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Focus on Tax Controversy and Litigation

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Editor's Note

Dear Readers,

It has been a very active month for significant developments on the domestic and international tax controversy fronts, thus making this a lengthy and comprehensive newsletter. In this issue we address, among other things, the oral arguments in *Textron*; additional briefing in the UBS John Doe summons case; the circuit courts of appeals opinions in *Klamath*, *Xilinx*, and *Keller*; and the Tax Court's privilege decision in *Countryside*. Next month's issue promises to be another interesting one; we will cover, among other topics, the Supreme Court's recent opinion in *Polar Tankers Inc. v. Valdez, Alaska*, involving the constitutionality of an ordinance that imposed a tax on particular large vessels, as well as the Eleventh Circuit's opinion in *Nero Trading* involving the appropriate limits of the IRS's summons power. Hope you have an enjoyable summer!

If you have comments or suggestions for future publications, please contact Lawrence M. Hill at lhill@dl.com. They are very much appreciated.

IRS Strategizes in Preparation for FTC Generator Cases

The Internal Revenue Service (“IRS”) has recently commented on its strategy for litigating the upcoming foreign tax credit (“FTC”) generator cases.¹ The IRS has been searching for an appropriate and effective strategy for dealing with these transactions, and officials recently stated that they are in the early stages of developing and testing in exam a new issue resolution tactic. The IRS previously indicated that it will use the “three and out” technique, where it tries what it determines to be the three best cases and then settles the others.² An IRS official recently stated that the IRS intends to litigate several transactions in multiple jurisdictions. Conscious of efficiency concerns, the IRS intends to set precedent broadly. By choosing cases with varied fact

patterns and in different jurisdictions, the IRS intends to test lines of argument, determine which jurisdictions are sympathetic to its case, and set precedent. The official stated that the IRS will utilize statutes, regulations, and judicial doctrines such as substance over form and economic substance in court in order to hone in on its most effective arguments going forward.

The IRS official also indicated that the IRS is currently working on creating an informal issue resolution mechanism that will allow it to expedite the handling of these cases and resolve them as quickly as possible. The official described the new procedure as a less formal version of the fast-track settlement process.³ The IRS will officially announce the program once it has been developed further.

Since 2004, the IRS has issued temporary and proposed regulations

in an attempt to prohibit what it sees as “transactions that exploit the FTC regime.”⁴ These regulations have not yet been issued. The IRS has also added this transaction to its Tier I listed transactions list, which has heightened awareness and enforcement.⁵

– T. Knox⁶

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1. Crystal Tandon, “Service Honing Its Strategy as FTC Cases Head to Court, Official Says,” *Tax Notes Today*, June 1, 2009.

2. For more information, see “IRS Plans to Apply ‘Three and Out’ Litigation Strategy to FTC-Generator Cases”, *Focus on Tax Controversy and Litigation*, Nov. 17, 2008 at 3.

3. Tandon, *supra* note 1.

4. Memorandum from Walter Harris, Industry Director, Financial Services and Issue Owner to Industry Directors, LMSB Tier I Issue Foreign Tax Credit Generator Directive—Revision 1 (Feb. 19, 2009), available at <http://www.irs.gov/>. For the 2004 news release and Notice see News Release, Dep’t of the Treasury, Office of Public Affairs, Treasury and IRS Issue Guidance on Abusive Foreign Tax Credit Transactions (Feb. 17, 2004), available at <http://www.irs.gov/> and I.R.S. Notice 2004-20, 2004-11 I.R.B. 608, available at <http://www.irs.gov/>. For the temporary and proposed regulations, see Reg-156779-06 (T.D. 9416), 2008-46 I.R.B. 1142.

5. For the list of transactions on the Tier I list, see <http://www.irs.gov/>; see also “IRS Revised Foreign Tax Credit Generator Directive,” *Focus on Tax Controversy and Litigation*, Mar. 2009, at 17.

6. Tim Knox is a summer associate in Dewey & LeBoeuf’s New York office.

IRS Commissioner Shulman Outlines Plan for Addressing International Tax Concerns

IRS Commissioner Douglas Shulman recently reaffirmed his commitment to addressing international tax issues in addition to outlining steps that he hopes will be taken to increase enforcement. On June 2, the Commissioner addressed the Organization for Economic Co-operation and Development (“OECD”) in Washington, DC,⁷ emphasizing that international tax issues are “a top priority.”

Shulman began by providing statistics that demonstrate how inter-related OECD nations have become and how the member nations are operating in a global economy. He stated that international tax issues have moved to center stage in the United States and are a major priority for President Obama, who recently outlined a number of international legislative proposals.⁸ Though the proposed changes are significant, he noted that “these are ideas I have and discussions we’re starting to have. Nothing is imminent.”⁹

The Commissioner outlined three IRS priorities for strengthening enforcement. First, he stated that the government must increase hiring. The IRS in past years has had insufficient resources to compete with taxpayers who can hire outstanding legal assistance, making it difficult for the IRS to handle some cases. Shulman explained that the IRS needs to retain and hire a wide range of experts in order to better manage international tax issues. Second, he stated that better information reporting is necessary to boost compliance, and better data collection and analysis are required. Third, he said that numerous revisions and additions to the Code and regulations are needed. He specifically mentioned improvements to the Qualified Intermediary (“QI”) program, increased information reporting from foreign countries and financial institutions, and an extension of the statute of limitations for international tax enforcement from three years to six years.

Shulman also emphasized the different approaches the IRS takes with respect to corporations and individuals. He reiterated that, with respect to corporations, the IRS has particular interest in the areas of transfer pricing, financial instruments, hybrid structures, and withholding taxes. Shulman was very frank concerning individuals, saying that US taxpayers holding overseas assets “must pay [their] taxes or [the

IRS] will be very focused on finding [them]. It’s as simple as that.”

The Commissioner also discussed the Obama Administration’s proposals related to international tax issues. Regarding corporations, he noted the check-the-box and deferral proposals. For individuals, Shulman focused on proposals aimed at greater information reporting, increased withholding, stiffer penalties, and the shifting of the burden of proof onto taxpayers. He noted that the Obama Administration’s proposed changes to the QI system are complicated and summarized the proposals into five components, stating the belief that the enhanced QI system that has been proposed “is a good starting point eventually for a multilateral QI system.”

Commissioner Shulman said that he believes “joint examinations with other nations and working towards joint definitions around information reporting requirements” would benefit both the government and taxpayers by reducing administrative burdens. He explained that whether similar issues exist between countries ought to be explored in order to better assess how to proceed.¹⁰

– D. Earley¹¹

7. The full text of Commissioner Shulman’s remarks is available on the IRS website. “Prepared Remarks of Douglas H. Shulman, Commissioner of Internal Revenue, Before the Organization for Economic Co-operation and Development,” June 2, 2009, available at <http://www.irs.gov/>.

8. For more information on the Obama Administration’s proposals, see “Obama Administration Releases Its 2010 Revenue Proposals,” *Focus on Tax Controversy and Litigation*, May 2009, at 12.

9. Alison Bennett, “Shulman Says IRS Discussing Possibility of Joint Examinations with Other Countries,” *Daily Tax Report*, June 3, 2009.

