DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
October 13, 2000

OFFICE OF
CHIEF COUNSEL

Number: **200103051**
Release Date: 1/19/2001
UILC: 708.01-00

TL-N-1188-99
CC:PSI:Br9

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ILLINOIS DISTRICT COUNSEL

FROM: Associate Chief Counsel
Passthroughs & Special Industries
CC:PSI

SUBJECT: Section 708

This Field Service Advice responds to your memorandum dated June 1, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

DISCLOSURE STATEMENT

Field Service Advice is Chief Counsel Advice and is open to public inspection pursuant to the provisions of section 6110(i). The provisions of section 6110 require the Service to remove taxpayer identifying information and provide the taxpayer with notice of intention to disclose before it is made available for public inspection. Sec. 6110(c) and (i). Section 6110(i)(3)(B) also authorizes the Service to delete information from Field Service Advice that is protected from disclosure under 5 U.S.C. § 552 (b) and (c) before the document is provided to the taxpayer with notice of intention to disclose. Only the National Office function issuing the Field Service Advice is authorized to make such deletions and to make the redacted document available for public inspection. **Accordingly, the Examination, Appeals, or Counsel recipient of this document may not provide a copy of this unredacted document to the taxpayer or their representative.** The recipient of this document may share this unredacted document only with those persons whose official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND:

T=

A=
B=
C=
D=
E=
F=
G=
H=
J=
L=
N=
P=
S=
U=
V=
X=
Y=
Z=
AA=
BB=
CC=
DD=
EE=
FF=
GG=
HH=
JJ=

Region 1=
Country 2=
Region 3=
Country 4=

Date 1=
Date 2=
Date 3=
Date 4=
Date 5=

Date 6=
Date 7=
Date 8=
Date 9=
Date 10=
Date 11=
Date 12=
Date 13=
Date 14=
Date 15=
Date 16=
Date 17=
Date 18=

Period 1=
Period 2=
Period 3=
Period 4=

Publication #1=

Publication #2=

Publication #3=

$ amount 1=
$ amount 2=
$ amount 3=
amount 4=
amount 5=
amount 6=
amount 7=
amount 8=
amount 9=
$ amount 10=
$ amount 11=
$ amount 12=
$ amount 13=

$ amount 14=
$ amount 15=
$ amount 16=

Foreign Currency A=
Foreign Currency B=

Foreign Currency A #1=
Foreign Currency A #2=
Foreign Currency A #3=
Foreign Currency A #4=

ISSUES:

1. Whether T and its related entities may deduct a foreign currency loss under Internal Revenue Code § 988 that does not reflect movements in exchange rates but rather the purchase price of stock.

2. Whether T, who purchased highly appreciated stock, may use sections 708(b) and 732(c) to generate a significant tax benefit by engaging in the following tax avoidance transaction: (1) T arranged to have the stock and a cost basis liquid asset put into a foreign partnership; (2) T purchased the partnership; (3) T claimed that the deemed liquidation and basis allocation rules in sections 708(b) and 732(c), respectively, thereby increased the adjusted basis of the liquid asset significantly above its fair market value; and (4) T sells the liquid asset and recognizes a large loss.

CONCLUSION:

1. The transaction should be recharacterized in accordance with its economic substance and T's loss should be totally disallowed under Treas. Reg. § 1.988-2(f). Moreover, T should be required to take into account foreign currency gain in the aggregate of approximately $ amount 11 that S realized upon disposition of the Foreign Currency A.

2. No. T cannot increase the adjusted basis of the liquid asset because the rules in sections 708(b) and 732(c) do not apply to the transaction. The foreign partnership T purchased is not a partnership for federal tax purposes because it fails the definition of a partnership and because it lacks economic substance. Even if the foreign partnership is a partnership for federal tax purposes, T cannot increase the basis of the foreign currency under section 732(c) because the purchase of the foreign currency by the foreign

partnership is a sham transaction that has no effect for federal tax purposes and because the foreign currency is not an asset of the foreign partnership.

