INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 20, 2005

Third Party Communication: None
Date of Communication: Not Applicable

Number: **200604033**
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Index (UIL) No.: 1001.00-00, 1058.01-00
CASE-MIS No.: TAM-120696-05

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =
Parent =
Counterparty =

ABC Company (ABC) =
XYZ Corporation (XYZ) =
Corporation D =
Corporation E =
Trustee =
Securities Corporation =

Guarantor =
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	=
Date 19	=
Date 20	=
Date 21	=
Date 22	=
Date 23	=
Date 24	=
Date 25	=
Date 26	=
Date 27	=
Date 28	=
Date 29	=
Date 30	=
Date 31	=
Date 32	=
Date 33	=
Month 1	=
Year 1	=
Year 2	=
Year 3	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
i	=
j	=
k	=
l	=
m	=

n	=
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r	=
s	=
t	=
u	=
v	=
w	=
x	=
y	=
z	=

ISSUE:

Is there a current sale of shares for tax purposes when Taxpayer has entered into an agreement to sell shares to Counterparty and placed those shares in a pledge account for the benefit of Counterparty, and Counterparty has borrowed those shares pursuant to a share lending agreement?

CONCLUSION:

When Taxpayer has loaned shares to Counterparty that were originally pledged to the Counterparty, and the Counterparty disposed of the shares, the cumulative effects of the agreement result in a current sale of shares for tax purposes, notwithstanding Rev. Rul. 2003-7, 2003-1 C.B. 363.

FACTS:

Background

Taxpayer is a wholly owned subsidiary of the Parent. Parent elected to treat Taxpayer as a qualified subchapter S subsidiary under § 1361(b)(3)(B)(ii) of the Internal Revenue Code, effective Date 1 and Taxpayer was included in Parent's consolidated federal income tax returns for Year 1 and Year 2.

During the tax years ended Date 3 and Date 4, Taxpayer owned publicly-traded shares of common stock in ABC Company (ABC) and XYZ Corporation (XYZ). Beginning in Month 1 Year 1, Taxpayer entered into a series of transactions intended to result in the purchase and sale of the ABC and XYZ shares to Counterparty.[1] As

[1] Taxpayer acquired these shares as strategic rather than portfolio investments. With respect to XYZ common stock and in connection with the merger of XYZ and Corporation D in Year 3, Taxpayer entered into long term shareholder agreements with XYZ and ABC, which contained material provisions concerning the control and oversight of XYZ and ABC, including the right for Taxpayer to appoint a

described more fully below, the series of transactions were enacted through three tiers of agreements that provide the operating terms under which the purchase and sales were to occur. The first tier consisted of a Master Stock Purchase Agreement ("MSPA"), which provide terms available for use for individual tranches of shares (the "Tranches"). The second tier consisted of two Pledge Agreements for the ABC and the XYZ stock that provided the mechanism by which the Tranches would be placed in collateral accounts for the benefit of Counterparty. The third tier consisted of three Share Lending Agreements, one for the ABC stock and two for the XYZ stock, which permit Counterparty to borrow the Tranches.

Stock Purchase Agreements

On Date 2, Taxpayer executed the MSPA with Counterparty and Securities Corporation. Securities Corporation acted as agent for both Taxpayer and Counterparty in arranging and facilitating the sale of the shares owned by Taxpayer. Taxpayer acknowledged and understood that none of Counterparty, the agent, or any other affiliate of Counterparty was acting as a fiduciary or advisor to Taxpayer. the MSPA establishes a procedure for the parties to enter into a "forward purchase and sale transaction," which may be subdivided into one or more Tranches (each a "Tranche"), by executing a "Transaction Schedule" setting forth certain financial terms of the specific transaction. the MSPA creates the basic contractual obligations constituting a prepaid forward sale contract by, among other things, obligating Taxpayer to sell and Counterparty to purchase shares of common stock , providing for payment on a Payment Date (scheduled to occur in close proximity to the execution of the Transaction Schedule) and delivery of the shares on a future Settlement Date , and creating a cash settlement option . the MSPA sets forth certain conditions that must be satisfied before a transaction may be established to create the forward sale obligation specified , including entering into a Pledge Agreement and delivering to the Collateral Agent under the Pledge Agreement the maximum number of shares subject to the transaction . In turn, the Pledge Agreement directs the Collateral Agent to enter into a Share Lending Agreement, and the MSPA requires that certain legal opinions be rendered with respect to the validity and enforceability of the Pledge Agreement and the Share Lending Agreement. The MSPA contemplates that it would be amended from time to time by additional later agreements, including the Transaction Schedule for the transaction, the Pledge Agreement, and the Share Lending Agreement for such transaction.

member of the board of each company. One of the reasons Taxpayer decided to enter into the stock purchase agreements described below was to preserve its rights under the shareholder agreements.

Taxpayer entered into three stock purchase agreements[2] with Counterparty with respect to the ABC and the XYZ stock under the terms of the MSPA. Pursuant to the MSPA, each stock purchase agreement was set up as a "Transaction," with terms as defined under its specific Transaction Schedule. Within each Transaction, there are one or more Tranches, each with terms provided by a Pricing Schedule . The MSPA provides for the Counterparty to enter into short sales to establish the Purchase Price for a Tranche under the related Pricing Schedule (each, an "Initial Short Position") . The parties also acknowledged that the Counterparty might enter into hedging transactions, including short sales, from time to time.

The Purchase Price is an upfront amount paid by Counterparty to Taxpayer upon execution of a Tranche. All Transactions are to be settled approximately g years after execution of a particular Tranche based on a defined settlement calculation. Each of the Transactions is substantially the same except where noted.

On Date 2, the same date as the MSPA, Taxpayer entered into the first Transaction with Counterparty with respect to the ABC shares (the "First Transaction"). Pursuant to the Transaction Schedule for the First Transaction ("First Transaction Schedule"), dated Date 2, Taxpayer agreed to sell and Counterparty agreed to purchase up to a ABC shares.[3] On Date 5, Taxpayer entered into the second Transaction with respect to the XYZ shares (the "Second Transaction"), as amended on Date 6. Pursuant to the Transaction Schedule for the Second Transaction ("Second Transaction Schedule"), dated Date 5, Taxpayer agreed to sell and Counterparty agreed to purchase up to b XYZ shares. On Date 7, Taxpayer entered into the third Transaction with respect to additional XYZ shares (the "Third Transaction," collectively the "Transactions"). Pursuant to the Amended and Restated Transaction Schedule No. 2 dated Date 6, the Transaction Schedule for the Third Transaction ("Third Transaction Schedule"), Taxpayer agreed to sell and Counterparty agreed to purchase up to c XYZ shares.

