OFFICE OF
CHIEF COUNSEL

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

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Assistant Chief Counsel (Field Service) CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated August 25, 1998. 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.

LEGEND:

P =
S =

F1 =
F2 =
F3 =
F4 =

FP =

X =

A =
B =
C =
$a =
$b =

$c =
$d =
$e =
$f =
$g =
$h =
$i =

aa% =
bb% =
cc% =
dd% =

aaa =
bbb =

Year 1 =
Year 3 =
Year 4 =

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

Country X =

ISSUE:

Whether the $a loss claimed on the consolidated return of P upon the purported sale of F1's stock to X should be disallowed because the substance of the sale and management agreement was a payment to X for managing the liquidation of the assets of F1 and not a sale of F1's stock.

CONCLUSION:

[redacted]

FACTS:

The transaction involving the purported sale of F1's stock to X has been the subject of several prior FSAs. The facts concerning this transaction were set forth in more

detail in those prior FSAs. The pertinent facts will only be briefly summarized herein.

During the year at issue, P was the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. S was a member of the P consolidated group. S owned all of the stock of F1, a Country X corporation.

On Date 1, following a corporate restructuring: (1) S also owned all of the stock of F2, and (2) F1 owned all of the stock of F3 (which owned an aa% interest in FP) and bb% of the stock of F4. F2, F3 and F4 are all Country X corporations.

On Date 2, S entered into an agreement with X to sell the stock of F1 for $b. The purported sale was consummated on Date 3.

The owner of X was A, who prior to the Date 1 restructuring had managed the leasing business of the F2 group.

Under the agreement, X will manage the lease portfolio of F2. In exchange, X will receive a management fee equal to cc% of the aggregate moneys outstanding under the F2 leases. As of Date 3 (i.e., the date the purported sale was consummated), this fee amounted to $c. This fee was guaranteed to be paid by S to X in the first year irrespective of the size of the F2 lease book. In other words, even if F2 sold the lease book on the first day following the F1 sale, X would still receive the full management fee.

In addition, X would receive a success fee for arranging for the sale or assignment of F2 leases equal to dd% of the aggregate amount realized by F2 upon such sale or assignment. This fee was computed to be approximately $d.

F2 provided the financing for the FP lease portfolio held by F3 in connection with the purported purchase by X of F1's stock. F2 and F3 entered into a loan agreement whereby F2 provided a loan to F3 in the amount of $e.

On Date 3 (when the purported sale was consummated), the agreement between S and X was amended as follows: (1) X could not sell, transfer, assign or terminate its (a) FP leases financed by the F2 loan and (b) F4 stock, without the consent of F2 for the aaa-month period following the purported sale, (2) X agreed to use its best efforts to pay out the F2 loan as expeditiously as possible, and (3) X would be entitled to receive a success fee in the amount of dd% of the aggregate amount of the F2 loan refinanced by loans from third party lenders for the bbb-month period following the purported sale.

The P consolidated group claimed a long term capital loss of $a on its consolidated return for the year ending Date 4, of which $f was deducted. The remainder ($g) was carried back to the group's Year 1 tax year and fully utilized.

LAW AND ANALYSIS

In determining whether the form of a transaction should be disregarded, it is important to keep in mind that so long as there is a business purpose for a transaction and the transaction has economic substance, a person is free to structure the transaction in such a manner as to minimize taxes. See generally Gregory v. Helvering, 293 U.S. 465, 469 (1935); Frank Lyon Co. v. United States, 435 U.S. 561, 580 (1978); United States v. Cumberland Public Service Co., 338 U.S. 451, 455 (1950); Commissioner v. Tower, 327 U.S. 280, 288 (1946); Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974). But see Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945); Higgins v. Smith, 308 U.S. 473, 476-477 (1940). Thus, it is not enough to show that the structure of the transaction in question was driven by tax considerations. Rather, in order to disregard the form of the transaction, it is necessary to demonstrate that the form does not comport with the substance of the transaction. In the instant case, that means that it must be established that the benefits and burdens of ownership did not pass to X.

As recognized by our respective offices in the numerous memoranda that have been exchanged with respect to this transaction, it is well settled that the economic substance of transactions, rather than their form, governs for tax purposes. Gregory v. Helvering, 293 U.S. 465 (1935). Similarly, the transfer of mere legal title is insufficient to shift the incidents of taxation attributable to ownership of property where the transferor continues to retain significant control over the property transferred. Commissioner v. Sunnen, 333 U.S. 591 (1948). The test for determining whether a transaction is a sale is whether the benefits and burdens of ownership have passed to the purported purchaser. This is a question 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. Haggard v. Commissioner, 24 T.C. 1124, 1129 (1955), aff'd, 241 F.2d 288 (9th Cir. 1956). Some of the factors that have been considered by courts in making this determination include (1) whether legal title passed to the purchaser; (2) how the parties treated the transaction; (3) whether an equity was acquired in the transaction; (4) whether the right of possession is vested in the purchaser;
(5) which party bears the risk of loss; and (6) which party receives the profits from the operation and sale of the property. Grodt & McKay Realty, Inc. v. Commissioner, 77 T.C. 1221, 1237-1238 (1981).

As you are undoubtedly aware, substance over form and the related analysis of the benefits and burdens of ownership are highly factual inquiries. In addition, there is no mechanical test setting forth how to balance or weigh the relevant factors. This may vary from case to case depending on the specific facts and circumstances that exist, with no one factor being controlling. Consequently, as we discussed informally, this is a determination about which reasonable minds may differ. We will address the specific points raised in your request in the context of our discussion of

further case development, litigation hazards and other considerations, which follows infra.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

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By: _____
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