10. *Id.*

11. David Earley is a summer associate in Dewey & LeBoeuf’s New York office.

First Circuit Hears *En Banc* Arguments in *Textron*

On June 2, 2009, in an *en banc* rehearing, the First Circuit reconsidered the role of tax accrual workpapers in litigation. Earlier this year, the First Circuit upheld the district court's determination that tax accrual workpapers are protected by the work product doctrine. Subsequently, upon the government's motion, the First Circuit vacated the judgment and granted the *en banc* hearing.

Judith Hagley argued on behalf of the Justice Department's Tax Division. She began by arguing that under the standard set out in *Maine v. Department of Interior*,¹² tax accrual workpapers should not be protected under the work product doctrine.

Ms. Hagley was quickly interrupted by Judge Juan Torruella, who questioned Ms. Hagley on whether or not the advocated test would apply to the IRS. She replied that it would. He asked her if it would apply to everyone. She replied that it would. Then Judge Torruella said, "So you're asking for a fundamental change in the rule then."

Ms. Hagley replied that she was not asking for a change in the rule. "The rule that was set out in *Maine* was that documents which are generated in the ordinary course of business or that would have been generated

in an essentially similar form, irrespective of any existing or expected litigation, are not protected by the work product doctrine." She argued that tax accrual workpapers are mandatory business documents; they are not work product because public corporations must generate them every year whether they anticipate tax litigation or not.

Judge Torruella asked her how this case differed from *Delaney, Migdail & Young, Chartered v. IRS*,¹³ where the government had opposed the disclosure of work product. Hagley differentiated *Delaney* by noting that in that case there had been no dispute that the documents were generated in anticipation of litigation. Here, the SEC required Textron to file audited financial statements every year.

Judge Kermit Lipez inquired if the business requirement was the driving force behind her argument. He asked if it was true, as the district court found, that Textron would have never prepared these documents if the litigation had not been anticipated.

Ms. Hagley answered that this was not true. The district court found that these workpapers had been generated because they were required by the auditors, not because litigation was anticipated. Further, she said,

dual purpose documents are not protected under *Maine* if they are generated in the ordinary course of business or would have been generated in an essentially similar form irrespective of litigation. Because these documents analyzed all questionable positions, and not just those that Textron expected to litigate, they could not have been prepared for the purposes of litigation.

Ms. Hagley reiterated that the work product doctrine does not protect content; it only considers the function of the document and the reason the document was prepared. Furthermore, the work product doctrine is not intended to protect all lawyer thought processes per se; it is meant to combat the potential chilling effect of legal analysis disclosure in an adversarial process.

Textron's lawyer, John Tarantino, began his argument by rebuking Ms. Hagley's claim that the government was applying the test set forth in *Maine*. The district court found "that these documents would not have been prepared, were it not for Textron's reasonable anticipation of disputes and litigation with the IRS." Further, he pointed out that the documents served a dual purpose but argued that the dual purpose does not eviscerate the protection.

Mr. Tarantino noted that the SEC does not actually require the hazard analysis contained in the tax accrual

12. *Maine v. Department of the Interior*, 298 F.3d 60 (1st Cir. 2002).

13. *Delaney, Migdail & Young, Chartered v. IRS*, 826 F.2d 124 (D.C. Cir. 1987).

workpapers. Chief Judge Lynch questioned whether this analysis must always be given to the accountants. Mr. Tarantino replied in the affirmative and admitted that the legal analysis must be performed in order for the accountants to be able to comply with SEC rules. However, Mr. Tarantino said that sharing the workpapers with accountants did not constitute a waiver of privilege. Chief Judge Lynch expressed a policy concern that work would be given to lawyers in an effort to avoid compliance with the SEC rules and create a privilege where none should exist.

Mr. Tarantino tried to reemphasize the argument that the work had been given to lawyers because Textron anticipated litigation. Otherwise the work may have been done by accountants, as it is in many circumstances. Textron chose lawyers because of the nature of the work.

Chief Judge Lynch retorted, “It does tend to look like that choice was meant to try to shield documents... to manipulate the system.”

Mr. Tarantino argued that Textron met the “because of” test under *Maine* because the workpapers had been prepared in preparation of possible litigation. Though the documents served a dual purpose, if there had been no SEC requirement, the workpapers would still have been prepared. “It was reasonable for Textron to expect disputes with IRS on these positions because they were unclear grey positions. Textron is audited every year by the IRS. Every year there are unclear tax positions that are disputed at least at the administrative process and sometimes in court between Textron and the IRS.”

At the end of the arguments, Chief Judge Lynch indicated that the outcome of the case would depend on the court’s interpretation of the first prong of the circuit’s “because of” test and not the litigation prong.

On June 1, 2009, in a meeting of tax executives, senior IRS official J. Richard Harvey said, “As I look into the future, my suspicion is that corporate transparency will continue to be a hot topic.”¹⁴ He continued, “Having said that, however, at the present time the IRS has no current plans to alter its policy of restraint with respect to requesting tax accrual workpapers.”

– J. Dorfman¹⁵

14. See Michael Joe, “IRS to Continue Policy of Restraint on Tax Accrual Workpapers, Official Says,” *Tax Analysts*, June 2, 2009.

15. Jessica Dorfman is a summer associate in Dewey & LeBoeuf’s New York office.



United States and Luxembourg Amend Tax Treaty to Facilitate Increased Information Exchange

On May 20, the Treasury Department announced that the United States and Luxembourg have signed a protocol updating the current income tax treaty between the two countries. Aiding the Treasury Department's aggressive efforts to enforce US tax laws and create a fairer tax code, the protocol will facilitate a more substantial exchange of tax information between the two countries.

The protocol will amend the existing tax treaty to incorporate the OECD tax treaty standard on information exchange for tax purposes. As a result, the Treasury Department will be able to obtain information from Luxembourg upon request and in specific cases. Information on all types of federal taxes, and in both civil and criminal matters, will be available for all taxable years beginning in or after 2009.

According to Treasury Secretary Geithner, "This treaty is a critical step forward in our efforts to level the playing field of US taxpayers."¹⁶ "Greater information exchange among nations is a key part of enforcing the tax Code fairly so that everyone pays their fair share."¹⁷ The Administration hopes to reduce tax losses, close unintended loopholes, and curb the use of illegal hidden accounts by wealthy individuals.

At the G-20 Leaders' Summit on Financial Markets and the World Economy in early April, the United States reportedly led efforts to close the tax gap by ensuring all countries

submit to international standards for the exchange of tax information. The United States also signed the first-ever tax information exchange agreement entered into by Gibraltar in late March.

OECD Secretary General Angel Gurría said similar agreements are in the works between Luxembourg and some of its other treaty partners. He hopes for increased commitment to OECD standards and for more countries to follow suit.

– J. Dorfman¹⁸

16. A copy of the press release is available on Treasury's website at www.treas.gov/press/releases/tg143.htm.

17. Press Release, U.S. Dep't of the Treasury, *United States, Luxembourg Bolster Tax Information Exchange* (May 21, 2009).