In order to meet the requirements of the MSPA, Taxpayer entered into two Pledge Agreements with Counterparty, with respect to the ABC and the XYZ stock. The parties to the Pledge Agreements are Taxpayer, as pledgor, Counterparty, as pledgee, and the Trustee as agent on behalf of Counterparty. Under the terms of each Pledge Agreement, Taxpayer was required to pledge its shares of ABC or XYZ stock in collateral accounts as collateral for its obligations under the Transactions.

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[2] A forward agreement is so-called because the parties to the agreement identify stock to be delivered on a date in the future. Because the accuracy of this label is part of the dispute in this case, we use more neutral terms to describe the transaction.

[3] Ultimately, only u shares of ABC common stock became subject to the First Transaction. Around Date 33, ABC merged with Corporation E, and each share of ABC common stock was converted into v shares of Corporation E common stock. The u shares actually comprise w shares of ABC common stock and x shares of Corporation E common stock.

Trustee was to hold the shares in trust on behalf of Counterparty and was granted the power of sale, as well as Taxpayer's rights, title, and interest in the pledged shares, the collateral accounts, and the Share Lending Agreements.

At the time the Pledge Agreement was executed, Taxpayer was required to deliver to Trustee the maximum number of ABC or XYZ shares (the "Initial Pledged Shares") that would be subject to that Tranche, which shares were to be held until released under the terms of the Pledge Agreement for a Transaction.

[4] The pledged shares were divided up by Tranche in the collateral accounts. Each Tranche differed by type of stock, date of execution, maturity date, number of shares, and other factors related to the determination of the number of shares to be delivered on the maturity or termination of a Tranche, as set forth in a Pricing Schedule for a Tranche under the MSPA.

On the same date as the MSPA and the First Transaction, on Date <u>2</u>, Taxpayer entered into the Pledge Agreement with respect to the ABC shares (the "ABC Pledge Agreement"). Tranches Nos. 1 and 2 of the First Transaction were entered into on Date <u>8</u> and Tranches Nos. 3 through 6 entered into on Date <u>9</u>, through Date <u>10</u> (the Tranche execution dates). The pledged ABC shares were deposited in the collateral accounts with Trustee on Date <u>11</u>, Date <u>12</u>, and Date <u>13</u>.

On the same date as the Second Transaction, on Date <u>5</u>, later amended on Date <u>6</u> by an amended and Restated Transaction Schedule, Taxpayer entered into a Pledge Agreement with respect to the XYZ shares for the Second and Third Transactions (the "XYZ Pledge Agreement"). The dates that the Tranches under the Second and Third Transactions were entered into are not available. For purposes of this technical advice memorandum, however, we assume that all Tranches were entered into under similar schedules as for the First Transaction. The pledged XYZ shares were deposited in the collateral accounts with Trustee on Date <u>14</u>, Date <u>15</u>, and Date <u>16</u> (the Tranche execution dates).

As contemplated under both Pledge Agreements, Trustee, acting as Taxpayer's agent rather than Counterparty's agent as under the Pledge Agreement, entered into three Share Lending Agreements with Counterparty with respect to the ABC and XYZ stock. the Pledge Agreements instructs the Trustee to enter into a Share Lending Agreement with respect to the pledged shares on Taxpayer's behalf with a party approved by Counterparty. Under the Pledge Agreements, Taxpayer acknowledges and Trustee agrees to all representations,

[4] Taxpayer is restricted under the Pledge Agreement from entering into any agreement, other than the Pledge Agreement or Share Lending Agreement, that restricts

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addition, the parties agree that Trustee warranties, and covenants that Trustee will make on its behalf in the Share Lending Agreements. The Pledge Agreements also provide Taxpayer's instructions to Trustee to commence lending any or all of the pledged shares pursuant to the Share Lending Agreements "promptly" following execution of the Pledge Agreements.

the Share Lending Agreements provides the procedures for loaning the pledged shares. In order to loan the pledged shares, Counterparty must notify Trustee of its intentions the business day prior to the commencement date of the "loan." Once the notice and instructions are delivered, Counterparty is able to borrow shares, terminate the loan of the shares, and re-borrow the shares at its choice.[5] The number of loaned shares could be adjusted from time to time without resulting in an increase in the Tranche fees. The loan occurred when the shares were transferred to Counterparty. Once a Share Lending Agreement was executed, Counterparty had the right to promptly "borrow" shares from the collateral accounts by issuing to Trustee a Tranche Establishment Notice (and Notice of Borrowing), as set forth under the Share Lending Agreements ("Borrowing Notice") and the Pledge Agreements. The Borrowing Notice provided the terms of the borrowing, including the Tranche being borrowed, the number of shares, the commencement and expiration dates of a Tranche, and the Prepaid Tranche Fee for a Tranche.[6] Without consent of Counterparty, Taxpayer could terminate a loan of any or all of the pledged shares upon z days notice by Trustee to Counterparty, and the subject shares are to be returned to the collateral accounts. Counterparty's obligation to return the borrowed shares is unconditionally guaranteed by Guarantor.

Over the course of a loan, Counterparty was given all incidents of ownership in the loaned shares, including the right of transfer, and Taxpayer and Trustee waived voting rights in the shares under the Share Lending Agreements.

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[5] Under the Share Lending Agreements, Taxpayer warranted that it was acting as a principal on its own behalf and that it would independently decide whether to have Trustee enter into a Share Lending Agreement and any loan of pledged shares on Taxpayer's behalf.

[6] Under the Share Lending Agreements, Taxpayer has the option to either receive the Prepaid Tranche Fees upfront, at the time of receipt of a Borrowing Notice, or quarterly in arrears over the term of a Loan. If a Tranche is terminated prior to its expiration date, then Taxpayer is required to repay a pro rata amount of any Prepaid Tranche Fees.

Counterparty, however, was required to pay to Trustee certain distributions received on the loaned shares .

