Internal Revenue Service

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Department of the Treasury

Washington, DC 20224 199913032

Person to Contact:

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Date:

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Taxpayer:

Taxpayer's EIN:

Taxpayer's Address:

Legend:

Depository =

State A =

Stock Exchange =

Agreement =

L Contract =

M Contracts =

N Contracts =

Plan A =

Escrow Company =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

month 1 =

month 2 =

date 1 =

date 2 =

date 3 =

date 4 =

date 5 =

date 6 =

date 7 =

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Dear

This letter responds to your request for a private letter ruling, dated October 28, 1997, supplemented and modified by letters dated March 11, 1998, March 20, 1998, May 13, 1998, May 19, 1998, June 19, 1998, July 7, 1998, and August 12, 1998. Specifically, Taxpayer has requested a ruling that it may deduct under § 162 of the Internal Revenue Code amounts paid in cash and the fair market value of stock allocated to certain qualifying facilities ("QFs") in consideration for the termination of uneconomic power purchase agreements with these QFs. Taxpayer has also requested a ruling that, in accordance with § 461, it may deduct these amounts in the taxable year in which such cash and stock are delivered to Depository on behalf of the QFs. Moreover, Taxpayer requested a ruling that, under § 1032, it shall recognize no gain as a result of the issuance of its own stock in consideration for the termination of such contracts.

CONCLUSIONS

(1) Taxpayer may deduct under § 162 the amount of cash paid and the fair market value of stock delivered to Depository and allocable to QFs holding N Contracts in consideration for the termination of such contracts.

(2) Taxpayer may deduct the cash and the fair market value of stock allocable to QFs terminating N Contracts in the taxable year that the cash was paid and the stock was delivered to Depository under § 461.

(3) Pursuant to § 1032(a), Taxpayer shall recognize no gain to the extent that Taxpayer issues its stock as consideration for the termination of the N Contracts.

FACTS

Taxpayer is an investor-owned public utility engaged in the generation, transmission, distribution and sale of electricity and natural gas in State A. Its outstanding capital stock includes common stock and several series of preferred stock, all of which are traded over the Stock Exchange. Taxpayer files a consolidated corporate federal income tax return on a calender year basis and uses the accrual method of accounting.

Taxpayer produces its own electricity in its nuclear power, hydro, and fossil fuel plants, and also purchases electricity from other power producers for resale. As a public utility, Taxpayer is subject to regulation by the State A Public Service Commission ("PSC") and the Federal Energy Regulatory Commission ("FERC").

Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA") require that electric utilities offer to purchase electricity from "qualifying small power producers" and "qualifying cogenerators" (collectively known as "qualifying facilities" ("QFs")) . PURPA further requires that FERC promulgate rules to promote the use of QFs. FERC regulations mandate that a utility purchase electricity from qualifying facilities at a rate up to the utility's full forecasted "avoided cost." Avoided cost is the cost that the utility would have incurred had it instead generated the purchased electricity itself or obtained it from another source. The contract price for electricity purchased from a QF is considered acceptable provided that the prices paid during the entire term of the contract do not exceed the utility's long run avoid cost ("LRAC") for electricity, as projected at the time a legally enforceable contract obligation arose. Under this pricing regime, rates paid for electricity at any given time during the contract period might be above or below the utility's actual avoided costs.

Responsibility for specific implementation of the QF rules was delegated to state authorities such as the PSC. In year 1, the State A legislature passed a law requiring electric utilities to enter into contracts to purchase electricity with QFs under terms that the PSC found to be "just and economically reasonable." In year 2, this law was amended to require the PSC to establish a minimum price of a cents per kilowatt hour ("kwh") for electricity purchased from QFs. At that time, this rate was thought to be reasonable and an accurate estimate of the future cost of electricity in State A.

