

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

**Viewpoint
Tax Professionals' State of the Union**

"Economic Substance" has been bantered about quite a lot recently. There had been recent IRS victories on this topic, and there had also been talk about codification. This is an important topic which may shift more exposure to tax professionals. Consequently, let's take a closer look at "economic substance".

In Notice 99-59, 1999-52 I.R.B. 761, the IRS described arrangements that purportedly gave rise to Section 165 losses (e.g., ordinary losses) based on shareholders selling stock with artificially high bases (e.g., lack of economic substance). Further, Notice 2000-44 discussed shutting down tax shelters that lacked economic substance.

Last month, the U.S. Supreme Court denied review to both *Dow Chemical Company*¹ and *Coltec Industries, Inc.*¹ Both of these cases were IRS victories in which the taxpayer failed to meet the burden of proof for economic substance.

We have been watching with interest the evolution of the "economic substance" cases coming down and wondering when the other proverbial shoe is going to drop. On February 17, the "Stop Tax Haven Abuse Act" (S. 681) was introduced by Senators Carl M. Levin (D-Mich), Norman Coleman (R-Minn), and Barack Obama (D-III). Section 401 codifies the economic substance doctrine including proposing a new Section 6662B-Penalty for Understatements Attributable to Transactions Lacking Economic Substance, etc., under which if a taxpayer has a non-economic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40% of the amount of such understatement.

It is interesting to note that also under S.681, the legislation proposes the prohibition against patenting tax strategies. The anti-patent language would become effective on the date of enactment and would apply to any patent that had not been granted by that date. It is my understanding that to date the patent office has issued around 50 tax strategy patents.

From the above, tax professionals have their plate full. But, we might as well take it one step further. On February 21, Gov. Rod Blagojevich announced that he would seek legislation requiring that tax preparation firms be licensed by the state. This appears to be another attempt to regulate the industry. However, we need to ask, is it a necessary one? Is it an effective one?

In his discussions before the Practicing Law Institute's annual SEC Speaks Conference, SEC Chief Accountant Conrad Hewitt suggested that the audit profession seek legislation that would impose caps on lawsuits. He noted that five European countries-Germany, Australia, Belgium, Greece and Slovenia-currently have caps. Furthermore, Britain is introducing a similar concept. However, in my opinion, the ease with which to follow a lawsuit in the United States differentiates us from the rest of the world.

More woes for tax professionals:

1. On February 20, Misuzu Audit Corp., a Japanese affiliate of PricewaterhouseCoopers announced that it would shut down at the end of July, 2007 for its lax audit of Nikko-Cordial Securities Co.'s accounting manipulations.

2. On February 21, the U.S. District Court for the Southern District of New York denied Grant Thornton's bid to dismiss charges over the Parmalat audit based on its relationship with an overseas affiliate.

If tax season wasn't difficult enough, these continuing-and additional-developments need our collective analysis.

The lesson to be learned from all this: For any professional who has assets to protect, protect them now, or run the serious and real risk of losing them.

¹ *Dow Chemical Co. v. United States*, U.S., No. 06-478, cert, denied, 2/20/07.
² *Coltec Industries Inc. v. United States*, U.S., No. 06-659, cert, denied 2/20/07.

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