

Consolidated Edison Turns on the Lights

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This article reviews the recent taxpayer victory in *Consolidated Edison* and attempts to place it in the context of other decisions involving the economic substance argument.

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In a lengthy opinion, *Consolidated Edison Co. of New York, Inc. v. United States*,¹ Judge Horn of the Court of Federal Claims recently found for the taxpayer in a lease-in, lease-out transaction. Is this opinion, which deals with economic substance, consistent with other recent cases in the economic substance area?

The Facts of *Consolidated Edison*

Consolidated Edison (Con Ed) is a major supplier of electricity, natural gas, and steam in the New York City area. The transaction Con Ed entered into was a leveraged lease of an interest in a facility in the Netherlands that delivered heat, electricity, and carbon dioxide to its customers. At the time Con Ed entered into the LILO transaction,² it was attempting to deal with the deregulation of the electric industry in New York. It was given a limited right to invest in unregulated subsidiaries that invested in energy projects. The court understood that the LILO transaction was expected to be profitable on a pretax basis. It was not structured to eliminate items of income or to duplicate deductions. However, it would change the timing of the income and deductions, resulting in greater losses at the beginning of the transaction and more income toward the end.

¹No. 06-305T (Fed. Cl. 2009), *Doc 2009-23332*, 2009 TNT 203-7 (Opinion).

²A LILO generally refers to a leveraged lease with a tax-indifferent party such as a tax-exempt entity. As a practical matter, the user of property subject to a leveraged lease is generally an entity that, at least temporarily, cannot make maximum use of the tax deductions available to the property owner.

The opinion contains a detailed analysis of the facts surrounding the transaction. The court found that Con Ed engaged in extensive due diligence regarding the transaction — including on-site inspections and investigation into the creditworthiness of the Dutch counterparty — besides getting opinions on U.S. law (particularly tax law) and Dutch law. The court provides a long description of the documents that effected the transaction. Con Ed leased a 47.47 percent interest in the facility³ from the Dutch counterparty for about 43 years. The lease required Con Ed to make two large rental payments: about \$120 million at closing and approximately \$831 million when the lease terminated. The \$120 million payment consisted of about \$39 million of equity committed by Con Ed and a nonrecourse note from a third party for roughly \$81 million.

The sublease back to the Dutch counterparty was of particular importance to the court. The term of the sublease was about 20 years. At that point, the Dutch counterparty could purchase the remaining lease interest for a price fixed in the agreement (the sublease purchase option). If it did not, Con Ed had two choices:

- It could renew the sublease with the Dutch counterparty for 16 years (with the amount of rental payments specified in the contract equal to Con Ed's obligation to make nonrecourse debt service payments during that period) (the sublease renewal option). If it chose that option, Con Ed could lease the facility to any party for the last 7 years of its 43-year lease.
- Alternatively, Con Ed would get the right to lease the property until the termination of the agreement in 2041 (the retention option). If Con Ed did that, it would be required to satisfy its nonrecourse debt obligation immediately.

Because Con Ed's rental payments in the LILO transaction were substantially greater than its rental receipts in the years at issue and because it also incurred interest expenses, Con Ed reported a substantial loss on the transaction in those years.

Analysis of the Transaction

The IRS argued that Con Ed did not truly own an interest in the facility and did not incur a genuine indebtedness. In the alternative, the IRS argued that the transaction failed because of a lack of economic substance. In evaluating the transaction, the court stressed that each LILO transaction has unique facts that must be analyzed. Following the Federal Circuit's position in

³That is, an interest of about 47/99. Banc One Leasing Inc. entered into a leveraged lease for the remainder of the facility.

TAX PRACTICE

Coltec Industries, Inc. v. United States,⁴ the court required that the transaction have an objectively reasonable possibility of profit, as well as subjectively having been entered into for a business purpose other than the tax benefits.