FACTS:

T is a United States corporation. It is the largest commercial E in Region 1. A is a U.S. subsidiary of T.

B, is a Country 2 corporation unrelated to T or any of its subsidiaries, owned principally by U, a foreign individual. B owned C percent of the stock in D. D is a Country 2 corporation. It is the largest commercial E in Country 2. F, is a Country 2 corporation, unrelated to T or any of its subsidiaries, owned principally by U. The remaining stock of D was owned by F.

In Date 1, T intended to expand its operations into Region 3. As part of such expansion, T sought to acquire a controlling interest in D from U who indirectly owned D. Under the initial purchase agreement dated Date 2, B was to sell G percent of the voting stock in D to a subsidiary of T for Foreign Currency B equivalent of $ amount 1. The sale was set to close on Date 3. On Date 4, T and B entered into an agreement which extended the closing date from Date 3 to Date 7. The sale date was later extended a second time to Date 5.

T suggested to U's counsel that B hold the stock through a partnership, N, and that T purchase the interests in N, rather than T merely having one of its subsidiaries purchase the shares of D directly.

On Date 6, A contributed $ amount 2 to H, a U.S. corporation, and $ amount 3 to J a U.S. corporation, in exchange for all of the stock of each corporation.

On Date 7, H and J formed L, a Country 2 entity. Each partner owned 50 percent of L.

On the same date, B and F formed N, a Country 2 entity. B contributed P shares of D voting stock valued at Foreign Currency B amount 4 to N in exchange for a 99.5 percent interest, and F contributed Foreign Currency B amount 5 to N in exchange for a 0.5 interest. (Foreign Currency B is the currency of Country 2). F, however, did not fund its contribution to N until Date 8 (although the partnership was formed on Date 7). After its formation, N owned G percent of D.

Also, on Date 7, the sale of D was restructured. T, B, J, L, F, and N entered into an amendment to the Date 2 agreement. F was to sell its interest in N to J for Foreign Currency B amount 6 and B was to sell its interest in N to L for Foreign Currency B amount 7.

On Date 18, D sold V percent of its stock to the public. In connection with the public offering, subsequent to the signing of the Date 2 Agreement, D declared a dividend, the first portion to be paid on Date 14, and the second portion to be paid on Date 8. The Date 2 Agreement allowed B to retain approximately the Foreign Currency B equivalent of $ amount 12 of the dividend, i.e., its portion of the dividend paid on Date 14.[1] Using this dividend and the cash contributed by F, N acquired Foreign Currency A #1 on Date 9, (one date following Date 8) for Foreign Currency B amount 9. On Date 10, Foreign Currency A #1 was transferred to the N bank account at Country 4 Bank Corporation.

On Date 5, (three days following Date 8) F and B sold their respective interests in N to J and L. N became S.

On Date 11, (approximately 6 months after Date 9), S withdrew Foreign Currency A #2 from its account and sold them. It claimed a foreign exchange loss on the sale in the approximate amount of $ amount 10. On Date 12, (approximately 11 months after Date 9), S withdrew Foreign Currency #3 from its account and sold them. It claimed a foreign exchange loss on the sale in the amount of $ amount 10. The claimed losses were premised on N's reallocation of inside basis.[2] In fact, although the fair market value of the Foreign Currency A constituted only X percent (a minute percent) of the fair market value of the assets of the partnership, as a result of N's reallocation of inside basis, Y percent (a very large percent) of T's basis in the partnership, was allocated to the Foreign Currency A. Economically, S realized a gain of approximately $ amount 11 on the two sales of the Foreign Currency A. Taxpayer asserts that converting Foreign Currency B to a less volatile foreign currency like Foreign Currency A, is in accordance with standard business practice in Country 2.

---

[1] Although the declaration of the dividend occurred subsequent to the Date 2 Agreement, U had previously notified T of its intention to have D pay the dividend.