Although Taxpayer was not required to give written instruction to initiate a Share Lending Agreement, under the Pledge Agreements, Trustee could request in writing an instruction in writing from any party with respect to any action which Trustee is authorized to take.[7] On Date 19, Taxpayer gave written instructions to Trustee to enter into a Share Lending Agreement with Counterparty with respect to ABC shares pledged under the ABC Pledge Agreement for the First Transaction (the "First Share Lending Agreement). On Date 20, prior to the date of the written instructions, Trustee entered into the First Share Lending Agreement with Counterparty with respect to the pledged ABC shares. On Date 21, Counterparty issued Borrowing Notices for loans of pledged shares from Tranche Nos. 1 through 3 on Date 22. Later, on Date 23, Counterparty issued additional Borrowing Notices for loans of pledged shares from Tranche Nos. 4 through 6 on Date 23. The maximum number of shares that could be loaned under the Date 20 Share Lending Agreement was a shares, and each loan of pledged shares was to be carried out with respect to a specific Tranche of shares.[8]

On Date 24, Trustee entered into the Second Share Lending Agreement with Counterparty with respect to the pledged XYZ shares (the "Second Share Lending Agreement"). On Date 25, Counterparty issued Borrowing Notices for loans of pledged shares from Tranche Nos. 1 and 2 on Date 26. Later, on Date 27, Counterparty issued a Borrowing Notice for a loan of pledged shares from Tranche No. 3 on Date 28.

On Date 18, Taxpayer gave written instructions to Trustee to enter into a Share Lending Agreement with Counterparty with respect to XYZ Shares pledged under the XYZ Pledge Agreement under the Third Transaction (the "Third Share Lending Agreement). On Date 17, Trustee entered into the Third Share Lending Agreement with Counterparty with respect to the pledged XYZ shares, prior to the date of Taxpayer's written instructions. On Date 17, Counterparty issued Borrowing Notices for loans of pledged shares from Tranche Nos. 1 and 2 also on Date 17.

The upfront amounts received by Taxpayer (the "Initial Purchase Price") pursuant to each Tranche depended upon Counterparty's Initial Short Position in the shares, which was established by the amounts that Counterparty obtained for other shares in its short sales entered into with third parties immediately prior to a particular Transaction

[7] As described below, it appears that on several occasions, Trustee "loaned" the pledged shares to Counterparty prior to receiving any written instructions from Taxpayer. On one occasion, Trustee entered into a Share Lending Agreement with Counterparty on Date 17 and the shares were transferred to Counterparty but the Trustee did not receive written instructions to do so until almost a year later, on Date 18.

[8] Ultimately, only u shares of ABC Common Stock became subject to the First Share Lending Agreement, as discussed supra.

(the "Average Hedge Price" for a Tranche). Under the MPSA, the Initial Purchase Price equals the product of the Base Amount of shares in the Tranche, the Average Hedge Price for the Tranche, and the Purchase Price Multiplier for the Transaction, which is a term of the Transaction . Within y business days after the Initial Short Position was established with respect to a Tranche, the MSPA required Counterparty to deliver to Taxpayer a pricing schedule ("Pricing Schedule") that provided the "Terms of the Tranche."

Each date of delivery of a Pricing Schedule is a Tranche Notice Date. Counterparty is required to deliver the Purchase Price for each Tranche three business days following the Tranche Notice Date ("Payment Date").

In conjunction with entering into the Transactions under the MSPAs, Counterparty (or its affiliate) entered into various short sale arrangements with unrelated third parties. An amount equal to about d percent (a total of $e for the ABC shares and a total of $f for the XYZ shares) of the proceeds received by Counterparty (or its affiliate) from third parties on the short sales was paid to Taxpayer by Counterparty as the Initial Purchase Price under the MSPA. At the approximately g year maturity date of the Transaction, the Trustee, the collateral account agent, was required to deliver to Counterparty the ABC and the XYZ shares based on an exchange formula tied to a h day trading average, under the MSPA. The MSPA also provided that the maximum number of shares would be adjusted to take account of distributions on, mergers or other similar events affecting the value of the shares.

As discussed above, the MSPA contemplated that Taxpayer and Counterparty would initiate a Transaction pursuant to the MSPA, by executing a "Transaction Schedule" in the form provided by the MSPA. Each Transaction Schedule was required to specify the issuer and security to be the subject of the Transaction, the effective date, the maximum number of shares or other units of that security that could be sold pursuant to that Transaction, along with other terms of the Tranche relating to the pricing of the Tranche and the formula for determining the amount of shares deliverable on the settlement date, including the Hedging Termination Date, the Initial Threshold Appreciation Price Multiplier, the Maximum Borrow Cost Spread Trigger, the Maximum Number of Shares, the Minimum Average Hedge Price, the Purchase Price Multiplier, the Range of Maturity Dates, and any other terms of such Transaction as Counterparty and Taxpayer may agree. Thus, many key contractual terms for a Transaction, including the Initial Purchase Price, were determined separately for each Tranche.

The MSPA also provided that Counterparty would determine the "Terms of the Tranche," which are defined as the Base Amount of shares,[9] the Initial Purchase Price,

[9] The Base Amount of shares is defined under to mean the initial number of shares placed in a Tranche as adjusted for any Potential Adjustment Event, discussed below.

the Payment Date, the Average Hedge Price,[10] the Downside Protection Threshold Price,[11] the Threshold Appreciation Price, and the Maturity Date, based on the amounts, prices, and dates at which Counterparty (or its affiliate) effects short sales of shares of ABC and XYZ stock in establishing Counterparty's Initial Short Position with respect to a Tranche. See Thus, the actual number of shares to be delivered at the settlement date of a specific Tranche depended upon the terms defined in the Transaction Schedule by Counterparty.

The operation of a Transaction is best illustrated by an example of the terms of a particular Tranche within a particular Transaction. On the same date as the execution of the MSPA (Date 2), the First Transaction Schedule was issued within the meaning of the MSPA. The First Transaction Schedule designated the common stock as ABC common stock. It also supplied other terms required under the MSPA, such as the dates when the Transaction was to become effective, the maximum number of shares to be subject to the Transaction, and the possible maturity dates.

The Pricing Schedule relating to Tranche No. 1 of the First Transaction provides for a Base Amount of i shares, an Average Hedge Price of $j, and a Purchase Price of $k, which equals approximately d percent of the Base Amount times the Average Hedge Price. The Pricing Schedule provides a Downside Protection Threshold Price of $j, which represented the fair market value of one ABC share on the date the Tranche was executed, and is equal to the Average Hedge Price that Counterparty obtained when it entered into its Initial Short Position on the shares. The Threshold Appreciation Price was set at $l. According to the Pricing Schedule, this Tranche was entered into on Date 8, the upfront Initial Purchase Price was paid to Taxpayer on Date 29, and the Tranche matures in approximately g years, on Date 30.

The shares to be delivered by Taxpayer to Counterparty are equal to the number of the Settlement Shares, which generally equals, under the MSPA, the Base Amount of shares in a Tranche multiplied by the Average Settlement Ratio. There are three possible formulae for the Average Settlement Ratio, and the applicable formula depends on the value of the Adjusted Settlement Price Per Share, as defined

[10] the MSPA provides that the definition of "Average Hedge Price" means, with respect to any Tranche of any Transaction and as set forth in the related Pricing Schedule, the volume weighted average of the per share prices at which Counterparty (or an affiliate of Counterparty) sells short shares of ABC or XYZ common stock that is the subject of such Transaction in establishing Counterparty's Initial Short Position with respect to such Tranche; provided that the weighted Average Hedge Price for such Tranche and all the previously established Tranches within such Transaction shall not be less than the Minimum Average Hedge Price for such Transaction.