18. Jessica Dorfman is a summer associate in Dewey & LeBoeuf's New York office.

Court Allows Additional Amicus Brief in Swiss Banking Case

The United States District Court for the Southern District of Florida has granted a motion allowing two US-based trade associations and three international trade associations representing the financial services sector to file an amicus brief opposing the IRS's enforcement of a John Doe summons¹⁹ in the current litigation involving UBS. The court granted the motion to appear as *amici curiae* filed by the Institute of International Bankers ("IIB"), the International

19. The John Doe summons states (in part) the following: "John Does are United States taxpayers, who at any time during the years ending December 31, 2002 through December 31, 2007, had signature or other authority (including authority to withdraw funds; to make investment decisions; to receive account statements, trade confirmations, or other account information; or to receive advice or solicitations) with respect to any financial accounts maintained at, monitored by, or managed through any office in Switzerland of UBS AG or its subsidiaries or affiliates in Switzerland, and for whom UBS AG or its subsidiaries or affiliates (1) did not have in its possession Forms W-9 executed by such United States taxpayers, and (2) had not filed timely and accurate Forms 1099 naming such United States taxpayers and reporting to United States taxing authorities all payments made to such United States taxpayers." The summons is available at http://www.usdoj.gov/tax/UBS_Order.pdf.

The petition to enforce the John Doe summons was filed by the Department of Justice on February 19, 2009 and is available at <http://online.wsj.com/public/resources/documents/UBSPetitionofJohnDoe20090219.pdf>.

Bankers Association of California ("IBAC"), the Swiss Bankers Association, the Swiss-American Chamber of Commerce, and Economiesuisse on May 18, 2009.²⁰ These organizations filed briefs separate from those already filed by UBS and the Government of Switzerland,²¹ claiming to offer additional arguments that the previous briefs had not addressed. Though the IRS did not oppose the filing, it refused consent, claiming that the application was too late and that the arguments in the brief would be no different from those mentioned in the previous briefs of UBS and the Swiss government.

The organizations' *amicus* brief argues that allowing IRS enforcement of the John Doe summons would be inconsistent with the provisions of the US-Swiss Double Taxation Treaty, which limits the exchange of tax-related information only to specific, narrowly tailored requests.²² Additionally, they argue, under the administrative provisions of the treaty,

20. The motion to file the *amicus* brief and the *amicus* brief itself are available at <http://www.iib.org/associations/6316/files/20090515FinalBrief.pdf>.

21. See "Briefs Filed in Swiss Banking Case," *Focus on Tax Controversy and Litigation*, May 2009, at 8.

22. The treaty limits the exchange of information to wrongdoing of "tax fraud or the like."

courts are not the appropriate forum in which to resolve tax information requests; instead, the IRS should solicit the required information under the mechanisms provided in the treaty.

Second, the *amici* argue, the summons violates the principle of comity because the broad scope of the summons would violate Swiss privacy and criminal laws.²³ US enforcement of the summons would compel a foreign institution to violate laws of a foreign sovereign in the sovereign's own territory, and would therefore have the effect of discouraging foreign corporations from engaging in business activities in the United States.

Similarly, the brief argues that allowing the IRS to circumvent established treaty protocols would create a precedent for other governments to take similar actions in the future. These actions would also hamper international trade because actions

23. The Swiss statutes at issue are Article 47 of the Swiss Banking Law, Article 271 of the Swiss Penal Code, and Article 273 of the Swiss Penal Code. In fact, a Basel Cantonal Bank executive was sentenced to three months' imprisonment for violating Article 47 of the Swiss Banking Law on April 24, 2009 for providing banking information to German tax inspectors.



Court Allows Additional Amicus Brief in Swiss Banking Case (cont'd)

taken outside the scope of an established treaty would undermine the predictability of the law and create uncertainty for businesses engaged in cross-border transactions. US companies operating offshore would also suffer, the brief claims, because such precedent would allow foreign governments to act outside of their treaty obligations and impose similar burdens on US firms, even if it contravenes US law.

Finally, the brief argues that allowing the summons would jeopardize the effectiveness of the international tax sharing treaty regime, as well as

the US's ability to negotiate other tax treaties in the future. Allowing for the enforcement of a summons outside the scope of the treaty would undermine the primacy of a treaty and eliminate the incentive for other countries to enter into further treaties with the United States.

– A. Cahn²⁴

24. Alexander Cahn is a summer associate in Dewey & LeBoeuf's New York office.

NY Adopts Federal Procedures for Losses Attributable to Ponzi Arrangements

On May 29, 2009, the New York State Department of Taxation & Finance (“State Tax Department”) issued a statement regarding the treatment of losses from investments in fraudulent Ponzi-type investment arrangements.²⁵ Victims of the recent slew of Ponzi-type investment arrangements, including, most notably, the one run by Bernie Madoff, have been demanding something be done, and the IRS and the State Tax Department have answered.

According to the statement, the State Tax Department has generally adopted rules similar to those issued by the IRS, including the safe harbor recently announced in Revenue Procedure 2009-20 (“the safe harbor”), which will be available for personal income tax purposes.²⁶ The federal rules and procedures for reporting losses realized as a result of investment in fraudulent Ponzi-type arrangements were promulgated by the IRS on March 17, 2009 in

Revenue Ruling 2009-9.²⁷ The ruling provides that an investor’s losses:

- Should be treated as a theft loss rather than a capital loss, thus allowing victims to avoid the \$3,000 cap under section 1211,²⁸
- Should be treated as a loss from a transaction for profit, thus allowing a deduction under section 165(c)(2) for the year in which the theft was discovered and are therefore not limited by sections 67, 68, or 165(h),
- May be carried back as a net operating loss (“NOL”) for up to five years instead of three years by classifying individuals as “sole proprietorships” as long as the individuals have gross revenues less than \$15 million and finally
- Are allowed to escape the mitigation and claim of right provisions of sections 1311-14 and 1341, respectively.

Notwithstanding Revenue Ruling 2009-9, the process for determining losses under section 165 can be

laborious since both the amount and the time when the loss occurred must be shown. Alternatively, the safe harbor allows qualified investors to avoid the ordinary filing rules for reporting their qualified losses. The IRS has acknowledged that determining losses in the ordinary way would likely be an overwhelmingly difficult and costly factual determination for both the taxpayer and the IRS to make. The safe harbor allows taxpayers to deduct 95 percent of their net investment if they do not pursue recovery from a third party, or 75 percent if they intend to do so. These amounts are further reduced by amounts actually recovered or amounts expected to be recovered either directly or from insurance (including Securities Investor Protection Corporation (“SIPC”) recovery).

State taxpayers wishing to claim a state deduction using the amount determined under the safe harbor must complete the “special condition code” entry space on their state income tax returns with the condition code “56.” Further, they should attach the casualties and thefts form, Form 4684, and other documents required to be executed pursuant to the federal safe harbor.

25. New York State Dep’t of Taxation & Finance, Office of Tax Policy Analysis Taxpayer Guidance Division, New York State Income Tax Treatment of Losses from “Ponzi-Type” Fraudulent Investment Arrangements, TSB-M-09(7) (May 29, 2009).

