

165 T.C. 171-246

# UNITED STATES TAX COURT

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## REPORTS

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November 30, 2025

UNITED STATES TAX COURT  
WASHINGTON, D.C.



## JUDGES OF THE UNITED STATES TAX COURT

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### *Judges*

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ZACHARY FRIED, *Chief Special Trial Judge*

PETER J. PANUTHOS

LEWIS R. CARLUZZO

DIANA L. LEYDEN

JENNIFER SIEGEL

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CHARLES G. JEANE, *Clerk*

SHEILA A. MURPHY, *Reporter of Decisions*



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SUNIL S. PATEL AND LAURIE McANALLY PATEL, ET AL.,<sup>1</sup>  
PETITIONERS *v.* COMMISSIONER OF INTERNAL REVENUE,  
RESPONDENT

Docket Nos. 24344-17, 11352-18, Filed November 12, 2025.  
25268-18.

Ps claimed deductions under I.R.C. § 162 on their 2013, 2014, 2015, and 2016 tax returns for amounts paid to purported captive insurance companies A and B and to entity C, which purported to reinsure a portion of A and B's risk. R denied the deductions and determined that Ps are liable for accuracy-related penalties under I.R.C. § 6662(a), including penalties under I.R.C. § 6662(b)(6), which applies the economic substance doctrine as codified under I.R.C. § 7701(o). In *Patel v. Commissioner*, T.C. Memo. 2024-34, we held that amounts paid to insurance companies A and B were not insurance premiums for federal income tax purposes. *Held*: The codified economic substance doctrine requires a relevancy determination within the meaning of I.R.C. § 7701(o). *Held, further*, the codified economic substance doctrine is relevant in these cases. *Held*,

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<sup>1</sup> Cases of the following petitioners have been consolidated herewith for purposes of trial, briefing, and disposition: Sunil S. Patel and Laurie M. McAnally-Patel, Docket Nos. 11352-18 and 25268-18.

*further*, Ps are liable for penalties under the codified economic substance doctrine pursuant to I.R.C. § 6662(a) and (b)(6) and the increased rate under I.R.C. § 6662(i), for the relevant tax years at issue, as limited by *Patel v. Commissioner*, T.C. Memo. 2020-133. *Held, further*, Ps are liable for the remaining accuracy-related penalties under I.R.C. § 6662(a), as set forth herein and as limited by *Patel*, T.C. Memo. 2020-133.

JONES, *J.*, wrote the opinion of the Court, which URDA, *C.J.*, and KERRIGAN, BUCH, NEGA, PUGH, ASHFORD, COPELAND, TORO, GREAVES, MARSHALL, WEILER, WAY, LANDY, ARBEIT, GUIDER, JENKINS, and FUNG, *JJ.*, joined.

*David D. Aughtry and Patrick J. McCann, Jr.*, for petitioners.<sup>2</sup>  
*Nicholas D. Doukas, Alicia H. Eycler, and William D. Richard*, for respondent.

JONES, *Judge*: This Opinion addresses issues reserved by our prior opinions in *Patel v. Commissioner (Patel I)*, T.C. Memo. 2020-133, and *Patel v. Commissioner (Patel II)*, T.C. Memo. 2024-34. In *Patel II*, T.C. Memo. 2024-34, at \*52, the Court held that the transactions at issue did not constitute insurance for federal income tax purposes. Accordingly, the Court sustained the Commissioner's deficiency determinations and the disallowance of those deductions for taxable years 2013, 2014, 2015, and 2016 (tax years at issue). *Id.* Now, the remaining issue for decision is whether Sunil

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<sup>2</sup> Briefs amici curiae were filed by (1) *Robert J. Kovacev and Samuel A. Lapin* as attorneys for The Chamber of Commerce of the United States of America; (2) *David M. Brotz, George M. Clarke III, Joseph B. Judkins, Carlton A. Tarpley, and Joy A. Williamson* as attorneys for Alliance for Business Partnerships; (3) *H. Craig Pitts, Brett D. Sanger, and Mark A. Weitz* as attorneys for Modoc Nation; (4) *Joseph D. Henchman* as attorney for the National Taxpayers Union Foundation; (5) *Jonathan C. Bond, Nicole M. Butze, Michael J. Desmond, Matt Donnelly, Lucas C. Townsend, and Lael D. Weinberger* as attorneys for the National Association of Manufacturers; (6) *Jenny A. Austin, May Y. Chow, Anne Gordon, and Gary B. Wilcox* as attorneys for National Foreign Trade Council, Inc.; (7) *David B. Blair and William E. Sheumaker* as attorneys for Eversheds Sutherland (US) LLP; (8) *Miriam L. Fisher, Molly C. Harding, Elizabeth A. Kanyer, and Jean A. Pawlow* as attorneys for the American College of Tax Counsel; (9) *Kelsey Merrick* as attorney for The Tax Law Center at NYU Law; and (10) *George Gerachis, Gary Huffman, Stephen Josey, and Kathleen Pakenham* as attorneys for American Forest & Paper Association. At respondent's request, we ordered the parties to file briefs in response to the amicus briefs. At the parties' request, we held oral argument on the issues raised by the briefs.

S. Patel, M.D. (Dr. Patel), and Laurie M. McAnally-Patel, M.D. (Dr. McAnally-Patel),<sup>3</sup> are liable for accuracy-related penalties for the tax years at issue, as limited by our prior opinion, *Patel I*, T.C. Memo. 2020-133. See also *Patel II*, T.C. Memo. 2024-34, at \*3 n.5.

The Notices of Deficiency (NODs) for the tax years at issue listed several alternative grounds for respondent's imposition of penalties, including that the transactions lacked economic substance within the meaning of section 6662(b)(6).<sup>4</sup> In this Opinion, we will address, inter alia, the Internal Revenue Service's (IRS) determination that the transactions lacked economic substance and its assertion of penalties on that ground.<sup>5</sup>

For the reasons set forth herein, we will sustain the Commissioner's determinations with respect to the codified economic substance doctrine under section 6662(a) and (b)(6), as well as the increased penalty under section 6662(i). We will also sustain the remaining accuracy-related penalties, as set forth herein.

## FINDINGS OF FACT

We summarize our findings of fact from *Patel I* and *Patel II*. We also make additional findings of fact.

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<sup>3</sup> We sometimes refer to Dr. Patel and Dr. McAnally-Patel as the Patels.

<sup>4</sup> Unless otherwise indicated, statutory references are to the Internal Revenue Code, Title 26 U.S.C. (Code), in effect at all relevant times, regulatory references are to the *Code of Federal Regulations*, Title 26 (Treas. Reg.), in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure. All monetary amounts are rounded to the nearest dollar.

<sup>5</sup> We understand the interaction of section 6662(a) and (b)(6) to impose a single penalty. Because the Commissioner determined that penalty for multiple years (each of the tax years at issue), we will refer to it in the plural (penalties).

I. *Dr. Patel's Background and Decision to Form First Microcaptive*<sup>6</sup>

Dr. Patel has practiced medicine in Texas since 1997. He has an extensive education that includes a doctor of philosophy degree in immunology and a doctor of medicine degree. *Patel II*, T.C. Memo. 2024-34, at \*4.

Dr. Patel also has an extensive business background. *Id.* He has formed multiple medical-related businesses, including his own eye surgery practice, Ophthalmology Specialists of Texas (OST), where he specializes in the evaluation and management of certain eye-related medical conditions. *Id.* at \*4–5. Dr. Patel also conducts clinical research trials through two companies he established: Integrated Clinical Research, LLC (ICR), and Strategic Clinical Research Group, LLC (SCR). *Id.* at \*5.

After reading books on asset management and captive insurance, Dr. Patel decided to form a captive insurance company. *Id.* at \*6–7. A colleague introduced Dr. Patel to a financial planner, Christopher Fay, to discuss financial and insurance products. *Id.* at \*7.

But even before the introductory call with Mr. Fay, Dr. Patel already knew he wanted to form a captive insurance company because of his self-study. *Id.* Dr. Patel describes himself as a “savvy financial person” and stated that he did not want any advice from Mr. Fay. *Id.* Rather, Dr. Patel knew that he wanted to form a captive insurance company before engaging Mr. Fay. *Id.*

Although Dr. Patel disclaimed any interest in financial advice from Mr. Fay, he nonetheless completed a financial feasibility

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<sup>6</sup> As we explained in *Patel II*, T.C. Memo. 2024-34, at \*2 n.3, “[a] ‘captive insurance company’ is a corporation whose stock is owned by one or a small number of companies and which handles all or a part of the insurance needs of its shareholders or their affiliates.” *Caylor Land & Dev., Inc. v. Commissioner*, T.C. Memo. 2021-30, at \*8 n.4; see also *Harper Grp. v. Commissioner*, 96 T.C. 45, 46 n.3 (1991), *aff'd*, 979 F.2d 1341 (9th Cir. 1992). In our prior cases, we have adopted the term “microcaptive” to refer to “a small captive insurance company,” i.e., one that takes in less than \$1.2 or \$2.2 million (adjusted for inflation) in premiums depending on the tax year at issue. See *Caylor Land & Dev.*, T.C. Memo. 2021-30, at \*8 n.4; see also *Avrahami v. Commissioner*, 149 T.C. 144, 179 (2017); *Keating v. Commissioner*, T.C. Memo. 2024-2, at \*50 n.52 (explaining that amendments to section 831(b) increased the premium ceiling).

study at Mr. Fay's request. *Id.* Dr. Patel's answers on the feasibility study did not address captive insurance or the need for insurance products. *Id.* at \*8. Dr. Patel stated that his goals were aggressive growth and wealth accumulation. *Id.*

Mr. Fay recommended that Dr. Patel meet with Sean King<sup>7</sup> of CIC Services, LLC (CIC Services), to discuss forming a microcaptive. *Id.* at \*7. In an email sent to facilitate a meeting between Dr. Patel and Mr. Sean King, Mr. Fay stated that Dr. Patel was the "MD paying almost 2.5M in income taxes and did his own research on [microcaptive insurance companies]. He wants to talk with Sean about doing potentially 2 [captive insurance companies]." *Id.* Indeed, many of the contemporaneous emails exchanged during the tax years at issue contain similar suggestions that the purpose of forming a captive was tax avoidance, not insurance protection. *Id.* at \*7–8.

In June 2011 Dr. Patel met with Mr. Sean King and Mr. Fay. *Id.* at \*8. Since Dr. Patel already knew that he wanted to form a captive, the meeting was focused on discussing the formation and structure of a captive insurance company, not whether a captive was necessary for Dr. Patel's businesses. *Id.*

Mr. Sean King advised that CIC Services could manage a captive for Dr. Patel. *Id.* However, he recommended attorneys that Dr. Patel could contact to form a captive, including James Coomes. *Id.* In July 2011, without conducting any studies related to the need to form a captive, Dr. Patel informed Mr. Fay that he wanted to move forward with forming two captive insurance companies. *Id.*

Dr. Patel retained Mr. Coomes—a tax attorney who has focused his practice on captive insurance, as well as business and estate planning—to help form a captive. *Id.* at \*8–9. Mr. Coomes does not have formal training in captive insurance or writing insurance policies. *Id.* at \*9. Rather, he learned to write insurance policies by self-study, including reviewing commercial insurance policies, reading articles, and studying books. *Id.*

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<sup>7</sup> In *Patel II*, T.C. Memo. 2024-34, we discussed facts about both Thomas King and Sean King. As we mentioned in *Patel II*, Thomas King of CIC Services is Sean King's father. *See id.* at \*7 n.10. Although we do not discuss Thomas King in this Opinion, for clarity and for the sake of consistency with our prior opinion, we will continue to refer to them as Mr. Sean King and Mr. Thomas King. *See id.*

## II. *Magellan Insurance Co.*

After engaging Mr. Coomes, Dr. Patel and his assistant, Lindsay Guerrero, completed applications in November 2011 for microcaptive insurance. *Id.* Upon receiving the applications, Mr. Coomes forwarded them to an actuary, Allen Rosenbach of ACR Solutions Group, to purportedly price the premiums for the policies. *Id.* at \*9–10. On one occasion, Mr. Coomes and Mr. Rosenbach interviewed Dr. Patel about the applications. *Id.* Mr. Coomes and Mr. Rosenbach identified coverages for the insureds, including OST and ICR. *Id.*

Further, Mr. Coomes created a business plan for the proposed insurance company, Magellan Insurance Co. (Magellan), outlining proposed insurance coverages through the captive. *Id.* at \*10. The business plan set forth the purported business rationale for forming the microcaptive including, inter alia, “retaining profits that would otherwise have to be paid to commercial insurers in the form of premiums in excess of the amounts repaid to cover losses.” *Id.* The business plan also noted that “[i]t is also intended that [Magellan] will limit its insurance activity to levels where its premiums are not in excess of US \$1,200,000 per annum.” *Id.* Consistent with the business plan, in Magellan’s first year, premiums charged were expected to be in the range of \$1,145,000. *Id.*

The record establishes that the business plan was created to serve as justification to form a captive—after the decision had already been made—not to analyze whether a captive was necessary. *See id.* at \*11. No person associated with Magellan completed a feasibility study to determine the costs and merits of a captive arrangement for Dr. Patel’s businesses. *Id.* Moreover, neither Dr. Patel nor his advisers explored the cost and availability of the same policies on the commercial market. *Id.*

## III. *Decision to Form Second Microcaptive During Increased Scrutiny of Captives Formed by Mr. Coomes*

In February 2015 Dr. Patel’s nephew (a tax attorney) emailed him an article about captive insurance companies being a “topic of conversation” for Congress and the IRS, and the nephew noted that captives will “likely be coming under heightened review/scrutiny.” *Id.* at \*13. Nonetheless, in February 2016, Dr. Patel informed Mr. Fay that he wanted to form a new captive. *Id.* at \*12.

The record demonstrates that Dr. Patel's decision to form a new captive was motivated by his desire to retain increased limits on income tax deductibility. *Id.* In February 2016 Mr. Fay emailed Mr. Sean King, informing him that Dr. Patel wanted to move forward with his new captive that year. *Id.* In that same email Mr. Fay stated that Dr. Patel's accountant had been contacted by the IRS about Dr. Patel's captive. *Id.* The returns of several captives formed by Mr. Coomes were being examined by the IRS. *Id.*

Although Dr. Patel was aware of these IRS examinations, he insisted on forming another captive. *Id.* Emails over the next several months discussed the ownership structure of Magellan and Dr. Patel's anticipated second captive, in no small part for the purpose of determining the new captive's income tax benefits. *Id.* at \*12–13.

#### *IV. Formation of and Initial Contributions to Plymouth Insurance Co.*

Plymouth Insurance Co. (Plymouth) was formed in December 2016. *Id.* at \*13. Plymouth was initially capitalized with \$25,000 in cash and a \$225,000 Irrevocable Letter of Credit from Dr. Patel. *Id.* at \*14. Dr. Patel's advisers stated that he would likely increase his contribution to Plymouth “to approx[imately] \$1 million while adding \$1.1 million to [the] other captive to meet the 2017 2.1-2.2 million increase”<sup>8</sup> in favorable tax treatment for microcaptives. *Id.*

#### *V. Policies Issued by Magellan and Plymouth*

During the tax years at issue, Magellan—and Plymouth in 2016—issued direct written policies to OST and ICR, and SCR (which began in 2015). *Id.* at \*14 & n.11. The captive policies fell into several policy categories, including administrative, various business interruption coverages, employment, legal, tax, and special catastrophic risk. *Id.* at \*14–18.

But despite obtaining numerous policies through his captives, Dr. Patel continued to purchase insurance coverage with third-party commercial insurers for each of his entities.

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<sup>8</sup> During the tax years at issue an insurance company with net written premiums (or, if greater, direct written premiums) that did not exceed \$1.2 million (or \$2.2 million beginning in 2016) for the year could elect to be taxed under section 831(b).

*Id.* at \*25. Such policies insured many of the same risks as the captive policies, including regulatory, malpractice, worker's compensation, automobile, umbrella risks, and general business coverages. *Id.* Commercial premiums ranged between approximately \$68,000 and \$106,000 per year for the three entities. *Id.* at \*29. In contrast, during the same years, Dr. Patel's businesses paid premiums to the microcaptives totaling just over \$4.5 million. *Id.* Dr. Patel never consulted with his longtime commercial insurance agent about forming a microcaptive, nor did he inquire whether comparable—or even cheaper—coverage was available through commercial carriers. *Id.*

The Patels maintained commercial insurance coverage despite Dr. Patel's professing that he has an inherent distrust of commercial insurance. *Id.* Dr. Patel never placed his medical malpractice insurance coverage with his captives, despite also professing that one purpose of forming a microcaptive stemmed from a medical malpractice incident. *Id.*

#### VI. *Capstone Reinsurance Co., Ltd., and the Purported Reinsurance Program*

In an effort to legitimize the microcaptives he formed, Mr. Coomes formed Capstone Reinsurance Co., Ltd. (Capstone). *Id.* at \*9. Microcaptives—including Magellan and Plymouth—participated in a purported risk pool through Capstone via two written agreements: (1) a Reinsurance Agreement and (2) an accompanying Quota Share Retrocession Agreement. *Id.* at \*22. These agreements created a circular flow of funds whereby participants paid 51% of their premiums into the pooling arrangement as part of the reinsurance agreement. *Id.* at \*23. And in less than a year, they received a significant percentage of funds back as part of the quota share agreement. *Id.*

Magellan and Plymouth were no different. The money they paid under the Capstone agreements created a circular flow of funds such that OST, ICR, and SCR paid funds to Magellan (or Plymouth), those funds were paid to Capstone, and the money then flowed back to Magellan (or Plymouth). *See id.* at \*39.

## VII. *Premium Pricing*

Premium pricing for Magellan and Plymouth was developed to facilitate favorable income tax treatment for the Patels, not for business purposes. Although Mr. Rosenbach was retained to provide actuarially determined premium pricing, he did not do so. *Id.* at \*178, \*201. Instead, he was flexible in determining premium pricing, changing the premium amounts when requested to do so. *Id.* at \*30.

And although the Patels claimed that Mr. Rosenbach developed premium pricing for the captives, the record reveals that Dr. Patel provided target premiums he wanted to pay. *Id.* at \*32. For example, in December 2012 Ms. Guerrero inquired via email: “Dr. Patel wanted to know what the max is that we can pay into the captive.” *Id.* at \*32–33.

Mr. Rosenbach was aware of the \$1.2 million limit on exclusion from taxability under section 831(b), which was later increased to \$2.2 million. *Patel II*, T.C. Memo. 2024-34, at \*32. The final pricing reports he prepared for Mr. Coomes’s clients from 2011 to 2016 did not ever exceed \$1.2 million in premiums, which was the maximum deductible amount in those years. *Id.*

Relatedly, in 2014 Ms. Guerrero emailed Mr. Coomes and asked why policy premiums were less than the year before because “Dr. Patel was expecting a little closer to 1.2 million for the both.” *Id.* at \*33. After Mr. Coomes replied that they should consider adding other coverages or increasing limits the following year—apparently to increase the total amount of insurance premiums Dr. Patel was paying into the captive—Ms. Guerrero informed Mr. Coomes that Dr. Patel wanted to add another company to be insured by the captive in 2015. *Id.* Thus, Magellan began issuing policies to SCR. *Id.* at \*14 n.11.