The court carefully reviewed the testimony of the two parties' experts regarding the lease. The court recognized that, for the taxpayer to win, it must show that the sublease purchase option would not "necessarily . . . be exercised" by the Dutch utility when the initial term of the sublease ended in 2018.⁵ The government argued successfully in two recent leveraged lease cases that the original owner would repurchase the property at the end of the initial lease term and that the transaction was thus a financing, not a true lease.⁶ Indeed, it seems reasonable that the Dutch entity that has continued to use the facilities would not want to leave them in the hands of a third party. However, after a lengthy review of expert testimony for both parties, the court found that "the Sublease Purchase Option is not certain to be exercised."⁷ It also dismissed the government's argument that the transaction involved a circular flow of cash, noting that leveraged leases often contain terms that result in matching payments on both sides of the transaction. It follows, in the court's analysis, that the lease was a true lease, the debt was true debt, and Con Ed had a realistic possibility of profiting from the transaction.

The court then considered whether the transaction was entered into for reasons other than tax benefits. While Con Ed officers and employees admitted that tax considerations played a role in the investment, they also ascribed several nontax motives to Con Ed's entering the transaction. They included:

the ability to pursue new opportunities and alternatives in a deregulated market; the expectation of making a pretax profit through the . . . Transaction; plaintiff's entry into Western European energy markets; the potential for benefits from the output of the . . . Facility due to the life of the plant beyond the Sublease Basic Term; technical benefits to Con Ed of operating a state of the art plant in its own field of expertise; the ability to further develop and

share Con Ed's own cutting edge technology; and environmental benefits, including gaining expertise, while involved with a world-class, environmentally friendly plant and improving plaintiff's environmental public image.⁸

The court examined at length the nontax reasons given by the Con Ed witnesses for the transaction, paying particular attention to Con Ed's nontax profit motive. The court concluded that there were nontax reasons for Con Ed to enter into the transaction. It then determined whether the transaction had "objective economic substance" — that is, a reasonable possibility of profit. The court considered at length each of the three possible outcomes in 2018, at the end of the initial lease term, and concluded that "objectively, the plaintiff expected a pretax profit under each of the possible Options structured in the Transaction."⁹ The court was concerned that the pretax profit would be of some significance, noting that other courts have looked to threshold returns of around 2 to 4 percent to conclude that the anticipated pretax profit was significant. It examined and distinguished the two recent cases dealing with leveraged leases that had found for the government,¹⁰ emphasizing again, as it did throughout the opinion, how fact-specific the LILO cases are. The court concluded that in this case, objective economic substance could be found.

Relation to Other Economic Substance Cases

Although the court gave substantial detail in laying out the facts of this case, it is difficult to evaluate those facts based solely on the opinion. The basic structure of the transaction appears to be substantially similar to those in other leveraged lease cases that have been decided recently. In those other cases, the courts had relatively little problem in concluding that the transactions lacked economic substance — they involved little more than a flurry of papers with a fee paid to promoters and accommodating parties.

⁴454 F.3d 1340 (Fed. Cir. 2006), *Doc 2006-13276*, 2006 TNT 134-10, *cert. denied*, 549 U.S. 1206 (2007). The court in *Coltec* is not crystal clear in its position, saying at one point: "While the [economic substance] doctrine *may* well also apply if the taxpayer's sole subjective motivation is tax avoidance even if the transaction has economic substance, a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance." (Emphasis in the original.) This seems to leave open the possibility that the court does not require the taxpayer to satisfy the subjective prong of the economic substance doctrine.

⁵Opinion at 55.

⁶*BB&T Corp. v. United States*, 523 F.3d 461 (4th Cir. 2008), *Doc 2008-9547*, 2008 TNT 84-15 (LILO); *AWG Leasing Trust v. United States*, 592 F. Supp.2d 953 (N.D. Ohio 2008), *Doc 2008-11830*, 2008 TNT 105-10 (sale-in, lease-out). In the text, the cases are all referred to as LILO cases although some are SILO cases. For this discussion, the issues are similar.

⁷Opinion at 91.