26. Rev. Proc. 2009-20, 2009-14 I.R.B. 749.

27. Rev. Rul. 2009-9, 2009-14 I.R.B. 735. See “IRS Responds to Requests for Guidance Regarding Tax Relief Available to Madoff Victims,” *Focus on Tax Controversy and Litigation*, Mar. 2009, at 27, for more information and insight into these rules and procedures.

28. Unless otherwise indicated, all section references are to sections of the Internal Revenue Code of 1986, as amended.



NY Adopts Federal Procedures for Losses Attributable to Ponzi Arrangements (cont'd)

New York residents filing state tax returns and claiming losses from fraudulent Ponzi-type investment arrangements – whether utilizing the safe harbor or not – must be aware of some particularly applicable state rules and limitations. First, the itemized deduction phase-out of section 615(f) remains effective, and works as follows:

- Up to a 25 percent reduction for single taxpayers with New York State adjusted gross income (“NYSAGI”) in excess of \$100,000, married taxpayers filing jointly with NYSAGI in excess of \$200,000, and heads of household with NYSAGI in excess of \$150,000,
- Up to an additional 25 percent – total of 50 percent – reduction for all

taxpayers with NYSAGI in excess of \$475,000, and

- Up to an additional 50 percent – total of 100 percent – reduction of noncharitable itemized deductions for all taxpayers with NYSAGI in excess of \$1 million.²⁹

Second, New York State taxpayers with losses resulting from fraudulent Ponzi-type investment arrangements must be aware of the limitations on NOLs. For residents, in computing their New York source income, only losses attributable to a business, trade, profession, or occupation actually conducted in New York will qualify and, according to the State Tax Department’s statement, “losses from *Ponzi-type* fraudulent invest-

ment arrangements generally would not qualify.”³⁰ However, under New York tax law, nonresidents or part-time residents will be able to carry over these NOLs, but not to a year in which the taxpayer was a resident.

The safe harbor also applies to trusts and estates, S-corporation shareholders, partners in a partnership, and LLC members based on the multifarious pro rata attribution rules.

– T. Knox³¹

30. TSB-M-09(7)I.

31. Tim Knox is a summer associate in Dewey & LeBoeuf’s New York office.

29. N.Y. Tax Law § 615(f).

Director of the IRS Office of Professional Responsibility Plans Several Changes

Karen L. Hawkins, Director of the IRS Office of Professional Responsibility (“OPR”), recently stated that she plans to introduce a number of changes.³² At the forefront is her announcement to impose monetary sanctions when penalizing firms. She intends to make this change once further guidance is available regarding section 10.34 of Circular 230, “Standards with respect to tax returns and documents, affidavits and other papers.” This additional guidance will help to reduce the current ambiguity that has existed since recent congressional changes to the section 6694 preparer penalty standard. She is also seeking to clarify the monetary penalty guidance in Notice 2007-39 given the legislative change to section 10.50(c) of Circular 230, “Sanctions.”

Ms. Hawkins is also defending the penalty grid found in the sanctions guidelines currently in place, and in

fact hopes to finish a collection of OPR guidelines by the end of June for inclusion in the Internal Revenue Manual. She referenced the recently revised version of OPR guidelines that clarify which practitioners OPR regulates, as a laudable example of dialogue between the practicing community and the IRS. Additionally, Hawkins hopes to address the implications of filing a Form 2848, “Power of Attorney and Declaration of Representative,” which at present essentially gives OPR power to regulate the filer. Another revision plan for the guidelines is to specifically address first-time offenders. Finally, referring to a case in which an administrative law judge noted that the tax attorney on trial should have engaged OPR much earlier, Hawkins stressed the importance of cooperation with OPR.

– C. Luschin³³

32. Jeremiah Coder, “OPR Plans to Impose Monetary Sanctions, Director Says,” *Tax Notes Today*, June 2, 2009.

33. Christoph Luschin is a summer associate in Dewey & LeBoeuf’s New York office.



Klamath: The Fifth Circuit Gets “Conjunctivitis”

In *Klamath Strategic Investment Fund v. United States*,³⁴ the U.S. Court of Appeals for the Fifth Circuit adopted the “conjunctive” economic substance test followed by the majority of circuit courts, which requires that a transaction have both objective economic substance and a subjective non-tax avoidance motive in order to be respected. The court reasoned that the minority test for economic substance, which respects transactions structured solely for tax reasons if the taxpayers had subjective profit motive, would permit taxpayers to keep their “heads in the sand.”

The plaintiffs were TEFRA partnerships through which two taxpayers participated in a three-stage premium loan transaction known as BLIPS. The taxpayers obtained loans including a premium portion on which an above-market rate of interest accrued. The taxpayers assigned the loans to the plaintiffs and asserted that the premium was not a liability for purposes of determining their bases in their partnership interests under section 752. After the IRS disallowed the tax benefits from the transactions, the taxpayers reformed the partnerships such that

the taxpayers became the managing partners of the partnerships and filed suits.

With respect to the plaintiffs’ transactions, the Fifth Circuit found that the evidence presented during the bench trial supported the district court’s decision that the plaintiffs’ transactions lacked economic substance. The Fifth Circuit determined that the relevant portion of the BLIPS transaction to analyze for purposes of the economic substance test was the loan because the loan gave rise to the tax benefits. Thus, the Fifth Circuit stated that any profit potential of the plaintiffs’ foreign currency investments was not relevant because the court found that the investments were not made with the loan proceeds. The court also found that any potential profits from the later stages of the BLIPS transaction, which is when the high-risk investments were to occur, were unlikely because it was not intended for investors to participate in the later stages of the transaction. The district court had found that the lender required that all of the loan proceeds be held on deposit as collateral for the loan and that the lender had the ability to effectively terminate the taxpayers’ transactions early.

The Fifth Circuit ruled that the government lacked standing to appeal the district court’s determination that the loan premium in BLIPS did not constitute a liability for purposes of section 752 because the government had not been aggrieved by the decision. The district court made the liability determination on the plaintiffs’ motion for summary judgment; however, the government’s argument that the transaction lacked economic substance ultimately prevailed. The Fifth Circuit ruled that the liability determination did not have collateral estoppel effects because the economic substance determination was independent of the earlier summary judgment decision.

The Fifth Circuit vacated the district court’s order permitting the plaintiffs to deduct interest expense and various fees as operational expenses. The Fifth Circuit found that the interest was not deductible because the transactions as a whole lacked economic substance and because the court found that the loans were not indebtedness for purposes of section 163. With respect to the fees paid by the partnerships, the Fifth Circuit found that the transaction lacked a profit motive. Profit motive is determined at the partnership level in a TEFRA partnership proceeding.

34. No. 07-40861 (5th Cir. May 21, 2009).

In making the profit motive determination, the Fifth Circuit stated that the relevant inquiry is the motives of the partners that were in control of the management of the partnerships. While the taxpayers in *Klamath* had a profit motive, the partner that acted as the managing partner of the plaintiffs at the time of the transactions was motivated by tax benefits. The Fifth Circuit remanded the issue for the district court to determine whether the taxpayers were in control of partnership management at the time of the transactions.