The foregoing facts demonstrate that the purpose of issuing policies through the microcaptives was to drive up premium prices to take advantage of the deductibility of premiums paid to the microcaptives. *See* §§ 162(a), 831(b). The record does not support a finding that the purpose of these transactions was to provide legitimate insurance coverage needs.

### VIII. *The Returns, IRS Examination, and Penalty Determinations*

The IRS conducted examinations of the Patels' joint federal income tax returns and issued NODs<sup>9</sup> for the tax years at issue. *Patel II*, T.C. Memo. 2024-34, at \*34. In brief, the NOD for 2013 disallowed the deductions for insurance expenses because of a lack of economic substance, while the NODs for 2014 through 2016 determined a disallowance of deductions for reasons other than the economic substance doctrine. Specifically, the NODs for the tax years at issue made the following determinations:

- **2013:** Deductions for insurance expenses were disallowed on account of a lack of economic substance and, in the alternative, because the expenses were not ordinary and necessary.
- **2014:** Deductions for “Other Expenses” (Sch. E1) and other items were disallowed on account of a “lack of substantiation.”
- **2015 and 2016:** Deductions for “Legal and Other Professional Fees” (Sch. E1) and “Other Expenses” (Sch. C2) were disallowed because the expenses were not ordinary and necessary. On the same page, deductions for “Other Expenses” (Sch. E1) were disallowed due to a lack of substantiation. For one set of disallowed expenses (Sch. E-Inc/Loss-Prtnrship/S Corps-Passve/Non-Passve), the NOD refers the reader to “Exhibit A” for more details regarding the adjustments. It provides that the relevant adjustments were made due to lack of substantiation, but makes no comment about a lack of economic substance.

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<sup>9</sup> On August 25, 2017, the IRS issued an NOD for tax year 2013. In addition, on March 15, 2018, the IRS issued an NOD for tax year 2014. Finally, on September 25, 2018, the IRS issued an NOD for tax years 2015 and 2016.

The IRS also determined the following penalties for the tax years at issue, which we reserved for this Opinion:

<i>Year</i>	<i>Penalty § 6662</i>
2013	\$99,157
2014	96,884
2015	95,037
2016	105,990

*See Patel I*, T.C. Memo. 2020-133, at \*2. For tax year 2013, the accuracy-related penalty in the 2013 NOD was determined pursuant to section 6662(b)(6) and (i) and, in the alternative, pursuant to section 6662(b)(1) and (2). *See Patel I*, T.C. Memo. 2020-133, at \*6. For tax years 2014 through 2016, accuracy-related penalties in the respective NODs were determined pursuant to section 6662(a) and (b)(1), (2), and (6). *Patel I*, T.C. Memo. 2020-133, at \*8, \*11.

#### IX. *Tax Court Proceedings*

Petitions to this Court followed the IRS's determinations. The relevant Answers filed by respondent relating to tax years 2014 through 2016 asserted that deductions were disallowed because of the economic substance doctrine. Further, as set forth in respondent's various Answers for tax years 2014 through 2016, the IRS determined increased penalties under section 6662(i).

In *Patel II*, T.C. Memo. 2024-34, at \*51, we held that Magellan's and Plymouth's purported captive transactions did not constitute insurance because they failed to distribute risk. We also held that, in the alternative, the Patels' microcaptives did not act as an insurer commonly would. *Id.*

In the Order issued pursuant to *Patel I*, T.C. Memo. 2020-133, at \*27, the Court granted in part the Patels' Motion for Partial Summary Judgment related to penalties. In relevant part, we held that respondent's agent failed to satisfy the supervisory approval requirement set forth in section 6751(b)(1) with respect to the penalties under section 6662(b)(2) and (6), as well as the increased rate under section 6662(i), for tax year 2013. *Patel I*, T.C. Memo. 2020-133, at \*27. In addition, in respondent's Seriatim Answering Brief, respondent concedes the increased rate under section 6662(i) for tax year 2016.

Thus, the last issue for us to decide is whether the Patels are subject to accuracy-related penalties, as limited by *Patel I*, T.C. Memo. 2020-133, at \*27. After concessions and our prior ruling regarding section 6751(b), the following section 6662(a) accuracy-related penalties for 2013 through 2016 are at issue:

<i>Year</i>	<i>Penalties at Issue</i>
2013	§ 6662(b)(1)
2014	§ 6662(b)(1), (b)(2), (b)(6), and (i)
2015	§ 6662(b)(1), (b)(2), (b)(6), and (i)
2016	§ 6662(b)(1), (b)(2), and (b)(6)

#### OPINION

### I. *Burden of Proof*

Before turning to the penalties at issue, we first examine the burden of proof. Section 7491(c) generally provides that “the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty.” This burden typically requires the Commissioner to come forward with sufficient evidence indicating that the imposition of the relevant penalty is appropriate. *See Higbee v. Commissioner*, 116 T.C. 438, 446 (2001).

Once the Commissioner satisfies his burden of production, the burden of proof is on the taxpayer to “come forward with evidence sufficient to persuade a Court that the Commissioner’s determination is incorrect.” *Id.* at 447. However, where the Commissioner asserts a new matter, such as a penalty, in an answer (rather than in the NOD), the Commissioner bears the full burden of proof regarding the penalty, including the taxpayer’s lack of reasonable cause or any other applicable affirmative defense. *See* Rule 142(a)(1); *Estate of Hoensheid v. Commissioner*, T.C. Memo. 2023-34, at \*47; *Full-Circle Staffing, LLC v. Commissioner*, T.C. Memo. 2018-66, at \*42–43, *aff’d in part, appeal dismissed in part*, 832 F. App’x 854 (5th Cir. 2020).

On February 24, 2022, the Patels filed a Motion to Shift the Burden of Proof to Respondent (Docket No. 24344-17, Doc. 173), seeking to shift the burden of proof on all issues

to respondent.<sup>10</sup> Respondent filed an Objection to Motion to Shift the Burden of Proof, generally objecting to the blanket shift (Docket No. 24344-17, Doc. 188). However, respondent acknowledged that he bears the burden of proof with respect to whether the microcaptive arrangements lacked economic substance.<sup>11</sup> This is consistent with respondent's statement in his Motion for Leave to File First Amendment to Answer (Docket No. 11352-18, Doc. 5).

Thus, respondent will bear the burden of proof with respect to (1) the disallowance of claimed benefits on the grounds of lack of economic substance and (2) the section 6662(i) increased penalties asserted for the first time in an Answer.<sup>12</sup> See Rule 142(a)(1); *Estate of Hoensheid*, T.C. Memo. 2023-34, at \*47. The Patels will bear the burden of proof with respect to the remainder of the penalties that were determined in the relevant NODs.

Having determined who bears the burden of proof, we will next address whether the Patels are liable for accuracy-related penalties. Section 6662(a) imposes a 20% penalty on the portion of an underpayment of tax attributable, in relevant part, to (i) the disallowance of claimed tax benefits by reason of

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<sup>10</sup> The Patels' blanket request to shift the burden of proof did not specifically reference the economic substance doctrine, although it did reference "all new matters pled" and penalties in respondent's Answer (Docket No. 24344-17, Doc. 173, at 3).

<sup>11</sup> Because of respondent's concession, we need not decide whether the disallowance of claimed tax benefits on the grounds of lack of economic substance is a "new matter" as opposed to a theory consistent with an assertion of penalties under the codified economic substance doctrine. See, e.g., *Blau v. Commissioner*, 924 F.3d 1261, 1280 (D.C. Cir. 2019) ("If a defense to a new matter 'is completely dependent upon the same evidence,' . . . as a defense to the penalty originally asserted, then there is no practical significance to shifting the burden of proof." (quoting *Shea v. Commissioner*, 112 T.C. 183, 197 n.22 (1999))), *aff'g RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (2017); *Hutchinson v. Commissioner*, 116 T.C. 172, 182 (2001) (quoting *Wayne Bolt & Nut Co. v. Commissioner*, 93 T.C. 500, 507 (1989)) (observing that new theories that simply supplement previously raised issues are not treated as new matters); *Shea*, 112 T.C. at 191 ("When the Commissioner attempts to rely on a basis that is beyond the scope of the original deficiency determination, the Commissioner must generally assume the burden of proof as to the new matter.").

<sup>12</sup> Regardless of who bears the burden of proof, there is ample support in the record demonstrating that the purported microcaptive arrangements lacked economic substance. See *infra* Opinion Part II.D.

a transaction lacking economic substance (section 6662(b)(6)); (ii) any substantial understatement of income tax (section 6662(b)(2)); or (iii) negligence or disregard of rules or regulations (section 6662(b)(1)). We will first analyze the parties' arguments regarding section 6662(b)(6) and (i) before turning to section 6662(b)(1) and (2). Then, we will examine whether the Patels have any defenses to accuracy-related penalties.

## II. *Transaction Lacking Economic Substance*

Section 6662(a) and (b)(6) imposes an accuracy-related penalty on the portion of an underpayment of tax required to be shown on a return attributable to the disallowance of claimed tax benefits by reason of a transaction lacking economic substance within the meaning of section 7701(o), which codifies the economic substance doctrine.<sup>13</sup> We will first briefly address how the economic substance doctrine has developed in caselaw. Then we will turn to codification of the economic substance doctrine and its application. And, finally, we will turn to application in these cases.

### A. *Brief History of the Economic Substance Doctrine*

The economic substance doctrine has developed in common law over the last 90 years, *see Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1352 (Fed. Cir. 2006), since the U.S. Supreme Court decided *Gregory v. Helvering*, 293 U.S. 465 (1935). In *Gregory* the Supreme Court disregarded a transaction that complied with the literal terms of the Code, where the taxpayer—solely to avoid a tax—transferred stock to a new corporation, which then transferred the stock directly to the taxpayer. *Id.* at 469–70. In reaching its decision the Supreme Court observed that “[t]he legal right of a taxpayer

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<sup>13</sup> In *Patel II*, T.C. Memo. 2024-34, at \*52, we sustained respondent's disallowance of deductions on the ground that the transactions failed to constitute insurance for federal tax purposes. That opinion was silent as to whether the transactions lacked economic substance as that determination was not necessary to resolve the disallowance of the deductions. *PDK Laboratories Inc. v. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004) (Roberts, J., concurring in part) (“[T]he cardinal principle of judicial restraint—if it is not necessary to decide more, it is necessary not to decide more—counsels us to go no further.”). Following the issuance of *Patel II*, the Court inquired whether the parties could reach an agreement regarding the penalties (Docket No. 24344-17, Doc. 364). They could not (*Id.* Doc. 365).

to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.” *Id.* at 469. Nonetheless, the Court went on to rule against the taxpayer, stating that although the transactions at issue were “conducted according to the terms of [the Code], [the transactions were] in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else.” *Id.* at 470.

Ten years later, the Supreme Court once again disregarded a transaction in which the taxpayer—to avoid a large corporate income tax—transferred an asset in the form of a dividend to two shareholders who in turn conveyed the asset to a purchaser who had originally negotiated with the corporation to purchase the asset. *Commissioner v. Ct. Holding Co.*, 324 U.S. 331, 333–34 (1945). For the next several decades, the Supreme Court continued to embrace principles of economic substance. *See, e.g., Frank Lyon Co. v. United States*, 435 U.S. 561, 583–84 (1978) (allowing a transaction because it was a “genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached”); *Knetsch v. United States*, 364 U.S. 361, 364–66 (1960) (denying an interest deduction on a transaction that lacked economic substance and holding that “there was nothing of substance to be realized by [the taxpayer] from this transaction beyond a tax deduction”).

Jurisprudence regarding the economic substance doctrine also developed in this Court, driven by the circuit where an appeal would presumptively lie. *See, e.g., Daichman v. Commissioner*, T.C. Memo. 2020-126, at \*17 (citing *Golsen v. Commissioner*, 54 T.C. 742 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971)) (noting that “the Court follows the law of that circuit with respect to its interpretation of the economic substance doctrine” and, as appropriate in that case, relying on the law of the U.S. Court of Appeals for the Fifth Circuit). Courts of appeals followed various tests, but they typically examined the transactions in the light of the following two tests: (1) whether the transaction had economic substance beyond tax benefits (objective test) and (2) whether the taxpayer had a nontax business purpose for entering the

disputed transaction (subjective test). *Gerdau Macsteel, Inc. v. Commissioner*, 139 T.C. 67, 168–71 (2012) (examining how various courts of appeals applied the economic substance doctrine).

But courts of appeals disagreed about the weight to be given to these tests. *Id.* at 169–70. Some courts, like the Fifth Circuit, applied a conjunctive test in which a transaction would be respected only if it had objective economic effects other than tax savings *and* a nontax business purpose. *See, e.g., Klamath Strategic Inv. Fund ex rel. St. Croix Ventures v. United States*, 568 F.3d 537, 544 (5th Cir. 2009) (adopting a multifactor test for analyzing whether a transaction lacks economic substance). Other courts employed a disjunctive test, requiring either an objective potential for profit *or* a nontax business purpose. *See Endeavor Partners Fund, LLC v. Commissioner*, T.C. Memo. 2018-96, at \*50–51 (noting that various courts of appeals applied different tests and applying the test of the court to which appeal of the case would lie), *aff'd*, 943 F.3d 464 (D.C. Cir. 2019). A third group of courts examined various factors deemed relevant to a determination concerning economic substance. *See, e.g., Reddam v. Commissioner*, 755 F.3d 1051, 1060 (9th Cir. 2014) (observing that the economic substance doctrine does not follow a rigid two-part test (citing *Sacks v. Commissioner*, 69 F.3d 982, 988 (9th Cir. 1995), *rev'g and remanding* T.C. Memo. 1992-596)), *aff'g* T.C. Memo. 2012-106.

### B. Codification of the Economic Substance Doctrine

After years-long development in caselaw, Congress codified the economic substance doctrine in 2010 as section 7701(o). *See* Health Care and Education Reconciliation Act of 2010 (Act), Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067; *see also Gerdau Macsteel, Inc.*, 139 T.C. at 168 n.68 (observing that Congress codified the economic substance doctrine). In relevant part, section 7701(o) provides:

Sec. 7701(o). Clarification of economic substance doctrine.—

(1) Application of doctrine.—In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

.....

(5) Definitions and special rules.—For purposes of this subsection—

(A) Economic substance doctrine.—The term “economic substance doctrine” means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) Exception for personal transactions of individuals.—In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) Determination of application of doctrine not affected.—The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) Transaction.—The term “transaction” includes a series of transactions.

The Act also added section 6662(b)(6), which imposes a 20% penalty on the portion of an underpayment of tax required to be shown on a return that is attributable to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance within the meaning of section 7701(o). *See also* Act § 1409(b), 124 Stat. at 1068.

### *C. Application of the Codified Economic Substance Doctrine*

This is the Court’s first opportunity to examine when the codified economic substance doctrine applies. Section 6662(b)(6) applies the accuracy-related penalty to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance within the meaning of section 7701(o). And as noted above, section 7701(o)(1) requires application of the economic substance doctrine “[i]n the case of any transaction *to which the economic substance doctrine is relevant.*” (Emphasis added.) We will first address whether section 7701(o) requires a relevancy determination.

#### *1. Statutory Interpretation*

##### *a. Statutory Text*

“Statutory interpretation . . . always . . . begins with the text.” *Ross v. Blake*, 578 U.S. 632, 638 (2016). The text before us is section 7701(o), which states in no uncertain terms that

it applies to “transaction[s] to which the economic substance doctrine is relevant.” § 7701(o)(1). It further states that “[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.” § 7701(o)(5).

Faced with these provisions, we easily conclude that the statute requires a relevancy determination. To put it plainly—the statute says so, right there, on its face. First, section 7701(o)(1) signals that a determination is required by conditioning application of the doctrine on certain circumstances—namely, the doctrine applies *if* there is a transaction to which it is relevant. Next, section 7701(o)(5) expressly directs us to make the determination (whether the doctrine is relevant) and, if that were not enough, the same provision explains *how* to make the determination (as if the statute had never been enacted). In short, Congress could hardly have been clearer, at least on this narrow point.

This same text tells us that the relevancy determination is not coextensive with the two-part test set forth in section 7701(o)(1)(A) and (B).<sup>14</sup> Congress specifically provided in the introductory sentence of section 7701(o)(1) that the two-part test applies only “[i]n the case of any transaction to which the economic substance doctrine is relevant.” Conflating the relevancy determination with the two-part test would ignore that direction and deprive the statute’s reference to relevance of independent meaning. And, of course, “[i]t is our duty ‘to give effect, if possible, to every clause and word of a statute.’” *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (quoting *United States v. Menasche*, 348 U.S. 528, 538–39 (1955)); *see also Polsell v. IRS*, 143 S. Ct. 1231, 1238 (2023) (observing that courts “giv[e] effect to every clause and word of a statute” (alteration in original) (quoting *Microsoft Corp. v. i4i Ltd. P’ship*, 564 U.S. 91, 106 (2011))). We are thus “reluctan[t] to treat statutory terms as surplusage’ in any setting.” *Walker*, 533 U.S. at 174 (quoting *Babbitt v. Sweet Home Chapter of Cmty. for a Great Or.*, 515 U.S. 687, 698 (1995)); *accord Antonin*

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<sup>14</sup> In the light of the text, we respectfully disagree with other courts that have held that the relevancy requirement is coextensive with the requirements of section 7701(o)(1)(A) and (B). *See, e.g., Liberty Glob., Inc. v. United States*, No. 20-cv-63501, 2023 WL 8062792 (D. Colo. Oct. 31, 2023); *see also Chemoil Corp. v. United States*, No. 19-cv-6314, 2023 WL 6257928, at \*5 (S.D.N.Y. Sept. 26, 2023).

Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 174, 176 (2012) (“Because legal drafters should not include words that have no effect, courts avoid a reading that renders some words altogether redundant.”). And we do not read words out of statutes. See *United States v. Felt & Tarrant Mfg. Co.*, 283 U.S. 269, 273 (1931) (“[I]t is not within the judicial province to read out of the statute the requirement of its words.” (citing *Rand v. United States*, 249 U.S. 503, 510 (1919))).

b. *Legislative History*

“For those who consider legislative history relevant,” *Warger v. Shauers*, 574 U.S. 40, 48 (2014), the legislative history of the codified economic substance doctrine is fully consistent with our interpretation that section 7701(o)(1) requires a relevancy determination, see, e.g., *Church of Scientology of Cal. v. IRS*, 792 F.2d 153, 162 n.4 (D.C. Cir. 1986) (Scalia, J.) (“Legislative history is used to clarify the meaning of a text, not to create extra-statutory law.”), *aff’d*, 484 U.S. 9 (1987). Observing the lack of uniformity in the application of the economic substance doctrine, see H.R. Rep. No. 111-443(I), at 293–95 (2010), as reprinted in 2010 U.S.C.C.A.N. 123, 224–28, the committee expressed its intent “to provide greater clarity and uniformity in the application of the economic substance doctrine in order to improve its effectiveness at deterring unintended consequences,” *id.* at 295, 2010 U.S.C.C.A.N. at 228.

