

## Federal Circuit Reverses Trial Court in *Coltec v. United States*

Tax Controversy Alert

**07.12.2006**

Today, the Federal Circuit reversed and remanded the decision of the Court of Federal Claims in *Coltec Industries, Inc. v. United States* (see the [Federal Circuit's opinion](#)). Taxpayers and the government both had awaited the decision, in light of lower court's suggestion that the economic substance doctrine had no application -- at least under Federal Circuit precedent. See *Coltec Industries v. United States*, 62 Fed. Cl. 716 (2004).

The government was concerned about the nationwide effects if the Federal Circuit upheld the lower court decision because taxpayers throughout the country may bring their tax refund cases in the Court of Federal Claims, with appeal to the Federal Circuit. Indeed, the government persuaded the Court of Federal Claims in another important case, *Jade Trading* (which also involves economic substance issues), to stay its proceedings pending the Federal Circuit's decision in *Coltec*. See *Jade Trading, LLC et al. v. United States*, No. 03-2164T (April 27, 2006).

In today's opinion, Judge Dyk of the Federal Circuit reversed the lower court. The Federal Circuit highlighted the 70-year history of the doctrine and reminded the lower court on the need to follow Supreme Court, Federal Circuit, and Court of Claims precedent. The court justified the economic substance doctrine as a means to "prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." Slip Op. at 21. "In this regard, the economic substance doctrine is not unlike other canons of construction that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute." Id.

Will *Coltec* appeal to the Supreme Court? Too early to tell. But absent a successful appeal, the Federal Circuit opinion will impact future economic substance cases brought before the Court of Federal Claims and the Federal Circuit. We also expect the government to argue that its victory in this case has broad applicability to other cases involving the economic substance doctrine.

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