The Fifth Circuit held that the district court had jurisdiction in a TEFRA partnership proceeding to determine the plaintiffs' reasonable cause and good faith defense. The district court found that the plaintiffs were not subject to accuracy-related penalties under section 6662 because the plaintiffs satisfied the reasonable

cause and good faith defense. The government argued that the defense was a partner-level defense over which the court lacked jurisdiction in a partnership-level proceeding; however, the court found that the defenses belonged to the plaintiff-partnerships. While the substance of the lower court's reasonable cause determination was not appealed, the Fifth Circuit noted that the lower court's decision was based on the fact that the taxpayers, the *current* managing partners of the partnerships, had obtained tax opinions that the BLIPS transaction complied with the law. Interestingly, the Fifth Circuit did not indicate that the partnership's reasonable cause defense should be determined by reference to the partners who were in control of the management of the partnerships at the time of the transactions, unlike with respect to the deduction of fees discussed above.

Finally, the Fifth Circuit held that the district court lacked jurisdiction in a suit for readjustment of partnership items under section 6226 to order a refund. The district court based its jurisdiction on section 6230(d)(5), which provides that a refund of a partner's overpayment relating to a partnership item shall be made without requiring the partner to file a refund claim. The Fifth Circuit found that section 6230(d)(5) relates to the IRS's administrative procedures and does not expand the district court's jurisdiction in actions pursuant to section 6226. The Fifth Circuit also noted that section 7422 provides that no refund action can be maintained unless a refund claim was timely filed.

– R. Partain



Tigers Eye Trading: The U.S. Tax Court Upholds Regulations and Denies Motion for Summary Judgment

In a recent opinion related to what the government alleges is a Son of Boss transaction, Judge Renato Beghe of the U.S. Tax Court upheld Treasury regulation section 301.6221-1T(c) and (d), and concluded that such regulation prohibited a partner from raising a partner-level reasonable cause defense to penalties in a partnership-level proceeding, and denied the motion for summary judgment filed by the participating partner of Tigers Eye Trading (“Tigers Eye”).³⁵ The court held that: (1) the regulation is valid and potentially applicable to the case at hand and thus, if the court sustains the IRS determination with respect to accuracy-related penalties, the participating partner could not assert a partner-level defense in a partnership-level proceeding in the Tax Court; instead, partner-level defenses must be asserted in refund actions in district court or the Court of Federal Claims, (2) the court had jurisdiction to decide whether Curtis Mallet, the participating partner’s lawyers, was acting as a promoter, and (3) if the court determines that Curtis Mallet did not act as a promoter, reliance on

the opinion of Curtis Mallet would be permitted as a partner-level defense.

The IRS issued a notice of final partnership administrative adjustment (“FPAA”) to Tigers Eye in which it determined that Tigers Eye was not a partnership and was an economic sham for federal income tax purposes. The IRS further determined in the FPAA that Tigers Eye partners’ outside bases in their partnership interest were zero and that accuracy-related penalties determined at the partnership level should be imposed on the partners. In challenging the penalties, the participating partner, Mr. Logan, sought to raise a reasonable cause defense based on his reliance on professional advice and the receipt of a Curtis Mallet opinion. Mr. Logan filed a motion for summary judgment to declare invalid section 301.6221-1T(c) and (d) of the regulations on the grounds that this regulation prevents the partners from raising the reasonable cause defense to which he is entitled.

Following the precedent of *New Millennium Trading, LLC v. Commissioner*,³⁶ the court agreed with the IRS position that the regulation is

valid and applicable. The application of a penalty generally requires consideration of any defenses to that penalty; however, the court found Treasury regulation section 301.6221-1T(c) and (d) prohibits “partner-level defenses” in any partnership-item proceeding. A partner who wishes to assert a partner-level defense must do so in a separate refund action following assessment and payment. This would mean asserting the defense in the district court or the Court of Federal Claims, after, in this case, the significant penalty has been paid in full.

Mr. Logan sought to assert his defense by showing that he reasonably relied on competent professional advisors, including Curtis Mallet. Reliance on the Curtis Mallet opinion may be prohibited if Curtis Mallet were viewed as a promoter or had a conflict of interest as claimed by the IRS. Mr. Logan originally sought to introduce the report of an expert witness who agreed that Mr. Logan had been reasonable in his reliance on the Curtis Mallet opinion, but the court excluded the report on the grounds that it consisted almost entirely of legal conclusions. The construction of legal conclusions should, the court said, be left to the judge.

35. *Tigers Eye Trading, LLC v. Commissioner*, T.C. Memo 2009-121. Dewey & LeBoeuf represents Sentinel Advisors, LLC, the tax matters partner.

36. *New Millennium Trading, LLC v. Commissioner*, 131 T.C. ____ (2008).

The court further concluded that Mr. Logan could only assert his partner-level defense of reasonable reliance on the Curtis Mallet report if the court, in a partnership-level proceeding, determined that Curtis Mallet had been a disinterested party. This determination would be made in the partnership-level proceeding because, according to the court, it is neither personal to the partner nor dependent on the partner's separate return. Reliance on the Curtis Mallet opinion potentially may not be asserted as a defense in any other proceeding if the court found that Curtis Mallet was a promoter.

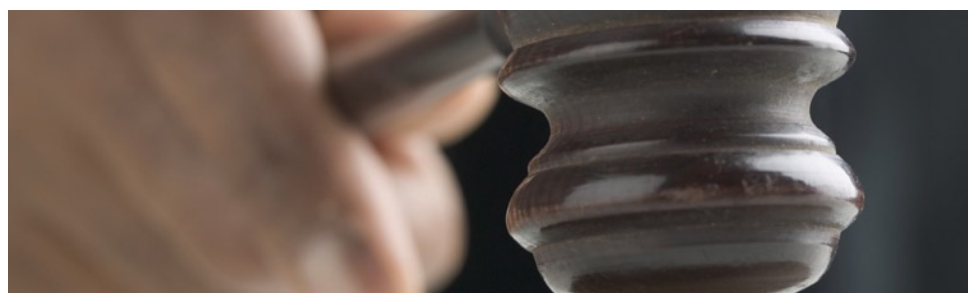
The court noted the problems faced by Mr. Logan and other investors in purported Son of Boss transactions. The Taxpayer Relief

Act of 1997, under which section 301.6221-1T(c) and (d) of the regulations were promulgated, denies taxpayers a prepayment forum for the determination of penalties on deficiencies arising from partnership-level proceedings. To alleviate this problem, the Secretary has proposed new regulations that would enable the IRS to convert partnership items into nonpartnership items in some cases.³⁷ These regulations would postpone the application of penalties until such time when partner-level defenses could be raised.