⁸*Id.* at 111. Absent from the court's discussion is any consideration of the fact that Con Ed had an interest in only 47.47 percent of the facility, and the other party was Banc One Leasing Inc., which presumably had no experience in operating power generation facilities. There is no discussion of any agreements or understandings between Con Ed and Banc One regarding how the facilities would be operated if the Dutch company didn't exercise the sublease purchase option, although presumably the Dutch company had an option with Banc One similar to its option with Con Ed to purchase the sublease. Con Ed, Banc One, and the Dutch entity signed a facility operating agreement under which the Dutch entity would operate the facility during the sublease period. That agreement has provisions dealing with the operator of the facility for the postsublease period, and there is no indication in the opinion that Con Ed would play any different role than Banc One at that time. Opinion at 19.

⁹*Id.* at 139.

¹⁰*See supra* note 6. The United States won two similar cases, *Fifth Third Bancorp & Subsidiaries v. United States*, No. 05-350 (S.D. Ohio Apr. 18, 2008), *Doc 2008-9425*, 2008 TNT 83-17, and *Altria Group, Inc. v. United States*, No. 06-9430 (S.D.N.Y. July 9, 2009), but they were decided by juries, and the *Con Ed* court thought it could not review the juries' logic in those cases.

Yet even without a thorough understanding of the facts, it is clear that the court found an important difference between *Con Ed* and the other recent leveraged leasing cases. In those other cases, the courts saw the leveraged lease as a deal looking for an investor.¹¹ But in *Con Ed* the court found a taxpayer with a real business connection to the investment. It found that “as a result of deregulation, the [Con Ed] development company . . . sought international LILo investments in order to diversify its assets and develop strategic alliances abroad.”¹² The taxpayer’s business reasons for entering the transaction did not include only the wish to earn income — a wish whose bona fides are not easy for a court to evaluate when the economic return, absent tax benefits, will surely be less than alternative investments that don’t provide the tax advantages of a leveraged lease. *Con Ed* could also point to reasons it was interested in the Netherlands plant that related to the business in which it was engaged, the generation of electricity.¹³

In that respect, *Con Ed* is comparable to *United Parcel Service of America Inc. v. Commissioner*.¹⁴ In *UPS*, the court of appeals reversed a government victory and found for the taxpayer. It did so in the context of a transaction — the creation of an offshore entity to take over UPS’s insurance business — that had many trappings of a classic tax shelter. But the business in *UPS* was real, and it was an integral part of UPS’s profitmaking enterprise. The transaction, certainly heavily influenced by tax considerations, was brought to the taxpayer’s attention by its insurance broker. It was not a deal provided by a generic promoter, a deal whose only nontax business purpose would have been making a pretax profit that was less than what the taxpayer could make elsewhere. Instead, the transaction in *UPS* was a real restructuring of the taxpayer’s business, albeit one with significant tax benefits.

The extent to which courts will be favorably disposed to a transaction that otherwise looks like a tax shelter, because its purpose can be related to the specific business of the taxpayer, should not be underestimated. For example, the court in *BB&T Corp. v. United States*, which made short shrift of a LILo transaction similar to the one in *Con Ed*, distinguished the lease transaction before it

from the one in *Frank Lyon Co. v. United States*,¹⁵ a taxpayer victory. The court was careful to note that in *Frank Lyon*:

regulatory restrictions prevented the Worthen-Bank & Trust Company (“Worthen”) from financing the construction of a new bank and office building through a conventional mortgage. Worthen therefore arranged “an alternative solution” — a sale and lease-back arrangement with Frank Lyon Co. — that would “provide [Worthen] with the use of the building, satisfy the state and federal regulators, and attract the necessary capital.”¹⁶

Similarly, in *Shell Petroleum Inc. v. United States*,¹⁷ the taxpayer successfully defended a transaction with significant tax benefits that was brought to management’s attention by the company’s tax department, not an outside promoter, with no mention of the tax benefits.¹⁸ On the record, at least, the decision to proceed with the transaction was made by the taxpayer based on nontax considerations.¹⁹

However, in *Schering-Plough Corp. v. United States*,²⁰ a transaction highly engineered by investment bankers to give the taxpayer the benefit of foreign earnings without running afoul of subpart F was disapproved of by a court that held that the transaction was equivalent to a loan (which is taxed under subpart F). The transaction had two strikes against it, without reference to the technical analysis. First, it was a financial product developed by investment bankers. Second, as a financial product, it had no direct connection to the specific business of the taxpayer.