[11] the MSPA provides that the definition of "Downside Protection Threshold Price" means, with respect to any Tranche of any Transaction and as set forth in the related Pricing Schedule, the Average Hedge Price for such Tranche, as adjusted on account of any Potential Adjustment Event for such Transaction in accordance with the provisions of the MSPA.

under the MSPA, as it relates to the Threshold Appreciation Price and the Downside Protection Threshold Price.

If the Adjusted Settlement Price Per Share is less than the Threshold Appreciation Price but greater than the Downside Protection Threshold Price, then the Average Settlement Ratio equals the Downside Protection Threshold Price divided by the Adjusted Settlement Price Per Share. If the Adjusted Settlement Price Per Share is equal to or greater than the Threshold Appreciation Price, then the Average Settlement Ratio equals the (1) sum of the Downside Protection Threshold Price and the Adjusted Settlement Price Per Share, less the Threshold Appreciation Price, divided by (2) the Adjusted Settlement Price Per Share. If the Adjusted Settlement Price Per Share is equal to or less than the Downside Protection Threshold Price, then the Average Settlement Ratio equals one. Therefore, under these formulae, the maximum number of shares to be delivered will never exceed the number of shares placed in a Pledge Account. The minimum number of shares to be delivered will depend on the terms of the Tranche, specifically the value of the Downside Protection Threshold Price and the Threshold Appreciation Price.

Applying these formulae to the terms of the Pricing Schedule for Tranche No. 1 of the First Transaction provides a range of how much stock will be available to Counterparty at maturity of the Tranche. If the Adjusted Settlement Price Per Share is less than $l but greater than $j, then the Average Settlement Ratio equals between approximately m percent and n percent, providing Taxpayer with an increasing share of appreciation as the stock value appreciates. Thus, at this range, between o and p shares would be delivered. Once the Adjusted Settlement Price Per Share reaches $l, however, Taxpayer's share in the appreciation begins to gradually decline. If the Adjusted Settlement Price Per Share is equal to or greater than $l, then the Average Settlement Ratio equals at least n percent or greater, approaching q percent as the Adjusted Settlement Price Per Share increases. Thus, as stock prices increase above $l, Taxpayer must deliver an increasing amount of shares which is capped at the Base Amount. For example, at an Adjusted Settlement Price Per Share of about $r, approximately s percent of the shares would be delivered. Thus, at this range, at least p shares would be delivered, increasing up to i shares as the Adjusted Settlement Price Per Share increases. If the Adjusted Settlement Price Per Share is equal to or less than the $j, then the Average Settlement Ratio equals q percent. Therefore, under these formulae, the maximum number of shares to be delivered will never exceed i shares, the Base Amount, and the minimum number of shares to be delivered equals about p shares.

Additional Terms of the MSPA and the Pledge Agreements

In lieu of delivering shares at maturity of the Transactions, under the MSPA Taxpayer has the ability to elect to settle the Transactions in cash (the "Cash

Settlement Option").[12] Under the Cash Settlement Option, with t days notice to Counterparty, Taxpayer could deliver the cash value of the subject shares at time of settlement. The Cash Settlement Option was deleted from the First and Second Transactions under the First and Second Transaction Schedules in light of Securities and Exchange Commission (SEC) Rule 10a-1. Thus, Taxpayer does not currently have the ability to cash settle these Transactions; however, Taxpayer may still cash settle the Third Transaction. According to Taxpayer, the cash settlement options were removed from the First and Second Transactions due to concern about application of the "uptick rule" under Rule 10a-1 of the Securities Exchange Act of 1934 ("1934 Act"). Rule 10a-1 limits the prices and times at which securities may be sold short by providing that no person can effect a short sale of securities at a price below the last reported sales price, or at the last reported sales price, unless that price was higher than the previously reported price.

the MSPA provides rules for acceleration of the obligations with respect to a particular Tranche upon the occurrence of a defined "Event of Default." The Events of Default apply with respect to the MSPA, the Pledge Agreements, and the Share Lending Agreements. For instance, the MSPA includes as an Event of Default any event that in Counterparty's reasonable judgment would have a material adverse effect on Taxpayer's ability to perform

These cross events of default include any incorrect or misleading representation made by Taxpayer with respect to a Transaction or otherwise under the MSPA, as amended and supplemented by the Transaction Schedule, the Pledge Agreement, or the Share Lending Agreement, and any failure to fulfill any obligations under the MSPA, as amended and supplemented by the Transaction Schedule, the Pledge Agreement, or the Share Lending Agreement. An Event of Default may also occur if Counterparty:

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12 the MSPA provides, however, that Taxpayer does not expect to cash settle a Tranche.

If any of these Event of Defaults occur, then Counterparty would give notice to Taxpayer, with respect to a particular Tranche, and Taxpayer must deliver the number of shares of stock that is the subject of such Tranche.
The calculation of the number of shares deliverable upon acceleration is obtained by dividing (x) the Acceleration Amount for such Tranche by (y) the price per share on the trading day prior to the acceleration. The "Acceleration Amount" is an amount that approximates the aggregate payments that Counterparty would have received after the date of the acceleration had the acceleration not occurred, up to an amount equal to the product of the Base Amount of the Tranche and price per share on the trading day prior to the acceleration.

Taxpayer has the obligation, under the Pledge Agreements, to provide additional collateral to the collateral account upon the occurrence of certain events, including a dividend or other in-kind distribution on the stock, as discussed further below. The Pledge Agreements provide that any dividends and other distributions received with respect to the pledged shares held in a collateral account are required to be deposited in that collateral account. After those amounts are deposited, the dividends may then (i) be used to purchase additional shares of ABC or XYZ common stock for the collateral account from Counterparty and thereby satisfy Taxpayer's obligation to pledge additional shares as collateral; (ii) be used to make payments to Counterparty that reduce Taxpayer's future obligations to deliver shares on the Settlement Dates, and also offset Taxpayer's obligation to deposit additional shares as collateral; or (iii) continue to be held in the collateral accounts, or, upon Taxpayer's request, be released from the collateral accounts to Taxpayer.