– J. Dorfman³⁸

37. Notice of Proposed Rulemaking, 74 Fed. Reg. 7206 (Feb. 13, 2009).

38. Jessica Dorfman is a summer associate in Dewey & LeBoeuf's New York office.



Tax Motivation of Partnership Actions Found Reviewable in Partner-Level Cases

On June 3, the U.S. Court of Appeals for the Ninth Circuit held in *Keller v. Commissioner*,³⁹ a consolidated appeal of 16 cases, that the Tax Court had jurisdiction in the taxpayers' partner-level proceedings to determine whether the transactions of the taxpayers' partnerships were tax motivated. Each taxpayer had invested in one or more Hoyt partnerships, which the government asserted were marketed tax shelters. The Ninth Circuit went on to find that the taxpayers' partnership transactions were tax motivated. Further, the Ninth Circuit affirmed the Tax Court's decision that the IRS had not abused its discretion in rejecting certain of the taxpayers' offers in compromise.

before the Tax Court in 1996 in a TEFRA partnership-level proceeding filed by Durham Genetic Engineering 1985-5, Ltd. ("DGE 85-5"), one of the Hoyt partnerships in which a *Keller* taxpayer was a partner. The Tax Court held in that TEFRA partnership-level proceeding that the determination regarding whether a partnership transaction is tax motivated is a partner-level item such that the court lacked jurisdiction in the partnership-level proceeding to make the determination.⁴⁰ Around 2001, each of the *Keller* taxpayers filed partner-level proceedings in the Tax Court contesting the IRS's adjustments. In 2005, while each of the *Keller* taxpayers' cases were pending in Tax Court, the Ninth Circuit held in *River City Ranches #1 Ltd. v. Commissioner*,⁴¹ an unrelated case, that whether a partnership's transactions are tax motivated is a partnership-level item such that a court in a partner-level proceeding lacks jurisdiction to make the determination.

Because the *Keller* partner-level proceedings were appealable to the

Ninth Circuit, the Tax Court adopted the holding in *River City Ranches* that the determination of whether a partnership transaction is tax motivated is a partnership-level item and held that the Tax Court lacked jurisdiction in the partner-level proceedings to make the determination. Each of the *Keller* taxpayers who sought review of the IRS's imposition of additional interest under former section 6621(c) asked the Tax Court to use its findings in the DGE 85-5 partnership-level proceeding to determine by analogy whether the transactions of the *Keller* partnerships were tax motivated. The Tax Court declined to examine its findings in the DGE 85-5 partnership-level proceeding, concluding that the Tax Court lacked jurisdiction to determine whether the DGE 85-5 partnership transactions (and thus the *Keller* partnership transactions) were tax motivated. As a result of the Tax Court's decisions, the *Keller* taxpayers were unable to obtain judicial review of the additional interest because the Tax Court found that it lacked jurisdiction in both the partnership-level and partner-level proceedings.

On appeal, the Ninth Circuit vacated the decisions of the Tax Court in the *Keller* cases and held that the Tax Court had jurisdiction to determine

16 | Jurisdiction to Determine Whether Partnership Transactions Are Tax Motivated

In *Keller*, certain of the taxpayers were contesting the IRS's imposition of the higher rate of underpayment interest provided under former section 6621(c), which applied to taxpayers with a "substantial underpayment attributable to tax motivated transactions." This issue was initially

39. No. 06-75466 (9th Cir. June 3, 2009).

40. *Shorthorn Genetic Engineering 1982-2, Ltd. v. Commissioner*, T.C. Memo 1996-515 (the DGE 85-5 case was consolidated with the *Shorthorn Genetic Engineering* case).

41. 401 F.3d 1136 (9th Cir. 2005).

whether the taxpayers' partnership transactions were tax motivated in the partner-level proceedings. The Ninth Circuit noted that "[w]hile *River City Ranches #1* recognized that jurisdiction lies in the partnership-level proceeding to decide whether partnership transactions are tax motivated, we did not purport to revoke the Tax Court's residual jurisdiction in a partner-level proceeding to entertain issues over which the taxpayer otherwise would have no review." Thus, the Ninth Circuit held that "[the Tax Court] did have jurisdiction in the partner-level proceedings in these cases to review the record of the DGE 85-5 partnership-level proceeding to determine whether the partnerships' transactions were tax motivated."

Ninth Circuit Finds that Partnership Transactions Were Tax Motivated

The Ninth Circuit conducted its own review of the record of the DGE 85-5 partnership-level proceeding and concluded that the DGE 85-5 transaction was tax motivated. The court noted that, while no explicit findings had been made on partnership-level issues relevant to whether the DGE 85-5 transaction was tax motivated, a necessary implication of the Tax Court's adjustment to the value of DGE 85-5's qualified investment property from \$4,701,120 to \$480,000 was that the Tax Court had found that underpayment of DGE 85-5 was attributable to either an overvaluation or a sham transaction. "Either way," the Ninth Circuit noted, "the transactions were tax motivated."

Rejection of Offers-in-Compromise Not an Abuse of IRS Discretion

The Ninth Circuit affirmed the Tax Court's determination that the IRS had not abused its discretion in rejecting the offers-in-compromise submitted by the taxpayers, finding that "the Commissioner was not obliged by compelling considerations of public policy or equity to accept the [t]axpayers' offers-in-compromise."

– W. Kellogg⁴²

42. William Kellogg is a tax associate in Dewey & LeBoeuf's New York office. He is not yet admitted to practice in New York.



Tax Court Limits the Scope of the Exception to the Section 7525 Privilege in *Countryside*

In a case of first impression, on June 8, 2009, the Tax Court determined that documents at issue were protected by the section 7525 privilege (also known as the federally authorized tax practitioner privilege) and the government had failed to meet its burden of proving that the corporate tax shelter exception contained in section 7525(b) applied. After the court granted petitioner's motion for partial summary judgment,⁴³ the government moved to compel the production of certain documents. Petitioner objected to the disclosure on grounds of attorney-client and the section 7525 privileges. The court resolved most of the issues contained in the motions by order. The only remaining issue was whether certain documents, determined by the court to be protected by the section 7525 privilege, were subject to the privilege exception contained in section 7525(b) and therefore discoverable.

The documents at issue were meeting minutes that contained descriptions of communications between clients and either their lawyers or a federally authorized tax practitioner. Other documents at issue were handwritten notes, made

by a member of the partnership, that recorded confidential communications regarding tax advice received during a meeting with the tax practitioner.

Section 7525 protects communications relating to tax advice between taxpayers and a federally authorized tax practitioner. Section 7525(b) provides an exception to the privilege for communications regarding corporate tax shelters, stating in part that such privilege does not apply to "any written communication" between a federally authorized tax practitioner and a representative of a corporation "in connection with the promotion of the direct or indirect participation" of the corporation in any tax shelter.⁴⁴ Relying on the Seventh Circuit opinion in *United States v. BDO Seidman LLP*,⁴⁵ the court determined that petitioner bears the burden of proving the preliminary facts establishing the privilege, while respondent bears the burden of proving the preliminary facts to establish the exception. The court found that petitioner met its burden, and therefore, the court shifted the focus of its analysis to whether the government met its burden of showing that all the elements of the exception had been

satisfied. Although petitioner argued that respondent failed to satisfy four elements of the tax shelter exception, the court focused on whether the government had met its burden with respect to the "written communication" and "promotion" elements of the exception.⁴⁶

The court determined that the handwritten notes did not qualify as "written communication." After reviewing the notes, the court determined that the notes were "neither a verbatim record of an oral communication nor anything resembling that"; rather, the notes were "nothing more than the holographic record of the salient points of discussion." Because the corporate tax shelter exception is limited to written communications, and the notes were merely a reflection of information communicated orally, the court determined that such notes did not constitute a written communication to the extent needed to satisfy the "written communication" element of the section 7525(b) exception.