Shortly thereafter, the PSC began to require State A electric utilities, including Taxpayer, to enter into long-term power purchase contracts with QFs. Eventually, the PSC endorsed three forms of power purchase contracts between Taxpayer and various QFs. One type of contract provided for payment at the greater of a cents or the b tariff rate, but required the QF to bear the risk that the a cent minimum would be repealed. A second type of contract fixed the contract rate at a cents until Taxpayer's LRAC was equalized. The third type of contract provided rate schedules which exceeded Taxpayer's short term avoided cost, but which were projected not to exceed its LRAC over the entire life of the contract.

Between year 3 and year 5, partially as a result of these contracts, Taxpayer's charges to customers for electricity rose approximately c%. To address the need for rate relief, the company filed a rate proposal in month 1, year 4 that included traditional rate increases for the following year. The rate filing was litigated before the PSC. However, the PSC would not agree to increase electricity prices, and ultimately decided to take a more comprehensive approach by directing the parties to develop a long-term solution to address Taxpayer's escalating rates. In response, in month 2, year 5 Taxpayer filed with the PSC a proposed restructuring plan called "Plan A." Plan A was designed to stabilize retail prices, to enable Taxpayer to reduce its costs for electricity, and to enable it to operate in a deregulated electric power market. In exchange for Taxpayer's willingness to undertake these initiatives, Taxpayer asked, in part, that State A help in reducing the costs of above-market QF contracts.

By year 6, Taxpayer's avoided costs were much lower than were projected when the fixed payment power purchase contracts were entered with QFs. Moreover, Taxpayer had excess capacity, and could generate additional electricity at a marginal cost of between d and e cents per kwh and could purchase electricity in the market at prices substantially lower than the a cent minimum mandated in many of its contracts. At this time, Taxpayer was obligated under f contracts with QFs, with remaining terms ranging from 20 to 40 years to purchase approximately g megawatts of power at an average cost in excess of h cents per kwh, in contrast to its year 6 avoided costs rate of less than i cents per kwh. Taxpayer estimated that in year 6 it would make nearly $j in above-market payments under its QF contracts and that substantial excess payments would continue to be required under such contracts in future years.

Following the filing of Plan A, Taxpayer engaged in extensive negotiations with all parties including the QFs with which it had uneconomic power purchase contracts. On date 1, Taxpayer executed an Agreement with k QFs whereby the k QFs agreed to modify, renegotiate, or terminate their existing power purchase contracts with Taxpayer in exchange for certain consideration. The Agreement was modified by amendments executed by the parties on date 2, date 3, date 4, date 5, and date 6. Under the final Agreement, l QF contract ("L Contract") will be amended by modifying the price and certain other contract terms, m QF contracts ("M Contracts") will be renegotiated and restructured in accordance with certain criteria set out in the Agreement, and n QF contracts ("N Contracts") will be terminated, leaving Taxpayer with no further obligation to purchase electricity under such contracts.

In consideration for the k QFs' agreement to amend, renegotiate, or terminate their current power purchase agreements with Taxpayer, Taxpayer agreed to pay the k QFs a combination of cash and newly issued shares of Taxpayer's stock. Specifically, Taxpayer agreed to pay and/or deliver to the Depositary on behalf of the k QFs $o in cash and p newly issued shares of Taxpayer's common stock, subject to certain adjustments set out in the Agreement.[1] Under the terms of the Agreement, the cash must be paid and the stock must be delivered to the Depository on the closing date of the Agreement, i.e., the date that the transactions contemplated under the Agreement will be consummated. The consideration will then be allocated to the various QFs in accordance with an allocation separately agreed to by the QFs and deposited with Escrow Agent on or before the date of the Agreement. On the closing date, Taxpayer will receive a written schedule setting forth the aggregate amount of the cash payment and company shares allocated to the QFs holding L Contracts, M Contracts, and N Contracts, respectively.

