Case No. 11-1832

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

HISTORIC BOARDWALK HALL, LLC,

Petitioner-Appellee

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT

BRIEF OF AMICUS CURIAE REAL ESTATE ROUNDTABLE IN SUPPORT OF PETITIONER-APPELLEE AND AFFIRMANCE OF THE UNITED STATES TAX COURT

A. DUANE WEBBER
RICHARD M. LIPTON
ROBERT S. WALTON
DEREK M. LOVE
SAMUEL GRILLI
Baker & McKenzie LLP
300 E. Randolph Street, Suite 5000
Chicago, IL 60601
(312) 861-8000
Attorneys for Amicus Curiae

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IDENTITY AND INTEREST OF AMICUS CURIAE

The Amicus Curiae ("Amicus"), the Real Estate Roundtable (Roundtable),[1] is a Federal policy organization comprised of real estate industry leaders. Its members are the Chairs, Presidents and CEOs of the Nation's 100 leading commercial and multifamily real estate companies, and the Managing Directors of major financial institutions. The Roundtable also includes the elected leaders and executive directors of major real estate trade organizations.

The Roundtable serves as the vehicle through which industry leaders come together to identify, analyze and advocate policy positions on issues important to the national real estate community. Collectively, Roundtable members hold portfolios containing over 5 billion square feet of developed property valued at more than $1 trillion. The Roundtable members, including participating trade associations such as the National Association of Realtors and the National Association of Real Estate Investment Trusts, represent more than 1.5 million people involved in virtually every aspect of the real estate business.

The Amicus is uniquely positioned to provide this court with information regarding the impact of this case on the real estate industry. The Amicus has filed a

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[1] Pursuant to Rule 29(c)(5), counsel for Amicus Curiae states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than Amicus Curiae, its members, or its counsel made a monetary contribution to its preparation or submission.

motion seeking leave to appear in order to comment on issues relevant to the case before this court that have industry-wide significance. The Amicus has secured the consent of the taxpayer to its appearance. The Government has stated that it takes no position with respect to the Amicus' motion for leave to appear until it has reviewed said motion.

PRELIMINARY STATEMENT

This brief is filed to call the court's attention to the problematic consequences of the government's argument on page 50 of its brief that the transaction at issue, which involved historic rehabilitation tax credits, lacked economic substance under the sham-partnership theory, mistakenly described as "a variant of the economic-substance (sham-transaction) doctrine." The government continues this argument on pages 57 through 59 of its brief. The government concludes erroneously on page 59 of its brief that "although Congress clearly intended to encourage the underlying *activity* (historic preservation)," the transaction is impermissible under "the normal application of the sham-partnership doctrine."

This argument must be thoroughly and unequivocally rejected by the court. The enactment of Section 7701(o) of the Code in 2010, and the related 40% no-fault penalty under Section 6662(d)(6), increased the importance of a clear and precise understanding of the scope, as well as the limitation, of the economic

substance doctrine (the ESD). The government in this case is arguing that the ESD should be applied to a transaction where it is clearly inapplicable. This argument runs afoul not only of precedents which were either ignored or mis-cited by the government but also of the IRS' own recent guidance concerning the scope of the ESD.

ARGUMENT

I. *THE GOVERNMENT FAILS TO DISTINGUISH BETWEEN THE ECONOMIC SUBSTANCE DOCTRINE AND THE SUBSTANCE OVER FORM DOCTRINE*

A. The Economic Substance Doctrine

The ESD is one of several judicial doctrines which can be applied by the courts. The ESD allows a court to disregard, for tax purposes, a transaction that complies with the literal terms of the Code but lacks economic reality. Coltec Indus. Inc. v. U.S., 454 F.3d 1340, 1354 (Fed. Cir. 2006). The application of the ESD requires consideration of a two-part test: (1) first, the subjective factor, whether the taxpayer had a business purpose for engaging in the transaction, and (2) second, the objective factor, whether the transaction offered a significant economic benefit to the taxpayer beyond the creation of tax benefits. In determining whether the ESD is applicable, consideration must also be given to whether the tax benefits that are claimed by the taxpayer are of a type which Congress intended to spur a given activity, such as rehabilitation or low income housing tax credits. These credits are enacted by Congress to cause otherwise non-economic activity to occur, so that a transaction to take advantage of such tax benefits should be per se outside of the ESD.