[2] Generally, non-functional currency is treated as property. See Treas. Reg. § 1.988-2(a)(1)(i).

B, F, and N do not have EINs and have never filed a United States income tax return; they are foreign entities with no United States reporting requirements. S applied for an EIN and filed a partnership return for Date 1 and Date 13.

For purposes of this assistance we assume that during the relevant taxable year, Date 1, S constituted a qualified business unit (QBU) under section 989 of the Code, and had a Foreign Currency B functional currency under the rules of section 985.

T claims a variety of business purposes for the arrangement of the transaction. Among them, T asserts that the sale of D shares was structured as a sale of a partnership which held the shares, N, for various reasons relating to its and U's Country 2 situations. In regard to T's tax planning, T asserts that a publicly traded Country 2 corporation, which D was, is required to distribute at least Z percent of its earnings as dividends each year. T claims that it decided to hold the D shares through two Country 2 entities to ameliorate the effects of an AA percent withholding tax on dividends distributed to non-Country 2 shareholders. By holding the D shares through two Country 2 entities, and having the higher tier entity borrow a part of the purchase price from Country 2, the interest paid on the loans would be deductible from the dividend for purposes of the withholding tax.

T further asserts that the partnership structure also benefitted U. D had already declared a dividend of approximately 50 percent of its Date15 earnings, the second installment of which had not yet been paid. In an effort to resolve a controversy over the purchase price of the D shares, T noted that under Country 2 law if the dividend is paid to a partnership, the partners will receive increased basis in their partnership interests for the dividend, as long as the dividend is retained by the partnership. Accordingly, by a partnership holding the G percent of D shares which U intended to sell, and the partnership receiving the dividend, U, or B, his wholly owned corporation, would reduce its substantial capital gains on the sale of the D shares.

T claims that it originally had planned to finance the purchase of the D shares through borrowing from Country 2 banks, in order to reduce the high withholding tax burden on the dividends it expected to receive on the D shares. In fact, T's upper tier partnership, L, borrowed the Foreign Currency B equivalent of $ amount 13 of the purchase price from Country 2 banks. T claims that circumstances changed, D was not as profitable as expected, and the amount of the dividends was insufficient to require their being sheltered with interest payments on otherwise unattractive debt. Accordingly, in Date 16, L retired the Foreign Currency B equivalent of $ amount 14 of the debt. The debt was retired in part with the Foreign Currency A, which were converted to Foreign Currency B, and distributed by S to L. The remainder of the proceeds used to retire the debt, $ amount 15, were contributed by A, the domestic parent of H and J, through H and J, to L.

The remainder of the Foreign Currency A were converted by S to Foreign Currency B in Date 17, and used for its current operating expenses.

LAW AND ANALYSIS

1. Section 988

Sections 985-989, which were enacted as part of the Tax Reform Act of 1986, set forth a comprehensive set of rules for the treatment of foreign currency transactions. Section 988(a)(1)(A) provides that foreign currency gain or loss attributable to a section 988 transaction is computed separately and treated as ordinary income or loss. Foreign currency gain on a section 988 transaction is generally defined as the gain on the transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date. Section 988(b)(1). Foreign currency loss is similarly defined in section 988(b)(2). In this manner, Congress intended that only gain or loss to the extent it is realized by reason of a change in exchange rates between the date the asset or liability is taken into account for tax purposes and the date it is paid or otherwise disposed of, will be treated as foreign currency gain or loss. S. Rep. No. 313., 99th Cong., 2d Sess. 461 (1986). In addition, any gain or loss from the disposition of nonfunctional currency is treated as foreign currency gain or loss under the assumption that any gain or loss realized on the disposition of nonfunctional currency must be attributable to the fluctuation in the foreign exchange rates between the purchase and sale of the currency. Section 988(c)(1)(C)(i). This is confirmed by committee reports describing the principles of section 988 prior to its amendment by the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"). (TAMRA did not change section 988 with regard to issues implicated in this case.) Thus, the House Ways and Means Committee Report to the Miscellaneous Revenue Act of 1988 stated that "[i]n the case of any disposition of nonfunctional currency, the relevant period for measuring rate changes is the time between acquisition and disposition of the currency." H.R. Rep. No. 795, 100th Cong., 2d Sess. 296 (1988). See also, S. Rep. No. 445, 100th Cong., 2d Sess. 331 (1988) (containing identical language).