Further, the House report made clear that the economic substance doctrine does not apply to every transaction. *Id.* at 296, 2010 U.S.C.C.A.N. at 228–29 (providing a nonexhaustive list of transactions to which the doctrine does not apply). The House report stated that the codified economic substance doctrine applies “in the case of any transaction to which the economic substance doctrine is relevant” and that “[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if the provision had never been enacted.” *Id.* at 295, 2010 U.S.C.C.A.N. at 228. The House report also confirms that “the provision does not change current law standards in determining *when* to utilize an economic substance analysis.” *Id.* at 295–96, 2010 U.S.C.C.A.N. at 228 (emphasis added). Thus, the legislative history confirms that the codified economic

substance doctrine is not intended to apply to every transaction and may be applied only when it is “relevant.”

Having determined that section 7701(o) requires a relevancy determination, we turn to the content of that requirement. There too Congress has answered the question by directing courts to the existing application of the doctrine.

## 2. *The Economic Substance Doctrine in the Insurance Context*

As noted *supra* Opinion Part II.A, the economic substance doctrine has developed over the last 90 years. Our survey of caselaw revealed a variety of circumstances in which the doctrine has been applied. This includes, as relevant here, cases involving insurance transactions and, in particular, captive insurance transactions. See *Malone & Hyde, Inc., & Subs. v. Commissioner*, 62 F.3d 835 (6th Cir. 1995) (captive insurance), *rev'g and remanding* T.C. Memo. 1993-585; see also, e.g., *Knetsch*, 364 U.S. 361 (deferred annuity savings bonds); *Dow Chem. Co. v. United States*, 435 F.3d 594, 600–05 (6th Cir. 2006) (corporate-owned life insurance); *IRS v. CM Holdings, Inc. (In re CM Holdings, Inc.)*, 301 F.3d 96, 102–07 (3d Cir. 2002) (corporate-owned life insurance); *Salley v. Commissioner*, 464 F.2d 479 (5th Cir. 1972) (individual-owned life insurance), *aff'g* 55 T.C. 896 (1971); *Golsen v. Commissioner*, 445 F.2d 985 (individual-owned life insurance); *Winn-Dixie Stores, Inc. & Subs. v. Commissioner*, 113 T.C. 254 (1999) (corporate-owned life insurance), *aff'd per curiam*, 254 F.3d 1313 (11th Cir. 2001).<sup>15</sup>

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<sup>15</sup> In some other cases, courts analyzed the economic substance of a transaction and determined that the requirements of the economic substance doctrine were satisfied. Those cases also reflect the relevance of the doctrine, even though the transactions at issue were not recharacterized under the doctrine. See *United Parcel Serv. of Am., Inc. v. Commissioner*, 254 F.3d 1014, 1020 (11th Cir. 2001) (“We therefore conclude that UPS’s restructuring of its excess-value business had both real economic effects and a business purpose, and it therefore under our precedent had sufficient economic substance to merit respect in taxation.”), *aff'g* T.C. Memo. 1999-268; *Humana Inc. v. Commissioner*, 881 F.2d 247, 255–56 (6th Cir. 1989) (holding that the Tax Court had misapplied the economic substance doctrine by recharacterizing a transaction “absent a finding of sham or lack of business purpose under the relevant tax statute”), *aff'g in part, rev'g in part and remanding* 88 T.C. 197 (1987); *Rent-A-Center, Inc. v. Commissioner*, 142 T.C. 1, 10–13 (2014) (observing that “[w]e respect the separate taxable treatment of a captive unless there is a finding of sham or lack of business

In *Malone & Hyde*, the closest case to those before us, the taxpayer was a corporation that established an insurance subsidiary in Bermuda to reinsure selected risks. The taxpayer capitalized its Bermuda subsidiary with just \$120,000 and then entered into primary insurance contracts with a third-party insurer (Northwestern). The taxpayer arranged for Northwestern to enter into reinsurance contracts with the taxpayer's Bermuda subsidiary. Because the Bermuda subsidiary was thinly capitalized, the taxpayer executed a hold-harmless agreement stating that, if the Bermuda subsidiary defaulted on any of its reinsurance obligations, the taxpayer would shield Northwestern from any resulting liability.

The taxpayer paid insurance premiums to Northwestern, which in turn paid on a portion of the premiums to the Bermuda subsidiary. The taxpayer deducted the full amount of the premiums it paid to Northwestern on its tax returns, thus claiming deductions for amounts ultimately received by its Bermuda subsidiary as reinsurance premiums.

The Commissioner challenged the taxpayer's deductions for the portion of the insurance premiums received and paid on to its Bermuda subsidiary. Relying on a prior decision of the U.S. Court of Appeals for the Sixth Circuit, our Court found for the taxpayer, explaining that "[t]he Sixth Circuit in *Humana* criticized this Court for misapplying the 'substance over form' analysis, absent a finding of sham or lack of business purpose." *Malone & Hyde, Inc. & Subs. v. Commissioner*, T.C. Memo. 1993-585, 1993 WL 516207, at \*9 (citing *Humana Inc. v. Commissioner*, 881 F.2d at 254-55), *supplementing* T.C. Memo. 1989-604. But the Sixth Circuit reversed our decision, explaining as follows:

This court clearly applied the *Le Gierse* analysis in *Humana*. But it did so only after finding that *Humana's* use of a Colorado captive insurance company was not a sham and that it served a legitimate business purpose.

We believe the tax court put the cart before the horse in this case. It should have determined first whether [the taxpayer] created [the Bermuda subsidiary] for a legitimate business purpose or whether the captive was in fact a sham corporation. A taxpayer is "free to arrange his financial affairs to minimize his tax liability." *Estate of Stranahan v. C.I.R.*, 472 F.2d 867, 869 (6th Cir.1973). Thus, "the presence of tax

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purpose" and holding that the taxpayer's captive insurance corporation was not a sham and was created for significant and legitimate nontax reasons).

avoidance motives will not nullify an otherwise bona fide transaction.” *Id.* However, the establishment of a tax deduction is not, in and of itself, an “otherwise bona fide transaction” if the deduction is accomplished through the use of an undercapitalized foreign insurance captive that is propped-up by guarantees of the parent corporation. The captive in such a case is essentially a sham corporation, and the payments to such a captive that are designated as insurance premiums do not constitute bona fide business expenses, entitling the taxpayer to a deduction under § 162(a).

*Malone & Hyde, Inc., & Subs. v. Commissioner*, 62 F.3d at 840; *see also* § 7701(o)(5)(A) (“The term ‘economic substance doctrine’ means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.”); *United Parcel Serv. of Am., Inc. v. Commissioner*, 254 F.3d at 1018 (“This economic-substance doctrine, also called the sham-transaction doctrine, provides that a transaction ceases to merit tax respect when it has no ‘economic effects other than the creation of tax benefits.’” (quoting *Kirchman v. Commissioner*, 862 F.2d 1486, 1492 (11th Cir. 1989), *aff’g* *Glass v. Commissioner*, 87 T.C. 1087 (1986))); *N. Ind. Pub. Serv. Co. v. Commissioner*, 115 F.3d 506, 512 (7th Cir. 1997) (noting that the Commissioner had cited *Malone & Hyde* and other captive insurance cases as showing “that even legitimate corporations may engage in transactions lacking economic substance and that the Commissioner may disregard transactions between related legitimate corporations” and explaining that the cases “allow the Commissioner to disregard transactions which are designed to manipulate the Tax Code so as to create artificial tax deductions”), *aff’g* 105 T.C. 341 (1995).

The parallels between *Malone & Hyde* and the cases before us are easy to draw. And we perceive no mitigating factors in these cases that would argue for a different approach from the one we and the courts of appeals have previously taken. Therefore, heeding Congress’s direction that we proceed in the same manner as if section 7701(o) had never been enacted—to determine whether the economic substance doctrine is relevant to a transaction—we conclude that the doctrine is relevant to these cases.<sup>16</sup>

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<sup>16</sup> We understand Congress’s direction to mean that, among other things, courts have the same flexibility to identify relevant contexts for application

### 3. *The Patels' Argument That They Were "Congressionally Induced"*

Before we apply subparagraphs (A) and (B) of section 7701(o)(1), it is worthwhile to address the Patels' argument that the economic substance doctrine does not apply when the taxpayer has engaged in a purported "Congressionally induced" or "Congressionally incentivized" transaction. Citing *Sacks v. Commissioner*, 69 F.3d at 992, and *Cross Refined Coal, LLC v. Commissioner*, 45 F.4th 150, 158 (D.C. Cir. 2022), the Patels argue that "the judicial doctrine [of economic substance] also excludes policy-based Congressional inducements like this small captive insurance arrangement."

As a starting point, it is already well established that the economic substance doctrine applies to insurance arrangements. *See supra* Opinion Part II.C.2. This alone would be sufficient reason to reject the Patels' argument.

Even if we were to overlook the existing precedent applying the economic substance doctrine to insurance arrangements, the Patels' argument would fail because their reliance on *Sacks* and *Cross Refined Coal* is misplaced. The "inducement" cited by the Patels is the tax treatment of insurers under section 831(b). For small insurers, section 831(b) imposes tax on investment income in lieu of taxable income as otherwise defined in section 832. But the primary issue in these cases is the deductibility of purported insurance premiums reported as ordinary and necessary business expenses under section 162. Further, we previously concluded that the premiums paid and deducted by the Patels did not constitute insurance for federal tax purposes. *Patel II*, T.C. Memo. 2024-34, at \*51. The Patels do not direct us to any congressional inducement to claim deductions for premiums for purported insurance that is not, in fact, insurance.

Once the relevancy question is answered in the affirmative, we then examine the transaction by applying the two-part test outlined by Congress:

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of the codified doctrine as they possessed before codification. § 7701(o)(5)(C); H.R. Rep. No. 111-443(I), at 295, 2010 U.S.C.C.A.N. at 228 ("The provision provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects.").

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

§ 7701(o)(1). We will now turn to analyzing the Patels' transactions in the light of our determination.

#### D. Application of Section 7701(o) to the Patels' Microcaptives

##### 1. Objective Test: Change in Economic Position

First, we examine whether the transactions at issue changed in a meaningful way (apart from federal income tax effects) the taxpayer's economic position. See § 7701(o)(1)(A). "[T]ransactions lack objective economic reality if they 'do not vary[,] control[,] or change the flow of economic benefits.'" *Southgate Master Fund, L.L.C. ex rel. Montgomery Cap. Advisors, LLC v. United States*, 659 F.3d 466, 481 (5th Cir. 2011) (alterations in original) (quoting *Klamath Strategic Inv. Fund*, 568 F.3d at 543). "This is an objective inquiry into whether the transaction either caused real dollars to meaningfully change hands or created a realistic possibility that they would do so." *Id.* (footnote omitted). Moreover, "a circular flow of funds among related entities does not indicate a substantive economic transaction for tax purposes." *Merryman v. Commissioner*, 873 F.2d 879, 882 (5th Cir. 1989), *aff'g* T.C. Memo. 1988-72.

The transactions here did not result in a meaningful change in economic position with respect to insurance. As noted more fully in *Patel II*, the transaction involving Capstone, Magellan, and Plymouth involved a circular flow of funds such that money paid into Capstone was returned—in substantial part—to Magellan and Plymouth. *Patel II*, T.C. Memo. 2024-34, at \*23–25; see also *supra* Findings of Fact Part VI. Dr. Patel maintained ownership of Magellan and Plymouth, except to the extent that he transferred ownership of these entities to his children so that assets would pass outside of his taxable estate. *Patel II*, T.C. Memo. 2024-34, at \*11–14.<sup>17</sup>

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<sup>17</sup> Because the issues before the Court relate only to the imposition of penalties resulting from the Patels' claim of income tax deductions under section 162, this Opinion does not address the estate tax. See §§ 2001–2801. The Patels did not argue that their estate planning objective gave their

Further, Dr. Patel paid unreasonable and excessive premiums, up to the amount allowed by section 831(b), while maintaining his commercial insurance coverage. *See, e.g., Patel II*, T.C. Memo. 2024-34, at \*27, \*29, \*31; *see also supra* Findings of Fact Parts V and VII. Specifically, Dr. Patel’s businesses paid premiums to the microcaptives totaling just over \$4.5 million while commercial premiums ranged between approximately \$68,000 and \$106,000 per year for the three entities during those same years. *See supra* p. 178 (citing *Patel II*, T.C. Memo. 2024-34, at \*29). Accordingly, we hold that the transactions at issue did not meaningfully change the Patels’ economic position, aside from federal tax effects. *See Southgate*, 659 F.3d at 481.

## 2. *Subjective Test: Tax Avoidance*

The Patels’ failure of the objective test is sufficient to conclude that the transactions at issue lack economic substance. However, for the sake of completeness, *see Tooke v. Commissioner*, 164 T.C. 16, 34 n.11 (2025) (citing *Mukhi v. Commissioner*, 163 T.C. 150, 162 (2024), *supplementing* 162 T.C. 177 (2024)), we will examine whether the Patels had a substantial purpose (apart from federal income tax effects) for entering into the microcaptive arrangements, *see* § 7701(o)(1)(B). Considering the totality of the facts and circumstances in evidence, we cannot conclude that the Patels possessed the requisite “substantial purpose.”

To begin, Dr. Patel orchestrated the operations of Magellan and Plymouth to maximize income tax deductions without regard to insurance and business principles. How do we know? Mr. Rosenbach did not provide actuarially determined policy premiums. *See supra* p. 179. To the contrary, he changed the premium amounts when requested to do so. *See supra* p. 179. We further note that Dr. Patel provided target premiums he wanted to pay, focusing on the maximum amounts he could pay into the captive. *See supra* p. 179 (citing *Patel II*, T.C. Memo. 2024-34, at \*32). Those maximums coincided with the relevant limit provided by section 831(b), and Mr. Rosenbach was aware of the ceiling. *Patel II*, T.C. Memo. 2024-34, at \*32–33; *see supra* p. 179.

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microcaptive arrangement economic substance; we likewise restrict our analysis to the microcaptive transaction and its income tax effects.

We cannot overlook the fact that Magellan’s and Plymouth’s premiums were not set by actuarial principles, but by their only customer whose expressed interest was in paying the maximum deductible amount. *Patel II*, T.C. Memo. 2024-34, at \*32–33; see *supra* p. 179. While we observe the oddity of a purported customer seeking to maximize his expense, we also observe that Dr. Patel sat on both sides of the transactions, doubling as Magellan’s and Plymouth’s sole customer and founder. *Patel II*, T.C. Memo. 2024-34, at \*2, \*10–11, \*13–14. These facts and circumstances undermine the Patels’ claim that they possessed a “substantial purpose” for the transactions apart from federal income tax effects.

We also note evidence showing Dr. Patel’s focus on income tax benefits when he decided to form Plymouth, his second microcaptive. Even though he was aware of the IRS examination of Magellan and other captives formed by Mr. Coomes, he insisted on forming another captive. See *supra* p. 177 (citing *Patel II*, T.C. Memo. 2024-34, at \*12). Emails over the next several months discussed the ownership structure of Magellan and Dr. Patel’s anticipated second captive, in no small part for the purpose of determining the new captive’s income tax benefits. See *supra* p. 177 (citing *Patel II*, T.C. Memo. 2024-34, at \*12–13).

The record consistently reveals Dr. Patel’s intent to maximize income tax deductions through his formation of Magellan and Plymouth. To the extent the Patels contend that they had a business purpose—and that it was substantial—the evidence does not support their position.<sup>18</sup>

Dr. Patel’s answers on the financial feasibility study did not address captive insurance or the need for insurance products.

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<sup>18</sup> Under precodification caselaw, this subjective test was “a subjective inquiry into ‘whether the taxpayer was motivated by profit to participate in the transaction.’ Tax-avoidance considerations are not wholly prohibited; taxpayers who act with mixed motives, seeking both tax benefits and profits for their businesses, can satisfy the business-purpose test.” *Southgate*, 659 F.3d at 481–82 (footnote omitted) (quoting *Dow Chem. Co.*, 435 F.3d at 599). In the pre-codification context, the presence of a legitimate business purpose to a taxable event was enough to satisfy the tax-avoidance test in the Fifth Circuit. *Id.* Nevertheless, a transaction could still lack economic substance if the objective test—whether the transaction resulted in a meaningful change to the taxpayer’s economic position (apart from federal income tax effects)—was not satisfied.

*See supra* p. 175 (citing *Patel II*, T.C. Memo. 2024-34, at \*8). We also note that no person associated with Magellan completed a cost or feasibility study to determine the costs and merits of a captive arrangement for Dr. Patel’s businesses. *See supra* p. 176 (citing *Patel II*, T.C. Memo. 2024-34, at \*11).

In addition, the business plan for Magellan was created to serve as justification to form a captive—after the decision had already been made—not to analyze whether a captive was necessary. *See supra* p. 176 (citing *Patel II*, T.C. Memo. 2024-34, at \*11). Furthermore, many of the contemporaneous emails exchanged during the tax years at issue contain suggestions that the purpose of forming a captive was to reduce income taxes, not increase insurance protection. *See supra* p. 175 (citing *Patel II*, T.C. Memo. 2024-34, at \*7–8) (quoting Mr. Fay’s email describing Dr. Patel as “the MD paying almost 2.5M in income taxes” who “did his own research on [microcaptive insurance companies],” and “wants to talk with Sean [King] about doing potentially 2 [captive insurance companies]”).

Notwithstanding the facts and circumstances related to captive formation, other facts and circumstances indicate that the Patels were keenly interested in maximizing their income tax deductions. Dr. Patel continued to purchase commercial insurance policies that insured many of the same risks that the captive policies purported to cover; eliminating overlapping policies would have lowered his deductions. *See supra* p. 177 (citing *Patel II*, T.C. Memo. 2024-34, at \*25). Also, Dr. Patel never placed his medical malpractice insurance coverage with his captives, despite professing that he has an inherent distrust of commercial insurance and that one purpose of forming a microcaptive was to prevent a recurrence of his experience with a medical malpractice incident. *See supra* pp. 177–78 (citing *Patel II*, T.C. Memo. 2024-34, at \*29).

As we have discussed at length, the evidence demonstrates that the Patels entered into the microcaptive transactions to reduce their federal income tax bill, not for any business purpose. This evidence includes, but is not limited to, the Patels and their entities (1) paying excessively high premiums designed to maximize deductions; (2) demonstrating through overwhelming contemporaneous emails and documents that the microcaptives served no legitimate business purpose; and

(3) maintaining commercial insurance during the tax years at issue, for significantly lower premiums, which often covered the same risks as the microcaptives. *See, e.g., Patel II*, T.C. Memo. 2024-34, at \*11, \*29, \*32; *supra* pp. 174–82. Accordingly, we cannot conclude that the Patels had a “substantial purpose” for the transaction apart from federal income tax effects. *See* § 7701(o)(5)(D) (providing that the term “transaction” includes a series of a transactions).

#### E. Application of Section 6662(b)(6)

Because the ongoing dispute about the section 6662(b)(6) penalty requires us to decide whether there is a “transaction lacking economic substance (within the meaning of section 7701(o)),” we have reached and resolved that issue. *See supra* Opinion Part II.C and D. For the reasons discussed, we concluded that the purported insurance transactions are “transaction[s] lacking economic substance (within the meaning of section 7701(o)).” *See supra* Opinion Part II.C and D.

Next, we must examine whether the section 6662(b)(6) penalty applies in the light of our holding that the transactions lack economic substance. The introductory clause of section 6662(b) provides that the section “shall apply to the portion of any underpayment which is attributable to 1 or more” of the situations set forth in subsection (b), including paragraph (6). In turn, paragraph (6) describes “[a]ny disallowance of claimed tax benefits *by reason of* a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law.” (Emphasis added.) Following the text of section 6662(b)(6), we must now consider whether “[a]ny disallowance of claimed tax benefits” is “by reason of” such “transaction lacking economic substance.”