Taxpayer's obligation to contribute additional shares to the collateral account arises from time to time upon the occurrence of certain events, without the receipt of additional payment from Counterparty.[13] These types of events are generally described as "Potential Adjustment Events" or "Distribution Events." See the Pledge Agreements; see also the Share Lending Agreements. In general, a Potential Adjustment Event includes an event that may impact the value of the outstanding shares of common stock, such as a common stock adjustment, distribution, spin-off, merger, and other events that may result in dilution or concentration in the value of the stock. A Distribution Event is defined under the MSPA to mean either a distribution of

[13] Under certain conditions, Trustee may release collateral to Taxpayer when Taxpayer has met its obligation to contribute additional collateral, even where the shares have been lent out pursuant to a share lending agreement. In cases where the shares have been lent out, assets received in exchange for the lending of pledged shares may be sold by Trustee to pay Taxpayer.

cash or “in-kind” (i.e. noncash distribution) to all stockholders.[14] If Taxpayer fails to deliver additional shares as required under these provisions, then a Collateral Event of Default may occur.

In general, unless an Event of Default has occurred, Taxpayer retains the right to vote the shares deposited in the collateral account.
Upon the occurrence of an Event of Default, as described above under
the MSPA, Trustee may take action with respect to the shares, including voting rights, as if Trustee were the absolute and sole owner of the shares.

When an Event of Default has occurred, Counterparty can request Trustee to deliver to it all of the collateral to satisfy Taxpayer’s obligation to deliver stock to Counterparty under the MSPA. At this point, Counterparty would own the shares free of any claim of Taxpayer, and Taxpayer also would waive all rights it would have had of redemption or other claim. If the delivery of stock from the collateral account is insufficient to cover Taxpayer’s obligations, Counterparty can instruct Trustee to sell all, or as much as is necessary, of the remaining collateral to satisfy these obligations. When Trustee sells the collateral, the buyer of that collateral buys it free of any claim of Taxpayer.

A Transaction is to become effective on the later of the listed date or the date on which all conditions to its effectiveness are either satisfied or waived.
A Transaction becomes effective when certain conditions are met under the MSPA, including: (1) that the Pledge Agreement has been entered into with respect to such Transaction; (2) that representations and warranties under the Pledge Agreement are true and correct and Taxpayer has performed all covenants and obligations thereunder; (3) that Taxpayer has delivered to Trustee the maximum number of shares of ABC or XYZ Common Stock that is the subject of such Transaction as provided under the Pledge Agreement; and (4) that Counterparty receive a satisfactory opinion of its counsel, dated as of the Effective Date for the Transaction, to the effect that Taxpayer is in good standing and authorized to execute the Transaction

and that the Share Lending Agreement for the Transaction, when executed, will be a valid and binding obligation of Taxpayer, subject to bankruptcy and other similar laws.

[14] A Cash Distribution Event occurred on Date 31 and a Share-for-Share Merger Adjustment occurred on Date 32, the net effect of which required Taxpayer to contribute additional collateral to the collateral accounts.

LAW AND ANALYSIS:

Issue #1 – Whether Taxpayer effected a transfer of ownership on the Transaction execution date?

a. Distinguishing Revenue Ruling 2003-7.

Revenue Ruling 2003-7, 2003-1 C.B. 363, concludes that a shareholder has neither sold stock currently nor caused a constructive sale of stock if the shareholder (1) receives a fixed amount of cash, (2) simultaneously enters into an agreement to deliver on a future date a number of shares of stock that varies significantly depending on the value of the shares on the delivery date, (3) pledges the maximum number of shares for which delivery could be required under the agreement, (4) retains an unrestricted legal right to substitute cash or other shares for the pledged shares, and (5) is not economically compelled to deliver the pledged shares. In determining whether a sale occurred, the ruling considers other relevant factors, such as voting and dividend rights, possession, and control, including the ability to reacquire the pledged shares.

The facts of the instant case are clearly distinguishable from the facts described in Rev. Rul. 2003-7. Most significantly, in this case, the Counterparty acquired possession and unfettered use of the pledged shares shortly after the Tranche execution date, which is the date at which a Tranche is executed. The revenue ruling did not envision delivery of the pledged shares at the time the shares were initially pledged into the collateral account. As a result, the conclusion reached in Rev. Rul. 2003-7 is not controlling.[15]

b. The Share Lending Agreements cannot be disregarded for purposes of determining whether a sale occurred.

Section 1001(c) provides that, except as otherwise provided in subtitle A of the Code, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized. The Code does not define a "sale or exchange." In determining whether a sale has occurred for federal income tax purposes, the Supreme Court looks to "the objective economic realities of a transaction rather than to the particular form the parties employed" and "has never regarded 'the simple expedient of drawing up papers,' Commissioner v. Tower, 327 U.S. 280, 291, 66

[15] Taxpayer also cites to the tax treatment of short sales prior to the enactment of § 1259 as support for its position. See Rev. Rul. 72-478, 1972-2 C.B. 487 and Rev. Rul. 73-524, 1973-2 C.B. 307. These rulings are distinguishable because the parties to the stock lending arrangement did not simultaneously execute a stock purchase agreement to cover the same shares over the same period of time. Rather, in the short sale cases, the taxpayers borrowed shares from, and sold to, different parties. Thus, there were no offsetting obligations. Also, in the instant case, Taxpayer's rights and obligations with respect to the "loaned" securities are more limited than in the short sale cases. For instance, Counterparty has the ability to cause a delivery of pledged shares by accelerating the Master Stock Purchase Agreement and offsetting the contract in certain circumstances.

S.Ct. 532, 538, 90 L.Ed. 670 (1946) as controlling for tax purposes when the objective economic realities are to the contrary." Frank Lyon Co. v. United States, 435 U.S. 561, 573, 98 S.Ct. 1291, 55 L.Ed. 550, 1978-1 C.B. 46 (1978), quoted in Grodt & McKay Realty, Inc. v. C.I.R., 77 T.C. 1221, 1236 (1981). Rather, the question is one of fact that "must be ascertained from the intention of the parties as evidenced by the written agreements read in light of the attending facts and circumstances." Grodt & McKay Realty, Inc., 77 T.C. at 1236. In particular, in Grodt & McKay Realty, Inc., the court found that any analysis of the transactions must consider various agreements relating to the purchase, including the sales agreements, registration certificates, and warranties and guaranties relating to the subject property. Thus, when considering whether a sale occurred for tax purposes, the Service is not limited by the four corners of any particular agreement, but instead must consider all surrounding circumstances, including the terms of any side agreements or related contracts.