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[1] The proportions of cash and stock delivered by Taxpayer on the closing date may change as a result of certain elections that are permitted to be made by each of the QFs under the Agreement. Under the Agreement, each QF has the right to elect to substitute cash for any of the company shares of stock that the QF otherwise would have received in the allocation. Such elections are required to be made, with notice given to Escrow Company, by 4:00 p.m. on the pricing date, which will be prior to the closing date of the Agreement. The amount of cash that will be substituted for each of these elected shares will be determined on the pricing date and will based on a formula set out in the Agreement. Taxpayer will pay this amount of cash to Depository at the same time and in the same manner as the cash payment required under the Agreement.

Under the terms of the Agreement and the deposit agreement, Depositary serves as an agent for the QFs and acquires no ownership or proprietary interest in any of the deposited items. The consideration allocable to a particular QF may be released and delivered by Depository immediately upon the closing, pursuant to specific instructions from the QF and subject to the receipt of prior notice regarding the details of the allocation and the time of closing. Any deposited items which are not immediately released will be held in a separate account for each QF, with cash items being invested for the sole benefit of each QF. Upon receipt of specific instructions from the QF regarding the release of any deposited items, such items shall be released and delivered immediately, together with any accrued income thereon.

Taxpayer has only requested rulings with regard to cash paid and stock allocated to the QFs holding N Contracts. No QF holding a N Contract also holds a L Contract or a M Contract. Under the Agreement, on the closing date each of the QFs holding N Contracts will enter a termination agreement with Taxpayer, pursuant to which such contracts shall be irrevocably terminated and rescinded. Thus, all rights and obligations of the parties to purchase and sell power under the N Contracts will cease and be completely extinguished. Accordingly, Taxpayer will no longer be required to purchase any electricity from the affected QFs under the existing N Contracts or at any time following termination.

While the Agreement does not foreclose the possibility of future relationships between Taxpayer and the former N Contract holders, Taxpayer represents that, at the time of the closing, Taxpayer had not negotiated or committed to negotiate with any QF holding N Contracts any form of power supply contract or other business arrangement which would require the delivery of electricity to Taxpayer. Any such contract that may subsequently be entered between Taxpayer and a N Contract holder will reflect mutually acceptable terms arrived at through arm's-length negotiation.

In addition, pending the establishment of fully functioning open market in State A for the sale of electricity, a terminated QF may request that Taxpayer serve as its marketing agent on a no-fee basis for periods up to one month for the sale of QF-generated power to third parties. On some occasions, Taxpayer may acquire technical legal ownership of the QF power and resell such power in the market. In such circumstances, Taxpayer represents that it would not acquire the power for its own account and would always resell such power at its cost.

The Agreement was consummated and closed on Date 7. On that date, all of the N Contracts were terminated and the consideration was paid to Depository as required in the Agreement. The aggregate amount of cash allocated to, and delivered to Depository for the benefit of, QFs holding N Contracts was $g. The aggregate

number of shares of Taxpayer's common stock allocated to, and registered in the names of, the QFs holding N Contracts was r.

LAW AND ANALYSIS

(1) Whether Taxpayer may deduct under § 162 the amount of cash paid and the fair market value of stock delivered to Depository and allocable to QFs holding N Contracts in consideration for the termination such contracts.

Section 162 provides, in part, that taxpayers may deduct all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Further, § 1.162-1(a) provides, in part, that deductible business expenses include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.

Sections 263(a)(1) and (a)(2) provide that taxpayers may not deduct amounts paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate or any amount expended in restoring property or making good the exhaustion thereof for which an allowance is or has been made.

Taxpayer has requested a ruling that it may deduct under § 162 the amount of cash paid and the fair market value of stock provided to Depository and allocable to QFs holding N Contracts. Taxpayer represents that this consideration is provided solely in exchange for the QFs agreement to terminate such contracts, which have become uneconomic to Taxpayer. Accordingly, Taxpayer contends that these amounts are ordinary and necessary business expenses, which are currently deductible under § 162.

