S. 1205 (2007) (No. 06-478), and *Coltec Industries, Inc.* v. *United States*, 549 U.S. 1206 (2007) (No. 06-659). The Court denied review in those cases, and there is no reason for a different result here.

Coltec Indus., Inc. v. *United States*, 454 F.3d 1340, 1352, 1356 n.16, 1360 (Fed. Cir. 2006), cert. denied, 549 U.S. 1206 (2007); *ACM P'ship*, 157 F.3d at 248; *James* v. *Commissioner*, 899 F.2d 905, 908 (10th Cir. 1990).

Contrary to petitioners' contentions, the court of appeals did not adopt a "proportionality rule" that transactions must satisfy in order to be respected for tax purposes, nor did it hold that "the size of a claimed loss, standing alone, authorizes a court to ignore a transaction where the transaction otherwise possessed economic substance." Pet. 16, 20 n.11. Instead, the court relied on the disparity between the claimed tax benefit and the maximum profit potential of the transaction as one of several factors indicating that the transaction lacked economic substance. See Pet. App. 11-14; pp. 6-8, *supra*.

The court of appeals' consideration of the magnitude of the claimed tax benefit in relation to the profit potential of the transaction was consistent with its task of determining whether the transaction *appreciably* affected petitioners' beneficial interest other than to reduce their taxes. The court's approach also was consistent with the approach taken by other courts of appeals. See *Jade Trading,* 598 F.3d at 1377 (relying on the "disproportionate tax advantage as compared to the amount invested and potential return" as one of several factors in concluding that a transaction lacked economic substance); *Rogers* v. *United States*, 281 F.3d 1108, 1116 & n.4 (10th Cir. 2002) (noting with approval a Treasury Department white paper stating that a transaction may lack economic substance "where the economic realities of [the] transaction are insignificant in relation to the tax benefits"); *Keeler*, 243 F.3d at 1219 (stating that the existence of some profit potential is "insufficient to im-

pute substance into an otherwise sham transaction") (internal quotation marks and citation omitted); *ACM P'ship*, 157 F.3d at 258 (stating that the prospect of a "nominal, incidental pre-tax profit * * * would not support a finding that the transaction was designed to serve a non-tax profit motive").

Petitioners assert (Pet. 19-22) that the court of appeals created a circuit conflict by considering the disproportionate relationship between the claimed tax benefit and the transaction's profit potential. Petitioners cite no decision of another circuit, however, holding that such consideration is inappropriate. The cases cited by petitioners (Pet. 20-21) simply indicate that transactions that otherwise have economic substance will not be disregarded merely because they were motivated in part by tax considerations. Nothing in the court of appeals' opinion is inconsistent with that principle.

In any event, the question whether the court of appeals erred in taking into account the disproportionate relationship between the claimed tax benefit and the transaction's profit potential is of limited ongoing importance. As petitioners note (Pet. 17-18), Congress recently codified the economic-substance doctrine as applied to transactions entered into after March 30, 2010. See Health Care and Education Reconciliation Act of 2010 (HCERA), Pub. L. No. 111-152, § 1409(a), 124 Stat. 1067 (to be codified at 26 U.S.C. 7701(*o*)). That legislation specifically addresses, for future transactions, how the relationship between the profit potential of the transaction and the claimed tax benefits affects the economic-substance determination. Section 7701(*o*)(2)(A) provides that, in determining whether a transaction has economic substance, the profit potential of the transaction may be taken into account "only if the

present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected." Pet. App. 98. Petitioners are therefore wrong in contending (Pet. 19) that review is necessary to "provide[] clear and proper objective guidance to the Nation's taxpayers" regarding the parameters of the economic-substance doctrine.

Petitioners are also mistaken in asserting (Pet. 18) that "a clear and objective standard" is "even more important" in light of the new "strict liability" penalty that applies to underpayments of tax attributable to application of the economic-substance doctrine. The new penalty applies only to transactions entered into after March 30, 2010, *i.e.*, transactions evaluated for economic substance under Section 7701(*o*). See HCERA § 1409(e), 124 Stat. 1070. There is consequently no merit to petitioners' assertion that the decision of the court of appeals "exposes taxpayers to vastly expanded liability." Pet. 18.

3. As an additional ground for review, petitioners contend (Pet. 22-25) that the court of appeals' decision is inconsistent with *Gitlitz* v. *Commissioner*, 531 U.S. 206 (2001), and *Cottage Savings Ass'n* v. *Commissioner*, 499 U.S. 554 (1991), because (in petitioners' view) the court of appeals "conclu[ded] that a loss is not allowable unless the taxpayer suffers 'actual economic harm' and 'a financial loss.'" Pet. 22 (quoting Pet. App. 7, 11). The court, however, announced no such conclusion. Instead, the court merely identified the wholly non-economic nature of petitioners' asserted loss as one of several factors—albeit the "[m]ost compelling" one, Pet. App. 11—supporting its holding that the Deerhurst GP transac-

tion lacked economic substance. See *id.* at 11-14; pp. 6-8, *supra*. That approach was appropriate and consistent with the analysis of other courts of appeals. See, *e.g.*, *Stobie Creek*, 608 F.3d at 1377 (citing the fictional nature of the claimed loss as one factor indicating that the transaction lacked economic substance); *Jade Trading*, 598 F.3d at 1377 (same).

As an alternative argument in the court of appeals, the government contended that, regardless of the economic-substance doctrine, the non-economic nature of petitioners' claimed loss by itself renders the loss nondeductible under 26 U.S.C. 165(a). Gov't C.A. Br. 60-63; Gov't C.A. Reply Br. 19-22; see *ACM P'ship*, 157 F.3d at 251-252. In response to that contention, petitioners argued below, as they do in their petition to this Court, that the government's Section 165(a) argument is foreclosed by *Gitlitz* and *Cottage Savings*. Compare Pet. C.A. Br. 36-38 with Pet. 22-23; see also Gov't C.A. Reply Br. 21-22 (replying to petitioners' argument). But the court of appeals found it unnecessary to consider the government's alternative ground for reversal because of the court's ruling that the Deerhurst GP transaction lacked economic substance. Pet. App. 14. Petitioners' disagreement with that alternative argument therefore provides no basis for this Court to grant review.

4. Finally, this Court's review of the Tenth Circuit's economic-substance ruling would be inappropriate because, as the government argued below, petitioners' claimed loss is nondeductible in any event under 26 U.S.C. 165(c)(2), which limits the deductibility of an individual's losses to those incurred in transactions entered into primarily for profit. See Gov't C.A. Br. 56. That conclusion necessarily follows from the court of appeals' threshold determination—which petitioners do not con-

test in this Court—that the loss-generating transaction was the year-end Deerhurst GP transaction rather than the entire Deerhurst Program. See *Keeler*, 243 F.3d at 1220 (observing that even if the trades at issue "were part of taxpayer's overall profit-motivated investment strategy, the transactions themselves would have to be profit-motivated" in order for the attendant losses to be deductible under Section 165(c)). As the court of appeals noted, the district court's finding that Sala satisfied the "primarily for profit" requirement of Section 165(c)(2) was "based on its consideration of the five-year Deerhurst Program as a whole." Pet. App. 13. The district court did not find, and petitioners did not contend on appeal, that Sala engaged in the Deerhurst GP transaction alone for the primary purpose of realizing an economic profit. Petitioners could not credibly have made such a contention because the Deerhurst GP transaction was designed to produce $24 million in tax savings but had a maximum profit potential (before fees) of only $550,000. *Id.* at 12.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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