The most natural reading of this statute is that a lack of economic substance must be the cause of the disallowance of the claimed tax benefit (here, deductions for purported insurance premiums). *See, e.g., City of S.F. v. EPA*, 145 S. Ct. 704, 715 (2025) (examining the “most natural reading” of a statute to determine its meaning).<sup>19</sup> For example, *Garner’s Modern*

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<sup>19</sup> The parties do not dispute—so we assume without deciding—that the deductions claimed for payments of purported policy premiums and other

*American Usage* notes that “by reason of is usually an artificial way of saying *because of*.” Bryan A. Garner, *Garner’s Modern American Usage* 124 (3d ed. 2009); see also *O’Gilvie v. United States*, 519 U.S. 79, 83 (1996) (noting that phrases “on account of,” “by reason of,” and “because of” have the same meaning); *Reason*, *The American Heritage Dictionary of the English Language* (4th ed. rev. 2006) (defining “by reason of” as “[b]ecause of”). Thus, we must determine whether the claimed tax benefits were disallowed “by reason of” (or “because of”) a transaction lacking economic substance.

Here, the NODs for tax years 2014 through 2016—the years in which section 6662(b)(6) is at issue—did not disallow the deductions for lack of economic substance. Rather, penalties for lack of economic substance were determined in each of the NODs. Further, the relevant Answers in these cases asserted the economic substance doctrine as a new ground upon which to disallow claimed deductions.

It is well settled that the Commissioner’s determinations may be affirmed on grounds other than those set forth in an NOD. *Estate of Horvath v. Commissioner*, 59 T.C. 551, 555 (1973); *Estate of Lassiter v. Commissioner*, T.C. Memo. 2000-324, 2000 WL 1545062, at \*9. More specifically, the Commissioner is permitted to assert in an answer the economic substance doctrine as a new ground upon which to disallow a claimed benefit. See, e.g., *Ax v. Commissioner*, 146 T.C. 153, 166 (2016) (permitting the Commissioner to amend an answer to assert as a new issue that a microcaptive lacked economic substance); *Claymont Invs., Inc. v. Commissioner*, T.C. Memo. 2005-254, 2005 WL 2848021, at \*5, \*9 (permitting the Commissioner to assert the economic substance doctrine in an answer).

In these cases, respondent asserted in relevant Answers that the deductions were disallowed by reason of (or because of) the economic substance doctrine. Moreover, respondent determined a section 6662(b)(6) penalty in the NODs. In *Patel II*, we did not need to decide whether the claimed tax benefits should be disallowed for lack of economic substance. But as noted above we must now decide whether the claimed

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expenses on the Patels’ tax returns constitute “claimed tax benefits” within the meaning of section 6662(b)(6).

tax benefits are disallowed for that reason, as an alternative ground to our holding in *Patel II*. See § 6662(b)(6).

As set forth *supra* Opinion Part II.D, the transactions at issue lacked economic substance. Thus, the disallowance of the claimed tax benefits is by reason of a transaction lacking economic substance within the meaning of section 7701(o), and section 6662(b)(6) is applicable in these cases. Therefore, we now sustain respondent's assertion of penalties under section 6662(a) and (b)(6) for tax years 2014 through 2016 on the ground that the transactions lacked economic substance.

#### F. *Increased Penalty Under Section 6662(i)*

Next, we must determine whether the Patels are subject to an increased rate under section 6662(i) for taxable years 2014 and 2015. Section 6662(i) increases the section 6662(a) penalty from 20% to 40% for any portion of an underpayment that is attributable to one or more nondisclosed noneconomic substance transactions under section 6662(b)(6). See also *Oropeza v. Commissioner*, 155 T.C. 132, 140 (2020) (“[S]ection 6662(i) does not impose a distinct penalty. It simply increases the rate of the penalty imposed . . . for engaging in a transaction lacking economic substance.”).

This is our first opportunity to consider what constitutes adequate disclosure under section 6662(i)(2). See *Royalty Mgmt. Ins. Co. v. Commissioner*, T.C. Memo. 2024-87, at \*53–54 (noting that the Court has not considered “what constitutes ‘adequate[] disclos[ure]’ of a microcaptive transaction under section 6662(i)(2)” (alterations in original)). Section 6662(i)(2) explains that “the term ‘nondisclosed noneconomic substance transaction’ means any portion of a transaction [lacking economic substance] with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return nor in a statement attached to the return.”

In other contexts, we have determined that “[a]dequate disclosure is a factual question.” *Highwood Partners v. Commissioner*, 133 T.C. 1, 21 (2009) (examining omitted gross income). For a disclosure to be adequate, it “must be sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one.” *Estate of Fry v. Commissioner*, 88 T.C. 1020,

1023 (1987). “The disclosure must be more substantial than providing a clue that would intrigue the likes of Sherlock Holmes but need not recite every underlying fact.” *Highwood Partners*, 133 T.C. at 21; see also *Estate of Reinke v. Commissioner*, 46 F.3d 760, 765 (8th Cir. 1995) (“To satisfy the disclosure requirement, the tax return must at least provide sufficient information to enable the Commissioner to identify the potential controversy involved.”), *aff’g* T.C. Memo. 1993-197, 1993 WL 140748; *Accardo v. Commissioner*, 942 F.2d 444, 453 (7th Cir. 1991) (“[M]ere declaration of a deduction does not entitle taxpayer to a reduced penalty.”), *aff’g* 94 T.C. 96 (1990); *Schirmer v. Commissioner*, 89 T.C. 277, 285–86 (1987) (finding that merely listing income and expense items is insufficient under prior version of section 6662); *Elliott v. Commissioner*, T.C. Memo. 1997-294, 1997 WL 351191, at \*6 (“What is critical is whether the taxpayer adequately disclosed enough relevant data concerning the treatment of the item to alert the Commissioner to a potential controversy.”), *aff’d*, 149 F.3d 1187 (8th Cir. 1998) (unpublished table decision); *Crouch v. Commissioner*, T.C. Memo. 1995-289, 1995 WL 377687, at \*4 (finding that a specific form was not per se sufficient for adequate disclosure under section 6662(b)(1) if a “material fact” is not disclosed); *Estate of Reinke v. Commissioner*, 1993 WL 140748, at \*7 (finding that adequate disclosure under old section 6661 required that the taxpayer “disclose the relevant facts”).

We find that the Patels did not attach a statement to their returns, nor did they adequately disclose the relevant facts or provide sufficient information on their returns to enable respondent to identify the potential controversy involved. Among other things, the Patels’ 2014 and 2015 returns did not reveal (1) the flow of funds from Dr. Patel to himself and his own family via intermediary entities; (2) the identities of, and relationships among, all the entities and individuals (e.g., CIC Services, Mr. Sean King, and Mr. Coomes) involved in the flow of funds; (3) how premium amounts were calculated; or (4) the Capstone pooling arrangement.<sup>20</sup> Accordingly, we will

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<sup>20</sup> We do not intend to suggest that all, or any particular one, of these items had to be disclosed for the Patels to have adequately disclosed the transaction under consideration. We provide this list as examples of the many things not disclosed by the Patels.

sustain the Commissioner's increased rate for the 2014 and 2015 taxable years.<sup>21</sup>

### III. *Negligence and Substantial Understatement of Income Tax*

Next, we turn to respondent's argument that the Patels are liable for accuracy-related penalties for negligence and substantial understatements of income tax. Only one accuracy-related penalty may be applied with respect to any given portion of an underpayment, even if that portion is penalizable on more than one of the grounds set forth in section 6662(b). *See New Phoenix Sunrise Corp. v. Commissioner*, 132 T.C. 161, 187 (2009), *aff'd*, 408 F. App'x 908 (6th Cir. 2010)). However, as set forth *supra* pp. 181–82, section 6662(b)(6) does not apply for the 2013 taxable year. Moreover, we explain our position as an alternative ground to sustain the Commissioner's penalty determinations.

Section 6662(a) and (b)(1) and (2) imposes an accuracy-related penalty equal to 20% of the portion of an underpayment of tax required to be shown on a return that is attributable to “[n]egligence or disregard of rules or regulations” or “[a]ny substantial understatement of income tax.” We will address each in turn before turning to the Patels' potential defenses.

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<sup>21</sup> For the first time, in a footnote in a sur-reply, the Patels attempt to argue that “[t]he Notice 2016-66 invalidation and Forms 1120-PC negate Section 6662(i).” The Patels' argument is not fully developed, and burying arguments in footnotes is seldom appropriate. *See Nat'l Oilseed Processors Ass'n v. OSHA*, 769 F.3d 1173, 1184 (D.C. Cir. 2014) (observing that courts generally decline “to consider an argument if a party buries it in a footnote and raises it in only a conclusory fashion”); *Estate of Saunders v. Commissioner*, 745 F.3d 953, 962 n.8 (9th Cir. 2014) (“Arguments raised only in footnotes, or only on reply, are generally deemed waived.”), *aff'g* 136 T.C. 406 (2011). Moreover, arguments made for the first time in a reply brief are deemed waived. *See Considine v. Commissioner*, 74 T.C. 955, 969–70 (1980) (characterizing as “untimely” and thus declining to consider an argument advanced for the first time in a reply brief); *Ashkouri v. Commissioner*, T.C. Memo. 2019-95, at \*24 n.9 (“Having conceded an issue by failing to advance a meaningful argument on that issue in their opening brief, [the taxpayers] could not withdraw that concession by belatedly including a cognizable argument in their reply brief.”); *see also United States v. Smith*, 609 F. App'x 180, 185 (5th Cir. 2015).

### *A. Negligence or Disregard of Rules or Regulations*

Negligence includes any failure to make a reasonable attempt to comply with the provisions of the Code. *See* § 6662(c); *Higbee*, 116 T.C. at 448–49; Treas. Reg. § 1.6662-3(b)(1). Treasury Regulation § 1.6662-3(b)(1)(ii) provides that negligence is strongly indicated where a taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion on a return that would seem “too good to be true” under the circumstances. *See also Neonatology Assocs., P.A. v. Commissioner*, 299 F.3d 221, 234 (3d Cir. 2002) (“When, as here, a taxpayer is presented with what would appear to be a fabulous opportunity to avoid tax obligations, he should recognize that he proceeds at his own peril.”), *aff’g* 115 T.C. 43 (2000). Disregard includes any careless, reckless, or intentional disregard of the rules and regulations. *See* § 6662(c); *Higbee*, 116 T.C. at 448.

Dr. Patel is extremely well educated; he holds multiple professional degrees. Moreover, he describes himself as a “savvy financial person” who did not need Mr. Fay’s advice about financial products or the decision to form a captive. Rather, relying on his own self-study, Dr. Patel knew that he wanted to form a captive.

Despite his education, the record does not disclose any attempt by Dr. Patel to question or investigate whether it was proper for him to drastically reduce his tax liabilities in the manner he chose. This is exactly the type of “too good to be true” transaction that should cause taxpayers to seek out competent advice from independent advisers. *See Neonatology Assocs., P.A. v. Commissioner*, 299 F.3d at 234.

Moreover, Dr. Patel decided to move forward with forming a second captive in 2016, despite being on notice that the IRS was examining the captive arrangements formed by Mr. Coomes. We also note that a member of Dr. Patel’s family warned him about the increased scrutiny of microcaptive arrangements.

Under the circumstances, we conclude that Dr. Patel was negligent in that he failed to make reasonable attempts to comply with the tax law and failed to make reasonable attempts to determine the correctness of deductions that should have seemed to him too good to be true. *See id.* (“As highly educated professionals, the individual taxpayers should have recognized that it was not likely that by complex

manipulation they could obtain large deductions for their corporations and tax free income for themselves.”).

### B. Substantial Understatements

An understatement of income tax is “substantial” if it exceeds the greater of 10% of the tax required to be shown on the return or \$5,000. *See* § 6662(d)(1)(A). We previously determined that the substantial understatement accuracy-related penalty is at issue for tax years 2014, 2015, and 2016. *See Patel I*, T.C. Memo. 2020-133, at \*27. The table below demonstrates that there is a substantial understatement of income tax with respect to each of the Patels’ returns for taxable years 2014 through 2016:

Year	Tax Required to be Shown	Tax on Return	10% of Tax Required to be Shown	Understatement
2014	\$690,571	\$206,151	\$69,057	\$484,420
2015	1,001,336	526,150	100,134	475,186
2016	1,094,601	564,652	109,460	529,949

Accordingly, to the extent Rule 155 computations confirm there are substantial understatements of income tax, we sustain respondent’s imposition of penalties for substantial understatements as each of the understatements at issue plainly exceeds \$5,000 and is greater than 10% of the tax required to be shown. *See, e.g., Swift v. Commissioner*, T.C. Memo. 2024-13, at \*48, *aff’d*, 144 F.4th 756 (5th Cir. 2025); *Caylor Land & Dev.*, T.C. Memo. 2021-30, at \*49–50.

### IV. Defenses to Accuracy-Related Penalties

The Patels can avoid certain accuracy-related penalties if they had “substantial authority,” or if they acted with reasonable cause and in good faith, for the positions taken on their returns.<sup>22</sup> *See* §§ 6662(d)(2)(B)(i), 6664(c)(1); Treas. Reg. § 1.6664-4(a). As discussed above, the Patels appear to argue that Congress induced them to form captives and there was uncertainty in the law at the time the captives were formed.

<sup>22</sup> Neither defense applies to portions of underpayments attributable to the codified economic substance doctrine. *See* § 6664(c)(2).

Thus, they argue that they should not be “punished.” Moreover, we construe the portion of the Patels’ statement of issues that sets forth summary arguments about penalties in the opening brief as an assertion that they: (1) had substantial authority and (2) acted with reasonable cause and in good faith.

#### A. *Substantial Authority*

A substantial understatement penalty generally may not be imposed if there was substantial authority for the deductions claimed. *See* Treas. Reg. § 1.6662-4(d)(1). Substantial authority for the treatment of an item exists only if the weight of the authorities supporting the treatment of the item is substantial in relation to the weight of authorities supporting contrary treatment. *Id.* subpara. (3)(i). The weight of the authorities is determined in the light of all relevant facts and circumstances. *Id.*

The substantial authority standard is an objective standard involving an analysis of the law and application of the law to the relevant facts. *Id.* subpara. (2). “In evaluating whether a taxpayer’s position regarding treatment of a particular item is supported by substantial authority, the weight of authorities in support of the taxpayer’s position must be substantial in relation to the weight of authorities supporting contrary positions.” *Antonides v. Commissioner*, 91 T.C. 686, 702 (1988), *aff’d*, 893 F.2d 656 (4th Cir. 1990).

The Patels appear to assert that there was substantial authority for the Magellan and the Plymouth transactions for two reasons: (1) revenue rulings provided safe harbors and (2) prior captive cases supported their position. We have already rejected the Patels’ arguments that the revenue rulings provided authority for their transactions. *See Patel II*, T.C. Memo. 2024-34, at \*45. And no prior captive cases supported the allowance of deductions as insurance expenses for payments that were not made for insurance.

The authority cited by the Patels suggests only that a captive arrangement can exist when the requirements of insurance are met. But the evidence is clear that the Patels’ captive arrangement never met, and was not designed to meet, the requirements of insurance envisioned by that authority. *See Neonatology Assocs., P.A.*, 115 T.C. at 101 (finding that the

fact that the taxpayer-physicians attempted to surreptitiously withdraw money from closely held corporations in a case of first impression “in the setting of a speciously designed life insurance product” does not negate the fact that the underlying tax principles involved are well settled).

Further, contrary to the Patels’ argument, the Court in *Avrahami*, 149 T.C. 144, did not cite uncertainty in the law as its reason to find substantial authority that supported a similar captive arrangement. Rather, after determining that the taxpayers had reasonably relied upon an adviser, the Court determined that the reliance was in good faith because the case was one of first impression involving a microcaptive. *Id.* at 207. However, as set forth below, the Patels have not presented evidence that they reasonably relied upon an adviser. Thus, *Avrahami*—which was decided after the transactions at issue—does not support a finding of substantial authority here.

Finally, the Patels argue that captive insurance precedent “told Sunil and his advisors that his business judgment remained well grounded in the law.” In making this assertion, the Patels offer a string cite, without analysis, of various cases in the following order: *Helvering v. Le Gierse*, 312 U.S. 531 (1941); *Humana Inc. v. Commissioner*, 881 F.2d 247; *Harper Grp.*, 96 T.C. 45; *AMERCO & Subs. v. Commissioner*, 96 T.C. 18, 38 (1991), *aff’d*, 979 F.2d 162 (9th Cir. 1992); *Sears, Roebuck & Co. & Affiliated Corps. v. Commissioner*, 96 T.C. 61 (1991), *supplemented by* 96 T.C. 671 (1991), *aff’d in part, rev’d in part*, 972 F.2d 858 (7th Cir. 1992); *Rent-A-Center, Inc.*, 142 T.C. 1; *Securitas Holdings, Inc. & Subs. v. Commissioner*, T.C. Memo. 2014-225; *R.V.I. Guar. Co. & Subs. v. Commissioner*, 145 T.C. 209 (2015).

As an initial matter, several of the cases cited by the Patels were decided after Dr. Patel made the decision to form a microcaptive. Moreover, nothing in these cases permitted Dr. Patel to form a captive without any business rationale and for the sole purpose of obtaining tax benefits. We therefore conclude that there was no substantial authority supporting the Patels’ position regarding the Magellan and the Plymouth transactions.

### B. Reasonable Cause and Good Faith

Finally, section 6664(c)(1) provides that a penalty under section 6662 shall not apply to any portion of an underpayment if it is shown that there was reasonable cause for the taxpayer's position and that the taxpayer acted in good faith with respect to that portion. *See Higbee*, 116 T.C. at 448; *see also Swift v. Commissioner*, 144 F.4th at 771. The determination of whether the taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all the pertinent facts and circumstances. Treas. Reg. § 1.6664-4(b)(1). The Patels have the burden of proving that the negligence and the substantial understatement penalties are inappropriate because of reasonable cause. *See Higbee*, 116 T.C. at 446–47.

“Reasonable cause requires that the taxpayer have exercised ordinary business care and prudence as to the disputed item.” *Neonatology Assocs., P.A.*, 115 T.C. at 98. The good faith reliance on the advice of an independent, competent professional as to the tax treatment of an item may meet this requirement. *Id.* (citing *United States v. Boyle*, 469 U.S. 241 (1985)). In determining whether the reasonable cause and good faith exception applies, we examine all the relevant facts and circumstances, including whether the taxpayers relied in good faith on professional advice and whether their reliance was reasonable. *See id.*; Treas. Reg. § 1.6664-4(b) and (c). Reliance on an adviser is reasonable if (1) the adviser was a competent professional who had sufficient expertise to justify reliance; (2) the taxpayer provided necessary and accurate information to the adviser; and (3) the taxpayer actually relied in good faith on the adviser's judgment. *Neonatology Assocs., P.A.*, 115 T.C. at 99.