The many son-of-BOSS cases suggest how reluctant courts are to bless a transaction that is structured by promoters and cannot be related to the business of the taxpayer. There were, potentially, three issues in the cases:

1. The technical question courts faced was whether a contingent liability was a liability for purposes of section 752. If it was not, the amount realized on a sale of property subject to the liability would not include the amount of the contingent liability (and hence would result in a significant loss because the

¹¹The court in *AWG* discusses how the promoters of the transaction “initiated the process of securing a U.S. leasing transaction involving the Facility.” The taxpayer was a partnership of two financial services companies. In *BB&T*, a promoter solicited a financial services company to obtain an interest in pulp manufacturing equipment using a “tax driven structure.”

¹²Opinion at 5.

¹³With a different taxpayer, the government might have more easily convinced the court that the transaction was structured so that the lease would terminate in 2018 at the end of the initial lease term. Because *Con Ed*’s business was the generation of electricity, it presumably was able to take over operation of the property at the conclusion of the initial lease term. *But see supra* note 8.

¹⁴254 F.3d 1014 (11th Cir. 2001), *Doc 2001-17453*, 2001 TNT 122-5. Others have noted how *UPS* may serve as a prime example of a transaction that has more reason to be accepted than a “tax shelter.” *E.g.*, David P. Hariton, “Kafka and the Tax Shelter,” 57 *Tax L. Rev.* 1, 11 (2003).

¹⁵435 U.S. 561 (1978).

¹⁶*BB&T Corp. v. United States*, 523 F.3d 461, 474 (4th Cir. 2008). When *Frank Lyon* was issued, not everyone was convinced that the Court had properly evaluated the taxpayer’s position for tax purposes. *See* Bernard Wolfman, “The Supreme Court in the Lyon’s Den: A Failure of Judicial Process,” 66 *Cornell L. Rev.* 1075 (1981).

¹⁷2008-2 USTC para. 50,422 (S.D. Tex. July 3, 2008), *Doc 2008-14880*, 2008 TNT 131-10.

¹⁸*Id.* at Finding of Fact No. 243.

¹⁹For another case in which the taxpayer won because it had a plausible business purpose specific to the taxpayer’s business, even though the taxpayer clearly gained a significant tax benefit, *see Hopkins Partners v. Commissioner*, T.C. Memo. 2009-107, *Doc 2009-11472*, 2009 TNT 95-8.

²⁰651 F. Supp.2d 219 (D.N.J. 2009), *Doc 2009-19512*, 2009 TNT 167-3.

TAX PRACTICE

buyer would take the contingent liability into account in deciding how much to pay for the property).

2. In any event, however, the IRS issued regulations in 2003 that disallowed the losses in cases such as son-of-BOSS transactions, retroactive to 1999. Taxpayers affected by the regulations argued that it was improper to apply them retroactively.

3. Finally, the government attacked these transactions under a general economic substance argument.

A recent review of those cases indicates that courts found for the government in 9 of the 10 cases, although the courts' conclusions on the three issues cannot be reconciled.²¹ Of the seven cases that reached the issue of economic substance, six found that there was no economic substance. The one case that found for the taxpayer is on appeal.²²

How Profitable Should Investments Be?

Emphasizing the connection between the tax-favored transaction and the taxpayer's business is an understandable approach for courts that have to deal with the tax shelter phenomenon. It helps them cope with a puzzle that the *Con Ed* court touches on but doesn't elucidate directly. The court explains that prior courts have focused on the extent to which a taxpayer should expect a pretax return on an investment, noting that courts have looked to returns in the 2 to 4 percent range. It then considers a government argument that the return should be converted to a present value. The court in *ACM*²³ had raised that as a possibility.

