

Documenting Business Purpose After IRS' 10th Circ. Win

By **Carina Federico and Starling Marshall** (May 6, 2026, 5:44 PM EDT)

In a highly anticipated and long awaited decision, on April 21 the U.S. Court of Appeals for the Tenth Circuit ruled in favor of the IRS in *Liberty Global Inc. v. U.S.* The court held that Liberty Global's disputed transactions lacked economic substance and that the economic substance doctrine did not require a threshold relevancy determination to be applied.

Unlike in other recent economic substance cases, Liberty Global conceded that the transactions at issue were undertaken solely for tax purposes and did not present a business purpose for the transactions. Therefore, the sole issue before the court was whether the economic substance doctrine should apply to the transactions at issue.



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History of the Economic Substance Doctrine

The decision is significant given the Internal Revenue Service's increased economic substance enforcement and the intense debate about when the doctrine may be applied.

For decades, economic substance developed as a common law doctrine that allowed courts to set aside transactions they found to be undertaken for tax avoidance rather than a legitimate business purpose.

Piecemeal development by courts exercising their equitable powers and reacting to unique facts led to a confusing landscape for taxpayers. Some courts had a subjective test for business purpose, while others looked for objective evidence of profit. Some courts required a business purpose for each step in a plan, while others viewed the transaction holistically.



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In 2010, the economic substance doctrine was codified. The legislative history made clear that codification was meant only to clarify and enhance the judicial doctrine and not to replace it, and that the doctrine should not be applied to ordinary transactions and business decisions.

The text of Title 26 of the U.S. Code, Section 7701, itself states that the economic substance test is applicable only to "any transaction to which the economic substance doctrine is relevant." This last phrase has been the subject of much debate and is the crux of the issue in *Liberty Global*.

Initially, the IRS required executive approval for exam teams to raise economic substance and the associated strict liability penalties — 40% of the benefit lowered to 20% with adequate disclosure — in its audits.

But in 2022, after multiple reports by the Treasury Inspector General for Tax Administration criticized the IRS' failure to adequately scrutinize tax avoidance strategies employed by large corporations and partnerships, the IRS lifted the executive approval requirements.

Examiners began raising the doctrine more frequently without clear guidance from the courts or the U.S. Department of the Treasury about when doing so was actually relevant.

The IRS has issued some guidance over the past few years, and, although the proposed regulations were not finalized and the guidance projects appear to have been abandoned, the guidance demonstrates the IRS' expansive view of the doctrine's applicability.[1]

Recent Economic Substance Decisions on Relevance of Doctrine

Increased enforcement by the IRS has led to several recent decisions on economic substance with different outcomes. In its recent decision, a divided Tenth Circuit affirmed the U.S. District Court for the District of Colorado's 2023 ruling in Liberty Global, holding that the codified economic substance doctrine applies even when a taxpayer mechanically utilizes the provisions of the Tax Code.

The court also held that common mergers and acquisitions elements and basic business transactions are not categorically carved out from the economic substance doctrine. The court dismissed the taxpayer's argument that a separate relevancy determination needs to be made before the economic substance doctrine can be applied.

Liberty Global centers around a four-part, cross-border transaction called Project Soy, through which Liberty Global intended to take advantage of a timing mismatch in the Tax Cuts and Jobs Act between the global intangible low-taxed income and Subpart F regimes, and the 245A dividends-received deduction to treat \$2.4 billion in taxable gain as a dividends-received deduction.

Liberty Global conceded in the district court that the first three steps of its four-part plan failed the economic substance test, leaving as the only question on appeal whether the codified economic substance doctrine was relevant to Project Soy.

U.S. Circuit Judge Allison Hartwell Eid dissented, finding support for a threshold relevancy determination in the text of the statute. This dissent may tee up the relevancy issue for further appeal in this case via a petition for en banc reconsideration or even certiorari, and even if not, this increases the likelihood that the issue will be pursued in other cases in other circuits.

The Liberty Global decision differs from other recently decided economic substance doctrine cases. For example, in November 2025 the Tax Court recently held in *Patel and McAnally Patel v. Commissioner* that Congress "could hardly have been clearer" that the economic substance doctrine is only relevant to certain transactions. The *Patel* decision is being appealed in the U.S. Court of Appeals for the Fifth Circuit.

The Tax Court will follow its own precedent unless an appeal of another case lies in a circuit court that applies a different standard.

In *Perrigo Co. v. U.S.*, currently pending appeal in the U.S. Court of Appeals for the Sixth Circuit, the U.S. District Court for the Western District of Michigan found that the common law economic substance

doctrine did not invalidate the taxpayer's related-party transactions despite tax reduction being one driver of the plan.

While the district court did not address whether a relevancy test is formally necessary under the codified economic substance doctrine, the Perrigo case demonstrates that the IRS may not prevail when asserting the economic substance doctrine to disregard transactions that are compliant with other specific tax rules.

Patel and Perrigo, which were decided prior to the Tenth Circuit's decision in Liberty Global, create a clear contrast between the different courts and could lead to a circuit split that increases the likelihood that the U.S. Supreme Court may weigh in on the issue.

Practical Advice for Taxpayers

Although this decision could be appealed and additional litigation may follow, the IRS will likely be emboldened by its win and continue to challenge transactions under the economic substance doctrine, particularly those based upon mechanical compliance with Internal Revenue Code provisions resulting in a tax benefit that is difficult to reconcile with congressional intent.

Taxpayers can take steps to ensure that they are in the best position should they become the subject of an IRS audit concerning economic substance.

Taxpayers should maintain contemporaneous documentation supporting economic substance in transactions and not rely on technical compliance alone. Taxpayers must carefully document that the transactions are driven by business needs, and that tax planning around those business-driven decisions was appropriate but followed the business considerations.

Transactions should always have a business owner who can provide evidence and explanation to show the business needs or issues that the transaction is intended to address.

Documentation of the business purpose of transactions should be consistent in all communications, including tax memos and opinions, slide decks, internal and external correspondence about the transaction, board communications and press releases. Project names that denote a tax objective should be avoided.

Taxpayers should also keep key transaction documents in anticipation of an IRS examination. These may include the formal reorganization plan, business-purpose documentation, financial analysis and projections (both pre- and post-transaction), alternative options that were considered and operational substance.

Conclusion

The Tenth Circuit's decision in Liberty Global is likely not the last word on economic substance.

Liberty Global may file for an en banc rehearing or seek certiorari from the Supreme Court based on the dissent's taxpayer-favorable opinion that a threshold relevance test should precede the application of the economic substance doctrine. The issue will no doubt be raised in other cases in other courts that are not bound by the Tenth Circuit's decision.

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[1] See Prop. Reg. Sect. 1.6011-18, Notice 2024-54, Rev. Rul. 2024-14.