Liquid Capital Partners

The Economic Substance Doctrine

[Quoted from IRS Notice 2014-58]

The economic substance doctrine is a judicial doctrine that was codified in section 7701(o) by section 1409 of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152. Section 7701(o)(5)(A) defines "economic substance doctrine" as the common-law doctrine that disallows tax benefits under subtitle A of the Internal Revenue Code if the transaction that produces those benefits lacks economic substance or a business purpose.

Under section 7701(o)(1), a transaction has economic substance if: (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position; and (2) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

For purposes of determining whether the codified economic substance doctrine applies, "transaction" generally includes all the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement; and any or all of the steps that are carried out as part of a plan. Facts and circumstances determine whether a plan's steps are aggregated or disaggregated when defining a transaction.