In certain instances, the courts have allowed taxpayers to currently deduct amounts paid by taxpayers to terminate burdensome and uneconomic contracts. See, e.g., Capitol Indemnity Ins. Co. v. Commissioner, 237 F.2d 901, 903 (7th Cir. 1956) (amounts incurred by taxpayer to free itself from an unprofitable agency contract were deductible); Montana Power Co. v. U.S., 171 F. Supp. 943 (Ct. Cl. 1959) (cash paid and the fair market value of stock surrendered to relieve the taxpayer of its obligation under supply contract was deductible business expense); Stuart Co. v. Commissioner, T.C. Memo ¶ 50,171, aff'd, 195 F.2d 176 (9th Cir. 1952) (an amount allocable to the cancellation of an onerous supply contract was deductible as an ordinary and necessary business expense); Olympia Harbor Lumber Co. v. Commissioner, 30 B.T.A. 114 (1934), aff'd, 79 F.2d 394 (9th Cir. 1935) (amount paid to terminate an unsatisfactory waste disposal contract was a currently deductible business expense).

In addition, both the courts and the Internal Revenue Service have maintained that amounts paid solely to reduce or eliminate future costs are also deductible. See, e.g., T.J. Enterprises, Inc. v. Commissioner, 101 T.C. 581, 589 (1993) (amounts paid to majority shareholder to compensate her for refraining from causing an royalty rate increase were currently deductible); Rev. Rul. 95-32, 1995-1 C.B. 8 (expenditures incurred by a public utility for the implementation and operation of energy load management programs are currently deductible under § 162); Rev. Rul. 94-77, 1994-2 C.B. 19 (Supreme Court's decision in INDOPCO, Inc. v. Commissioner, 503 U.S. 79 (1992), does not affect the treatment of severance payments, made by a taxpayer to its employees, as business expenses that are generally deductible).

Nevertheless, in certain cases, the courts have required taxpayers to capitalize amounts paid or incurred in connection with the termination of unprofitable contracts. For example, in Darlington-Hartsville Coca-Cola Bottling Co. v. U.S., 273 F. Supp. 229 (D. S.C. 1967), aff'd, 393 F.2d 494 (4th Cir. 1968), the taxpayer reimbursed Coca-Cola for the cost of removing a middleman in exchange for new contracts to directly obtain Coca-Cola syrup at more favorable prices. The court noted the general rule that an expenditure is a capital outlay, as opposed to an ordinary and necessary business expense, if it brings about the acquisition of a business advantage extending into the indefinite future. The court concluded that the payments were capital expenditures, not deductible business expenses, because they obtained for the taxpayer an intangible business advantage of an indefinite duration. Similarly, in Rodeway Inns of America v. Commissioner, 63 T.C. 414 (1974), the court held that a taxpayer's payment to cancel a territorial franchise agreement was a capital expenditure because the costs were incurred to acquire the unrestricted right to conduct business and derive profits over future years.

More recently, in U.S. Bancorp & Consol. Subsidiaries v. Commissioner, 111 T.C. No. 10 (1998), the Tax Court held that the charge incurred by a taxpayer lessee in terminating a lease of a mainframe computer was not a currently deductible expense where the taxpayer simultaneously initiated a new lease of a more powerful mainframe computer with the same lessor. The court noted that the lease cancellation cases illustrate two ends of a spectrum:

> At one end is the case where a lessee pays a lessor to terminate a lease and no subsequent lease is entered into between the parties. In such a case the termination fee is clearly deductible in the year incurred, as there is no second lease raising the possibility that the lessee will realize significant future benefits beyond the taxable year as a result of the termination payment. At the opposite end is the case of a lessee that cancels a lease and then immediately enters into another lease with the same lessor, covering the same property. In substance, the first lease is not canceled but continues in modified form, and any

> unrecovered costs of the first lease, or costs incurred to cancel the first lease, are not currently deductible but rather are costs of continuing the first lease in modified form.