The Patels argue in passing that Dr. Patel relied upon advisers in deciding to form the captives. *See Patel II*, T.C. Memo. 2024-34, at \*4 n.6 (noting the record does not reflect that Dr. McAnally-Patel had any involvement in the purported microcaptive transactions but that our decisions in these cases will affect her joint federal income tax returns). The Patels do not identify these advisers in their argument. Thus, the Court is left to guess. The Court is not bound to sift through the record to develop arguments for a taxpayer, and we could reject the Patels' argument on this basis alone. *See Stringer*

*v. Commissioner*, 84 T.C. 693 (1985) (refusing to sift through a voluminous and unintelligible record without the aid of a brief), *aff'd*, 789 F.2d 917 (4th Cir. 1986) (unpublished table decision); *Kersting v. Commissioner*, T.C. Memo. 1999-197, 1999 WL 398129, at \*5 (noting that the Court is not required to wade through voluminous records to develop arguments). Nonetheless, on the basis of the record, we assume without deciding that the Patels are referring to (1) Mr. Coomes; (2) Mr. Sean King; and (3) Mr. Fay.

We have held that a taxpayer cannot reasonably rely in good faith on an adviser who is a “promoter” of the disputed transaction. *Avrahami*, 149 T.C. at 206; *Swift*, T.C. Memo. 2024-13, at \*49. A promoter is “an adviser who participated in structuring the transaction or is otherwise related to, has an interest in, or profits from the transaction.” *106 Ltd. v. Commissioner*, 136 T.C. 67, 79 (2011) (quoting *Tigers Eye Trading, LLC v. Commissioner*, T.C. Memo. 2009-121, 2009 WL 1475159, at \*19), *aff'd*, 684 F.3d 84 (D.C. Cir. 2012).

We find that the Patels cannot reasonably rely on Mr. Coomes or Mr. Sean King (or anyone at CIC Services) because they were promoters of the Magellan and the Plymouth transactions. Mr. Coomes structured the captive transactions, drafted the purported insurance policies, and designed and set up the reinsurance programs, which he sold to his clients. *See Patel II*, T.C. Memo. 2024-34, at \*22–23 (describing Coomes’s role in setting up the captives); *see also Avrahami*, 149 T.C. at 206 (finding an individual in a similar role was a promoter because she “structured the captive-insurance-company transaction, drafted the purported insurance policies, and designed and set up the failed risk-distribution programs”); *Swift*, T.C. Memo. 2024-13, at \*49 (finding that an individual in a role comparable to Mr. Coomes’s was a promoter because she was the primary promoter of the transaction). Mr. Coomes also profited from the transactions, receiving a \$5,000 ceding fee each year from each of the captives that participated in the Capstone pooling arrangement. *See Patel II*, T.C. Memo. 2024-34, at \*9, \*22–23; *see also Avrahami*, 149 T.C. at 206 (holding that individual who profited from transaction was a promoter).

Relatedly, Mr. Sean King and CIC Services also provided captive management services for Magellan and Plymouth. So

at the same time that Dr. Patel and his purported captives affiliated with CIC Services, Mr. Sean King profited from the Capstone pooling arrangement. *Patel II*, T.C. Memo. 2024-34, at \*33–34 (describing ownership interests of individuals affiliated with CIC Services). Thus, we find that the Patels cannot reasonably rely on Mr. Coomes, Mr. Sean King, or anyone at CIC Services because they were also promoters of the micro-captive arrangement. *See 106 Ltd.*, 136 T.C. at 79 (finding that a promoter is one who profits from the transaction or has an interest in the arrangement).

Mr. Fay is a closer call, but Dr. Patel’s own testimony tips the balance. Dr. Patel repeatedly stated that he was not seeking advice from Mr. Fay about forming a captive. Rather, Dr. Patel already knew that he wanted to form a captive when he contacted Mr. Fay. *Patel II*, T.C. Memo. 2024-34, at \*7–8. According to Dr. Patel, Mr. Fay did not know much about captives, and Dr. Patel simply wanted an introduction to someone who could help him form one. *Id.* Accordingly, we find that Dr. Patel did not rely upon Mr. Fay as an adviser to form his captive. Thus, we need not decide whether Mr. Fay was a promoter.

Aside from the advice from advisers, a court may also consider the taxpayer’s “experience, knowledge, and education” to determine whether the taxpayer had reasonable cause and acted in good faith. Treas. Reg. § 1.6664-4(b)(1). Courts have long held that sophisticated taxpayers must recognize that when a transaction offers “fabulous” tax benefits, they are proceeding at their own peril and the transaction may be “too good to be true.” *Stobie Creek Invs., LLC v. United States*, 82 Fed. Cl. 636, 716 (2008) (citation omitted), *aff’d*, 608 F.3d 1366 (Fed. Cir. 2010).

Dr. Patel is highly educated and considers himself to be financially savvy. The evidence demonstrates that Dr. Patel was motivated predominantly by tax avoidance concerns. Considering his experience, knowledge, and education, we conclude that Dr. Patel did not have reasonable cause for his position, and he should have recognized a transaction that was too good to be true.

### V. Conclusion

On the basis of the foregoing, we sustain the Commissioner's section 6662(a) and (b)(6) penalties for tax years 2014 through 2016 and the increased rate under section 6662(i) for tax years 2014 and 2015. We also sustain the Commissioner's remaining accuracy-related penalty determinations for tax year 2013, and as an alternative position for tax years 2014 through 2016, as set forth herein and as limited by *Patel I*.

In reaching our conclusions, we have considered all arguments made by the parties, and to the extent not mentioned or addressed, they are irrelevant or without merit.

To reflect the foregoing,

*Decisions will be entered under Rule 155.*

Reviewed by the Court.

URDA, *C.J.*, and KERRIGAN, BUCH, NEGA, PUGH, ASHFORD, COPELAND, TORO, GREAVES, MARSHALL, WEILER, WAY, LANDY, ARBEIT, GUIDER, JENKINS, and FUNG, *J.J.*, agree with this opinion of the Court.

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APACHE CORPORATION AND SUBSIDIARIES, PETITIONER  
*v.* COMMISSIONER OF INTERNAL REVENUE,  
RESPONDENT

Docket No. 25984-22.

Filed November 13, 2025.

For each of 2016 and 2017, P reported a net operating loss that consisted in part of a "specified liability loss" within the meaning of I.R.C. § 172(f)(1). P's return for each year included an election under Treas. Reg. § 1.1502-21(b)(3)(i) to waive the entire carryback period pursuant to I.R.C. § 172(b)(3) for the consolidated net operating loss of the consolidated group of which P was the common parent. P expressly stated that P did not elect under I.R.C. § 172(f)(6) to relinquish the carryback period with respect to the specified liability loss incurred in each year. P received a tentative refund for each of 2006 and 2007 from the carryback of the specified liability losses it reported for 2016 and 2017, respectively. R then determined deficiencies for 2006 and 2007 based on the disallowance of the carrybacks. P has moved for partial summary

judgment that its election for each year relinquished the carryback of only that portion of its net operating loss that exceeded its reported specified liability loss. R seeks partial summary judgment that P's election for each of 2016 and 2017 relinquished the carryback of its entire net operating loss for the year. *Held*: P's election for each year relinquished the carryback of only that portion of its net operating loss that exceeded its reported specified liability loss. *Held, further*, P's Motion will be granted; R's Motion will be denied.

TORO, *J.*, wrote the opinion of the Court, which URDA, *C.J.*, and KERRIGAN, NEGA, PUGH, ASHFORD, COPELAND, JONES, GREAVES, WEILER, WAY, LANDY, ARBEIT, GUIDER, JENKINS, and FUNG, *JJ.*, joined and which BUCH, *J.*, joined as to Part IV.

BUCH, *J.*, wrote a concurring opinion.

HALPERN, *J.*, wrote an opinion concurring in part and dissenting in part, which MARSHALL, *J.*, joined.

*Shawn R. O'Brien and Edward L. Froelich*, for petitioner.  
*Estevan D. Fernandez, Monica D. Polo, Jennifer C. Arthur, Christopher M. Menczer, Casinova O. Henderson, and Michael A. Sienkiewicz*, for respondent.

#### OPINION

TORO, *Judge*: “A ‘net operating loss’ results from deductions in excess of gross income for a given year.” *See United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 825 (2001) (citing I.R.C. § 172(c)).<sup>1</sup> Section 172 permits taxpayers to carry net operating losses through time, taking them backward or forward to years for which they can be deducted.<sup>2</sup> *See United Dominion*, 532 U.S. at 825. The provision serves to smooth a taxpayer's profits and losses, allowing it “to set off its lean years against its lush years.” *Libson Shops, Inc.*

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<sup>1</sup> Unless otherwise indicated, statutory references are to the Internal Revenue Code, Title 26 U.S.C. (I.R.C. or Code), in effect at all relevant times, regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure.

<sup>2</sup> We use the present tense to refer to the law that existed for the years at issue in this case, 2016 and 2017. In 2017, Congress amended section 172 with the result that, under current law, most net operating losses cannot be carried back at all. I.R.C. § 172(b)(1) (as amended by the Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13302(b), 131 Stat. 2054, 2122 (2017)).

*v. Koehler*, 353 U.S. 382, 386 (1957); accord *United Dominion*, 532 U.S. at 825.

By default, a net operating loss can be carried back 2 years and then forward 20 years. I.R.C. § 172(b)(1)(A). Over time, Congress has defined categories of losses which can be carried back further, recognizing that certain types of losses “tend to be particularly ‘large and sporadic.’” *United Dominion*, 532 U.S. at 825 (quoting Staff of J. Comm. on Tax’n, 95th Cong., General Explanation of the Revenue Act of 1978, JCS-7-79, at 232 (J. Comm. Print)). As relevant here, in 1990, Congress changed the law so that a “specified liability loss” could be carried back ten years.<sup>3</sup>

But Congress did not leave taxpayers without choices. Section 172 permits taxpayers to elect not to carry back their net operating losses and instead to carry such losses only forward. The election is helpful to taxpayers who have tax attributes (such as credits) that might otherwise expire unused. A taxpayer in that position might prefer to use expiring credits during the earlier years to which a net operating loss would otherwise have been carried back and have the loss available for use in the future.

Petitioner, Apache Corp. & Subs. (Apache), is one such taxpayer. For 2016 and 2017, it made elections under section 172(b)(3) to waive the carryback period for its normal net operating losses. That is, it chose to carry those losses only forward. But it expressed an intent not to relinquish the ten-year carryback for its specified liability losses.

Now before the Court are Cross-Motions for Partial Summary Judgment concerning whether Apache was able to restrict its elections to its normal net operating losses. We conclude it was. The text of section 172, its structure, the context in which it developed, judicial precedent interpreting it, and even the

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<sup>3</sup> As the Supreme Court observed in *United Dominion*, 532 U.S. at 829 n.6:

The difference [between the specified liability losses (SLLs) at issue here and the product liability losses (PLLs) involved in that case] does not matter. The PLL was a statutory predecessor to the SLL, and PLLs were folded into the SLL provision in § 11811(b)(1) of the Omnibus Budget Reconciliation Act of 1990, [Pub. L. No. 101-508,] 104 Stat. [1388,] 1388–532. Thus, “[i]n all relevant respects, the provisions on [PLLs] and SLLs are the same.” Leatherman, *Current Developments for Consolidated Groups*, 486 *PLI/Tax* 389, 393, n. 5 (2000) . . . .

Government's past interpretation of the statute as expressed in regulations all point in favor of Apache's position. We will therefore grant Apache's Motion and deny the Commissioner's.

### *Background*

Apache is an oil and gas exploration and production company organized under Delaware law. When it filed its Petition, Apache's principal place of business was in Houston, Texas.

During 2016 and 2017, Apache was the common parent of an affiliated group. That group filed a consolidated calendar year Form 1120, U.S. Corporation Income Tax Return, for both years.

#### *I. 2016 Tax Returns*

Apache timely filed Form 1120 for the taxable year 2016 on September 21, 2017, having requested an extension. On October 13, 2017, Apache filed a superseding Form 1120.

On both its initial and superseding Forms 1120 for 2016, Apache reported a net operating loss of \$1,931,356,691. Within that amount, Apache reported that \$40,734,363 qualified as a specified liability loss within the meaning of section 172(f)(1). The parties have stipulated that Apache did not claim any of its 2016 specified liability loss as product liability amounts under section 172(f)(1)(A).

Apache included the following statement on its initial and superseding Forms 1120 for 2016:

ELECTION TO FOREGO NET OPERATING LOSS CARRYBACK PURSUANT TO INTERNAL REVENUE CODE § 172(b)(3) AND TREAS. REG. § 1.1502-21(b)(3)

This is an election under § 1.1502-21(b)(3)(i) to waive the entire carryback period pursuant to section 172(b)(3) for the 2016 CNOLs of the consolidated group of which Apache Corporation (EIN . . . ) is the common parent.

Apache Corporation and Subsidiaries does not elect to relinquish the carryback period with respect to specified liability losses incurred in this tax year ended December 31, 2016 pursuant to Internal Revenue Code § 172(f)(6).

Ex. 1-J, p. 244; Ex. 2-J, p. 243.

On October 6, 2017—between the filing of its initial and superseding Forms 1120—Apache filed Form 1139, Corporation Application for Tentative Refund, seeking to carry its

\$40,734,363 specified liability loss back ten years to its tax year 2006. As a result, on Form 1139, it claimed a refund of \$13,829,316. Apache received a tentative refund of that amount in January 2018.

## II. 2017 Tax Returns

Apache timely filed Form 1120 for the taxable year 2017 on October 10, 2018, having requested an extension. On October 15, 2018, it filed a superseding Form 1120.

On its initial and superseding Forms 1120 for 2017, Apache reported a net operating loss of \$3,082,583,587. Apache claimed that \$30,818,137 of that amount qualified as a specified liability loss. The parties have stipulated that Apache did not claim any of its specified liability loss as product liability amounts under section 172(f)(1)(A).

Apache included on its initial and superseding Forms 1120 for 2017 a statement almost identical to its 2016 statement. The statement elected to waive Apache's net operating loss carryback period but not the carryback period with respect to its specified liability loss.

On December 12, 2018, Apache filed Form 1139, seeking to carry its reported specified liability loss of \$30,818,137 back from 2017 to 2007. As a result, it claimed a refund of \$10,139,167 for the 2007 taxable year. Apache received a tentative refund of that amount in March 2019.

## III. Examination and Petition

The Commissioner examined Apache's 2016 and 2017 returns. On September 26, 2022, the Commissioner issued to Apache a Notice of Deficiency relating to the taxable years 2006, 2007, and 2015.<sup>4</sup> A Form 886-A, Explanation of Items, attached to the Notice stated:

It is determined that specified liability losses (SLL) within the meaning of section 172(f) reported in years 2016 and 2017 and carried back ten years to 2006 and 2007 are disallowed. The taxpayer elected to forgo the entire carryback under section 172(b)(3) for both 2016 and 2017 and is not allowed to separately carry back the SLL net operating losses (NOL).

Ex. 7-J, p. 24.

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<sup>4</sup>The deficiency determined with respect to taxable year 2015 is not implicated by the Motions now before us, and we do not discuss it further.

Apache timely petitioned this Court for redetermination of its deficiencies. In time, Apache and the Commissioner filed the Cross-Motions for Partial Summary Judgment now before the Court. Apache seeks a ruling that it properly carried back its claimed specified liability losses to 2006 and 2007. The Commissioner seeks a ruling that Apache's elections under section 172(b)(3) relinquished the carryback period for its claimed specified liability losses as well as the remainder of its net operating losses, and thus that Apache could not separately carry its claimed specified liability losses to 2006 and 2007.

### *Discussion*

#### *I. Summary Judgment Standard*

The purpose of summary judgment is to expedite litigation and avoid costly and unnecessary trials. *FPL Grp., Inc. & Subs. v. Commissioner*, 116 T.C. 73, 74 (2001). The Court may grant partial summary judgment when there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law. Rule 121(a)(2); *Elec. Arts, Inc. v. Commissioner*, 118 T.C. 226, 238 (2002); see also *Take v. Commissioner*, 82 T.C. 630, 633 (1984) (explaining that if both parties move for summary judgment or partial summary judgment, this rule applies to each motion), *aff'd*, 804 F.2d 553 (9th Cir. 1986). In considering the Motions, the Court construes factual materials and inferences drawn from them in the light most favorable to each nonmoving party. *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994).

#### *II. Net Operating Loss Carryover Deductions*

##### *A. In General*

Section 172(a) allows as a deduction for a taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to that year and (2) the net operating loss carrybacks to the year. See *Metro One Telecomms., Inc. v. Commissioner*, 704 F.3d 1057, 1059–60 (9th Cir. 2012), *aff'g* 135 T.C. 573 (2010); *Powers v. Commissioner*, 43 F.3d 172, 176 (5th Cir. 1995), *aff'g in part, rev'g in part, and remanding* T.C. Memo. 1993-125 and 100 T.C. 457 (1993).

Section 172(b) defines net operating loss carryovers and carrybacks and provides rules for when they may be taken into account. Section 172(b) consists of three paragraphs.

Section 172(b)(1) sets out the years to which a net operating loss may be carried. As we have noted, as a general rule, net operating losses may be carried back 2 years and forward 20. I.R.C. § 172(b)(1)(A). Special rules exist, however, for specific types of losses. *See* I.R.C. § 172(b)(1)(B)–(F). Farming losses, for example, may be carried back five years and may not be carried forward. I.R.C. § 172(b)(1)(F). “Eligible losses” may be carried back three years, I.R.C. § 172(b)(1)(E),<sup>5</sup> and specified liability losses may be carried back ten years, I.R.C. § 172(b)(1)(C).

Section 172(b)(2) provides rules for determining the order of years to which a net operating loss will be carried. To start, the taxpayer carries the entire amount of a net operating loss to the earliest year to which it may be carried. I.R.C. § 172(b)(2). If the net operating loss exceeds taxable income for that year, then the excess of the loss over taxable income is carried to the following year, and so on until the loss is entirely consumed or may no longer be carried over. *Id.*

Section 172(b)(3) permits a taxpayer an election not to carry back a net operating loss. In relevant part, it provides: “Any taxpayer entitled to a carryback period under paragraph (1) [i.e., section 172(b)(1), described above] may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year.” I.R.C. § 172(b)(3). This is the main provision at issue here, but before analyzing it in greater detail, we pause briefly to discuss specified liability losses, the category of losses Apache seeks to carry back.

### B. *Specified Liability Losses*

A specified liability loss belongs to a category of losses subject to special rules under section 172(b). *See* I.R.C. § 172(b)(1)(C), (f). Section 172(f)(1) defines a specified liability loss to include (1) losses attributable to product liability, I.R.C. § 172(f)(1)(A), as well as (2) amounts that satisfy a liability

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<sup>5</sup> Generally speaking, “eligible losses” are losses from theft, fires, storms, shipwrecks, and other casualties incurred by individuals, as well as net operating losses attributable to federally declared disasters incurred by small businesses or farmers. *See* I.R.C. § 172(b)(1)(E)(ii).

under state or federal law relating to the reclamation of land, the decommissioning of a nuclear power plant, the dismantlement of a drilling platform, the remediation of environmental contamination, or payments under a workers compensation act, subject to certain timing and accounting conditions, I.R.C. § 172(f)(1)(B). The losses at issue here fall in the second category.