The legislative history of sections 985 - 989 suggests a consistent concern about tax motivated transactions. The Senate Finance Committee Report accompanying the Tax Reform Act of 1986 stated that one of the two reasons sections 985 - 989 were enacted was that prior law provided opportunities for tax motivated transactions. S. Rep. No. 313., 99th Cong., 2d Sess. 450 (1986). Accordingly, in enacting sections 985 - 989, Congress granted broad authority for the Service to promulgate regulations "as may be necessary or appropriate to carry out the purposes of [sections 985 - 989] . . . ." Section 989(c). The legislative history to the TAMRA, in discussing the law prior to the enactment of TAMRA, stated that "[t]he Secretary has general authority to provide the regulations necessary or appropriate to carry out the purposes of new subpart J. For example, the Secretary may prescribe regulations appropriately recharacterizing transactions to harmonize the general realization and recognition provisions of the Code with the policies of section 988." H.R. Rep. No. 795, 100th Cong., 2d Sess. 296 (1988); S. Rep. No. 445, 100th Cong., 2d Sess. 311 (1988) (containing identical language).

In response to Congress's concern about tax motivated transactions, the Service, under the authority of section 989(c), promulgated Treas. Reg. § 1.989-2(f) which states that if the substance of a transaction differs from its form, the Commissioner may recharacterize the timing, source, and character of gains or losses with respect to the transaction in accordance with the substance of the transaction.

Analysis

We believe that the transaction at issue should be recharacterized in accordance with its economic substance and T's loss totally disallowed under Treas. Reg. § 1.988-2(f). Moreover, T should be required to take into account foreign currency gain in the aggregate amount of approximately $ amount 11 that S realized upon disposition of the Foreign Currency A. As stated previously, Treas. Reg. § 1.988-2(f) states that "[i]f the substance of a transaction described in § 1.988-1(a)(1) differs from its form, the timing, source, and character of gains or losses with respect to such transaction may be recharacterized by the Commissioner in accordance with its substance."[3] In this case, in form the loss results from the sale of Foreign Currency A, a transaction described in Treas. Reg. § 1.988-1(a)(1)(i), in which the basis exceeded the amount realized by approximately $ amount 16. However, in substance T purchased the D stock, and in order to generate a large tax loss that was not economically present, it induced the seller, U, to package the D stock in a partnership with a relatively small amount of Foreign Currency A. Instead of T purchasing the D stock outright, as T and U had previously agreed, T purchased the partnership interests instead. In this manner, T claims that under

---

[3] Treas. Reg. § 1.988-2(f)(1) further provides, "For example, if a taxpayer enters into a transaction that it designates a "currency swap contract" that requires the prepayment of all payments to be made or to be received (but not both), the Commissioner may recharacterize the contract as a loan." This example indicates that the authority of the Service to recharacterize transactions in accordance with their substance is broad.

section 708(a) there was a technical termination of the partnership, and that under section 732(c) T's basis in the partnership property was allocated in a manner so that T's cost for the D stock was effectively shifted to the Foreign Currency A. Consequently, when it sold the Foreign Currency A and claimed its loss, it prematurely deducted a large portion of the cost of the D shares. An artificial shifting of basis to the Foreign Currency A so that the computation of foreign currency loss does not reflect economic substance is manifestly contrary to the intent of Congress as set forth above which requires that currency gain or loss be computed by reference to movements in exchange rates. In this case, the claimed loss is so vastly removed from the actual economic effect of exchange rate fluctuations in the Foreign Currency A that occurred (gain to S) when it sold the Foreign Currency A that no reasonable person could claim that the reported loss reflects realistically the movements in exchange rates.