²¹Monte Jackel and Robert Crnkovich, "Son-of-BOSS Revisited," *Tax Notes*, June 22, 2009, p. 1481, *Doc 2009-12881*, 2009 *TNT* 118-13.

²²*Sala v. United States*, 552 F. Supp.2d 1167 (D. Colo. 2008), *Doc 2008-9012*, 2008 *TNT* 80-10. *Murfam Farms LLC v. United States*, 88 Fed. Cl. 516 (2009), *Doc 2009-17336*, 2009 *TNT* 146-84, decided after the Jackel and Crnkovich article was published, held that retroactive application of reg. section 1.752-6 was invalid but remanded the case for further proceedings on other issues. In another recent case, *American Boat Co. LLC v. United States*, 583 F.3d 471 (7th Cir. 2009), *Doc 2009-21746*, 2009 *TNT* 189-10, the court of appeals affirmed a district court decision that ruled against the taxpayer on the basic son-of-BOSS transaction but refused to impose penalties on the taxpayer. The justification for not imposing penalties was partially that the advice on the tax shelter came as part of advice on a legitimate issue relating to the reorganization of the taxpayer's business. In contrast, in *Palm Canyon X Investments LLC v. Commissioner*, T.C. Memo. 2009-288, *Doc 2009-27494*, 2009 *TNT* 239-11, penalties were imposed on a taxpayer engaged in a son-of-BOSS transaction involving foreign currency options in which none of the taxpayer's businesses had any foreign connections. The court held that the transaction had no economic substance, and it did not consider the contingent liability issue or the retroactivity of the regulations.

²³*ACM Partnership v. Commissioner*, 157 F.3d 231, 259 (3d Cir. 1998), *Doc 98-31128*, 98 *TNT* 202-7, *cert. denied*, 526 U.S. 1017 (1999). In *Wells Fargo & Co. v. United States*, No. 06-628T (Fed. Cl. 2010), 2010 *TNT* 6-15, a more recent SILO case, decided by the Court of Federal Claims for the government, the court was swayed by the fact that Wells Fargo lost money under a pretax,

(Footnote continued in next column.)

The problem with expecting an investment with any associated tax benefits to generate a positive present value using a market discount rate is that you would effectively be expecting that transaction to generate a return comparable to an investment with no tax benefits. In other words, you would be expecting investors to associate no value with the tax benefit. That is not sensible,²⁴ although determining how the market values the tax benefits may be difficult.²⁵

But once you concede that the investor will take tax benefits into account in making an investment, it is hard to see why we should demand any particular positive pretax return on the investment. If Congress gave taxpayers a 125 percent credit for investments in windmills, it would be perfectly sensible for a taxpayer who could use that credit to invest in a windmill that lost money.²⁶

When Congress's purpose seems self-evident, as would be true with the hypothetical windmill credit, and is true, for example, with the exemption for interest on municipal bonds, courts don't stop to analyze pretax returns. But when it is unclear whether Congress had a particular purpose in mind in granting a tax benefit, courts have not been given, and haven't been able to develop, a convincing standard to distinguish an acceptable investment from an unacceptable one.

present-value analysis. *Wells Fargo* opinion at 66. The court argued separately that the non-tax return was less than Wells Fargo's cost of funds, although that is equivalent to a present-value analysis using the bank's cost of funds as the discount rate.

²⁴The point was made most eloquently in Alvin C. Warren, "The Requirement of Economic Profit in Tax Motivated Transactions," 59 *Taxes* 985 (1981). As Warren points out, even the IRS has acknowledged that a government program that assumes that investors will get substantial tax benefits cannot be tested against norms of pretax profitability. *Id.* at 991 (discussing Rev. Rul. 79-300, 1979-2 C.B. 112 (low-income housing)).