Id. slip op. at 12-13. The court concluded that the taxpayer's situation was more similar to a modification. Specifically, the court was persuaded by the "integrated nature of the agreements and transactions by which the first lease was terminated and the second lease was entered." Id. slip op. at 14. The court emphasized that the termination of the first lease was expressly conditioned on the taxpayer's initiation of a new lease with the same lessor, that the parties to the transaction were identical, and that the properties covered by the two leases were similar. Thus, the court reasoned that the charge should not be viewed as an isolated fee for terminating the first lease, but is more properly viewed as a cost of entering into a new lease. Accordingly, the court concluded that the taxpayer's obligation to pay the fee was a capital expenditure amortizable over the new lease term.

In the instant case, however, the cash paid and the stock distributed by Taxpayer, through Depository, to the QFs terminating N Contracts were more in the nature of deductible termination costs than capital expenditures under § 263. Specifically, these amounts were paid to terminate Taxpayer's long-term contractual obligations to purchase power from these QFs under the N Contracts. As a result, these payments will reduce future costs to Taxpayer by allowing it relief from burdensome and uneconomic power purchase agreements. As discussed above, amounts paid to terminate burdensome contracts and to reduce or eliminate future costs, without more, are generally considered ordinary and necessary business expenses under § 162. See Capitol Indemnity Ins. Co., 237 F.2d at 901; Montana Power Co., 171 F. Supp. at 943; Stuart Co., T.C. Memo at ¶ 50,171; see also Rev. Rul. 95-32, 1995-1 C.B. 8.

In addition, Taxpayer's payments to these QFs do not create or enhance any asset. Unlike U.S. Bancorp, no part of the Agreement suggests that Taxpayer's compensation to these QFs should be viewed as a cost of entering into new power purchase agreements with these QFs. Neither Taxpayer's payment of cash and stock to QFs holding N Contracts nor the termination of such contracts is conditioned upon Taxpayer entering any agreement for future purchase of electricity from these QFs. Furthermore, unlike the taxpayers in Darlington-Hartsville and Rodeway Inns, Taxpayer does not obtain any other significant future benefits by making the termination payments to the N Contract holders. Other than relief from its uneconomic long-term supply contracts, Taxpayer's payment does not secure any additional business advantage or right from the terminating QFs. While the Agreement does not prevent Taxpayer and any terminated QF from subsequently entering new power purchase agreements reflecting mutually acceptable terms, such future arrangements will be

independent from the contract terminations described in the Agreement. Furthermore, while the Agreement does contemplate the possibility of certain future relationships between Taxpayer and the terminated QFs, such as the interim marketing relationships, such relationships will exist only at the option of the QF and do not provide any significant future benefit to Taxpayer. Accordingly, the amount of the consideration delivered by Taxpayer to Depository for the benefit of the QFs terminating N Contracts are not capital expenditures under § 263. Rather, such amounts are ordinary and necessary business expenses under § 162.

In determining the amount of the deduction permitted under § 162, it is appropriate for Taxpayer to take into account both the amount of the cash paid and the fair market value of the stock allocated to the QFs terminating N Contracts. In general, the courts and the Service have permitted taxpayers to deduct the fair market value of stock issued in payment of a business expense if the payment of cash would have otherwise given rise to a deduction under § 162. For example, the Service has held that a corporation may deduct the fair market value of its stock (either treasury or unissued) as a business expense when distributed as compensation to its employees. See Rev. Rul. 69-75, 1969-1 C.B. 52; Rev. Rul. 62-217, 1962-2 C.B. 59, modified by, Rev. Rul. 74-503, 1974-2 C.B. 117. In addition, the courts have applied this rule to stock issued in payment of liabilities other than employee compensation. See Duncan Industries, Inc. v. Commissioner, 73 T.C. 266 (1979) (taxpayer's payment of discounted stock as consideration for a loan constituted a capital expenditure, which may be ratably deducted over the life of the loan); Hollywood Baseball Ass'n v. Commissioner, 42 T.C. 234 (1964) (taxpayer may amortize the issuance date fair market value of its predecessor's stock paid as organizational expenses), aff'd on other issues, 352 F.2d 350 (9th Cir. 1965), vacated on other issues per curiam, 383 U.S. 824 (1966). Thus, in the present case, Taxpayer may deduct under § 162 the amount of cash paid as well as the fair market value of the shares distributed to the QFs in consideration for the termination of the N Contracts.