In the instant case, when identifying the rights and obligations of Taxpayer and Counterparty with respect to the pledged shares, we have considered all agreements relating to the relationship between Counterparty and Taxpayer, including the Transactions, the Pledge Agreements, and the Share Lending Agreements, and conclude that these altogether evidence one whole, continuous transaction, rather than distinct component parts.[16]

It also appears that the parties, in form, did not always respect the purported separateness of the MSPA and the Share Lending Agreement transactions. For instance, the Pledge Agreements, as required under the MSPA, instruct Trustee to enter into the Share Lending Agreements and contain Taxpayer's pre-approval of any and all representations, warranties, and covenants under the Share Lending Agreements made on its behalf by Trustee. Section 2(e) of the Pledge Agreements. In addition, on one occasion there was a delay of almost a year between when Counterparty borrowed the shares and when Taxpayer actually notified Trustee in writing to release the shares to Counterparty. On Date 17, Trustee, as Taxpayer's agent, entered into a Share Lending Agreement with Counterparty with respect to the pledged XYZ shares, as contemplated by the Date 6 Pledge Agreement relating to the

[16] Circumstances evidencing the interrelationships of the transactions include: (i) The MSPA, the Pledge Agreements, and the Share Lending Agreements were executed between the same parties, Counterparty and Taxpayer, with respect to the same Tranches of shares. (ii) The MSPA and the Pledge Agreements obligate Taxpayer to enter into the respective Share Lending Agreements. (iii) The upfront amounts paid by Counterparty to Taxpayer under the MSPA for each Tranche specifically relate to, and depend upon, the amounts received by Counterparty in establishing its Initial Short Position in those shares under the Transactions, under of the MSPA. (iv) Because of the uptick rule, under the First and Second Transactions, the cash settlement options provided for under the MSPA were deleted from the Transaction Schedules in order to permit Counterparty greater ability to sell the shares obtained under the Share Lending Agreement in a downward market. By deleting the cash settlement option, Counterparty had an unconditional right to acquire, and Taxpayer was bound to deliver, shares of the class specified in the Transaction. (v) No independent collateral was required to be posted by Counterparty under the Share Lending Agreements. Rather, the collateral arrangements for the Pledge Agreements offset Counterparty's obligation to deliver shares back to the collateral accounts under the Share Lending Agreements.

Third Transaction. Pursuant to section 1.2 of the Share Lending Agreement dated Date 17 , Counterparty issued two Borrowing Notices to Trustee, also dated Date 17 , indicating that shares from Tranche Nos. 1 and 2 of the Third Transaction would be borrowed on Date 17 . Taxpayer issued written instructions to Trustee to begin entering into a Share Lending Agreement with Counterparty almost a year later on Date 18 . These instructions were said to be effective as of Date 17 . Thus, it appears that once the MSPA and Pledge Agreements were executed, there was no action required by Taxpayer to initiate and carry out the Share Lending Agreements.

c. Application of the Facts and Circumstances Test.

The courts have considered many factors significant in determining whether a sale or other disposition of property has occurred. The relevant factors, and the weight to be accorded to each factor must be determined in light of the nature of the property involved. See Torres v. Commissioner, 88 T.C. 702, 721 (1987). Courts considering whether a transfer of stock occurred have placed more weight on (1) who has the right to share in appreciation and who bears the risk of loss, (2) who has the right to vote the shares, (3) who has the right to receive dividends, and (4) who has the right to sell or re-hypothecate the shares. See Miami Nat'l Bank v. Commissioner, 67 T.C. 793 (1977); Hall v. Commissioner, 15 T.C. 195, 200 (1950) aff'd 194 F.2d 538 (9th Cir. 1952) ("unfettered right of sale is one of the most important attributes of ownership").[17]

Rev. Rul. 2003-7, and certain authorities cited in the ruling, support the position, however, that a transfer of actual possession of stock or securities and legal title may not itself be sufficient to constitute a transfer of beneficial ownership when the transferor retains the unrestricted right and ability to reacquire the securities. See, e.g., Cruttenden v. United States, 644 F.2d 1368 (9th Cir. 1981); Lorch v. Commissioner, 70 T.C. 674 (1978), aff'd, 605 F.2d 657 (2d Cir. 1979), cert. denied, 444 U.S. 1076, 100 S.Ct. 1024, 62 L.Ed. 759 (1980); Miami Nat'l Bank, supra (despite the right of the brokerage firm to sell stock in a subordination account to satisfy its creditors, the transferor remained the owner of the stock.). Likewise, a conveyance of the right to some appreciation and the burden of any depreciation, while indicative of a sale, is not necessarily determinative. Solicitor's Opinion 1179 and Hendricks v. Commissioner,

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[17] Other relevant factors may include:

> (1) whether legal title passes; (2) how the parties treat the transaction; (3) whether an equity was acquired in the property; (4) whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments; (5) whether the right of possession is vested in the purchaser; (6) which party pays the property taxes; (7) which party bears the risk of loss or damage to the property; and (8) which party receives the profits from the operation and sale of the property.

Grodt & McKay Realty, Inc., 77 T.C. at 1237-8 (citations omitted).

423 F.2d 485 (4th Cir. 1970); Commissioner v. Levis' Estate, 127 F.2d 796 (2d Cir. 1942), cert. denied, 317 U.S. 645, 63 S.Ct. 38, 87 L.Ed. 520 (1942); Richardson v. Commissioner, 121 F.2d 1 (2d Cir. 1941), cert. denied, 314 U.S. 684, 62 S.Ct. 186, 86 L.Ed. 548 (1941); and Rev. Rul. 72-478, 1972-2 C.B. 487; Rev. Rul. 73-524, 1973-2 C.B. 307. See also Stanley v. United States, 436 F.Supp. 581 (N.D. Miss. 1977), aff'd per curiam, 599 F.2d 672 (5th Cir. 1979). As a result, it is necessary in each case to consider and evaluate each factor and determine its relative importance, rather than relying on any one particular factor to dictate the ultimate determination.

The instant case is similar to the case of Hope v. Commissioner, 55 T.C. 1020 (1971), aff'd, 471 F.2d 738 (3d Cir. 1973), cert. denied, 414 U.S. 824, 94 S.Ct. 126, 38 L.Ed. 57 (1973). In Hope, the Tax Court, in determining that a sale had occurred, relied on the seller's receipt of sales proceeds and the purchaser's receipt of title and possession of shares without restriction in use. In that case, the taxpayer was the owner of approximately 57 percent of the common stock of a company that had recently become a publicly traded company, and was having difficulty in disposing of his remaining large block of stock. The taxpayer made an arrangement with an investment bank for a sale at a price that was approximately one half of the price at which the stock was currently trading. Under the arrangement, the investment bank earned its fee by reselling 25 percent of the block of stock to the general public. The investment bank held the remainder of the stock subject to options to purchase the stock at the investment bank's cost and subject to proxy agreements that transferred to the optionees the right to vote the shares for the election of directors. Half of the options and proxy rights were held by the taxpayer's brother; the other half were held by two individuals who were employees of the company. Subsequent to the closing of the transaction, the taxpayer became dissatisfied with the sale price and brought a suit for rescission. The litigation was not concluded in the year of the transaction. On advice of counsel, the taxpayer held the sales proceeds in cash and marketable securities pending settlement of the litigation. On his tax return for the year of the transfer, the taxpayer disclosed the transfer but did not include in income his gain on the sale on the ground that the transfer was not a completed sale on which gain was recognized.