²⁵For example, one might expect the return on tax-exempt bonds to equal the return on comparable taxable bonds less the tax paid by the lowest-rate purchaser of those bonds. In that case, a purchaser would gain no after-tax advantage in buying those bonds. See Boris Bittker, "Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities?" 16 *San Diego L. Rev.* 735 (1979). However, the relationship between the interest rate on tax-exempt bonds and comparable taxable bonds appears to be more complex than is suggested by the simple model described here. For an examination of the issue, see Francis A. Longstaff, "Municipal Debt and Marginal Tax Rates: Is There a Tax Premium in Asset Prices?" National Bureau of Economic Research Working Paper 14687 (Jan. 2009).

²⁶The point that there is no reason to demand a positive return is made by Warren, *supra* note 24, who would disregard a pretax return at least when tax provisions reflect a clear congressional intent to encourage a specific type of investment. The importance of focusing on the congressional purpose for a provision has been stressed by others. E.g., David P. Hariton, "When and How Should the Economic Substance Doctrine Be Applied?" 60 *Tax L. Rev.* 29 (2006) (Hariton would emphasize whether any profit earned in the transaction is significant when compared with the losses it generates); Michael L. Schler, "Ten More Truths About Tax Shelters," 55 *Tax L. Rev.* 325, 328 (2002). However, congressional intent does not seem to have been a concern of the *Con Ed* court.

The Direction of Economic Substance Cases

The issue of economic substance has taken up so much of commentators' attention that our forests would be imperiled if someone not bucking for tenure tried to cite all those commentaries. It is difficult to trace a coherent path through the case law. More than 25 years after Prof. Isenbergh provided powerful criticisms of *Gregory* and its progeny,²⁷ and more than 40 years after Prof. Chirelstein, after careful review, suggested the limited scope that Judge Learned Hand intended for his opinion in that case,²⁸ courts and commentators appear reasonably comfortable going down the economic substance path without a clear sense of where it will lead them.

Why do courts continue to rely on a doctrine whose precise details are so difficult to determine? Isenbergh suggested that one reason courts may follow *Gregory* is "the desire not to look naive."²⁹ Indeed, courts that have found for taxpayers in complicated tax shelter transactions have been characterized as confused.³⁰ And over the past decade courts have generally supported the government's position when economic substance issues have been raised.

Perhaps what keeps the economic substance argument active in judicial decisions is the courts' nontechnical reaction to the phenomenon of tax planning. The courts, I would suggest, are beset with the irreconcilability of two conflicting approaches. On one hand, as suggested above, there is no way a transaction with significant tax aspects can be analyzed sensibly without reference to the tax benefits involved. Ultimately, a business person will judge an investment based on its after-tax yield. And transactions with significant tax benefits are so common that courts realize they cannot simply disallow all of them.³¹ On the other hand, it is apparently too offensive to allow a transaction to go forward if it appears to have

been built solely around tax benefits that are not directly and specifically authorized by statute.³² Courts believe this, and so look for a way to draw a line between acceptable and unacceptable behavior. Because they cannot operate as legislators, courts are uncomfortable setting a particular pretax return as a benchmark. Moreover, it is far from clear that such a benchmark would make sense.³³ So the courts look for other sensible factors that will limit the transactions taxpayers will be allowed to enter into. As suggested above, the case law reveals that courts are more willing to accept transactions that can be related to a taxpayer's business and to rule against seemingly generic transactions when the only business purpose is to make a return, even though the pretax return is always less than what would otherwise be

benefits: As Isenbergh observes, the tax benefit of home ownership may be fully discounted in the price of housing, making it not much of a benefit. See Bittker, *supra* note 25. For more on whether the tax benefit of home ownership is fully discounted in the price of housing, see Dennis R. Capozza et al., "Taxes, Mortgage Borrowing, and Residential Land Prices," in Henry J. Aaron and William G. Gale, eds., *The Economic Effects of Fundamental Tax Reform* (Brookings, 1996) at 198 (the authors argue that elimination of the mortgage interest deduction and deduction for property taxes would reduce housing prices by 8 percent to 27 percent, depending on the region of the country); Capozza et al., "Taxes and House Prices: Large or Small Effect?" *Proceedings of the 91st Annual Conference of the National Tax Association*, 19-24 (1999) (short review of the conflicting literature on this issue).