(2) Whether Taxpayer may deduct the cash and the fair market value of stock allocable to QFs terminating N Contracts in the taxable year that the cash was paid and the stock was delivered to Depository under § 461.

Section 461(a) provides generally that the amount of any deduction shall be taken for the taxable year which is the proper year under the method of accounting used in computing taxable income.

Section 461(h) provides that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 461(h)(2)(D) provides generally that in the case of liabilities other than those described in §§ 461(h)(2)(A), (B), and (C) economic performance occurs at the time determined under the regulations prescribed by the Secretary.

Section 1.461-1(a)(2) provides generally that under the accrual method of accounting, a liability is incurred and generally taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 1.461-4(g)(1)(i) provides that in the case of liabilities described in paragraphs (g)(2) through (7) of this section, economic performance occurs when, and to the extent that, payment is made to the person to which the liability is owed. Thus, except as otherwise provided in §§ 1.461-4(g)(1)(iv) and 1.461-6, economic performance does not occur as a taxpayer makes payments in connection with such a liability to any other person, including a trust, escrow account, court-administered fund, or any similar arrangement, unless the payments constitute payment to the person to which the liability is owed under § 1.461-4(g)(1)(ii)(B). Instead, economic performance occurs as payments are made from that other person or fund to the person to which the liability is owed.

Section 1.461-4(g)(1)(ii)(A) provides that the term "payment" has the same meaning as is used when determining whether a taxpayer using the cash receipts and disbursement method of accounting has made a payment. Thus, for example, payment includes the furnishing of cash or cash equivalents and the netting of offsetting accounts.

Section 1.461-4(g)(1)(ii)(B) provides that payment to a particular person is accomplished if § 1.461-4(g)(1)(ii)(A) is satisfied and a cash basis taxpayer in the position of that person would be treated as having actually or constructively received the amount of the payment as gross income under the principles of § 451. With regard to constructive receipt, § 1.451-2(a) of the regulations provides that income, although not actually reduced to a taxpayer's possession, is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Section 1.461-4(g)(2) through (g)(6) set out specific liabilities for which payment is economic performance. In general, these liabilities include those arising under a workers compensation act or out of any tort, breach of contract, or violation of law,

liabilities to pay rebates or refunds, liabilities to provide awards, prizes, or jackpots, liabilities arising out of the provision to the taxpayer of insurance, warranty or service contracts, and liabilities of a taxpayer to pay taxes.

Section 1.461-4(g)(7) provides that in the case of a taxpayer's liability for which economic performance rules are not provided elsewhere in this section or in any other regulation, revenue ruling or revenue procedure, economic performance occurs as the taxpayer makes payment in satisfaction of the liability to the person to whom the liability is owed.

Taxpayer has requested a ruling that it may deduct the cash and fair market value of stock allocable to QFs holding N Contracts in the taxable year that this cash was paid and the stock was delivered to Depository under § 461. Thus, under this view, Taxpayer would be entitled to deduct these amounts in its year 7 taxable year, the year that the Agreement was consummated and closed. Taxpayer contends that at this time, all the events have occurred that establish the fact of Taxpayer's liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. We agree with Taxpayer's conclusion.