The Court concluded that the transaction constituted a sale of the entire block:

> The facts of this case conclusively establish that on July 27, 1960, the petitioner sold 206,400 shares of . . . stock to [an investment bank] as agent for several purchasers as well as for its own account. The sale was completed on that date when title and possession of the certificates were transferred by the petitioner to [the investment bank], and the petitioner received $4,000,032 as payment in full. . . . The petitioner received the money from the sale without any restrictions on his use or disposition of those funds.

55 T.C. at 1029. See also, Greenfield v. Commissioner, T.C. Memo. 1982-617 (1982).

In addition to the fact that Taxpayer (i) received payment in full on the Transaction execution date and had immediate and unrestricted use of the money, which would never have to be repaid, and (ii) transferred actual possession and unfettered use of the pledged shares to the purchaser shortly after the Transaction execution date, the following additional factors support sale treatment:

(i) Transfer of risk of loss and opportunity for gain

It is undisputed that Taxpayer's risk of loss and opportunity for gain were reduced as to an amount of the ABC and the XYZ stock that were pledged.[18] Nonetheless, Taxpayer argues that because the identity of the specific shares remains subject to change by Taxpayer, the Service cannot state that risk of loss and opportunity for gain were reduced for any specific shares. Taxpayer fails to acknowledge that the specific pledged shares were transferred to Counterparty on the dates that the Tranches were commenced, unrestricted as to their use, and nearly simultaneously transferred by the purchaser in a hedging transaction so that not even Taxpayer is capable of reacquiring the "specific pledged shares." In light of these facts, it seems somewhat contradictory for Taxpayer to argue no sale occurred because it has not yet identified the specific shares to be delivered. Under these facts, economically, taxpayer has reduced its risk of loss and opportunity for gain on a block of stock represented by the pledged shares.[19]

(ii) Transfer of voting and dividend rights

With respect to the voting and dividend rights, the Pledge Agreements provide that Taxpayer is entitled to vote the pledged shares *held in the collateral account*. (emphasis added) The Pledge Agreements also provide that any dividends paid on the pledged shares *held in the collateral account* will be deposited in the collateral account and held, paid, or used for Taxpayer's benefit (emphasis added). As soon as pledged shares were delivered to Counterparty, however, under the agreement, Taxpayer's rights to vote and receive dividends ceased. Therefore, because these rights were actually transferred by Taxpayer and the method of their transfer, namely the share lending agreement, was envisioned by the parties and expressly made part of the Transaction, Taxpayer did not retain voting and dividend rights in any substantial

[18] Taxpayer acknowledges that until the Settlement Dates, the Transactions do protect Taxpayer from the downside price risk, and offset some of the upside price potential, flowing from Taxpayer's ownership of the ABC and the XYZ common stock. But since Taxpayer is not required to deliver the specific pledged shares at settlement, the Transactions may affect the risks and rewards of shares of ABC or XYZ common stock other than pledged shares.

[19] For example, Taxpayer has transferred the risk of loss and opportunity for gain on the pledged shares. Also, Taxpayer's right to reacquire the shares is significantly limited by Counterparty's ability to cause a delivery of pledged shares by accelerating the Stock Purchase Agreement under the MSPA.

manner. The fact that Taxpayer receives dividend equivalent payments does not change our conclusion under the facts of this case.[20]

(iii) Transfer of possession and control

Taxpayer argues that it had the right to terminate the share lending agreement at any time and recover the rights to vote and receive dividends. Moreover, despite the absence of such a provision in the relevant agreements, Taxpayer asserts that it can nonetheless prevent a re-borrowing of the pledged shares and substitute identical shares. Even if Taxpayer retained a right to reacquire the shares, this right is significantly limited by Counterparty's right, under certain circumstances, to force Taxpayer to lend the shares in the collateral account or accelerate and offset the obligations under the two contracts. the MSPA provides that, under certain circumstances, purchaser may accelerate the Transaction and offset its obligation under the lending agreement, thereby limiting Taxpayer's ability to identify the shares that will be delivered on the settlement date. One of the potential acceleration events is purchaser's inability to establish, re-establish, or maintain any hedging transaction necessary to hedge the price and market risk with respect to the Transactions. This inability can result from market illiquidity, illegality, or any other factor, including a "lack of availability of hedging transaction market participants on "reasonable terms." The acceleration provision in the MSPA has the effect of allowing the purchaser, not Taxpayer, to decide what shares are ultimately delivered under certain circumstances. Moreover, the ability to offset liabilities on the two contracts is

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[20] Under the Pledge Agreement, it appears that Taxpayer may not actually be receiving the dividends distributed on the stock as a cash equivalent. When dividends or other distributions are paid on the stock, Taxpayer in turn has the obligation to make certain additional payments to Counterparty, including pledging additional shares without apparent additional cash received in return from Counterparty. As discussed above, the dividends paid on the stock may be used to purchase additional shares of ABC or XYZ stock for the collateral account to satisfy Taxpayer's obligations to pledge additional shares as collateral, be used to pay Counterparty to reduce Taxpayer's future obligations to deliver shares at settlement, or continue to be held in the collateral accounts, until released to Taxpayer at Taxpayer's request, provided these obligations have been fulfilled.

Taxpayer also argues that it had a strategic business purpose for retaining voting rights of transferred shares. We do not agree that Taxpayer's subjective intent is decisive here. Union Planters Nat'l Bank of Memphis v. United States, 426 F.2d 115 (6th Cir. 1970), cert. denied, 400 U.S. 827, 91 S.Ct. 53, 27 L.Ed.2d 56 (1970). The intent of the parties may be important in determining their contractual relations, but in the instant case, there is little dispute over what the rights and obligations were to confer. See also Richardson, supra. In Richardson, the court noted that even if taxpayer had the intent to use the shares to cover the short sales, without actual control over the shares,

> Such a shifting intent to cover a short sale ought not be the critical event which would determine gain or loss under a tax statute. It would leave the whole matter of fixing the event to the taxpayer's own will. We hold that the time of delivery was the time at which the covering transactions must be regarded as closed.

