



# TaxNewsFlash

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## Federal Circuit: Claims court erred in applying hybrid legal standard conflating step transaction and economic substance doctrines

The U.S. Court of Appeals for the Federal Circuit today overturned a decision of the federal claims court granting summary judgment in favor of the government on the grounds that the claims court erred by applying a hybrid legal standard that improperly conflated the step transaction doctrine and economic substance doctrines.

The case is: *GSS Holdings (Liberty) Inc. v. United States*, No. 2021-2353 (September 21, 2023). Read the Federal Circuit's [decision](#) [PDF 150 KB] that includes a dissenting opinion.

### Background

The taxpayer serves as the managing member and owner of an investment fund partnership. Between September 2006 and December 2011, the partnership entered into a series of transactions that resulted in the partnership claiming a loss for the 2011 tax year. In 2013, the taxpayer filed an amended income tax return for the 2009 tax year, seeking to carry the loss from 2011 back to 2009.

The IRS disallowed the claimed loss deduction on the grounds that the transactions must be treated as a single transaction under the step transaction doctrine, and accordingly, was disallowable under section 707(b)(1) as a loss from the sale of property between a partnership and a person owning more than 50% of the capital interest in the partnership.

The taxpayer filed a complaint in the federal claims court seeking a federal tax refund or credit for the 2009 tax year concerning its disallowed deduction, and after cross-motions for summary judgment, the claims court denied the taxpayer's motion, granted the government's motion, and entered final judgment in favor of the government. The taxpayer then appealed to the Federal Circuit.

### Federal Circuit

The taxpayer argued that the claims court "improperly used the economic substance doctrine's rule looking only to the step that creates the tax benefit in analyzing the step transaction doctrine." The Federal Circuit agreed and found that the claims court applied a hybrid legal standard conflating the step transaction doctrine and the economic substance doctrine. Specifically, the Federal Circuit found

that the claims court did not correctly apply the step transaction's end result test to assess the taxpayer's intent from the outset, but instead focused on the transaction giving rise to the alleged tax benefit as taught by the economic substance doctrine.

The Federal Circuit thus vacated the claims court's decision and remanded for a determination under the correct legal standard. The Federal Circuit stated that as part of this examination, the claims court must determine the outset of the series of transactions, considering the series of transactions as a whole. If the claims court does conclude that the separate transactions were "really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result," then the step transaction doctrine applies.

The Federal Circuit noted that the government argued that the same outcome would be reached under the correct legal standard. However, the taxpayer disagreed, contending that the intent differed at various timeframes. Thus, the Federal Circuit stated that the claims court must make a new determination under the correct legal standard in the first instance.

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