

Holding a Bad Hand: The Third Circuit Addresses Economic Substance, Part III.

What lessons can we take from *Crispin v. Commissioner*, No. 12-2275 (3d Cir. Feb. 25, 2013)?

The Court's decision on economic substance is on very solid ground, as the case had a variety of bad facts suggesting that the taxpayer was playing audit roulette:

- *First*, Crispin entered into his transaction *after* the IRS had issued a notice relating to inflated basis transactions generally. *Crispin v. Comm'r*, No. 12-2275, slip op. at 5 (citing Notice 2000-44, 2002-2 Cum. Bull. 255 (Aug. 13, 2000)).
- *Second*, the IRS issued another notice that critiqued CARDS transactions *before* Crispin filed the relevant returns. *Id.* at 5-6 (citing Notice 2002-21, 2002-1 Cum. Bull. 730 (Mar. 18, 2002)).
- *Third*, the taxpayer took over a transaction that had been abandoned by another client of the promoter. *Id.* at 6.
- *Fourth*, the taxpayer apparently had a conversation with the promoter in which he indicated that he wanted to shelter a specific amount of income, and the transaction generated a nearly "perfect" loss. *Id.* at 7-8.
- *Fifth*, the taxpayer filed the relevant returns *after* the promoter alerted him to a voluntary disclosure program that would have permitted him to avoid penalties. *Id.* at 11 n. 11.

My only concern with the opinion is an old one: the Third Circuit treats the ultimate conclusion that a particular transaction lacks economic substance as a factual finding subject to deferential review under the clearly erroneous standard. *Id.* at 13 (citing *ACM P'ship v. Comm'r*, 157 F.3d 231, 245 (3d Cir. 1998)). This approach is not universal, as other courts apply more stringent review. See *Klamath Strategic Inv. Fund v. United States*, 568 F.3d 537, 543 (5th Cir. 2009) ("a district court's characterization of a transaction for tax purposes is a question of law subject to *de novo* review, but the particular facts from which that characterization is made are reviewed for clear error").

Applying a deferential standard of review to the ultimate question whether a particular transaction lacks economic substance can impair the development of a consistent body of precedent. See *Salve Regina Coll. v. Russell*, 499 U.S. 225, 232 (1991) (noting that plenary review permits clarification of legal doctrines); cf. *Ornelas v. United States*, 517 U.S. 690, 697-98 (1996) (*de novo* review "necessary if appellate courts are to maintain control of, and to clarify, the legal principles") (citations omitted).

Under the Third Circuit's Internal Operating Procedures, the panel in *Crispin* was bound by the prior opinion in *ACM*, which also applied a deferential standard to that issue. 3d Cir. I.O.P. 9.1. Still, a shift away from a deferential standard of review would be a welcome development in this area. While plenary review probably would not have made a difference here, it can with cases that are at the margins, which is how legal doctrine develops. The other advantage is that plenary review helps to assure that cases with similar facts have similar outcomes.

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