A New Form of Obsenity? Sorting through the Federal Circuit's "We Know It When We See It" Ruling in Coltec
Handout

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By Mark J. Silverman, Matthew D. Lerner, and Gregory N. Kidder

It is perhaps unfortunate, but the most recognizable line from a Supreme Court opinion may be Potter Stewart’s explanation of obscenity as “I know it when I see it” in Jacobellis v. United States. Justice Stewart’s declaration was made in a short concurrence to an opinion overturning the obscenity conviction of Nico Jacobellis for showing the film “Les Amants” (“The Lovers”) in his movie theater. The context of Justice Stewart’s statement is usually omitted when it is cited.

I have reached the conclusion, which I think is confirmed at least by negative implication in the Court’s decisions since Roth and Alberts, that under the First and Fourteenth Amendments criminal laws in this area are constitutionally limited to hard-core pornography. I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.

Justice Stewart’s declaration can be read as an honest admission of the limits of reason to discriminate between the acceptable and the offensive or it can be read as evasive and evidence of an unwillingness to pursue consistency in the application of the law.

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One might raise a similar question about the Federal Circuit’s recent decision in *Coltec Industries, Inc. v. United States.*\(^3\) In *Coltec*, the Federal Circuit found that the taxpayer’s capital loss on the sale of stock in a subsidiary was technically correct under the Internal Revenue Code (the “Code”), but that such loss should be disallowed because the transaction lacked economic substance. The Federal Circuit’s opinion offers an ambiguous and potentially expansive view of the economic substance doctrine. The language of the opinion is very difficult to decipher and it is impossible to determine exactly what standard the Federal Circuit adopted and applied. In addition, the Federal Circuit applied its ambiguous standard of the economic substance doctrine to a single step of the transaction. The combination of the Federal Circuit’s narrow focus on a single step of a transaction and its ambiguous and expansive view of the economic substance doctrine has the potential to dramatically expand the authority of the IRS to review whether the tax consequences of an individual transaction are appropriate. Although the Court made clear that it found the transaction at issue offensive, the opinion shows a striking disregard for the possible implications of the logic that the court used to disallow the capital losses at issue.

Before turning to the facts and decision in *Coltec*, it is useful to review the history of obscenity law. The Supreme Court first declared obscenity to be speech that was not protected by the First Amendment in *Roth v. United States*, and a companion case, *Alberts v. California*, in 1957.\(^4\) The general standard for obscenity set forth in Justice Brennan’s majority opinion was material whose "dominant theme taken as a whole appeals to the prurient interest" to the "average person, applying contemporary community standards." This case started an increasing

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\(^3\) 454 F.3d 1340 (Fed. Cir. 2006)

\(^4\) 354 U.S. 476 (1957)
wave of obscenity cases, culminating in *Miller v. California* in 1973.\(^5\) In 1966, the Court refined the obscenity test set forth in *Roth* in *Memoirs v. Massachusetts*,\(^6\) and stated that for material to be declared obscene "it must be established that (a) the dominant theme of the material taken as a whole appeals to a prurient interest in sex; (b) the material is patently offensive because it affronts contemporary community standards relating to the description or representation of sexual matters; and (c) the material is utterly without redeeming social value." Justice Stewart’s famous “I know it when I see it” concurrence in *Jacobellis* occurred two years later in 1968 during the middle of a period in which the Court was flooded with obscenity cases. Finally, in 1973 *Miller* established a three prong test that must be satisfied for a work to be obscene and therefore unprotected speech: (i) the average person, applying contemporary community standards must find that the work, taken as a whole, appeals to the prurient interest; (ii) the work depicts or describes, in a patently offensive way, sexual conduct or excretory functions specifically defined by applicable state law; and (iii) the work, taken as a whole, lacks serious literary, artistic, political, or scientific value.

Reading the history of obscenity law and the test articulated in *Miller* it is striking to see the parallels to the judiciary’s recent crusade against what appears to be a new form of a obscenity—tax shelters. Recent cases have demonstrated that the line between legitimate tax planning and obscene tax shelters is proving as equally difficult to draw as the line between art and obscene pornography. Substitute “tax avoidance purpose” for “appeals to the prurient interest” and “economic reality” for “serious literary, artistic, political, or scientific value,” and you essentially have the tenets of the economic substance test. As the Federal Circuit’s opinion

\(^5\) 413 U.S. 15 (1973)  
\(^6\) 383 U.S. 413 (1966)