As we have noted, specified liability losses can be carried back for ten years. I.R.C. § 172(b)(1)(C). But, in addition to the election under section 172(b)(3) at issue here (relinquishing the entire carryback period), taxpayers may make another special election regarding the ten-year carryback: “Any taxpayer entitled to a 10-year carryback under subsection (b)(1)(C) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(C).” I.R.C. § 172(f)(6). That is, although specified liability losses are, by default, carried back 10 years, a taxpayer may opt to carry them back 2 years and forward 20, following the general rule for net operating losses.

Finally, specified liability losses are taken into account under section 172(b)(2) (sequencing the years to which a loss will be carried) according to a special rule. Section 172(f)(5) provides that “[f]or purposes of applying subsection (b)(2), a specified liability loss for any taxable year shall be treated as a separate net operating loss for such taxable year to be taken into account after the remaining portion of the net operating loss for such taxable year.”

### *III. Application to Apache’s Carrybacks*

The issue before us is whether, under section 172(b)(3), Apache may relinquish the carryback period for one portion of its net operating loss (the general portion, which has a two-year carryback period under section 172(b)(1)(A)), while retaining the carryback period for another portion of its net operating loss (the portion constituting a specified liability loss, which has a ten-year carryback period under section 172(b)(1)(C)). Based on the text, structure, and context of the statute, as well as caselaw, history, and the Government’s own prior position, we conclude that it may.

## A. *Multiple Carryback Periods*

### 1. *Statutory Text, Structure, and Context*

“As with any question of statutory interpretation, our analysis begins with the plain language of the statute.” *Jimenez v. Quarterman*, 555 U.S. 113, 118 (2009) (citing *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004)); see also *Universal Seismic Assocs., Inc. v. Harris Cnty. (In re Universal Seismic Assocs., Inc.)*, 288 F.3d 205, 207 (5th Cir. 2002) (“[I]n any case of statutory interpretation, we look to the plain language of the statute, reading it as a whole and mindful of the linguistic choices made by Congress.” (quoting *Whatley v. Resol. Tr. Corp.*, 32 F.3d 905, 909 (5th Cir. 1994))).

#### a. *Section 172(b)(3)*

As we have already noted, section 172(b)(3) provides, in relevant part, as follows: “Any taxpayer entitled to a carryback period under paragraph (1) may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year.” The text of the provision identifies first who may make an election—“Any taxpayer entitled to a carryback period under paragraph (1)” —and then what the election permits the taxpayer to do—“to relinquish the entire carryback period.” I.R.C. § 172(b)(3). It is constructed such that “the entire carryback period” refers back to “a carryback period under paragraph (1)” to which the taxpayer is entitled.

#### b. *Section 172(b)(1)*

We turn, therefore, to section 172(b)(1) to determine what carryback period or periods it provides to taxpayers. The Dictionary Act makes clear that “words importing the singular include and apply to several persons, parties, or things” unless context indicates otherwise. 1 U.S.C. § 1; see also *Niz-Chavez v. Garland*, 593 U.S. 155, 164–65 (2021) (“Suppose a statute made it a crime to vandalize ‘a’ bank. Under the Dictionary Act, someone who vandalizes five banks could not avoid prosecution on the ground that he vandalized more than one.”). Thus, the reference to “a carryback period” in section 172(b)(3) would be consistent with multiple carryback periods if section 172(b)(1) provides for such periods, which as we will see in a moment it does.

Section 172(b)(1) is titled “Years to which loss may be carried,” and it sets out carrybacks of varying lengths for different portions of a net operating loss. As we have discussed, under the general rule in section 172(b)(1) a net operating loss may be carried back for two years. I.R.C. § 172(b)(1)(A)(i) (providing that a net operating loss “shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss”). There is no carryback for a so-called REIT year. I.R.C. § 172(b)(1)(B)(i). In addition, the carryback is ten years for specified liability losses, I.R.C. § 172(b)(1)(C), variable for excess interest losses, I.R.C. § 172(b)(1)(D), three years for eligible losses, I.R.C. § 172(b)(1)(E), and five years for farming losses, I.R.C. § 172(b)(1)(F).

By our count, paragraph (1) of section 172(b) establishes at least six potential carrybacks of different lengths. The same taxpayer could be entitled to several of these in the same year. This fact strongly suggests that paragraph (1) establishes distinct “carryback periods”—i.e., multiple carryback periods—for purposes of the election in section 172(b)(3).

Of course, paragraph (1) refers to “carryback[s]” rather than “carryback periods” and the term “carryback period” is not defined by the Code. But the term’s ordinary meaning confirms that paragraph (1) establishes distinct carryback periods.

When the statute does not define a term, “we ask what that term’s ‘ordinary, contemporary, common meaning’ was when Congress enacted [the relevant provision].” *Food Mktg. Inst. v. Argus Leader Media*, 588 U.S. 427, 433–34 (2019) (quoting *Perrin v. United States*, 444 U.S. 37, 42 (1979)); see also *Dynamo Holdings Ltd. P’ship. v. Commissioner*, 150 T.C. 224, 234 (2018) (reviewed).

A period is a division of time. See *Period*, *Merriam Webster’s Collegiate Dictionary* (10th ed. 1993) (“a chronological division”); *Period*, *Black’s Law Dictionary* (6th ed. 1990) (“Any point, space, or division of time.”); *Period*, *The Random House Dictionary of the English Language* (2d ed. 1987) (“any specified division or portion of time”); *Period*, *The American Heritage Dictionary of the English Language* (1st ed. 1969) (“1. An interval of time characterized by the occurrence of certain conditions or events.”). And a carryback is a loss amount that can be deducted for prior years. See *Carry-back*,

*Black's Law Dictionary* (6th ed. 1990) (“A provision in the tax law which allows a taxpayer to apply a net operating loss in one year to the three immediately preceding tax years, beginning with the earliest year.”); *Carryback*, *The Random House Dictionary of the English Language* (2d ed. 1987) (“(in U.S. income-tax law) a special provision allowing part of a net operating loss or of an unused credit in a given year to be apportioned over one or two preceding years, chiefly in order to ease the tax burden”); *cf. Carryover*, *Merriam Webster's Collegiate Dictionary* (10th ed. 1993) (“something retained or carried over”); *Carryover*, *The American Heritage Dictionary of the English Language* (1st ed. 1969) (“1. A part or quantity, as of goods or commodities, left over or held for future use. 2. *Accounting*. A sum transferred to a new column, page, book, or account.”). A carryback period, then, is a division of time to which a loss amount can be carried back.<sup>6</sup>

Given this definition, the ordinary meaning of the term “carryback period” corresponds precisely with the content of section 172(b)(1). Each of the subparagraphs of section 172(b)(1) discussed above sets out a different division of time (whether two, three, five, or ten years) in which a loss amount may be carried back. Therefore, each of these divisions of time constitutes a distinct carryback period to which a taxpayer is “entitled . . . under paragraph (1)” within the meaning of section 172(b)(3).

c. *Section 172(f)(5)*

The structure of section 172—especially section 172(f)(5) and analogous provisions—supports this reading as well. A taxpayer has only one net operating loss for each year, and section 172(b)(2), which sequences the years to which a loss is carried, provides a rule that applies to “[t]he entire amount” of that net operating loss. For a portion of a net operating loss to be carried back separately under section 172(b)(2),

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<sup>6</sup> The meanings of these terms have not changed since the precursor to section 172(b)(3) was enacted. *See Period*, *Black's Law Dictionary* (5th ed. 1979); *Period*, *The Random House College Dictionary* (1980) (“any specified division or portion of time”); *Carry-back*, *Black's Law Dictionary* (5th ed. 1979) (“Provision in tax law which permits taxpayer to apply net operating loss in one year to recomputation of tax of several preceding taxable years.”); *Carryover*, *The Random House College Dictionary* (1980) (“that which is carried over, as to a later time, account, etc.”).

therefore, a special rule is required. Section 172(f)(5) provides that rule for specified liability losses: “For purposes of applying subsection (b)(2), a specified liability loss for any taxable year shall be treated as a *separate* net operating loss for such taxable year . . . .” (Emphasis added.) Analogous provisions exist for eligible losses and farming losses. I.R.C. § 172(b)(1)(E)(iv), (h)(2).

#### d. *Additional Context*

By contrast, no rule similar to that of section 172(f)(5) is required for section 172(b)(3), because the latter provision, together with section 172(b)(1), already contemplates multiple carryback periods working in tandem. Additionally, given that section 172(f)(5) and similar rules signal that portions of net operating losses are meant to be treated separately from the rest of the net operating loss—i.e., given that under those provisions and under section 172(b)(1) the losses are treated as separate losses and carried back for a different number of years—it is logical that those portions would have separate carryback periods as well.

This analysis suffices to conclude that a taxpayer may be entitled to multiple carryback periods under section 172(b)(1) and thus for purposes of section 172(b)(3).<sup>7</sup> But there is more.

### 2. *Judicial Interpretations of Section 172*

Perhaps unsurprisingly given the discussion above, two decisions from the courts of appeals, and one from this Court, confirm that section 172(b)(1) sets out different carryback periods for different types of losses. In *NextEra Energy, Inc. v. United States*, 893 F.3d 1353, 1356 (11th Cir. 2018), the U.S. Court of Appeals for the Eleventh Circuit wrote that “certain

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<sup>7</sup> *Plumb v. Commissioner*, 97 T.C. 632 (1991), supports this reading. In *Plumb*, we determined that a taxpayer could not relinquish the carryback period for his regular net operating loss while maintaining the carryback period for his alternative minimum tax net operating loss. To arrive at that conclusion, we reasoned that “[t]he statute deals with but a single carryback period of 3 years. An effective election under section 172(b)(3)(C) must of necessity relate to that carryback period, and would preclude any carryback whether it be the regular NOL or the alternative minimum tax NOL.” *Plumb*, 97 T.C. at 638. What we face here is not the single carryback period present in *Plumb*, but multiple carryback periods. Thus, the reasoning in *Plumb* favors the conclusion we reach.

types of net operating losses are allowed a longer carryback period.” Continuing, it noted that “[a]t all times relevant to this case, Section 172(f) of the tax code provided for one of the extended carryback periods. This section defined a ‘specified liability loss,’ which had a carryback period of ten years.” *Id.* (footnote omitted) (citing I.R.C. § 172(b)(1)(C), (f)).

The U.S. Court of Appeals for the Tenth Circuit likewise has pointed out that “[t]he tax code permits a longer carryback period for a special category of losses, so-called ‘specified liability losses.’” *Barrick Res. (USA) Inc. v. United States*, 529 F.3d 1252, 1254 (10th Cir. 2008). “Unlike ordinary net operating losses, [specified liability] losses have a ten-year carryback period.” *Id.* at 1258.

We ourselves have stated, in a case regarding bad debt losses under prior law, that different losses can have different carryback periods:

[G]enerally, the carryback period for a NOL is 3 years and the carryover period is 15 years.<sup>8</sup> Section 172(b)(1)(L) provides a special rule with respect to the bad debt losses of commercial banks: The portion of the NOL of a commercial bank that is attributable to bad debt losses is prescribed a carryback period of 10 years and carryover period of 5 years.

*Norwest Corp. v. Commissioner*, 111 T.C. 105, 164 (1998). Each of these decisions strongly supports the view that section 172(b)(1) sets out different carryback periods for different types of losses.

Of course, *NextEra Energy*, *Barrick Resources*, and *Norwest* did not address head-on the question of whether different carryback periods can be relinquished independently under section 172(b)(3). But they reflect the considered judgment of those courts as to how the text of section 172 operates; that is, they confirm that section 172(b)(1) sets out different carryback periods for different types of losses. And they therefore inform the proper interpretation of section 172(b)(3). We see no reason for ignoring or rejecting the views of two courts of appeals and our precedent in pursuit of some other interpretation.

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<sup>8</sup> These were the applicable periods before Congress amended the statute in 1997 to change the carryback period to 2 years and the carryover period to 20 years.

### 3. *Legislative History*

Finally, “[f]or those who consider legislative history relevant,” *Warger v. Shauers*, 574 U.S. 40, 48 (2014), this reading of the statute is supported by statements that were made in connection with the 1997 amendments to section 172. Those amendments (1) lengthened the default carryforward period from 15 years to 20 years, (2) shortened the default carryback period from 3 years to 2 years, and (3) nevertheless provided 3 years for certain portions of net operating losses related to casualty losses. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1082, 111 Stat. 788, 950.

The relevant congressional reports explained that the carryback provisions were intended to address typical business cycles, but that “allowing a two-year carryback of NOLs is sufficient to account for these business cycles,” in part because “certain deductions . . . are granted *special, longer carryback periods* under present law (which are retained by the bill.” S. Rep. No. 105-33, at 184 (1997), *reprinted in* 1997-4 C.B. (Vol. 2) 1067, 1264 (emphasis added). And it further explained: “The bill does not apply to NOLs arising from casualty losses of individual taxpayers.” *Id.*; see also H.R. Rep. No. 105-148, at 498–99 (1997), *as reprinted in* 1997 U.S.C.C.A.N. 678, 892–93 (providing similarly); Staff of J. Comm. on Tax’n, 105th Cong., General Explanation of Tax Legislation Enacted in 1997, JCS-23-97, at 268 (J. Comm. Print 1997) (“The Act does not apply to the carryback rules relating to REITs, specified liability losses, excess interest losses, and corporate capital losses.”); H.R. Rep. No. 105-220, at 585 (1997) (Conf. Rep.), *reprinted in* 1997-4 C.B. (Vol. 2) 1457, 2055 (“In addition, the Senate amendment preserves the 3-year carryback for NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas. . . . The conference agreement follows the Senate amendment.”).

These statements are consistent with the understanding that there can be different carryback periods for a year, that they operate independently of each other, and that taxpayers were expected to be able to continue to avail themselves of the special extended carryback periods in section 172(b)(1), even as the default shifted toward carryforwards.

## B. *Relinquishing Individual Carryback Periods*

Having concluded that section 172(b)(1) sets out distinct carryback periods for different kinds of losses, and thus that a taxpayer may be entitled to multiple carryback periods under section 172(b)(1) for the same year, we now explain why it follows that section 172(b)(3) permits the taxpayer to relinquish those carryback periods individually, as Apache did here.

### 1. *Text of Section 172(b)(3)*

Section 172(b)(3) allows a taxpayer to “relinquish the entire carryback period with respect to a net operating loss for any taxable year.” As discussed in Part III.A above, “the entire carryback period” refers to “a carryback period under paragraph (1)” to which the applicable taxpayer is entitled. I.R.C. § 172(b)(3); *see also MCR Oil Tools, L.L.C. v. U.S. Dep’t of Transp.*, 110 F.4th 677, 692 (5th Cir. 2024) (“‘The,’ by . . . contrast [to ‘a’], ‘indicat[es] that a following noun or noun equivalent is definite or has been previously specified by context.’” (quoting *Nielson v. Preap*, 586 U.S. 392, 408 (2019))). Thus, “the entire carryback period” that may be relinquished under section 172(b)(3) is the carryback period to which the taxpayer is entitled under section 172(b)(1).

When a taxpayer is entitled to multiple carryback periods under section 172(b)(1), section 172(b)(3) applies to each individual period, such that the taxpayer may elect to retain or relinquish the period independent of the others.<sup>9</sup> *See Niz-Chavez*, 593 U.S. at 164 (“[A] statute using the singular ‘a’ can apply to multiple persons, parties, or things.”); *Commissioner v. Kelley*, 293 F.2d 904, 912 (5th Cir. 1961) (“The

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<sup>9</sup> An interpretation requiring collective relinquishment would make little sense. Consider the following example of a rule with similar wording:

Any employee entitled to a day of sick leave under paragraph (1) may elect to donate the entire day of sick leave with respect to any employment year to another employee.

There is no reason to read this rule to require an employee to donate either all of his or her days of sick leave together or none at all. Rather, the best reading of the text is that the employee may decide to donate each day individually, so that the employee can donate no sick leave or one or more days of sick leave at his or her option. But the employee may not donate just some hours of leave from a particular day.

indefinite article ‘a’ says in plain language that there may be two or more substantial parts.”), *aff’g* 32 T.C. 135 (1959).

Reading section 172(b)(3) as providing a taxpayer with an all or nothing election—relinquish each and every one of the periods set out in section 172(b)(1) or be stuck with all of them—makes little sense given the number of different carryback periods set out in section 172(b)(1). It also makes little sense in view of Congress’s going out of its way to give taxpayers additional choices when it comes to specified liability losses, *see* I.R.C. § 172(f)(6), eligible losses, *see* I.R.C. § 172(b)(1)(E)(iv), and farming losses, *see* I.R.C. § 172(h)(2).<sup>10</sup> The Government itself recognized as much when interpreting a prior version of the statute.

## 2. *The Government’s Own Interpretation*

The Secretary read paragraphs (1) and (3) of section 172(b) to permit an election with respect to losses with one carryback period and not others when promulgating Treasury Regulation § 1.172-13. That regulation was promulgated before Congress adopted the 1990 amendments to section 172. *See United Dominion*, 532 U.S. at 829 n.6 (discussing amendments). The regulation was finalized in 1986. T.D. 8096, 1986-2 C.B. 39, 51 Fed. Reg. 30,481 (Aug. 27, 1986). It addresses product liability losses, a category that was later made part of a taxpayer’s specified liability loss by section 172(f)(1)(A). *See United Dominion*, 532 U.S. at 829 n.6. With respect to the section 172(b)(3) election (which, in 1986, was housed in section 172(b)(3)(C)), the regulation provides:

If a taxpayer sustains during the taxable year both a net operating loss not attributable to product liability and a product liability loss . . . , an election pursuant to section 172(b)(3)(C) (relating to election to relinquish the entire carryback period) does not preclude the product liability loss from being carried back 10 years . . . .

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<sup>10</sup> The Court’s reasoning in *Plumb* also cuts in favor of Apache here. In *Plumb*, 97 T.C. at 638, only one carryback period existed for the taxpayer to relinquish, and thus his election relinquished the whole carryback period for both regular taxes and the alternative minimum tax. But nothing in the Court’s reasoning in *Plumb* requires that only one carryback period can exist, or that the text of section 172(b)(3) requires that all carryback periods be relinquished together. Instead, *Plumb* is perfectly consistent with the possibility of multiple carryback periods and elections with respect to each.

Treas. Reg. § 1.172-13(c)(4).<sup>11</sup> That regulation has not been rescinded. If Apache had claimed a specified liability loss under section 172(f)(1)(A) instead of section 172(f)(1)(B), the Commissioner would be bound to permit Apache's carryback.

Moreover, there is no meaningful principle by which to justify treating product liability losses under section 172(f)(1)(A) differently, for purposes of the carryback period election, from other specified liability losses under section 172(f)(1)(B). Congress joined both categories together in 1990, and their carryback periods are provided by the same subparagraph of section 172(b)(1). "Thus, in all relevant respects, the provisions on PLLs and SLLs are the same." *United Dominion*, 532 U.S. at 829 n.6 (cleaned up).

### 3. *Additional Considerations*

In addition, courts assume that Congress was aware of the product liability loss regulation when it adopted the specified liability loss concept in 1990. See *Bragdon v. Abbott*, 524 U.S. 624, 645 (1998); see also Antonin Scalia & Brian A. Garner, *Reading Law: The Interpretation of Legal Texts* 322–26 (2012) (discussing the prior-construction canon). As we have already

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<sup>11</sup>The regulation was adopted in response to a comment that posed precisely the question now before the Court: "If a taxpayer has both a net operating loss carryback and a product liability loss carryback, and elects to forego the carryback of the net operating loss pursuant to section 172(b)(3)(C), the question is whether the product liability loss can still be carried back ten years under section 172(b)(1)(I)." Pet'r's Mot. for Partial Summ. J. Ex. B (Doc. 36) (Letter from R. Brown, Peat, Marwick, Mitchell & Co. to the Internal Revenue Service (Aug. 12, 1983)). The commenter answered the question in the affirmative. See *id.* ("We believe the answer should be yes.").

