No. 06-478

In the Supreme Court of the United States

DOW CHEMICAL COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that petitioner's transactions involving its corporate-owned life insurance plans lacked economic substance, and that petitioner was therefore not entitled to take tax deductions for interest and fees related to those plans, after discounting the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future.

2. Whether the court of appeals applied the correct standard of review in determining that petitioner's transactions lacked economic substance.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-34a) is reported at 435 F.3d 594. The opinion of the district court (Pet. App. 35a-186a) is reported at 250 F. Supp. 2d 748.

JURISDICTION

The judgment of the court of appeals was entered on January 23, 2006. A petition for rehearing was denied on May 24, 2006 (Pet. App. 205a-206a). On July 25, 2006, Justice Stevens extended the time within which to file a petition for a writ of certiorari to and including October 6, 2006. The petition was filed on October 4, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. As the name suggests, corporate-owned life insurance (COLI) is life insurance purchased by a corporation in order to insure the lives of its employees. Corporations originally purchased those policies in order to protect themselves from financial loss resulting from the death of key employees. Increasingly, however, corporations attempted to use those policies in order to reduce their federal income tax liability: namely, by obtaining loans on the policies (using the cash value of the policies as collateral), using those loans to pay most of the premiums on the policies, and then deducting the interest on the loans.

In 1986, Congress sought to curtail that practice by prohibiting a corporation from deducting the interest on any loan over $50,000 made in connection with a COLI policy. See 26 U.S.C. 264(a)(4) (1994). After that limitation was enacted, corporations began using "broad-based" COLI plans, under which they would purchase life insurance for a much greater number of their employees. Those plans were designed to circumvent the per-policy limitation on deductions for interest on COLI-related loans, and thereby to manufacture massive interest deductions that could be used to shelter unrelated income from taxation. See Department of the Treasury, *Report to the Congress on the Taxation of Life Insurance Company Products* 14 (1990). In 1996, Congress effectively ended that practice by limiting the number of employees as to whom a deduction for COLI-related interest could prospectively be taken. See 26 U.S.C. 264(a)(4) and (e).

b. Even when a taxpayer would otherwise qualify for a deduction under the Internal Revenue Code, the de-

duction may still be disallowed if the underlying transaction lacks economic substance, *i.e.*, if "there was nothing of substance to be realized by [the taxpayer] from th[e] transaction beyond a tax deduction." *Knetsch* v. *United States*, 364 U.S. 361, 366 (1960); see *Gregory* v. *Helvering*, 293 U.S. 465, 469-470 (1935). Before this case, three courts of appeals, applying the economic-substance doctrine, had disallowed tax deductions arising from "broad-based" COLI plans. See *American Elec. Power Co.* v. *United States*, 326 F.3d 737, 740-745 (6th Cir. 2003), cert. denied, 540 U.S. 1104 (2004); *In re CM Holdings, Inc.*, 301 F.3d 96, 102-107 (3d Cir. 2002); *Winn-Dixie Stores, Inc.* v. *Commissioner*, 254 F.3d 1313, 1315-1317 (11th Cir. 2001), cert. denied, 535 U.S. 986 (2002).

2. In 1988 and 1991, petitioner, a major corporation, purchased two COLI plans that insured the lives of more than 21,000 of its employees. From 1988 to 2000, petitioner "paid" for its premiums on those policies primarily by simultaneously taking loans on the policies (using the cash value of the policies as collateral) or by simultaneously making partial withdrawals from the portion of the cash value that had not already been used as collateral. Petitioner "paid" for nearly all of the interest on its loans in the same manner. Although petitioner "paid" nearly $1.6 billion in premiums and interest over that period, petitioner actually disbursed less than $150 million in cash to the insurers. Pet. App. 3a-5a.

Under both plans, the insurers charged a higher interest rate for loans to petitioner than they used in crediting the values of the policies. Accordingly, both plans were projected to generate negative pretax cash flows for the first 17 or 18 years of their existence. After that

time, if petitioner made massive cash infusions for approximately 10 to 12 years, the plans would eventually generate positive cash flows—but not until some 40 years had passed since their inception. Petitioner was under no obligation to make such massive cash infusions. Even if petitioner did make those infusions, moreover, it was unclear whether the net present value of the cash flows from the plans would be positive or negative, with the answer depending on the discount rate used in the analysis. In addition, both plans had features that protected the insurers from the losses that would result from unexpectedly high mortality rates among the insured employees. Pet. App. 5a-6a, 83a, 89a-94a, 103a-107a.