Under the terms of the Agreement, on the closing date, Taxpayer's liability became fixed and the amount of that liability could be determined with reasonable accuracy under §1.461-1(a)(2). In particular, on that date, all the events have occurred that establish the fact of the liability and Taxpayer could precisely determine the amount of the cash paid and the fair market value of the stock allocable to the QFs that held N Contracts.

Moreover, economic performance occurred when Taxpayer paid the cash and delivered the stock certificates to Depository. Specifically, Taxpayer's liability to compensate the QFs for termination of their power purchase agreements constitutes a liability for which economic performance rules are not provided elsewhere in § 1.461-4 of the regulations, in any other regulation, revenue ruling, or revenue procedure. Thus, pursuant to § 1.461-4(g)(7), economic performance occurs as Taxpayer makes payment in satisfaction of the liability to the person to whom the liability is owed. Under § 1.461-4(g)(1)(ii)(B), payment would be accomplished when Taxpayer furnishes the cash and stock consideration to the QFs and cash basis taxpayers in the position of the QFs would be treated as having actually or constructively received the amount of the payment as gross income under principles of § 451. Generally, in determining whether a cash method taxpayer has receipt of a payment, receipt by the taxpayer's agent is considered receipt by the taxpayer. Estate of Kamm v. Commissioner, 349 F.2d 953, 956 (3d Cir. 1965); Diescher v. Commissioner, 36 B.T.A. 732, 744-45 (1937), acq. and nonacq., 1938-1 C.B. 9, aff'd on other issues, 110 F.2d 90 (3d Cir.), cert. denied, 310

U.S. 650 (1940); Wilson v. Commissioner, 12 B.T.A. 403, 405 (1928), acq., VIII-1 C.B. 49; Strauss v. Commissioner, 2 B.T.A. 598, 600-01 (1925). Under the terms of the Agreement and the deposit agreement, Depository serves as an agent for the QFs. The amounts furnished to Depository are held solely for the benefit of and at the direction of the QFs. Moreover, neither the Agreement nor the deposit agreement imposes any restrictions, limitations, or conditions upon the QFs' rights to immediate access and full use of the cash and stock. Therefore, in Taxpayer's case, the furnishing of cash and stock to Depository constitute payment to the QFs under § 1.461-4(g)(1)(ii)(B). Accordingly, for purposes of § 461(h), economic performance has occurred with respect to Taxpayer's liability at this time.

Based on the forgoing analysis, Taxpayer may deduct the cash and the fair market value of stock allocable to QFs terminating N Contracts in the taxable year that this cash was paid and the stock was delivered to Depository under § 461.

(3) Whether, under § 1032, Taxpayer shall recognize no gain as a result of the issuance of its own stock in consideration for the termination of its N Contracts.

Section 1032(a) provides, in part, that no gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

Based on the facts and documentation submitted by Taxpayer, we conclude that, pursuant to § 1032(a), Taxpayer shall recognize no gain to the extent that Taxpayer issues its stock as consideration for the termination of the N Contracts.

* * *

Accordingly, based on Taxpayer's representations and the above analysis, we rule as follows:

(1) Taxpayer may deduct under § 162 the amount of cash paid and the fair market value of stock delivered to Depository and allocable to QFs holding N Contracts in consideration for the termination of such contracts.

(2) Taxpayer may deduct the cash and the fair market value of stock allocable to QFs terminating N Contracts in the taxable year that the cash was paid and the stock was delivered to Depository under § 461.

(3) Pursuant to § 1032(a), Taxpayer shall recognize no gain to the extent that Taxpayer issues its stock as consideration for the termination of the N Contracts.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. More specifically, no opinion is expressed, and no inference should be drawn, as to the tax treatment of cash paid and stock delivered to Depository and allocated to QFs holding L Contracts or M Contracts.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Assistant Chief Counsel
(Income Tax & Accounting)

By: Kelly Alton

Kelly Alton
Senior Technician Reviewer, Branch 5
Income Tax & Accounting