43. *Countryside Ltd. Partnership v. Commissioner*, T. C. Memo. 2008-3.

44. I.R.C. § 7252(b).

45. 492 F.3d 806 (7th Cir. 2007).

46. Petitioner argued that the government failed to satisfy the following four elements of the section 7525(b) exception: (1) the promotion of (2) a corporation's participation in (3) any tax shelter, and (4) a written communication.

Next, the court turned to whether the communications at issue were connected with the promotion of Countryside's alleged participation in a corporate tax shelter. First, the court looked at the length and the nature of the relationship between Countryside and the federally authorized tax practitioner. The court found that the tax practitioner had been servicing petitioner and its affiliates for over 25 years. During that time, the tax practitioner provided petitioner with various tax advisory services, including tax compliance, tax planning, and responding to notices and inquiries from federal and state tax officials. The court further found that the tax practitioner had previously provided tax advice on various alternatives in connection with the partnership redemptions. In addition, the court found that, in general, advising clients with respect to the tax consequences of partner-

ship redemptions is and has been a regular part of the tax practitioner's practice throughout his entire career. The court noted that, in formulating his advice to Countryside, the practitioner applied knowledge that is well known among partnership tax professionals and "did not rely on any generic prototypes, descriptive materials, or files maintained" by his accounting firm.

Because the term "promotion" is not defined in section 7525(b), the court was compelled to look to legislative history. The court highlighted that the legislative history of section 7525(b) illustrated that Congress did not view "the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client," and thus did not anticipate that the exemption would adversely

affect such routine relationships.⁴⁷ Although the court noted that "[t]here may be a point at which [a federally authorized tax practitioner's] actions cross the line, and will no longer be encompassed within the routine relationship... and will amount to tax shelter promotion," it found that respondent had failed to meet its burden of showing that, in this case, the communications between the tax practitioner and his client crossed the line "from trusted advisor to promoter." Therefore, the court held that the communication between the tax practitioner and Countryside at issue in this case remained privileged.

– Z. Ziering

47. H. Conf. Rept. 105-599, at 269 (1998), 1998-3 C.B. 747, 1023.



Xilinx, Inc. v. Commissioner: Ninth Circuit Requires Related Companies to Share All Joint Venture Costs

In a recent transfer pricing case, the Ninth Circuit held in *Xilinx, Inc. v. Commissioner*⁴⁸ that, under the law in place from 1997 to 1999, related companies undertaking a joint venture to develop intangible assets must allocate all costs related to the venture between the companies. Furthermore, the court held that employee stock options (“ESOs”) are a part of employee compensation and must therefore be shared between the companies, even though ESO costs would not be shared by unrelated companies.

In 1994, Xilinx created Xilinx Ireland (“XI”) in order to expand into the European market. In 1995, Xilinx and XI entered into an agreement under which the companies would jointly own any new technology developed by either company while sharing the costs of production. From 1997 to 1999, Xilinx deducted approximately \$177 million as business expenses under its ESO plans. None of the ESO costs were allocated to XI, and the IRS issued notices of deficiency to Xilinx for 1997, 1998, and 1999. The IRS asserted that such costs

should have been shared with XI, thereby reducing Xilinx’s deductions and increasing its tax liabilities for those years.

The Ninth Circuit majority found the two regulations primarily at issue “irreconcilable.”⁴⁹ Under section 1.482-1(b)(1) of the Treasury regulations,⁵⁰ the “arm’s length standard,” designed to achieve parity between controlled and uncontrolled taxpayers, requires “in every case” that income and deductions be allocated as if the two entities are unrelated.⁵¹ In the presence of a cost sharing agreement to develop intangible property, however, section 1.482-7(d)(1) requires that all costs of development be shared.⁵² Rejecting both parties’ suggested harmonizations of the two regulations, the majority held that section 1.482-7(d)(1) controls because it addresses a more specific area than the relatively broader section 1.482-1(b)(1). Therefore, the IRS has the power to allocate income and costs in this

context under a related regulation.⁵³ The court went on to hold that ESOs constitute a cost that must be allocated between the two companies.

Though the court ruled against Xilinx, the majority expressed concern about the assertion of accuracy-related penalties because the government later promulgated regulations clarifying how to handle this difficult situation. Consequently, the Ninth Circuit remanded the case to the Tax Court on that issue, as well as to determine whether the IRS had properly accounted for employees’ uses of time on activities other than the joint venture.

Judge Noonan dissented from the majority opinion, saying that the majority’s “simple solution is all too pat” because it relied upon a single canon of construction.⁵⁴ He voted to affirm the Tax Court’s decision to not require cost allocation.

Responses to the ruling have been somewhat mixed, though all agree that the case will have significant

48. No. 06-74246, slip op. 6151 (9th Cir. May 27, 2009).

49. *Id.*, slip op. at 6160.

50. All references to regulations are to those in effect during the years 1997, 1998, and 1999.

51. *Xilinx*, slip op. at 6161.

52. *Id.*, slip op. at 6161-62.

53. Treas. Reg. § 1.482-7(a)(2).

54. *Xilinx*, slip op. at 6180 (Noonan, J., dissenting).

implications. The case may effectively destroy usage of the arm's length standard with respect to cost sharing, meaning the IRS potentially could implement arbitrary and standardless rules in this area.⁵⁵

Given the magnitude of this victory by the IRS, some companies may seek more advance pricing agreements rather than litigating their issues.⁵⁶

55. Sam Young, "Ninth Circuit's Reversal of Tax Court in Xilinx a Major Government Victory, Practitioners Say," *Tax Notes Today*, May 28, 2009.

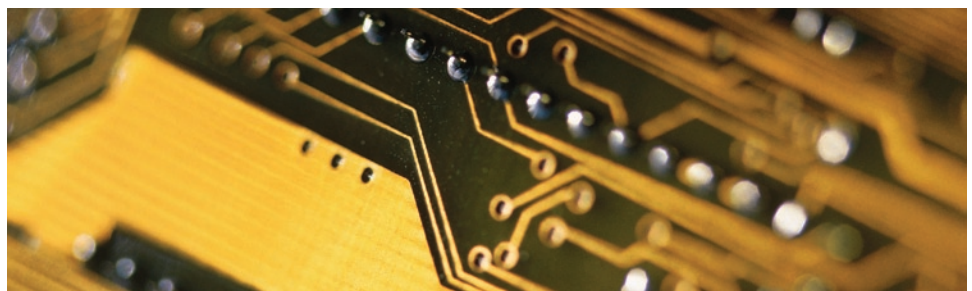
56. Reuven S. Avi-Yonah, "Xilinx and the Arm's-Length Standard," *Tax Notes Today*, June 9, 2009.

The impact has already been seen with respect to one company, as Cisco Systems Inc. stated that it would incur a one-time tax cost of \$130 million to \$150 million due to the ruling.⁵⁷

– D. Earley⁵⁸

57. Molly Moses, "Xilinx Ruling Causes Cisco to Record One-Time Charge of \$130-\$150 Million," *Daily Tax Report*, June 3, 2009.