On its income tax returns for 1989 to 1991, petitioner claimed deductions of over $33 million for interest paid on loans used to pay COLI premiums (and for administrative fees related to the COLI plans). On May 23, 2000, the Internal Revenue Service disallowed the deductions, and assessed tax deficiencies and interest totaling more than $22 million. Pet. App. 6a n.5, 118a-119a.

3. After paying the assessed amounts, petitioner filed a refund suit in the United States District Court for the Eastern District of Michigan. The district court held a bench trial, at which the government presented evidence that petitioner intended to engage in tax arbitrage through the COLI plans. See Gov't C.A. Br. 6-27 (summarizing evidence). At the conclusion of trial, however, the district court entered judgment in favor of petitioner. Pet. App. 35a-186a. The district court recognized that other courts had "generally determined that the ['broad-based'] COLI plans constituted economic shams, functioning only as interest-deduction engines

that drove no legitimate financial vehicles." *Id.* at 57a. In this case, however, the district court ultimately concluded that "there was an economic benefit that potentially could be derived from the plans without relying solely on the tax deductions for policy loan interest." *Id.* at 58a.

As is relevant here, the district court rejected the government's arguments (1) that petitioner's plans were projected to generate negative pretax cash flows; (2) that petitioner would not benefit from the accrual of interest on the cash value of the policies; and (3) that petitioner's ability to realize mortality gains from the plans was limited. Pet. App. 128a-153a. The court noted that "there are prepurchase illustrations that show positive cash flow coming from the plan[s] even without the tax deduction for policy loan interest." *Id.* at 131a; see *id.* at 148a. The court rejected the government's contention that "these illustrations are not reliable because * * * they rely on a payment strategy which [petitioner] would not likely adopt because it would require the infusion of significant amounts of cash in the middle years of the plan." *Id.* at 131a; see *id.* at 148a. Instead, the district court, crediting testimony from petitioner's officials, found that petitioner intended to make those cash infusions. *Id.* at 134a. The court further reasoned that, in determining whether petitioner's plans would generate positive pretax cash flows, it was required to "evaluate[] the transaction as a whole." *Id.* at 142a. After accepting petitioner's proposed after-tax discount rate for the net present value of the cash flows from the plans, the court concluded that petitioner had "demonstrate[d] a substantial, non-tax benefit." *Id.* at 143a; see *id.* at 150a.

Additionally, the district court determined that the transactions did not lack economic substance insofar as the plans contained mechanisms limiting the insurers' risk of suffering mortality losses. The court reasoned that the plans did not entirely *eliminate* the insurers' risk. Pet. App. 145a-146a, 150a-152a.

4. The court of appeals reversed. Pet. App. 1a-34a.

a. At the outset, the court of appeals noted that a district court's "ultimate conclusion" that petitioner's transactions had economic substance was subject to *de novo* review. Pet. App. 9a. At the same time, the court stated that any underlying factual findings were reviewed only for clear error. *Id.* at 8a. The court further observed that both parties had agreed on the appropriate standard of review. *Id.* at 9a n.8.

Turning to the merits, the court of appeals explained that, in determining whether similar transactions involving COLI plans had economic substance, courts had looked to "several indicators of the COLI plans' potential economic benefits: (i) projected pre-deduction cash flows, [(ii)] mortality gains to the beneficiary, who does not pay tax on proceeds, and [(iii)] interest-free inside build-up [the accrual of interest on the policy value]." Pet. App. 10a (internal quotation marks and citations omitted; brackets in original). The court of appeals proceeded to "examine the objective economic substance of [petitioner's] COLI plans against each of these standards." *Ibid.*

With regard to pre-deduction cash flows, the court of appeals noted that the district court had found that petitioner "intended to inject large amounts of cash into the plans in their middle years." Pet. App. 11a. The court of appeals reasoned, however, that the critical inquiry was whether "such highly-contingent cash flows are rel-

evant as a matter of law to the economic-sham analysis." *Ibid.* If they were not, the court explained, "it would undermine the finding that the plans would generate positive cash flows in their later years, which would in turn preclude the finding that each plan had a positive [net present value]." *Ibid.*