B. The Economic Substance Doctrine is Different from the Substance Over Form Doctrine

It is just as important to focus on what the ESD is not. The ESD is not the same as the "substance over form" doctrine (SOFD), which applies when the form of a transaction is not the same as its economic reality. Under the ESD, a transaction which is not "real" is completely disregarded for tax purposes; under the SOFD, the tax consequences of a "real" transaction are determined by its substance and not its form. See Gregory v. Helvering, 293 U.S. 465 (1935); Knetsch v. U.S., 364 U.S. 361 (1960). For example, assume that a taxpayer makes an economic investment in a partnership, but the government is concerned that the resulting tax benefits (such as rehabilitation tax credits) are not appropriate because the taxpayer should not be treated as a partner, even though the taxpayer made a real investment and the partnership engaged in real business activities. This situation, involving a bona fide transaction in which an alleged partner in a partnership may be determined not to be a partner, or to be acting as a lender rather than a partner, is subject to the SOFD rather than the ESD.

This distinction is best illustrated by several recent cases. In Countryside Ltd. P'Ship v. Commissioner, 132 T.C. 347 (2009), the Tax Court dismissed the IRS' attempt to apply the ESD because of the genuine, non-tax business purpose for the transaction. The taxpayers exchanged their limited partnership interests in Countryside for notes in order to withdraw from the partnership, before the sale of the partnership's investment property. The taxpayers chose tax-motivated means in

order to accomplish this legitimate non-tax business purpose. The Tax Court noted that the IRS' focus on the tax-motivated means, instead of the business-oriented end, had led them to an erroneous ESD argument.

The court in AWG Leasing Trust v. U.S., 592 F. Supp. 2d 953 (N.D. Ohio 2008), rejected the government's contention that a SILO (sale in, lease out) transaction lacked economic substance, while applying the SOFD to deny the taxpayer's claimed depreciation deductions. The bona fide transaction involved the investment of millions of dollars, allegedly for an equity interest in a German waste factory. In rejecting application of the ESD, the court focused on the investment made and whether the projections of cash flow and residual value were reasonable when the taxpayer entered into the transaction, not whether the predictions were ultimately proven true. See also Shell Petroleum Inc. v. U.S., 102 AFTR 2d (RIA) 5085 (S.D. Tex. 2008). In each of these decisions, the courts refused to apply the ESD but then considered whether the transaction should be recharacterized under the SOFD. None of these cases was discussed by the government in its brief.

This distinction was also emphasized by the Fifth Circuit in its recent decision in Southgate Master Fund, LLC v. U.S., 108 AFTR 2d (RIA) 6488 (5th Cir. 2011), which was cited by the government in its brief. The Fifth Circuit considered the two-part test for application of the ESD in determining that an

acquisition of non-performing loans had economic substance. The fact that the taxpayer might not be viewed as a partner (under the SOFD) or that the transaction should be characterized as a sale (again, under the SOFD) did not mean that the underlying transaction violated the ESD. However, the government contended in its brief (at page 50) that the sham partnership doctrine is "a variant of the economic substance (sham transaction) doctrine," citing to Southgate. The Fifth Circuit made no such statement in Southgate. The government has inappropriately blurred the line between the ESD and the SOFD in making this statement in its brief.

C. The IRS Issued a LB&I Directive Recognizing the Difference Between the Economic Substance Doctrine and the Substance Over Form Doctrine

The IRS is also fully aware of the distinction between the ESD and the SOFD. In its recent directive to IRS agents concerning the potential application of the ESD under Section 7701(o), IRS Guidance LB&I-4-0711-015 (July 15, 2011) ("Directive"), the IRS specifically notes that the ESD is not the same as the SOFD and urges IRS agents to consider whether a transaction should be challenged on the basis of the SOFD instead of the ESD.

II. *THE GOVERNMENT'S POSITION IS WRONG BECAUSE THERE IS ECONOMIC SUBSTANCE IN THIS CASE*

In its brief, the government stated either directly or implicitly that the ESD constitutes grounds to disallow the tax credits claimed by Pitney Bowes. However,

the government never engaged in the two-part analysis that is required for application of the ESD (determining whether there was a subjective business purpose and an objective business purpose for the investment). Instead, the government broadly stated that the transaction at issue lacked economic substance because tax credits should not be considered in applying the ESD to a transaction (contending that Sacks v. Commissioner, 69 F.3d 982 (9th Cir. 1995), was wrongly decided and that Friendship Dairies, Inc. v. Commissioner, 90 T.C. 1054 (1988) was correct). In making this argument, the government fails to distinguish between general investment tax credits and historic rehabilitation tax credits, and the legislative intent of each. Friendship Dairies involved the general investment tax credit, and not the rehabilitation tax credit, and the Tax Court appropriately distinguished the narrowly-focused rehabilitation tax credit in its opinion. The government, however, blurs this distinction and attempts to sweep this case into the scope of the ESD by arguing that the claimed tax credits cannot be considered in determining the economic substance of the transaction at issue.

