***From the desk of Jeanne M. Kerkstra, Esq., CPA***

## Viewpoint

## E&Y + CDS Spells IRS Disallowance

An interesting case that has recently been filed is *Fallon v. Ernst & Young LLP*.[1] This is an interesting case in part because of who the players are. They include Robert Puette, a former President of Apple Computer and former director of Cisco; Thomas Fallon, a former Vice President of Cisco; Carl Redfield, a Senior Vice President of Cisco; Richard Timmins, a Cisco Vice President; and Alexandre Balkanski, a well-known venture capitalist. These five men collectively invested more than $51 million in a product marketed by Ernst & Young ("E&Y") and known as the contingent deferred swap ("CDS") tax strategy. According to the Complaint filed January 30, 2007, the Plaintiffs are alleging that E&Y did not establish economic substance for the transaction even though it should have well been aware of the two Notices noted above on economic substance.

One of the arguments that the Plaintiffs put forth is that due to the fact that some of the partners at E&Y did not feel that the transaction would withstand challenges, then the transaction should not have gone forward. I think this is an erroneous conclusion. Great law firms, accounting firms and other professional corporations are a collection of great minds. These great minds often differ on their opinions. If we could not move forward on a matter unless there was unanimous consensus, then I believe the firms would be brought to a standstill. By looking at the sheer volume of the Internal Revenue Code, it is rare that there are obvious straightforward answers. Most fall in the grey area and require a complex analysis of sometimes apparently conflicting Code provisions or, at best, ambiguous.

The transactions in dispute in *Fallon* were partnership transactions for the calendar year 2000. The Plaintiffs argue that had E&Y done their job and took into account IRS Notices 199959 and 2000-44-both on lack of economic substance, this transaction would not have been marketed. Both notices came out before the related year 2000 federal tax returns were filed.

However, upon closer scrutiny, it would indeed seem that, in my opinion, E&Y may be done in by two issues:

1. The Plaintiffs ability to obtain internal E&Y emails, which make for colorful passages in the lawsuit concerning the marketing of the CDS's and the apparent "love of the fight" by a senior E&Y representative.

2. How an "independent" tax opinion letter by an outside firm was reviewed and edited by E&Y.

*Fallon* is a colorful case with big players on both sides of the lawsuit. The stakes are high for all involved—clients and advisors alike.

[1] *Fallon* v. *Ernst & Young LLP*, Cal. Super. Ct., No. 107CV079123, filed 1/30/07.

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