The court of appeals concluded that "the district court erred in including in its cash-flow analysis the highly-contingent positive cash flows projected for later years." Pet. App. 14a-15a. The court of appeals reasoned that, under this Court's decision in *Knetsch*, *supra*, "[c]ourts may consider future profits contingent on some future taxpayer action, but only when that action is consistent with the taxpayer's actual past conduct." Pet. App. 13a. On the other hand, "[c]ourts should be skeptical * * * when the asserted future profits hinge on future taxpayer action that seriously departs from past conduct, especially where such departure involves the expenditure of large sums of money." *Ibid.*

Applying those principles, the court of appeals determined that "the instant COLI plans would become profitable only upon the taxpayer's large future outlay of additional cash, and, considering [petitioner] had heretofore made no similar cash infusions, such additional spending would be a drastic departure from the taxpayer's past conduct." Pet. App. 13a-14a. The court further noted that "there was no contractual provision requiring [petitioner] to make substantial cash infusions in the future." *Id.* at 14a. Having concluded that "the future positive cash flows [in this case] should have been ignored," the court determined that, "[w]hen the future infusion of cash is properly removed from the analysis, only negative cash flows remain." *Id.* at 15a. The court similarly determined that, absent the future cash infu-

sion, "[petitioner] would have been unable to realize the benefit of inside build-up," *i.e.*, the accrual of interest on the cash value of the policies. *Id.* at 16a.

With regard to mortality gains, the court of appeals held that the district court erred by holding that petitioner's transactions would lack economic substance only if the plans entirely eliminated the insurers' risk of mortality losses. Pet. App. 17a-20a. The court of appeals reasoned that, in two of the three previous cases involving tax deductions related to "broad-based" COLI plans, "[the] challenged plans clearly did *not* eliminate 100% of all mortality gains and losses." *Id.* at 18a. The court also noted that "it is clear that the COLI plans were designed to reduce (even if not by 100%) [petitioner's] ability to realize mortality gains," and that "[the plans'] features are sufficiently similar to the other COLI-plan cases for us to conclude that [petitioner] would not significantly benefit from mortality gains." *Id.* at 20a.

Because petitioner's COLI plans "did not generate any of [the] benefits" discussed in earlier cases, the court of appeals concluded that petitioner's COLI-related transactions lacked economic substance. Pet. App. 20a.

b. Judge Ryan dissented. He reasoned that this Court's decision in *Knetsch* stood only for the proposition that potential future cash flows were irrelevant to the economic-substance analysis where "the taxpayer did not *intend* to make the * * * future investment" at issue. Pet. App. 22a. Having concluded that petitioner's potential future cash infusion was relevant as a matter of law, Judge Ryan agreed with the district court that petitioner would have realized the benefit of inside build-up on its plans. *Id.* at 23a-27a. Judge Ryan also "disagree[d] * * * that the district court committed

legal error" in concluding that petitioner's COLI plans were not mortality-neutral for purposes of the economic-substance doctrine. *Id.* at 27a. He reasoned that the plans in each of the two previous cases discussed by the majority were in fact designed to eliminate all mortality gains, *id.* at 28a-29a, and that the plans in this case were therefore distinguishable from those plans, *id.* at 29a.

5. The court of appeals denied a petition for rehearing, with Judge Ryan indicating that he would have granted panel rehearing. Pet. App. 205a-206a.

ARGUMENT

1. Petitioner contends (Pet. 19-30) that, in holding that petitioner's transactions involving its COLI plans lacked economic substance, the court of appeals erred by discounting the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future. The court of appeals' decision in that regard was correct and does not conflict with any decision of this Court or another court of appeals.