Id. at 4.

another factor indicating that a sale occurred on the Transaction execution date. See Greenfield, supra (offsetting nature of sale and loan obligations is relevant in determining the nature of the transaction).

Therefore, under the facts of the instant case, we find that Taxpayer transferred ownership of the pledged shares when the shares were loaned out of the collateral accounts and did not retain sufficient indicia of ownership to prevent a sale for federal income tax purposes. Taxpayer's conditional ability to substitute other reference shares on the settlement date, without more, does not represent sufficient control over the pledged shares to treat Taxpayer as the owner of the shares for tax purposes.

d. Section 1058 arguments

Furthermore, Taxpayer does not qualify for nonrecognition under § 1058. The legislative history of § 1058 makes clear that, absent application of a nonrecognition provision, securities lending agreements generally result in a taxable disposition of the shares.[21] Equally clear is that Congress did not intend to exclude all securities lending agreements from being treated as taxable dispositions. Section 1058(b) provides that an agreement qualifies for nonrecognition treatment only if it does not reduce the lender's risk of loss or opportunity for gain in the securities lent. § 1058(b)(3). Section 1058 clearly envisions that the "lender" retain a significant amount of risk of loss and opportunity for gain on the subject property as well as the ability, at any time, to regain possession of the subject property. Congress wanted to ensure that a taxpayer

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[21] When enacting § 1058 Congress was encouraging organizations and individuals to make their securities available to brokers for loans and delivery to other lenders, and exempted securities lending agreements in part to avoid interfering with the short sale market. H.R. (SEN.) REP. NO. 762, 95TH CONG., 2D SESS., 5 (1978). The Senate Report noted that the IRS had recently "declined to issue rulings as to whether a securities lending transaction constitutes a sale or exchange or whether the transaction interrupts the lender's holding period." Id. at 4. Congress acknowledged that securities lending agreements generally result in a transfer of ownership of the securities for tax purposes. The Senate Report states that:

> In a typical lending transaction involving stock, the lender receives from the borrower amounts equal to the dividends paid on the stock during the period of the loan. The Internal Revenue Service, in Rev. Rul. 60-177, 1960-1 C.B. 9, ruled that these dividend equivalents are not themselves dividends for certain income tax purposes since the lender does not retain ownership of the stock.

Id. Congress did not intend to change the established principle that a securities lending agreement transfers the tax ownership of the securities from the lender:

> Since the lender owns a contractual obligation and not securities during the period of the loan, dividend equivalents received by the lender do not constitute dividends for purposes of the Internal Revenue Code. This is consistent with the position taken in Rev. Rul. 60-177, described above.

Id. at 8, (footnote omitted).

receiving nonrecognition treatment under § 1058, in substance, retains some ownership characteristics over the subject shares, despite the fact that a share lending transaction generally results in transfer of ownership of the shares. To guard the revenue against "artful devices," provisions that result in the exclusion (or nonrecognition) of income must be narrowly construed and the substance rather than form take control for tax purposes. Cf. American Nat'l Bank of Austin v. United States, 421 F.2d 442 (5th Cir. 1970), cert. denied, 400 U.S. 819, 91 S.Ct. 36, 27 L.Ed.2d 46 (1970); aff'd, 497 F.2d 40 (5th Cir. 1974).

In the instant case, Taxpayer has given up nearly all indicia of ownership in the "lent" shares in a related transaction occurring nearly simultaneously with the lending transaction, including a transfer of its risk of loss and most of its opportunity for gain. In addition, it is doubtful that Taxpayer could regain possession of the pledged shares and terminate a Share Lending Agreement without accelerating the Transaction, leading to an offset of the two agreements.

Issue #2 – Whether the transfer qualifies for open transaction treatment, such that no gain or loss may be recognized in the contract year.

Having concluded that the transfer constitutes a taxable event for purposes of § 1001, we turn to the issue whether taxable gain may be "reasonably ascertained," and therefore, realized by Taxpayer. Section 1001(b) defines the "amount realized" upon a sale or other disposition as "the sum of any money received plus the fair market value of the property (other than money) received." In the instant case, the money and property received consists of an upfront cash payment and a contingent contractual right entitling Taxpayer to a return of some shares (or cash equivalent) based on a formula related to the appreciation, if any, in the fair market value of the pledged shares at settlement of the Tranche. Taxpayer takes the position that there is no way to compute the fair market value of the contingent contract right, and therefore, it is not possible to determine with reasonable certainty the taxable gain realized by Taxpayer. As a result, Taxpayer asserts the transfer is not a "closed and completed" transaction for federal income tax purposes.

The purpose of the open transaction doctrine is to relieve a taxpayer from having to report income that may never be received. Burnet v. Logan, 283 U.S. 404, 413, 51 S.Ct. 550, 75 L.Ed. 1143 (1931) (the Court concluded that the transaction was not "closed" because taxpayer might never recoup her capital investment). The open transaction doctrine is a "rule of fairness designed to ascertain with reasonable accuracy the amount of gain or loss realized upon an exchange, and, if appropriate, defer recognition thereof until the correct amounts can be accurately determined." Dennis v. Commissioner, 473 F.2d 274, 285 (5th Cir.1973). The open transaction treatment applies only in "rare and extraordinary circumstances." McShain v. Commissioner, 71 T.C. 998, 1004 (1979); Parrish v. Commissioner, T.C. Memo. 1997-474 (1997), aff'd, 168 F.2d 1098 (8th Cir. 1999).

The open transaction doctrine is only applicable, however, when it is not possible to determine the value of either of the assets exchanged. Davis v. Commissioner, 210 F.3d 1346, 1348 (11th Cir. 2000). In an arm's length transaction, where only one of the assets has an unascertainable value, it is presumed equal to the property for which it was exchanged. United States v. Davis, 370 U.S. 65, 82 S.Ct. 65, 8 L.Ed. 2d 335, 1962-2 C.B. 15 (1962). See also, Philadelphia Park Amusement Co. v. United States, 126 F. Supp. 184, 189, 130 Ct.Cl. 166 (1954) (the value of two properties exchanged in an arms-length transaction are presumed to be equal.)

In the instant case, the pledged shares are publicly-traded stock, and therefore, have a readily ascertainable value. As a result, the value of the property received is presumed to be equal to the value of the stock transferred. The contingent contract right received by Taxpayer has a value equal to the stock transferred less the cash received and taxable gain may be "reasonably ascertained" for tax purposes.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). § 110(k)(3) of the Code provides that it may not be used or cited as precedent.