Other factors that support our conclusion are as follows:

(1) N had no business other than holding the D shares and, even assuming that N served a legitimate business function, had no need for Foreign Currency A. The currency of N's business environment (again assuming that N served a legitimate business function) was Foreign Currency B (and not Foreign Currency A) as N did not have Country 4 operations.

(2) T claims that it was standard business practice in Country 2 to hedge the Foreign Currency B cash accounts and that N was simply following this standard practice. However, in the context of the facts of this case this argument rings hollow. B and F, the partners of N, had no economic interest in causing N to incur the costs of hedging its Foreign Currency B cash since B and F had contractually locked in the sales price for N (i.e., the D stock and the Foreign Currency B cash) in U.S. dollars. Thus, B and F had no risk of loss if the Foreign Currency B depreciated during the three days between the date that the Foreign Currency B was received by N (in the form of a dividend and a capital contribution) and the date N was sold because the sales price of all of N's assets including the Foreign Currency B was fixed in U.S. dollars on the contract date under the terms of the contract .[4]

---

[4] Even if the contract contained provisions barring N from wasting its assets, given the stability of the Country 2 economy and the relatively low rates of inflation set forth below, we do not believe that there existed a significant risk that the Foreign Currency B cash held by N would depreciate significantly for the three days between receipt and sale. Moreover, the Foreign Currency B cash held by N was only X percent of the total assets of N, (a virtually insignificant amount).

Moreover, during the Period 1, the Country 2 economy was growing at an annual rate of BB percent, Publication #1, and Foreign Currency B also had appreciated in real terms in relation to the U.S. dollar. Publication #2. Furthermore, during Period 2 the Country 2 government generated fiscal surpluses in each of the years. Publication #2. Finally, Country 2 inflation rates for Period 3 were CC percent, DD percent, and EE percent respectively. Publication # 3. None of these factors suggests that the Country 2 economy was so unstable or that inflation was so great that it would be standard business practice to hedge Foreign Currency B cash balances into Foreign Currency A. Accordingly, we do not believe that N purchased the Foreign Currency A to hedge the risk that the small amount of Foreign Currency B cash would depreciate against the U.S. dollar.

(3) T and U had no reason, other than federal income tax avoidance, for setting up N, and transferring U's interests in N, rather than simply selling the D stock outright. T claims that N was formed in order that to reduce B's Country 2 capital gains tax on the sale of the D shares. Yet, it is undisputed that T suggested to U to set up D. In addition, B's tax savings were dwarfed by T's $ amount 16 tax benefit. See Sheldon v. Commissioner, 94 T.C. 738 (1990) (comparing relative tax savings and alleged profit). T also claims that it expected that D would pay out a significant amount of dividends, and under Country 2 tax law, T's withholding tax on the dividends would be reduced by holding the D stock using two Country 2 tiers. Even if T anticipated that D would have paid a significant amount of dividends, T admits that it could just as easily have purchased the D stock and contributed the stock to its lower tier entities.

Accordingly, to reflect the economic substance of the transaction under Treas. Reg. § 1.988-2(f), the $ amount 16 loss should be disallowed; the basis in the Foreign Currency A should be adjusted to reflect solely the actual cost of the Foreign Currency A; any remaining basis attributed by T to the Foreign Currency A should be re-attributed to the D stock; and currency gain realized by S from the disposition of the Foreign Currency A reflecting actual exchange rate movements must be reported as ordinary income under section 988. Through the transaction being recharacterized according to its substance of T purchasing the D stock valued at approximately $ amount 1 and a relatively small amount of Foreign Currency A, T will be able to recover its basis in the D stock at the point at which T would have recovered its basis under the general realization and recognition provisions of the Code, i.e., when T (or its related entities) sells the stock, when it receives distributions in excess of earnings and profits, or when the stock becomes worthless. See H.R. Rep No. 795, 100th Cong., 2d Sess. 296 (1988) ("the Secretary may prescribe regulations appropriately recharacterizing transactions to harmonize the general realization and recognition provisions of the Code with the policies of section 988."); S. Rep. No. 445, 100th Cong., 2d Sess. 311 (1988) (containing identical language).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