a. As a preliminary matter, petitioner does not contend that the court of appeals' ultimate holding—*i.e.*, that petitioner's transactions involving its COLI plans lacked economic substance—conflicts with the holding of any other court of appeals. Nor could petitioner advance such a claim, because, as the court of appeals recognized (Pet. App. 9a-10a), all of the courts of appeals to have previously considered the issue similarly disallowed tax deductions arising from "broad-based" COLI plans under the economic-substance doctrine. See *American Elec. Power Co.* v. *United States*, 326 F.3d 737, 740-745 (6th Cir. 2003), cert. denied, 540 U.S. 1104 (2004); *In re CM Holdings, Inc.*, 301 F.3d 96, 102-107 (3d Cir. 2002); *Winn-Dixie Stores, Inc.* v. *Commis-*

sioner, 254 F.3d 1313, 1315-1317 (11th Cir. 2001), cert. denied, 535 U.S. 986 (2002).

b. Instead, petitioner contends only that the court of appeals erred by discounting the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future in determining, as part of its analysis under the economic-substance doctrine, (1) that petitioner's plans were projected to generate negative pretax cash flows and (2) that petitioner would not benefit from the accrual of interest on the cash value of the policies. See Pet. App. 10a-16a. This case, however, would constitute a poor vehicle for consideration of any question concerning the legal relevance of the possibility of future contributions under the economic-substance doctrine, because even a ruling in petitioner's favor on that issue would not necessarily change the ultimate conclusion that petitioner's transactions lacked economic substance. In addition to determining that petitioner's plans were projected to generate negative pretax cash flows and that petitioner would not benefit from the accrual of interest on the cash value of the policies, the court of appeals determined that petitioner's ability to realize mortality gains from the plans was significantly limited. See *id.* at 17a-20a. Petitioner does not challenge that determination before this Court.

Moreover, in light of its decision to discount the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future, the court of appeals did not reach the government's alternative arguments as to why petitioner's plans were projected to generate negative pretax cash flows—most notably, the argument that the district court used an erroneously low after-tax discount rate. See Pet. App. 15a. Because the alleged error by the court of appeals

was not clearly outcome-dispositive, further review of that alleged error in this case is not merited.

c. In any event, in applying the economic-substance doctrine, the court of appeals correctly discounted the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future. In so doing, the court of appeals relied on a footnote in this Court's decision in *Knetsch* v. *United States*, 364 U.S. 361 (1960), for the proposition that a court may not consider future profits that are contingent on a taxpayer's voluntary future conduct when that conduct would constitute a "drastic departure" from the taxpayer's previous conduct. Pet. App. 14a.

Contrary to petitioner's contention (Pet. 19-21), the court of appeals correctly applied *Knetsch*. The taxpayer in *Knetsch* claimed tax deductions for interest on loans used to pay for annuity savings bonds; the taxpayer claimed that his transactions involving the bonds had economic substance because the bonds would eventually produce monthly annuity payments or insurance proceeds. 364 U.S. at 362-366. The Court rejected that argument on the ground that petitioner "kept the net cash value, on which any annuity or insurance payments would depend, at the relative pittance of $1,000." *Id.* at 366. In the footnote cited by the court of appeals, the Court rejected the taxpayer's argument that "in 10 years the net cash value of the bonds would have exceeded the amounts [the taxpayer] paid as 'interest,'" on the ground that "[t]his contention * * * is predicated on the wholly unlikely assumption that [the taxpayer] would have paid off in cash the original $4,000,000 'loan.'" *Id.* at 366 n.3.

The better reading of that footnote is that, in assessing the pretax profitability of a scheme for purposes of

the economic-substance doctrine, a court should discount a taxpayer's future contributions when those contributions are "wholly unlikely," as an objective matter, in light of the taxpayer's previous conduct—not, as the dissent in this case asserted (Pet. App. 22a), that a court should discount a taxpayer's future contributions only when the court expressly finds that the taxpayer did not actually *intend* to make them. Thus, even if the ultimate inquiry focuses on "*the factual probability* of [a taxpayer's] claimed investment actually being made," as petitioner contends (Pet. 20-21), the court of appeals correctly applied *Knetsch* in holding that, when a taxpayer's voluntary future investment would represent a "drastic departure" from its previous conduct, that investment is sufficiently unlikely that, regardless of the taxpayer's stated intention, the possibility that the investment would be made can be discounted as a matter of law.[1]

d. Petitioner contends (Pet. 21-27) that, by discounting the possibility that petitioner would make uncharacteristically large cash contributions to the plans in the future for purposes of applying the economic-substance doctrine, the court of appeals' decision conflicts with