The Treasury Department and the IRS agreed:

Another commentator suggested that the final regulations be clarified with respect to the interaction of the election under section 172(b)(3)(C) (relating to election to relinquish the entire carryback period) and the election under section 172(j)(3) (relating to election to forgo 10-year product liability loss carryback period). The final regulations are clarified by providing in § 1.172-13(c)(4) that the election pursuant to section 172(b)(3)(C) does not preclude a product liability loss from being carried back 10 years.

Preamble, T.D. 8096, 1986-2 C.B. at 39, 51 Fed. Reg. at 30,481. The "election under section 172(j)(3)" referenced in the preamble was similar to the election now provided by section 172(f)(6), discussed above.

noted, the regulation applicable to product liability losses was finalized in 1986. Four years later, Congress folded product liability losses into specified liability losses, expanding the category of losses eligible for the ten-year carryback period. While the presence of the regulation may not be sufficient to invoke a strong form of the prior-construction or ratification canon, it certainly appears that, when Congress amended section 172, it made no effort to reject the administrative interpretation of the text that became section 172(b)(3).

Nor are we aware of any policy reason indicating that Congress wished to tie the hands of taxpayers who had multiple carryback periods under section 172(b)(1). By adopting the predecessor of section 172(b)(3) in the first instance, Congress demonstrated that it was sensitive to taxpayers facing a retroactive loss of favorable tax attributes because of future losses and wished to ameliorate their position. The Commissioner offers no valid reason why Congress would be stingy in its solution and make the election all or nothing, regardless of how many carryback periods a taxpayer had under section 172(b)(1).

As far as we can tell, the best the Commissioner can come up with is a claim of administrative inconvenience. In the Commissioner's telling, it would be challenging to track which carryback periods a taxpayer has relinquished and which it has retained. The argument does not persuade. Section 172(b)(1) is clear in the carryback periods it establishes. And a taxpayer who wishes to relinquish one or more specific periods must do so clearly (for example, by expressly cross-referencing the subparagraph under section 172(b)(1) that it wishes to relinquish). If the taxpayer makes no specific reference to one or more specific carryback periods in its election, the Commissioner would be entitled to treat the election as applying to all of the carryback periods to which the taxpayer is otherwise entitled.

In any event, the Commissioner already needs to track separately whether a taxpayer has retained its original carryback period for specified liability losses or has given that period up in favor of the general carryback rule. Continuing to track similar choices under section 172(b)(3) would not appear to present any undue administrative hardship.

### C. Application

In view of the foregoing, we conclude that Apache was permitted to elect to relinquish the two-year carryback period for its standard net operating loss without waiving the ten-year carryback for its specified liability loss. Accordingly, the relief it seeks in its Motion must be granted.

### IV. Tiebreaking Principle

To our mind, the foregoing analysis compels us to grant Apache's Motion. Even if the interpretative question before us is viewed as a close call, however, longstanding precedent would instruct us to construe the relevant provisions against the Commissioner. *See, e.g., Gould v. Gould*, 245 U.S. 151, 153 (1917) ("In case of doubt [statutes levying taxes] are construed most strongly against the government, and in favor of the citizen."); *United States v. Merriam*, 263 U.S. 179, 187–88 (1923) (applying the principle set out in *Gould* and noting with approval that under English law "if the crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be" (quoting *Partington v. Att'y Gen.*, L.R. 4 H.L. 100, 122 (1869))); *see also, e.g., Security Bank Minn. v. Commissioner*, 994 F.2d 432, 436 (8th Cir. 1993) (interpreting complex inter-related statutory provisions and observing that "when there is a reasonable doubt about the meaning of a revenue statute, the doubt is resolved in favor of those taxed"), *aff'g* 98 T.C. 33 (1992); *Leavell v. Blades*, 141 S.W. 893, 894 (Mo. 1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it").

At least one current member of the Supreme Court has applied this principle to the very statutory provision now before the Court. *See United Dominion*, 532 U.S. at 839 (Thomas, J., concurring) ("At a bare minimum, in cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter."). To the extent this case presents a close question of interpretation, section 172 should be construed in favor of Apache.

### V. A Brief Response to the Dissent

The opinion concurring in part and dissenting in part (for convenience, dissent) appears to premise its conclusion in significant part on the fact that “[i]n 1976, when Congress enacted the carryback waiver rule that now appears in section 173(b)(3), an election under that rule was necessarily an all-or-nothing matter.” See Halpern dissenting op. p. 233. And, in the dissent’s view, “Congress has given no indication that the rule that started out all-or-nothing has not remained all-or-nothing.” See Halpern dissenting op. p. 233.

We do not share the dissent’s view of how the statute as it existed in 1976 worked. But, in any event, as the Supreme Court has said, “[t]he starting point in discerning congressional intent is the existing statutory text, . . . and not the predecessor statutes.” *Lamie*, 540 U.S. at 534 (emphasis added). We recently recognized the same point, see *United Therapeutics Corp. v. Commissioner*, 160 T.C. 491, 507 (2023) (noting that predecessor statutes may not be used to create ambiguity), and were affirmed by the U.S. Court of Appeals for the Fourth Circuit, *United Therapeutics Corp. v. Commissioner*, 105 F.4th 183, 189 (4th Cir. 2024) (“Predecessor statutes, in other words, may not be used to manufacture ambiguity.”).

The years before us in this case are 2016 and 2017. The relevant provisions—section 172(b)(1), (2), and (3), as well as section 172(f)—were all amended after 1976 and before 2016, including a full reenactment of section 172(b) and (f) in 1990. Omnibus Budget Reconciliation Act of 1990 § 11811, 104 Stat. at 1388–530. Thus, while the text of the statute in 1976 offers historical context, it is not our focus. And, as we have explained, our own Court, courts of appeals, congressional committees, and even the Government itself have read the post-1976 statutory provisions as we do.

The dissent also misreads section 172(f)(6). As we have explained, exemplifying Congress’s solicitude for taxpayers who experience specified liability losses, that provision gives such taxpayers the choice to elect to waive the ten-year carryback under section 172(b)(1)(C). But the election does not eliminate the other carryback periods listed in section 172(b)(1) that might be available to those taxpayers. And whatever inference might arise from the text of section 172(f)(6) does not suffice to overcome the other textual indicators we have

discussed, especially when, as the dissent seems to acknowledge, the reference to “any loss year” included there served largely as an effective date provision. See Revenue Act of 1978, Pub. L. No. 95-600, § 371(a)(1), 92 Stat. 2763, 2859 (defining the term “loss year” as “a taxable year beginning after September 30, 1979”).

## VI. Conclusion

Section 172(b)(1)(C) provides a separate carryback period for specified liability losses. And section 172(b)(3) permits a taxpayer to relinquish “a carryback period” to which it is entitled, without specifying that all carryback periods for a given year must be relinquished together. Apache therefore was able to relinquish its normal net operating loss carryback period while retaining the ten-year carryback period for its specified liability loss. We will therefore grant Apache’s Motion and deny the Commissioner’s.

To reflect the foregoing,

*An appropriate order will be issued.*

Reviewed by the Court.

URDA, *C.J.*, and KERRIGAN, NEGA, PUGH, ASHFORD, COPELAND, JONES, GREAVES, WEILER, WAY, LANDY, ARBEIT, GUIDER, JENKINS, and FUNG, *JJ.*, agree with this opinion of the Court and BUCH, *J.*, agrees with Part IV.

MARSHALL and HALPERN, *JJ.*, concur in part and dissent in part.

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BUCH, *J.*, concurring: We are confronted with a question of statutory interpretation with no clear answer. Congress wrote that a taxpayer “may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year.” I.R.C. § 172(b)(3). And we are attempting to determine what Congress meant by its use of the indefinite article “a.” Did it choose to refer to “a net operating loss” because there is only one net operating loss? If so, why did Congress choose an indefinite article instead of the definite article “the?” Or did it choose to refer to “a net operating loss” because the

election to relinquish the carryback is made separately with respect to any one of several subtypes of net operating losses? The opinion of the Court and the dissent do an admirable job of wading through the evolution of the statute, the legislative history (for those who consider it to be relevant), and the various semantic canons. And their conflicting answers are equally plausible.

Where there is doubt as to the meaning of a taxing statute, we have over a century of precedent that tells us how to resolve that doubt: Taxing statutes are to be construed against the sovereign. Before there was an income tax, courts were called upon to decide the scope of tariffs. When effective dates were unclear, they were resolved against the government. *See, e.g., United States v. Wigglesworth*, 28 F. Cas. 595, 597 (C.C.D. Mass. 1842) (No. 16,690) (“In every case, therefore, of doubt, such statutes are construed most strongly against the government, and in favor of the subjects or citizens, because burdens are not to be imposed, nor presumed to be imposed, beyond what the statutes expressly and clearly import.”) When it was unclear whether a particular product fell within the definition of goods subject to a higher or lower tariff, that doubt was resolved in favor of the importer. *See, e.g., Am. Net & Twine Co. v. Worthington*, 141 U.S. 468, 474 (1891) (“[W]e should still feel obliged to resolve that doubt in favor of the importer, since the intention of congress to impose a higher duty should be expressed in clear and unambiguous language.”). When income taxes came into effect, this principle remained the same when deciding what fell within the definition of income. *See, e.g., Gould v. Gould*, 245 U.S. 151, 153 (1917) (“In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen.”).

The opinion of the Court and the dissent offer equally plausible interpretations. “At a bare minimum, in cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter.” *United Dominion*

*Indus., Inc. v. United States*, 532 U.S. 822, 839 (2001) (Thomas, J., concurring). For that reason, I join Part IV of the opinion of the Court.

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HALPERN, *J.*, with whom MARSHALL, *J.*, joins, concurring in part and dissenting in part: I agree with the majority that the Commissioner's Motion for Partial Summary Judgment should be denied. The Commissioner seeks a ruling that Apache relinquished the carryback of its *entire* net operating loss (NOL) for each of 2016 and 2017. The election statements included with Apache's returns for those years, however, show that Apache intended to relinquish the carryback of only *part* of its NOL for each year. Those statements cannot have effected valid elections to relinquish the carryback of Apache's NOLs altogether. They were either valid elections to relinquish only part of Apache's NOL for each year—as Apache intended and the majority holds—or they were invalid because Apache manifestly attempted to make elections the law does not allow. *See Plumb v. Commissioner*, 97 T.C. 632, 640 (1991) (“[A] taxpayer who attempts to make an election that is not legally available to him will be treated as having made no election . . . .”); *see also GWA, LLC v. Commissioner*, T.C. Memo. 2025-34 (following *Plumb*). Either way, the Commissioner's Motion should be denied.

I disagree, however, with the majority's disposition of Apache's Motion for Partial Summary Judgment. *That* Motion seeks a ruling that Apache validly elected to relinquish the carryback of only part of its NOL for each of 2016 and 2017. The election allowed by section 172(b)(3), as I read that provision, necessarily relinquishes the carryback of the electing taxpayer's entire NOL. Section 172(b)(3) provides: “Any taxpayer entitled to a carryback period under [section 172(b)(1)] may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year.” Because any NOL has only one carryback period, an election under section 172(b)(3) necessarily relinquishes the carryback of the taxpayer's entire NOL. Even if I were persuaded that a single NOL could have multiple carryback periods, I would still read section 172(b)(3) to say that a taxpayer entitled

to one or more carryback periods can elect to relinquish the carryback period or periods to which the taxpayer is entitled. Because Apache attempted to make an election legally unavailable to it, its election was invalid. Apache's Motion should also be denied.

*I. An NOL Has Only One Carryback Period.*

In 1976, when Congress enacted the carryback waiver rule that now appears in section 172(b)(3), an election under that rule was necessarily an all-or-nothing matter. As Apache acknowledges, at that time "a single taxpayer was not entitled to more than one carryback period with respect to any one NOL." Different taxpayers could carry their losses back for different periods, but any given taxpayer's NOL had to be carried back a specified number of years.<sup>1</sup> That explains Congress's repeated use of the singular term "carryback period" in the text of the waiver rule. Under the rule as initially enacted, a taxpayer who elected to waive its carryback relinquished the carryback of its *entire* NOL. While some aspects of the law have changed since 1976, Congress has given no indication that the rule that started out all-or-nothing has not remained all-or-nothing.

The possibility that portions of a single NOL could be carried back to different years arose for the first time with the Revenue Act of 1978 (1978 Act), Pub. L. No. 95-600, 92 Stat. 2763. As part of that legislation, Congress provided special rules for losses attributable to product liability claims. As amended by the 1978 Act, section 172 allowed "product liability losses" (PLLs) to be carried back ten years rather than the usual three.<sup>2</sup>

Once different portions of a single NOL could be carried back to different years, did that NOL have different *carryback periods*? Certainly, Congress did not say so explicitly. In fact, the predecessor to section 172(f)(6), enacted in 1978, indicates that, after 1978, a single NOL continued to

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<sup>1</sup> The majority does "not share" my view (and Apache's) "of how the statute as it existed in 1976 worked." Op. Ct. p. 229. But the majority offers no explanation of how its view differs from mine and Apache's.

<sup>2</sup> As the majority observes, in 1997 Congress revised the default rule so that portions of an NOL not covered by a special rule could be carried back only two years.

have just one carryback period—even if different portions of that NOL could be carried back to different years.<sup>3</sup>

When Congress enacted the PLL rules, it allowed a taxpayer with a PLL to waive the special ten-year carryback. Section 172(i)(3), as enacted in 1978, provided: “Any taxpayer entitled to a 10-year carryback under subsection (b)(1)(H) from any loss year may elect to have the carryback period *with respect to such loss year* determined without regard to subsection (b)(1)(H).” 1978 Act § 371(b), 92 Stat. at 2859 (emphasis added). (Section 172(b)(1)(H), the predecessor of section 172(b)(1)(C), defined the term “loss year” to mean “a taxable year beginning after September 30, 1979.” 1978 Act § 371(a), 92 Stat. at 2859. For present purposes, all these years later, we can treat “loss year” as synonymous with “taxable year.”) Section 172(f)(6), as in effect for the years in issue, provides the same waiver rule for taxpayers like Apache with a specified liability loss (SLL), allowing them to elect to “have the carryback period [for the] loss year determined without regard to [section 172(b)(1)(C)].” If a taxpayer with a PLL that was part of a larger NOL had *two* carryback periods (a ten-year period applicable to the PLL and a three-year period applicable to the rest of the NOL), Congress would have allowed the taxpayer to elect to have the carryback period *with respect to the PLL* determined without regard to the ten-year carryback rule. But that is not what section 172(i)(3) said (or what section 172(f)(6) says). Instead, a taxpayer with a PLL or an SLL that was part of a larger NOL could elect to have *the* carryback period *with respect to the taxable year* determined without regard to the ten-year carryback rule that would otherwise apply to the PLL or the SLL. That shows that, even after 1978, a taxpayer that incurred an NOL for a taxable year had just one carryback period for the year, and thus only one carryback period for the NOL it incurred for the year.

If a single NOL had just one carryback period even after 1978, as indicated by section 172(f)(6) and its predecessor, that would explain why Congress left the text of the carryback waiver rule unchanged in 1978. The 1978 Act redesignated the carryback waiver provision (moving it from section

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<sup>3</sup> The majority claims that I have “misread[] section 172(f)(6),” Op. Ct. p. 229, but (again) offers no explanation of why, in its view, my reading of the provision is incorrect.

172(b)(3)(E) to section 172(b)(3)(C)) but left its text unchanged. 1978 Act § 703(p)(1)(B), 92 Stat. at 2943. It continued to allow a taxpayer entitled to a *carryback period* (singular) to relinquish *the carryback period* to which the taxpayer was entitled.

Even leaving aside the clear implication of section 172(i)(3), as enacted in 1978, Congress's failure to revise the carryback waiver rule further supports the notion that Congress did not intend to allow a taxpayer with a PLL that was part of a larger NOL to carry the PLL back ten years while electing to forgo the carryback of the rest of its NOL. If Congress had intended to allow an election to that effect, applicable to only *part* of the taxpayer's NOL, I would have expected Congress to make that intention explicit by revising the text of the carryback waiver rule.<sup>4</sup>

This Court relied on similar reasoning in *Plumb*. In that case, we addressed a purported election by taxpayers to forgo the carryback of their regular tax NOL but not their alternative minimum tax (AMT) NOL. We concluded that the law did not allow a "split" election to that effect. "Had Congress intended to make available two elections, with such potentially disparate results," we reasoned, "one would certainly have expected that it would have explicitly so stated in the [Tax Equity and Fiscal Responsibility Act of 1982], which for the first time permitted carrybacks and carryovers of alternative minimum tax NOLs." *Id.* at 638–39. We thus held that, "[i]n the absence of any such clear expression of legislative intention in so complex a field, . . . there is but a single election [to forgo the carryback of an NOL], and that an effective election . . . must be applicable to both the regular NOL and the alternative minimum tax NOL." *Id.* at 639.

The same can be said about PLLs under the 1978 Act and about SLLs under the law in effect for the years before us. In *Plumb*, we reasoned that, if Congress had intended, after it

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<sup>4</sup> My analysis, unlike the argument the Supreme Court rejected in *Lamie v. United States Trustee*, 540 U.S. 526 (2004), does not seek to create ambiguity by comparing an existing statutory text to a predecessor. In *Lamie*, 540 U.S. at 530, the existing statutory text reflected a "substantive alteration" of the predecessor statute. By contrast, Congress has made no substantive alteration to the carryback waiver rule since its enactment in 1976. The *Lamie* Court also acknowledged that it would be "fair to doubt" that Congress would effect a significant change in the law without announcing it. *Id.* at 539.

became possible to carry AMT NOLs to other years, to allow a taxpayer to make a split election under the predecessor of section 172(b)(3) that applied to a taxpayer's regular tax NOL but not its AMT NOL, Congress would have said so explicitly. Similarly, if Congress had intended, after 1978, that an NOL that included a PLL have two carryback periods and that the taxpayer could elect to forgo the carryback of the non-PLL portion of its NOL without affecting the carryback of its PLL, again, Congress would have said so.

Curiously, the majority claims support from *Plumb* for its position that "a taxpayer may be entitled to multiple carryback periods." Op. Ct. p. 221. In *Plumb*, we accepted that the taxpayers had a single carryback period for both their regular tax NOL and their AMT NOL because each amount could be carried back three years. On the premise that "[w]hat we face here is not the single carryback period present in *Plumb*, but multiple carryback periods," the majority concludes that "the reasoning in *Plumb* favors" its position that an NOL can have multiple carryback periods. Op. Ct. note 7.