2. N was not a valid partnership

A partnership exists for federal income tax purposes if "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." I.R.C. § 761; 7701(a)(2); Commissioner v. Culbertson, 337 U.S. 733, 742 (1949); ASA Investerings Partnership v Commissioner, T.C. Memo. 1998-305, aff'd, 201 F.3d 505 (D.C. Cir. 2000). To be considered partners, the parties must "really and truly intend to join together for the purpose of carrying on business and sharing in the profits or losses or both." Commissioner v. Tower, 327 U.S. 280, 287 (1946). Courts examine objective factors in ascertaining the parties' true intent. Culbertson, 337 U.S. at 742; Luna v. Commissioner, 42 T.C. 1067, 1077-78 (1964). An arrangement intended and structured solely for United States tax benefits, between parties with no common business interests and who would not share profits and losses, is not a bona fide partnership. Culbertson, 337 U.S. 733. See Merryman v. Commissioner, 873 F.2d 879, 881 (5th Cir. 1989), aff'g T.C. Memo. 1988-72.

Here, B and F held a C and BB percent interest in D, respectively, at the time T agreed to purchase a G percent interest. After the initial sale agreement, and while bound by the revised sale agreement, they transferred a total of G percent of stock in D to a newly-formed partnership, N, which was owned 99.5 percent by B and 0.5 percent by F. N existed for only 15 days, and during that time its partners could not have intended to carry on a business because they knew when, and for how much, the partnership was to be sold. Thus, in the absence of a bona fide partnership, L and J must be treated as having bought the stock and Foreign Currency A directly from N's partners, and therefore the basis in the Foreign Currency A could not exceed the fair market value of the Foreign Currency A.

The basis in the Foreign Currency A cannot be stepped-up under section 732(c)

Even if N would be considered a partnership for federal tax purposes, the basis of the Foreign Currency A it purchased should not have been increased under section 732. As discussed above, N purchased the Foreign Currency A solely to provide T with a tax advantage. The purchase was devoid of economic substance and any business purpose. Therefore, the purchase by N is a sham and without effect for Federal tax purposes.

A transaction must have economic substance separate and distinct from the economic benefit achieved solely by tax reduction. If a taxpayer seeks to claim tax benefits, which were not intended by Congress, by means of transactions that serve no economic purpose other than tax savings, the doctrine of economic substance is applicable. United States v. Wexler, 31 F.3d 117, 122, 124 (3d Cir. 1994); Yosha v. Commissioner, 861 F.2d 494, 498-99 (7th Cir. 1988), aff'g Glass v. Commissioner, 87 T.C. 1087 (1986); Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966), aff'g 44 T.C. 284 (1965); Weller v. Commissioner, 31 T.C. 33 (1958), aff'd, 270 F.2d 294 (3d Cir. 1959); ACM Partnership v. Commissioner, T.C. Memo. 1997-115, aff'd in part and rev'd in part 157 F.3d 231 (3d Cir. 1998). Whether a transaction has economic substance is a factual determination. United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 456 (1950). This determination turns on whether the transaction is rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. The utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry. Cherin v. Commissioner, 89 T.C. 986, 993-94 (1987); ACM Partnership, supra. A rational relationship between purpose and means ordinarily will not be found unless there was a reasonable expectation that the nontax benefits would be at least commensurate with the transaction costs. Glass v. Commissioner, 87 T.C. 1087 (1986); ACM Partnership, supra.