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[1] In the alternative, petitioner suggests (Pet. 28-29) that its future cash contributions would not represent a "drastic departure" from its previous conduct. The court of appeals noted, however, that petitioner would have to contribute around $315 million in order to make its COLI plans profitable—more than twice the amount that petitioner had contributed to the plans between 1988 and 2000. Pet. App. 5a, 10a n.9. And far from holding that no "future investment would ever be entitled to be considered" (Pet. 29), the court of appeals expressly "le[ft] for another day the consequences of less drastic departures." Pet. App. 14a n.13. In any event, the case-specific question whether the hypothetical future contributions would represent a "drastic departure" from past conduct plainly does not merit review by this Court.

various decisions of this Court and other courts of appeals. That contention lacks merit.

The court of appeals' decision is consistent with this Court's decisions in *Frank Lyon Co.* v. *United States*, 435 U.S. 561 (1978), and *Commissioner* v. *Duberstein*, 363 U.S. 278 (1960). In *Frank Lyon*, the Court held that a transaction involving a sale-leaseback arrangement had economic substance, and therefore allowed a taxpayer to claim depreciation and interest deductions relating to the arrangement. 435 U.S. at 583-584. In rejecting the government's contention that the bank that originally sold the property (and then leased it back from the taxpayer) was effectively the owner of the property, the Court credited the district court's finding that "it was highly unlikely, as a practical matter, that any purchase option [by the bank] would ever be exercised." *Id.* at 570; see *id.* at 581. To the extent that the Court used an objective standard in disregarding potential future events relevant to application of the economic-substance doctrine, that standard was analogous to the objective standard used by the Court in *Knetsch* (and by the court of appeals in this case) in disregarding a taxpayer's own potential future conduct.

In *Duberstein*, the Court did not invoke the economic-substance doctrine at all, but instead merely determined whether certain transfers of property constituted "gifts" for purposes of the Internal Revenue Code. See 363 U.S. at 279-280. *Duberstein* therefore has no bearing on the question presented here: *i.e.*, under what circumstances a court should discount the possibility of a taxpayer's voluntary future investment in determining whether a scheme is profitable for purposes of the economic-substance doctrine.

Similarly, the court of appeals' decision does not conflict with any of the decisions of other courts of appeals cited by petitioner. Most of those decisions involve arrangements that are plainly distinguishable from the arrangement at issue here, and do not present any question concerning the relevance of a taxpayer's own potential future conduct. See *Sacks* v. *Commissioner*, 69 F.3d 982, 983-986 (9th Cir. 1995) (sale-and-leaseback arrangement similar to arrangement in *Frank Lyon*); *Bailey* v. *Commissioner*, 912 F.2d 44, 46-47 (2d Cir. 1990) (exchange of nonrecourse notes for stream of payments of arguably lower value); *Odend'hal* v. *Commissioner*, 748 F.2d 908, 908-912 (4th Cir. 1984) (exchange of nonrecourse notes for property of lower value), cert. denied, 471 U.S. 1143 (1985).

Among the cases cited by petitioner, the only even arguably comparable case is *Shirar* v. *Commissioner*, 916 F.2d 1414 (9th Cir. 1990). In that case, the taxpayer had purchased a life-insurance policy for his wife in order to cover anticipated estate-tax liability that would result from her death, and had paid the premiums in part with loans on the policy. *Id.* at 1416. The court of appeals concluded that transactions related to the policy had economic substance. *Id.* at 1416-1418. It was far from clear in that case, however, that the taxpayer's policy would generate negative pretax cash flows, or that the taxpayer would not benefit from the accrual of interest on the cash value of the policy, unless the taxpayer made voluntary future investments that would represent a "drastic departure" from his previous conduct. Cf. *id.* at 1416 (noting only that the taxpayer would not use loans to fund his premiums for the fourth through seventh years of the policy). Moreover, as the court explained, the taxpayer unambiguously received a

non-tax benefit from the policy, because, "absent the increased insurance coverage * * *, [the taxpayer] would not have had sufficient liquidity to meet the estate tax obligations upon the death of his wife." *Id.* at 1418. And the policy at issue, unlike the policy here, does not appear to have contained any features that would protect the insurer from losses resulting from premature mortality. Because *Shirar* is plainly distinguishable on its facts and does not hold that it is inappropriate to discount the possibility that a taxpayer would make uncharacteristically large cash contributions to an insurance plan in the future for purposes of applying the economic-substance doctrine, it does not conflict with the court of appeals' decision in this case.