³²The court in *Wells Fargo*, *supra* note 23, made the point quite forcefully:

Although well disguised in a sea of paper and complexity, the SILO transactions essentially amount to Wells Fargo's purchase of tax benefits for a fee from a tax-exempt entity that cannot use the deductions. . . . If the Court were to approve of these SILO schemes, the big losers would be the Internal Revenue Service . . . and the taxpaying public.

Wells Fargo opinion at 4.

The courts are certainly not discouraged from attacking tax shelters by the fact that Congress has provided legislative support for the government in many prominent tax shelter transactions. *E.g.*, section 901(k) (dealing with the *Compaq-IES* transactions, *supra* note 30); section 1259 (rules regarding short sales against the box passed after a plan involving the Estée Lauder estate was publicized).

³³At least two problems beset courts that would go down this path. First, it is not always easy to decide what is "the transaction" that a court should evaluate. More cash can be added to a deal to generate income that will make the investment, as a whole, profitable. The court must then separate the components of the whole deal to decide which part must be evaluated for profitability. This was one issue that the court in *ACM*, for example, had to deal with. 137 F.3d at 260. Secondly, the taxpayer cannot control the benefits that Congress inserts into the code. Suppose that a taxpayer would invest in a transaction with a 5 percent tax credit and make a before-tax profit. However, Congress raises the credit to 10 percent, and the increased credit is reflected in the price of the investment, which now produces a before-tax loss. Is it appropriate to say that the first transaction passes muster but the second, identical except that the added tax benefit has been captured in the price of the asset, does not?

²⁷Joseph Isenbergh, "Musings on Form and Substance in Taxation," 49 *U. Chi. L. Rev.* 859 (1982). At this point, one is tempted to speak of *Gregory's* harem, if not for the confusion that might engender.

²⁸Marvin Chirelstein, "Learned Hand's Contribution to the Law of Tax Avoidance," 77 *Yale L. J.* 440 (1968).

²⁹Isenbergh, *supra* note 27, at 882.

³⁰One reason the circuit courts performed so poorly in *Compaq* [*Computer Corp. v. Commissioner*, 277 F.3d 778 (5th Cir. 2001), *Doc* 2002-184, 2002 *TNT* 1-5] and *IES* [*Industries, Inc. v. United States*, 253 F.3d 350 (8th Cir. 2001), *Doc* 2001-16769, 2001 *TNT* 116-12] is that they were confused by a relatively novel tax structuring twist." Daniel Shaviro and David Weisbach, "The Fifth Circuit Gets It Wrong in *Compaq v. Commissioner*," *Tax Notes*, Jan. 28, 2002, p. 511, at 512, *Doc* 2002-2091, 2002 *TNT* 19-31.

³¹Whole classes of transactions could be shown to be uneconomical absent the effect of particular tax allowances. For example, one of the principal advantages of home ownership is the tax benefit of deductible mortgage interest coupled with the exclusion of the imputed rental income from taxation. In many cases the purchase of a house with borrowed money is demonstrably uneconomical without this tax benefit, a benefit often fully discounted in the price of housing. Isenbergh, *supra* note 27, at 876 (footnote omitted). The quotation neatly points out one of the problems of talking about tax

(Footnote continued in next column.)

available for a normal investment in the market. The relation between the transaction and the taxpayer's business may not always be crystal clear, but that standard reassures the courts that their decisions cannot be overextended.