58. David Earley is a summer associate in Dewey & LeBoeuf's New York office.



Upcoming Supreme Court Patent Case May Affect Tax Strategy Patents

The Supreme Court's recent grant of certiorari in *Bilski v. Doll*,⁵⁹ which involves the issue of whether business strategies are eligible for patent law protection, may have important implications for taxpayers and tax preparers. The case does not involve a tax question per se, but rather the patentability of a method used to hedge commodity risks; nevertheless, the ramifications of the decision will affect the broader issue of whether business strategies in general are subject to patent law protection. Because tax planning strategies are a subset of this category, they will also be affected.

22 | The Supreme Court will review the Federal Circuit Court of Appeals' denial⁶⁰ of patent protection to a method developed to hedge risks of commodity prices. The appellate court held that the method was not eligible for patent protection because it failed the "machine or transformation test," which allows for the patentability of a process only if "(1) it is tied to a particular machine or apparatus, or (2) it transforms a particular article into a different state or thing."⁶¹ The court overruled its

earlier ruling in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.* ("*State Street*")⁶² that allowed for patent eligibility where the process produced a "useful, concrete, and tangible result." The *State Street* ruling opened the door for the patentability of business methods.

The issue of whether business methods, and thus tax strategies, are patentable will have a major impact on the tax industry. Since the *State Street* decision, at least 77 tax-related patents have been granted by the Patent and Trademark Office.⁶³ In view of this, the ABA Section on Taxation has formed a special task force to explore the patenting of tax related advice.⁶⁴ The American Institute of Certified Public Accountants ("AICPA") also weighed in on the issue, filing an *amicus* brief in *Bilski* arguing against the applicability of patent law to tax strategies.

In general, the tax community has been opposed to the patentability of business and tax strategies. Dean Ellen Aprill, an authoritative professor of tax law, summed up the arguments against patentability of tax strategies in her testimony before a congressional subcommittee.⁶⁵ She argued that allowing the patenting of tax strategies will increase the already expensive cost of compliance with tax laws. "Tax practitioners and taxpayers will have to become more sensitive to the possibility that a tax strategy has been patented and adjust behavior accordingly," as "[a] taxpayer can infringe a patent without intent or actual knowledge of the patent."

The patenting of tax strategies would also "prevent affected taxpayers from arranging their affairs to minimize their taxes in a manner contemplated by Congress," according to AICPA's *amicus* brief, as the patents would limit the taxpayer from utilizing

59. *Bilski, et al., v. Doll*, No. 08-964, 2009 U.S. LEXIS 4103 (U.S. June 1, 2009).

60. *In re Bilski*, 545 F.3d 943 (Fed. Cir. 2008).

61. *Id.* at 954.

62. *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).

63. See US Patent and Trademark Office website: <http://patft.uspto.gov> (follow "Advanced Search" hyperlink under either "Issued Patents" or "Published Applications" sections; enter search term "ccl/705/36T"; click on "search") (last visited June 11, 2009).

64. See Task Force's website at <http://www.abanet.org/tax/patents/home.html> (last visited June 11, 2009).

65. *Hearing on Issues Relating to the Patenting of Tax Advice before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Ellen P. Aprill, Associate Dean of Academic Programs, Professor of Law, and John E. Anderson Chair in Tax law, Loyola Law School), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5106> (last visited June 11, 2009).

the beneficial provisions provided by the Code. This would “caus[e] some taxpayers to pay more tax than intended by lawmakers or pay more tax than other similarly situated taxpayers,” the brief argues.

Finally, as a practical matter, Professor Linda Beale of Wayne State University Law School points out that “tax strategy patents would likely be granted indiscriminately by a Patent Office unfamiliar with tax

law, inexperienced with tax planning, without access to critical resources available to expert tax lawyers, and unable to recognize the broad implications of the granting of tax strategy patents.”⁶⁶

– A. Cahn⁶⁷

66. Linda M. Beale, “Tax Patents: At the Crossroads of Tax and Patent Law,” 1, 2008 *U. Ill. Tech. & Pol’y* 107, 109.

67. Alexander Cahn is a summer associate in Dewey & LeBoeuf’s New York office.



Brazil High Court Denies Tax Credit for Raw Materials

On May 5, the Supreme Federal Court of Brazil ruled against the taxpayers in a case involving IPI excise tax credits. The court held that IPI tax credits for raw materials used to make final products are not permitted by Brazil's constitution.⁶⁸ The credits at issue were for expenditures both before and after 1999. A law was enacted forbidding the credit in 1999, but many companies sued, arguing that the issue had not been resolved by the courts.⁶⁹ Because the case was designated as "general

repercussion," the ruling will affect all similar ongoing cases.⁷⁰

Had the court ruled against the government, it could have cost R\$2 billion,⁷¹ slightly more than \$1 billion.⁷² The ruling is expected to have a significant impact upon some businesses operating in Brazil, with some having millions of dollars of such credits.

-D. Earley⁷³

70. "Companies Lose IPI Dispute in the Supreme Court," *Brazil Tax Online*, May 11, 2009.

71. *Id.*

72. XE, <http://www.xe.com> (as of June 4, 2009).

73. David Earley is a summer associate in Dewey & LeBoeuf's New York office.

68. Ed Taylor, "Brazilian Supreme Court Rejects Excise Tax Credit for Raw Materials," *Daily Tax Report*, May 19, 2009.
69. *Id.*

Miscellaneous

Upcoming Events

On Thursday, June 18, Lawrence Hill will speak on a panel before the Institute of International Bankers on “Enforcement Issues Relating to US Tax Information Reporting and Withholding, Qualified Intermediary (QI) Agreements, and FBAR Filings.”

Dewey & LeBoeuf's Tax Controversy Practice



26 | Dewey & LeBoeuf's Tax Controversy practice, led by partner Lawrence M. Hill (pictured above), is centered on large-case tax controversy examinations, tax litigation matters, and government investigations. Our lawyers represent taxpayers at the audit and appeals stages before the Internal Revenue Service, and our prominent team of nationally recognized trial lawyers litigates on behalf of taxpayers in the federal courts, from the U.S. Tax Court to the Supreme Court of the United States.

In addition, our tax controversy lawyers are active members of the American Bar Association Section of Taxation ("ABA Tax Section") and the New York State Bar Association Tax Section ("NYSBA Tax Section"). Mr. Hill recently ended his term as

Chairman of the ABA Tax Section's Court Procedure and Practice Committee, and several of our lawyers are subcommittee chairs of the committee. Our lawyers are also active participants in ABA Tax Section and NYSBA Tax Section comment projects regarding new and proposed rules and tax policy matters. Most recently, our tax controversy lawyers assisted in drafting both the ABA Tax Section and the NYSBA Tax Section comments regarding revised section 6694, Tax Return Preparer Penalties, and the proposed regulations thereunder.

Our tax controversy lawyers frequently participate in panels at tax law conferences and publish articles regarding significant tax controversy and litigation developments.

For more information about Dewey & LeBoeuf's tax controversy practice, please contact Lawrence M. Hill at lhill@dl.com or (212) 259-8330, Mark Allison at mallison@dl.com or (212) 259-6866, or your Dewey & LeBoeuf relationship partner.

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This memorandum is intended only as a general discussion of these

issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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