e. Finally, even if petitioner could identify a conflict that might otherwise warrant the Court's review, this case would constitute a poor vehicle for consideration of any question concerning the relevance of potential future investment under the economic-substance doctrine because it arises in a context of little if any prospective importance. In 1996, Congress effectively ended the prospective use of "broad-based" COLI plans to manufacture massive interest deductions for the purpose of sheltering unrelated income from taxation. See 26 U.S.C. 264(a)(4) and (e). We are aware of only one other pending case concerning the application of the economic-substance doctrine to such "broad-based" COLI plans. In the event that another court of appeals were subsequently to reject the approach of the court of appeals below, this Court could grant review to address the question identified by petitioner. In this case, however, further review on that question is unwarranted.

2. Petitioner also claims (Pet. 13-19) that the court of appeals erred by applying *de novo* review to the dis-

trict court's ultimate determination that its transactions had economic substance.[2] That claim likewise does not warrant further review.

a. In this case, the court of appeals explained that, while a district court's underlying factual findings are reviewed only for clear error, a district court's "ultimate conclusion" as to whether a transaction had economic substance is subject to *de novo* review. Pet. App. 8a-9a. That description of the applicable standard of review is correct. As this Court explained in *Frank Lyon* (in holding that a transaction involving a sale-leaseback arrangement had economic substance), "[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." *Frank Lyon*, 435 U.S. at 581 n.16.[3] That standard of review, moreover, is consistent with the standard of review applicable to similar "mixed"

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[2] The same question is presented in *Coltec Industries, Inc.* v. *United States*, petition for cert. pending, No. 06-659 (filed Nov. 8, 2006). Unlike the petitioner in *Coltec Industries*, petitioner in this case does not contend that the court of appeals applied an erroneous *substantive* standard in determining that the relevant transactions lacked economic substance.

[3] Petitioner contends (Pet. 17) that "this statement did not squarely address the proper standard of review for the determination whether a transaction has economic substance." The Court made the quoted statement, however, in the course of rejecting the government's contention that the taxpayer, although the nominal owner of the property purchased from and leased back to the bank, was not in substance the true owner entitled to take depreciation deductions. See *Frank Lyon*, 435 U.S. at 581. Moreover, the Court cited as authority for its statement of the standard of review a Fourth Circuit decision that similarly involved the economic-substance doctrine. See *id.* at 581 n.16 (citing *American Realty Trust* v. *United States*, 498 F.2d 1194, 1198 (4th Cir. 1974)).

questions of law and fact. See, *e.g.*, *Ornelas* v. *United States*, 517 U.S. 690, 696-697 (1996) (applying *de novo* review to "ultimate determinations of reasonable suspicion and probable cause," while recognizing that clear-error review applies to the "determination of historical facts" underlying that ultimate determination); cf. *Salve Regina Coll.* v. *Russell*, 499 U.S. 225, 233 (1991) (noting that 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") (internal quotation marks and citation omitted).

Petitioner correctly notes (Pet. 14 n.7) that several courts of appeals have stated that a district court's determination as to whether a transaction had economic substance was reviewable only for clear error. 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, 531 U.S. 871 (2000); *ACM P'ship* v. *Commissioner*, 157 F.3d 231, 245 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999); *Yosha* v. *Commissioner*, 861 F.2d 494, 499 (7th Cir. 1988); *Rice's Toyota World, Inc.* v. *Commissioner*, 752 F.2d 89, 92 (4th Cir. 1985). As petitioner concedes (Pet. 15), however, those decisions "[f]or the most part * * * have engaged in rote recital of conclusory language from earlier opinions, with little analysis"—and it is therefore unclear, with regard to at least some of those decisions, whether the courts were deferring to the ultimate determination on economic substance, or merely to underlying factual determinations that may have been dispositive of that ultimate determination. Moreover, as petitioner seemingly also concedes (Pet.