In determining whether a transaction has economic substance so as to be respected for tax purposes, both the objective economic substance of the transaction and the subjective business motivation should be evaluated. ACM Partnership, 157 F.3d at 247; Casebeer v. Commissioner, 909 F.2d 1360, 1363 (9th Cir. 1990). The two inquiries are not separate prongs, but are interrelated factors used to analyze whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes. ACM Partnership, 157 F.3d at 247; Casebeer, 909 F.2d at 1363; Rose v. Commissioner, 868 F.2d 851, 853 (6th Cir. 1989); Sochin v. Commissioner, 843 F.2d 351, 354 (9th Cir. 1988), cert. denied 488 U.S. 824 (1988).

While the profit potential or economic risk, relative to the expected tax benefit, necessary to meet the objective economic substance test has not been quantified, a reasonable prospect or possibility for profit is required. See ACM Partnership, 157 F.3d 231; Goldstein v. Commissioner, 364 F.2d 734, 740-42 (2nd Cir. 1966). Nominal or de minimis profit potential does not imbue a transaction with economic substance. Krumhorn v. Commissioner, 103 T.C. 29, 55 (1994); Sheldon v. Commissioner, 94 T.C. 738, 767-68 (1990).

With respect to allowing an artificial loss, the Tax Court stated:

> We do not suggest that a taxpayer refrain from using the tax laws to the taxpayer's advantage. In this case, however, the taxpayer desired to take advantage of a loss that was not economically inherent in the object of the sale, but which the taxpayer created artificially through the manipulation and abuse of the tax laws. A taxpayer is not entitled to recognize a phantom loss from a transaction that lacks economic substance.

ACM Partnership v. Commissioner, T.C. Memo. 1997-115, 73 T.C. M. (CCH) 2189, 2215, aff'd in part and rev'd in part 157 F.3d 231 (3rd Cir. 1998).

It appears that N purchased the Foreign Currency A with the prearranged purpose of allowing T to allocate the basis to the Foreign Currency A from the stock and a loss upon the sale of the Foreign Currency A was therefore realized. Thus, we believe that this is a loss "created artificially through manipulation and abuse" of sections 708 and 732. While taxpayers may choose their form of business, they may not do so for the sole purpose of creating a non-economic loss. The juxtaposition of the purchase of the Foreign Currency A immediately prior to the technical termination strongly suggests that the purpose behind the purchase was to achieve a phantom loss. Consequently, because we believe that there is no legitimate business purpose for the purchase of the Foreign Currency A prior to T's purchase of the partnership, and that purchase lacked economic substance, therefore, T is prohibited from increasing its basis in the Foreign Currency A under section 732.

Foreign Currency A was always an asset of T

Alternatively, Foreign Currency A was an asset of T at all times because N purchased them as T's agent. Cf. ASA Investerings, T.C. Memo. 1998-305, citing Commissioner v. Bollinger, 485 U.S. 340 (1988) (disregarding two nominal partners in the venture because it found that they were actually the agents of the real party in interest). After T had already agreed to purchase G percent of D, it discovered the elements necessary for an abusive tax shelter in the agreement. It therefore requested that B place the G percent interest T was purchasing in N and that N purchase the Foreign Currency A for T so that T could create an artificially high basis liquid asset to generate a tax loss. N has not shown an independent reason for purchasing the assets because it did so only as an accommodation to T. Moreover, the money used to purchase the Foreign Currency A indirectly came from T and not N. The majority of the funds used to buy the Foreign Currency A came from a dividend from D to N, funds that would be T's in GG days. The remaining funds came from F's capital contribution, a sum returned to F GG days later upon the sale of its interest in N. Thus, N should be deemed to have been T's agent in the purchase of the Foreign Currency A. Therefore, the Foreign Currency A were not partnership property subject to the basis rules of section 732 upon the technical termination of N under section 708.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

[redacted]

Please call if you have any further questions.

ASSOCIATE CHIEF COUNSEL
PASSTHROUGHS & SPECIAL INDUSTRIES

BY ____________________________________

PATRICK PUTZI
SPECIAL COUNSEL (BRANCH 9)
PASSTHROUGHS & SPECIAL INDUSTRIES