The government's position is wrong. Pitney Bowes' investment was a real economic outlay for which it will receive a return through tax credits that Congress specifically enacted to incentivize historic rehabilitation. Pitney Bowes made the type of investment Congress desired by advancing funds that were used, either directly or indirectly, to rehabilitate an historic building. Indeed, rehabilitation tax

credits are often the principal reason that an historic rehabilitation occurs. Any argument that these tax credits should be ignored in applying the ESD is wrong. Under the government's reasoning here, the IRS would be taking away with the executive hand what Congress has specifically endorsed in legislation in order to induce investment in such rehabilitation.

III. *THE SUBSTANCE OVER FORM DOCTRINE COULD APPLY WHERE THE ECONOMIC SUBSTANCE DOCTRINE IS INAPPLICABLE*

The fact that the tax credits at issue in this case cannot be challenged under the ESD does not mean that the government cannot challenge the allocation to Pitney Bowes under the SOFD. Frank Lyon Co. v. U.S., 435 U.S. 561, 580 (1978) ("The conclusion that the transaction is not a simple sham to be ignored does not, of course, automatically compel the further conclusion that Lyon is entitled to the items claimed as deductions"). The Tax Court concluded that the SOFD does not apply in this case, which is a factual issue on which reasonable minds might differ. However, the government's argument that the ESD "or a variant thereof" applies raises a legal argument that clearly must be rejected.

IV. *THE ECONOMIC SUBSTANCE DOCTRINE APPLIES TO DIFFERENT SITUATIONS*

We do not mean to imply that there are no situations in which the ESD can be applied to challenge claimed tax benefits. For example, a number of cases have held that the ESD is applicable to deny the tax benefits claimed in so-called "son of

BOSS" transactions. See, e.g., Sala v. U.S., 613 F.3d 1249 (10th Cir. 2010); Jade Trading, LLC v. U.S., 598 F.3d 1372 (Fed. Cl. 2011); Maguire Partners v. U.S., 104 AFTR 2d (RIA) 7839 (C.D. Cal. 2009). These decisions were not based on receiving a tax benefit Congress specifically authorized, such as tax credits intended to promote rehabilitation. There are cases in which the ESD is and should be applicable; this case simply is not one of them.

V. *THE RECENT CODIFICATION OF THE ESD NECESSITATES CLEAR DISTINGUISHMENT*

The importance of distinguishing between the ESD and the SOFD is highlighted by the enactment of Section 7701(o), which imposes a 40% no-fault penalty on transactions that lack economic substance. Section 7701(o) applies only to a transaction to which the ESD is "relevant," and this determination is made under Section 7701(o)(5) as if Section 7701(o) had never been enacted. Thus, the common law concerning the scope of the ESD will define the scope of the ESD going forward. Distinguishing between the ESD and the SOFD is essential for the application of Section 7701(o). The Tax Court correctly concluded that the ESD is not applicable in this situation, and we urge this court to do the same.

CONCLUSION

WHEREFORE, the Amicus Curiae respectfully request that this court affirm the Tax Court's conclusion that the ESD is not applicable to this case.

Respectfully Submitted,

s/ A. Duane Webber
A. DUANE WEBBER (Counsel of Record)
RICHARD M. LIPTON
ROBERT S. WALTON
DEREK M. LOVE
SAMUEL GRILLI
Baker & McKenzie LLP
300 E. Randolph Street, Suite 5000
Chicago, IL 60601
Telephone: (312) 861-8000
Attorneys for Amicus Curiae

December 21, 2011

COMBINED CERTIFICATION

It is hereby certified that:

1. At least one of the attorneys whose names appear on the brief is a member of the bar of this court.

2. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 2,231 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word 2003 in 14 point or more Times New Roman font.

3. Service of the foregoing brief has been made, by the Notice of Docket Activity through electronic filing, on counsel for the appellant and appellee (filing users) on this 21st day of December 2011. Ten paper copies of this Amicus Curiae brief has been sent to the Clerk's Office on the same day the E-Brief was electronically filed.

4. The text of the E-Brief and the Hard Copies of the brief are identical.

5. A virus check was performed on the PDF file and the Hard Copies of the brief using Trend Micro OfficeScan version 10.5.1842 virus software.

Dated: December 21, 2011

s/ A. Duane Webber
A. DUANE WEBBER

Baker & McKenzie LLP
300 E. Randolph Street, Suite 5000
Chicago, IL 60601
Telephone: (312) 861-8000
DC Bar Number: 396389