17), to the extent that those courts did hold that a district court's ultimate determination on economic substance was reviewable only for clear error, those decisions cannot be reconciled with this Court's statement of the applicable standard of review in *Frank Lyon*.

b. In any event, this case does not provide the Court with a suitable opportunity to revisit any question concerning the standard of review applicable to a district court's ultimate determination on economic substance, because petitioner did not preserve any argument that such a determination should be subject to deferential review. Far from "argu[ing] against *de novo* review," as petitioner now contends (Pet. 9 n.3), petitioner ultimately conceded in the court of appeals that, "for purposes of this appeal, * * * the ultimate conclusion on economic substance is reviewed de novo," and further agreed with the government that "legal standards are reviewed de novo and factual findings under the 'clearly erroneous' test." Pet. C.A. Br. 38; see Gov't C.A. Br. 33 (same). Petitioner proceeded to contend that the district court's underlying findings—such as its finding that petitioner intended to build equity in its COLI plans—were not clearly erroneous. See, *e.g.*, Pet. C.A. Br. 46-67. Accordingly, it is unsurprising that the court of appeals, without extended discussion, articulated the standard of review in the same way as petitioner. Pet. App. 8a-9a.[4]

This case would constitute a poor vehicle for considering the standard-of-review question now raised by

[4] Moreover, although petitioner sought rehearing on the court of appeals' substantive holdings, it did not seek rehearing on the standard-of-review issue. See, *e.g.*, Pet. for Reh'g 14 (seemingly conceding that the standard of review in the court of appeals for the ultimate determination on economic substance was "now" *de novo*).

petitioner for another reason. In reversing the decision of the district court, the court of appeals did not overturn any of the district court's factual findings (as petitioner acknowledges, see Pet. 2, 9), but instead held that (1) the district court erred by failing to discount the possibility that petitioner would make uncharacteristically large cash contributions to the plans many years into the future, see Pet. App. 10a-16a, and (2) the district court erred by concluding that petitioner's transactions would lack economic substance only if the plans entirely eliminated the insurers' risk of mortality losses, see *id.* at 17a-20a. Both of those errors were unquestionably *legal* in nature, as the court of appeals repeatedly noted. See, *e.g.*, *id.* at 11a (stating that the relevant question was whether "such highly-contingent cash flows are relevant as a matter of law to the economic-sham analysis"); *id.* at 12a (referring to that question as a "legal question"); *id.* at 15a (holding that "[petitioner's] putative additional outlay * * * should be disregarded as a matter of law"); *id.* at 19a (rejecting "a rule that permitted a COLI plan to be deemed mortality neutral only upon proof that 'every dime of mortality profit' is eliminated"); cf., *e.g.*, *id.* at 21a (Ryan, J., dissenting) (criticizing majority for "conclud[ing] that, as a matter of law, future profits contingent on taxpayer action are an appropriate component of the economic substance calculus *only* when that action comports with the taxpayer's actual past conduct"). Petitioner does not argue that the clear-error standard of review could meaningfully have been applied to the district court's resolution of those subsidiary legal questions.[5] *A forti-*

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[5] As discussed above, on the former issue, the court of appeals held that a taxpayer's voluntary future investment should be discounted for

ori, it would have been incongruous for the court of appeals to have engaged in clear-error review of the district court's *ultimate* determination that the transactions at issue had economic substance, when that determination evidently rested on the district court's (erroneous) resolution of those subsidiary legal questions. Because the court of appeals did not pass on *any* subsidiary factual issues in reversing the district court's ultimate determination on economic substance, this case is an exceptionally weak candidate for application of a deferential standard of review.

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purposes of the economic-substance doctrine when it would represent a "drastic departure" from its previous conduct. Although petitioner repeatedly characterizes that holding as an "exclusionary rule" (Pet. 10, 11, 19, 20, 28, 29), petitioner does not contend that the court of appeals was resolving a question of fact rather than law. See, *e.g.*, Pet. 2 (asserting that the court of appeals "bar[red] consideration, as a matter of law, of the trial court's finding regarding [petitioner's] intended cash investments"); Pet. 19 (criticizing court of appeals for characterizing *Knetsch, supra*, as holding that, "in any economic substance inquiry, investment by the taxpayer that somehow departs from the taxpayer's actual prior conduct is irrelevant as a matter of law").

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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