The majority assumes the point in issue with its premise that, in this case, we face "multiple carryback periods." At most, the majority offers grounds to distinguish *Plumb*. In the absence of any election in *Plumb*, the taxpayers' regular tax NOL and their AMT NOL would both have carried back three years. In the absence of any election by Apache, its SLLs would have carried back ten years and the rest of its NOLs would have carried back two years. But that distinction does not undermine the lesson I draw from *Plumb*: If Congress intended that changes to other provisions would significantly affect the consequences of an election under section 172(b)(3) or its predecessor—allowing split elections of a type not previously allowable—it is reasonable to suppose that Congress would have made its intention explicit. Again, Congress did not explicitly state that its 1978 amendments to section 172 created the possibility that a single NOL could have more than one carryback period. Indeed, it indicated in the predecessor to section 172(f)(6) that a taxpayer still had just one carryback for a taxable year and thus just one carryback period for any NOL it incurred for that year.<sup>5</sup>

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<sup>5</sup> In any event, the prospect that *Plumb* might be distinguishable does not mean that it *supports* the majority's position. The majority's treatment of

Just as I am not persuaded that *Plumb* affirmatively supports the proposition that, after 1978, a single NOL could have multiple carryback periods, I am also unpersuaded by the majority's other arguments for that proposition.

The majority reasons that section 172(b)(1)'s mandate that different portions of an NOL be carried to different years "strongly suggests" that that provision "establishes distinct 'carryback periods.'" Op. Ct. p. 219. As the majority acknowledges, however, "the term 'carryback period' is not defined by the Code." Op. Ct. p. 219. So the majority purports to look to the term's "ordinary meaning." Op. Ct. p. 219

The term "carryback period," however, *has* no ordinary meaning. It is a specialized term in the tax law.<sup>6</sup> The majority conjures a purported ordinary definition of carryback period by consulting four dictionaries. Not surprisingly, none defines "carryback period." The majority's proposed definition—"a division of time to which a loss amount can be carried back," op. Ct. p. 220—does not appear in any of the dictionaries the majority cites. But the majority *does* find separate definitions of "carryback" and "period." A "period," *Black's Law Dictionary* tells us, is a "division of time." *Period*, *Black's Law Dictionary* (6th ed. 1990). *Black's* also provides a definition of "carryback." So does *The Random House Dictionary of the English Language*. Neither of those dictionaries, however, gives us an "ordinary" meaning of "carryback." Each identifies the term as a tax law term.<sup>7</sup> And the definition each dictionary provides for "carryback" does not accurately reflect the tax law in effect when the dictionary was published.

*Black's* defines "carryback" as "[a] provision in the tax law which allows a taxpayer to apply a net operating loss in one year to the three immediately preceding tax years, beginning with the earliest year." *Carry-back*, *Black's Law Dictionary* (6th ed. 1990). By 1990, of course, different portions of a single NOL could be carried back different numbers of years.

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*Plumb* is one of several instances in which the majority views any authority not contrary to its position as affirmatively supporting its position.

<sup>6</sup> I find it difficult to imagine passersby on the street or shoppers at market conversing about "carryback periods."

<sup>7</sup> Thus, in the majority's tautological reasoning, the tax law looks to the "ordinary" meaning of "carryback period," and the ordinary meaning looks to the tax law.

The general three-year carryback rule was not uniform. So *Black's* description of the "provision in the tax law" by which it defines "carryback" did not accurately describe that provision. But we can forgive *Black's*—a general reference source—for its imprecision in defining a specialized tax law term. More to the point, *Black's* definition of "carryback" refers to the application of "a net operating loss" to offset income of prior years. It makes no reference to loss *amounts*. *Black's* definition of "carryback" thus supports the proposition that a single NOL has just one carryback period.

Random House defines "carryback" as "a special provision [in U.S. income-tax law] allowing part of a net operating loss or of an unused credit in a given year to be apportioned over one or two preceding years." *Carryback, The Random House Dictionary of the English Language* (2d ed. 1987). The Random House definition thus applies to net operating losses and credits—even though separate carryback rules applied to each. And the general carryback rule for losses in 1987 required a loss to be carried back to the *third* preceding year—not just the first or second preceding year. The Random House definition of "carryback," like *Black's*, makes no mention of "loss amounts." It *does* refer to the apportionment of parts of a loss or credit among prior years. I take that to refer to the ability to carry a loss or credit from earlier carryback years to more recent years when the taxpayer's income or tax liability for the earlier year is not sufficient to absorb the loss or credit. The reference to the apportionment of parts of a loss or credit among different years does not, to my mind, establish that a net operating loss had more than one carryback period. More generally, I would not view Random House as a reliable source for answering that question.

Next, the majority claims that "[t]he structure of section 172—especially section 172(f)(5) and analogous provisions" supports its reading of section 172(b)(1) as creating separate carryback periods. Op. Ct. p. 220. Section 172(f)(5) provides special treatment of SLLs under section 172(b)(2). Section 172(b)(2) requires the entire amount of an NOL to be carried to the earliest year to which the loss can be carried. If that rule were applied without modification to a taxpayer with an NOL that consisted in part of an SLL, the rule could be read to require the taxpayer to carry its entire NOL back to

the tenth preceding year—the earliest of the years to which (a portion of) the loss could have been carried under section 172(b). To foreclose that possibility, section 172(f)(5) provides that, “[f]or purposes of applying subsection (b)(2), a specified liability loss for any taxable year shall be treated as a separate net operating loss for such taxable year to be taken into account after the remaining portion of the net operating loss for such taxable year.”<sup>8</sup> Thus, a taxpayer with an NOL that consists, in part, of an SLL first carries the rest of its NOL back the appropriate number of years (generally two) and then carries its SLL back ten years.

The majority reasons that “no rule similar to that of section 172(f)(5) is required for section 172(b)(3), because the latter provision, together with section 172(b)(1), already contemplates multiple carryback periods working in tandem.” Op. Ct. p. 221. Again, the majority assumes the point in issue. *If* the different years to which portions of a loss can be carried back under section 172(b)(1) define different carryback periods, then it would be unnecessary to treat those portions of an NOL as separate NOLs for purposes of section 172(b)(3). But it would *also* be unnecessary to treat different portions of an NOL as separate NOLs for purposes of section 172(b)(3) if the NOL had just one carryback period and Congress intended an election under section 172(b)(3) to apply to the entire NOL. In other words, the absence of a “rule similar to that of section 172(f)(5) . . . for section 172(b)(3)” does not favor the majority’s position over my position. That section 172(f)(5) treats an SLL as a separate NOL only for purposes of section 172(b)(2) and not also for purposes of section 172(b)(3) is equally compatible with either position. It cannot be read to favor one position over the other. Once again, the majority claims affirmative *support* from an authority simply because that authority does not *refute* its position. By that reasoning, I could claim that section 172(f)(5) and the analogous provisions dealing with eligible losses and farming losses support the position that an NOL has only one carryback period so that an election under section 172(b)(3) necessarily relinquishes the carryback of the taxpayer’s entire NOL.

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<sup>8</sup> As the majority notes, analogous rules apply when an NOL includes other amounts subject to special carryback rules. See § 172(b)(1)(E)(iv) (regarding “eligible loss[es]”), (h)(2) (regarding “farming losses”).

The majority also relies on three opinions in which this Court and two appellate courts described portions of NOLs that could be carried back longer than the usual number of years as having their own carryback periods. As the majority acknowledges, however, none of those opinions “address[ed] head-on the question of whether different carryback periods can be relinquished independently under section 172(b)(3).” Op. Ct. p. 222. Nothing turned on whether the NOLs of the taxpayers in those cases had just one carryback period or more than one. The majority views those opinions as “reflect[ing] the considered judgment of those courts as to how the text of section 172 operates.” Op. Ct. p. 222. I agree that each opinion (in its entirety) reflects the court’s considered judgment *on the issue before it* (which, in each case, involved the operation of section 172). But I doubt that the particular statements the majority singles out reflected the court’s “considered judgment” on whether an NOL could have more than one carryback period. In none of the three cases was that question before the court. As the author of *Norwest Corp. v. Commissioner*, 111 T.C. 105, 164 (1998), I can say that, when I wrote that “[t]he portion of the NOL of a commercial bank that is attributable to bad debt losses is prescribed a carryback period of 10 years,” I did not focus on the number of carryback periods a single NOL could have. *Norwest* addressed how a consolidated group of corporations computed the portion of its consolidated NOL attributable to bad debt losses. Whether that portion of the NOL had its own carryback period or instead extended the NOL’s single carryback period was unimportant to the resolution of the computational issue *Norwest* presented.

Finally, the majority claims that its “reading of the statute is supported by statements that were made in connection with . . . 1997 amendments to section 172.”<sup>9</sup> Op. Ct. p. 223. Under the 1997 amendments, the portion of an NOL covered by the default carryback rule could be carried back only two years instead of the previous three. (The amendments also extended the *carryforward* period from 15 to 20 years.) The amendments, however, preserved the special carryback rules

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<sup>9</sup> Curiously, while claiming “support[.]” from the 1997 legislative history, the majority simultaneously suggests that it addresses the legislative history only as an accommodation “[f]or those who consider legislative history relevant.” Op. Ct. p. 223.

that allowed portions of an NOL to be carried back further than the default rule would allow.

The 1997 amendments had no bearing on the question of whether an NOL could have only one carryback period or more than one. Therefore, it is not surprising that most of the statements quoted by the majority do not favor its multiple carryback period theory over the single carryback period theory. For example, the House Ways and Means Committee report states that “the bill does not apply to NOLs arising from casualty losses of individual taxpayers.” H.R. Rep. No. 105-148, at 499 (1997), *as reprinted in* 1997 U.S.C.C.A.N. 678, 893. The report of the Senate Finance Committee includes the same statement. S. Rep. No. 105-33, at 184 (1997), *reprinted in* 1997-4 C.B. (Vol. 2) 1067, 1264. The Conference Report describes the Senate amendment, which the conference agreement followed, as “preserv[ing] the 3-year carryback for NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas.” H.R. Rep. No. 105-220, at 585 (1997) (Conf. Rep.), *reprinted in* 1997-4 C.B. (Vol. 2) 1467, 2055. And the General Explanation prepared by the Staff of the Joint Committee on Taxation states: “The Act does not apply to the carryback rules relating to REITs, specified liability losses, excess interest losses, and corporate capital losses.” Staff of J. Comm. on Tax’n, 105th Cong., General Explanation of Tax Legislation Enacted in 1997 (1997 Bluebook), JCS-23-97, at 268 (J. Comm. Print 1997). I fail to see how those statements “support[.]” the majority’s “reading of the statute.” That the 1997 amendments did not affect the carryback of amounts subject to special rules does not establish that those amounts had their own carryback periods.

The only statement the majority quotes that *could* support its reading of the statute is one by the Senate Finance Committee. The committee expressed the belief that “a two-year carryback of NOLs [would be] sufficient to account for [natural] business cycles.” S. Rep. No. 105-33, at 184, 1997-4 C.B. (Vol. 2) at 1264. In support of that belief, the committee noted that “many deductions allowed for tax purposes relate to future, rather than past, income streams and . . . certain deductions that do not relate to past income streams are granted special, longer *carryback periods* under

present law (which are retained by the bill).” *Id.* (emphasis added). I view the committee’s reference to “special, longer carryback periods” as akin to the dicta in the three cases the majority cites. The point the committee was making was that SLLs and similar amounts could continue to be carried back longer than the default rule would allow. Whether the additional years to which those amounts could be carried back defined separate “carryback periods” was not central to the committee’s justification for the amendments.<sup>10</sup>

To review, the majority’s position that an NOL can have multiple carryback periods if portions of that NOL can be carried back to different taxable years rests on (1) a purported “ordinary” meaning of “carryback period” not found in the sources on which the majority relies, (2) provisions of section 172 (that is, section 172(f)(5) and the analogous provisions for eligible losses and farming losses) that do not favor the majority’s multiple carryback period theory over the alternative proposition that a single NOL has only one carryback period, (3) dicta from prior opinions of this Court and two appellate courts, and (4) a statement in a 1997 report by the Senate Finance Committee that should be viewed as akin to dicta.

On the other side of the ledger, in support of the proposition that a single NOL continued to have just one carryback period even after it became possible for different portions of that NOL to be carried back to different years, we have (1) the clear implication of section 172(f)(6) and its predecessor, which the majority summarily dismisses,<sup>11</sup> and (2) the absence of any indication that the carryback waiver rule now provided in section 172(b)(3), which necessarily started out as an all-or-nothing rule, has not remained all-or-nothing, requiring the waiver of the carryback of the electing taxpayer’s entire

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<sup>10</sup> For similar reasons, I would not read much into the statement, included in each of the sources cited by the majority, that “[a] taxpayer may elect to forgo the carryback of *an NOL*” (rather than *all or part* of an NOL). H.R. Rep. No. 105-148, at 498, 1997 U.S.C.C.A.N. at 892 (emphasis added); S. Rep. No. 105-33, at 183, 1997-4 C.B. (Vol. 2) at 1263; H.R. Rep. No. 105-220, at 584, 1997-4 C.B. (Vol. 2) at 2054; 1997 Bluebook, at 267.

<sup>11</sup> After accusing me of “misread[ing] section 172(f)(6),” the majority opines: “[W]hatever inference might arise from the text of section 172(f)(6) does not suffice to overcome the . . . textual indicators” that the majority views as supporting its position. Op. Ct. p. 229.

NOL. In my judgment, the balance tips decidedly in favor of the proposition that an NOL has only one carryback period so that a valid election under section 172(b)(3) necessarily relinquishes the carryback of the electing taxpayer's entire NOL.

II. *Even if, After 1978, an NOL Could Have Multiple Carryback Periods, a Section 172(b)(3) Election Relinquishes the Carryback of the NOL in its Entirety.*

Even if I were to accept that, after 1978, a single NOL could have multiple carryback periods, I would still read the carryback waiver rule to require the relinquishment of any and all carryback periods to which the electing taxpayer might be entitled. The possibility of multiple carryback periods would allow us to interpret the singular noun “carryback period,” as used in section 172(b)(3), to refer to more than one carryback period. 1 U.S.C. § 1. In that case, we would read the statute to say that any taxpayer entitled to *a* carryback period (or periods) under section 172(b)(1) can elect to relinquish *the* carryback period (or periods). What carryback period (or periods) can the taxpayer elect to relinquish? The use of the definite article tells us that the period (or periods) referred to are those previously referred to—that is, the carryback period (or periods) to which the electing taxpayer is entitled. See *Nielsen v. Preap*, 586 U.S. 392, 408 (2019) (“[G]rammar and usage establish that ‘the’ is ‘a function word . . . indicat[ing] that a following noun or noun equivalent is definite or has been previously specified by context.’ (quoting *The, Merriam-Webster’s Collegiate Dictionary* (11th ed. 2005))). Therefore, even if I were to accept that an NOL can have more than one carryback period, I would still interpret section 172(b)(3) as allowing an election to relinquish any and all carryback periods to which the electing taxpayer is entitled.<sup>12</sup>

The majority claims that, if section 172(b)(1) establishes different carryback periods, it would “make[] little sense” to “[r]ead[] section 172(b)(3) as providing a taxpayer with an all or nothing election,” particularly because Congress went “out of its way to give taxpayers additional choices” by allowing

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<sup>12</sup> The phrase “the . . . carryback period,” as used in the second part of the operative sentence in section 172(b)(3), cannot be read to refer to whatever period or periods an electing taxpayer chooses to relinquish because those periods are not known until a taxpayer makes an election.

the elections provided in section 172(f)(6) and the analogous provisions for eligible losses and farming losses. Op. Ct. p. 225. Again, I am unpersuaded. Even if the different years to which portions of an NOL can be carried under section 172(b)(1) establish different carryback periods, it does not follow that those periods can be waived separately rather than collectively. The existence of multiple items in a group does not establish that differential, rather than uniform, treatment of those items should be allowed. And Congress's grant of *some* flexibility in the treatment of different portions of an NOL does not establish that Congress intended to allow the degree of flexibility Apache seeks.

The majority sees no "policy reason" to "tie the hands of taxpayers [with] multiple carryback periods under section 172(b)(1)." Op. Ct. p. 227. As the majority notes, Congress's enactment of the carryback waiver rule in 1976 showed that it was sympathetic to taxpayers whose loss carrybacks would have displaced other tax attributes that, if carried forward, might expire sooner. *See generally* Staff of J. Comm. on Tax'n, 94th Cong., General Explanation of the Tax Reform Act of 1976, JCS-33-76, at 189 (J. Comm. Print 1976). But an election to forgo the carryback altogether would preserve the tax attributes that would otherwise have been displaced. An all-or-nothing election would not be a "stingy . . . solution" to the problem Congress addressed in 1976. Op. Ct. p. 227. The relevant policy question is whether a taxpayer with an NOL that includes an SLL should be able to have its cake and eat it, too, by carrying its SLL back ten years while forgoing the carryback of the rest of its NOL and thereby avoiding the displacement of other tax attributes generated in the more recent years. I agree that there may be no compelling reason to require the taxpayer to give up the carryback of its SLL as the price of preserving the tax attributes that would be displaced by the carryback of the rest of the taxpayer's NOL. But I am also unaware of a strong policy reason to allow selective carryback waivers. The stated reason for the carryback waiver in the first place would be achieved by either a selective or an all-or-nothing waiver election.

As the majority notes, Treasury Regulation § 1.172-13(c)(4) allowed a taxpayer with a *PLL* to elect to relinquish the carryback of the rest of its NOL while still

carrying its PLL back ten years. The majority asserts that, if Apache's SLL had consisted of deductions described in section 172(f)(1)(A) (related to product liability), "the Commissioner would be bound [by Treasury Regulation § 1.172-13] to permit Apache's carryback." Op. Ct. p. 226. But the majority seems to accept that, because Apache's SLL consists entirely of deductions described in section 172(f)(1)(B) (not related to product liability), the regulation does *not* bind the Commissioner to accept Apache's election.

Therefore, it is not clear to me what point the majority seeks to make in regard to the regulation. The majority writes that "there is no meaningful principle by which to justify treating product liability losses under section 172(f)(1)(A) differently, for purposes of the carryback period election, from other specified liability losses under section 172(f)(1)(B)." Op. Ct. p. 226. That may be true. Even so, the majority seems to accept that, while the regulation (in its view) would bind the Commissioner in regard to SLLs consisting of product liability deductions described in section 172(f)(1)(A), it does not bind the Commissioner in regard to SLLs, such as Apache's, consisting of deductions described in section 172(f)(1)(B) that are unrelated to product liability. Certainly, *we* are not bound to adopt the interpretation of section 172 reflected in Treasury Regulation § 1.172-13. As the Supreme Court has recently instructed us, we must exercise our own "independent judgment" in interpreting statutes. *Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244, 2273 (2024).

Therefore, even if I were to accept that a single NOL could have multiple carryback periods, I would remain unpersuaded by the majority's arguments that a taxpayer can elect under section 172(b)(3) to relinquish some carryback periods and not others. Instead, giving the definite article its normal meaning, I would read section 172(b)(3) to allow a taxpayer entitled to *a* carryback period (or periods) to elect to relinquish *the* carryback period (or periods) to which the taxpayer is entitled.

Whether or not a single NOL, after 1978, could have multiple carryback periods, Apache, in attempting to preserve the ten-year carryback of its SLL while relinquishing the two-year carryback of the rest of its NOL, sought to make an election that the law does not allow. Apache's election was thus invalid. Apache should be allowed to carry its SLLs back

ten years but should also be required to carry the rest of its NOLs back two years. Both the Commissioner's and Apache's Motions should be denied.