The leveraged lease — the basic transaction involved in *Con Ed* — is a prime example of the type of transaction that causes difficulty for courts. In any lease, the owner of the property receives the tax benefits of ownership while the lessee uses the property. The leveraged lease structure, in which the owner borrows most of the funds for the transaction and the lease is a net lease, emphasizes the extent to which the owner is little concerned with the asset being leased. Yet this is a form of transaction that has long been entered into, and it normally results in a shift of deductions from a taxpayer that needs an asset but not deductions, to a taxpayer that has no interest in the asset but can use the tax deductions. The party using the property is compensated by having to pay rent that is below a fair market rate.³⁴ The details of acceptable leveraged leasing transactions have been worked out.³⁵ *Frank Lyon* involved a leasing structure, and the continuing controversy surrounding the Supreme Court's decision reflects the conflict that may be inherent in the area of tax-motivated transactions.³⁶

Conclusion

A case like *Con Ed* shows that some factors seem to weigh heavily in a taxpayer's favor. Although the rhetoric in the opinions focuses on economic substance, it seems reasonable to think that courts may be willing to ignore some of the niceties of a strict economic substance analysis if they find favorable answers to these two questions: Was the transaction a generic one brought to the taxpayer's attention, and was the actual investment

related more or less directly to the taxpayer's business?³⁷ This rule may not be fully satisfying intellectually, but it may suit the purposes of general jurisdiction courts. *Con Ed* illustrates that even when the answer to the first question seems to be yes (because, as the court realized, LILO transactions were quite rampant at the time),³⁸ a taxpayer may be allowed to engage in the transaction if in fact it relates to the taxpayer's business. Even in the current atmosphere in which taxpayers have been losing many cases, that factor can sway a court to accept the taxpayer's motives as genuine and to allow the taxpayer to claim the tax benefits.

³⁷This comes pretty close to what Mark P. Gergen has argued: "You can pick up tax gold if you find it in the street while going about your business, but cannot go hunting for it." Gergen, "The Common Knowledge of Tax Abuse," 54 *SMU L. Rev.* 131, 140 (2001). See also Joseph Bankman, "The Economic Substance Doctrine," 74 *S. Cal. L. Rev.* 5, 15-20 (2000).

³⁸The court cites several decisions on LILO transactions that were issued within two years of the *Con Ed* opinion. See cases cited in *supra* notes 6 and 10. Moreover, *Con Ed* used the services of an outside financial adviser, Cornerstone Financial Advisors LP, to obtain advice on possible leasing transactions and on this transaction in particular. Opinion at 5.

³⁴The structure is so successful in giving the user of the property the economic benefits of the tax deductions that Congress used it in 1981 to transfer benefits of accelerated depreciation with the safe harbor leasing structure. That leasing structure worked fairly efficiently for its intended purpose, and about 75 to 85 percent of the benefits went to the users of the property rather than to the accommodating taxpayers who entered into the transactions to get "tax shelter." See Joint Committee on Taxation, "Analysis of Safe Harbor Leasing," 25 (JCS-23-82) (1982). The JCT staff estimated that 76.5 percent of the benefits went to the users of the property; Treasury's estimate was 84.5 percent. Treasury, "Preliminary Report on Safe-Harbor Leasing Activity in 1981" (Mar. 26, 1982), discussed in the JCT analysis.

³⁵Rev. Proc. 2001-28, 2001-1 C.B. 1156, *Doc 2001-12729*, 2001 *TNT 88-8* (leasing guidelines). For further discussion of leasing rules, see, for example, Ian Shrank and Arnold G. Gough Jr. (eds.), *Equipment Leasing — Leveraged Leasing* (4th ed. 2001).

³⁶Thus, Lee A. Sheppard's commentary on *Consolidated Edison* ("Con Ed's Night of the Living Dead," *Tax Notes*, Nov. 9, 2009, p. 619, *Doc 2009-24279*, or 2009 *TNT 214-1*) begins: "The Court of Federal Claims celebrated Halloween by resurrecting the corpse of Frank Lyon in *Consolidated Edison Co. v. United States*." Wolfman's early attack on *Frank Lyon* was cited in *supra* note 16. However unhappy some commentators may be with the result in *Frank Lyon*, the courts must continue to wrestle with it because it is the Supreme Court's most recent attempt to deal with economic substance.