

Known Abusive Tax Shelter Arrangements

I.D.2. Listed Transactions

Notice 2001-51 Notice 2000-15, issued February 2000, published the first *list* of transactions that were determined to be tax avoidance transactions. Notice 2001-51 was issued in August, 2001. This Notice restated the list of transactions identified in Notice 2000-15 as “listed transactions” effective February 28, 2000, and updated the list by adding transactions identified in notices released subsequent to February 28, 2000. Notice 2001-51 follows:

“On February 28, 2000, the Internal Revenue Service issued Notice 2000-15, 2000-12 I.R.B. 826, identifying certain transactions as “listed transactions” for purposes of § 1.6011-4T(b)(2) of the temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the temporary Procedure and Administration Regulations. This notice restates the list of transactions identified in Notice 2000-15 as “listed transactions” effective February 28, 2000, and updates the list by adding transactions identified in notices released subsequent to February 28, 2000. Transactions that are the same as or substantially similar to transactions de-scribed in the list below have been deter-mined by the Service to be tax avoidance transactions and are identified as “listed transactions” for purposes of § .6011-4T(b)(2) and § 301.6111-2T(b)(2). As a result, corporate taxpayers may need to disclose their participation in these listed transactions as prescribed in § 1.6011-4T, and promoters (or other persons responsible for registering tax shelter transactions) may need to register these transactions under § 301.6111-2T. In addition, promoters must maintain lists of investors and other information with respect to these listed transactions pursuant to § 301.6112-1T.

(1) Rev. Rul. 90-105, 1990-2 C.B. 69 (transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year (identified as “listed transactions” on February 28, 2000));

(2) Notice 95-34, 1995-1 C.B. 309 (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of § 419 and 419A of the Internal Revenue Code (identified as “listed transactions” on February 28, 2000));

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I.D.2. Listed Transactions, Continued

- Notice 2001-51** (3) Notice 95-53, 1995-2 C.B. 334 (certain multiple-party transactions intended to allow one party to realize rental or other income from property or service contracts and to allow another party to re-port deductions related to that income (often referred to as “lease strips”) (identified as “listed transactions” on February 28, 2000));
- (4) Part II of Notice 98-5, 1998-1 C.B. 334 (transactions in which the reasonably expected economic profit is insubstantial in comparison to the value of the expected foreign tax credits (identified as “listed transactions” on February 28, 2000));
- (5) Transactions substantially similar to those at issue in *ASA Investering Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000), and *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998) (transactions involving contingent installment sales of securities by partner-ships in order to accelerate and allocate income to a tax-indifferent partner, such as a tax-exempt entity or foreign person, and to allocate later losses to another partner (identified as “listed transactions” on February 28, 2000));
- (6) Treas. Reg. § 1.643(a)-8 (transactions involving distributions described in §1.643(a)-8 from charitable remainder trusts (identified as “listed transactions” on February 28, 2000));
- (7) Rev. Rul. 99-14, 1999-1 C.B. 835 (transactions in which a taxpayer purports to lease property and then purports to immediately sublease it back to the lessor (that is, lease-in/lease-out or LILO trans-actions) (identified as “listed transactions” on February 28, 2000));
- (8) Notice 99-59, 1999-2 C.B. 761 (transactions involving the distribution of encumbered property in which taxpayers claim tax losses for capital outlays that they have in fact recovered (identified as “listed transactions” on February 28, 2000));
- (9) Treas. Reg. § 1.7701(l)-3, (transactions involving fast-pay arrangements as defined in § 1.7701(l)-3(b) (identified as “listed transactions” on February 28,2000));

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I.D.2. Listed Transactions, Continued

- Notice 2001-51** (10) Rev. Rul. 2000–12, 2000–11 I.R.B. 744 (certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions (identified as “listed transactions” on February 28, 2000));
- (11) Notice 2000–44, 2000–36 I.R.B. 255 (transactions generating losses resulting from artificially inflating the basis of partnership interests (identified as “listed transactions” on August 11, 2000));
- (12) Notice 2000–60, 2000–49 I.R.B. 568 (transactions involving the purchase of a parent corporation’s stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary to the parent’s employees, and the eventual liquidation or sale of the subsidiary (identified as “listed transactions” on November 16, 2000));
- (13) Notice 2000–61, 2000–49 I.R.B. 569 (transactions purporting to apply § 935 to Guamanian trusts (identified as “listed transactions” on November 21, 2000));
- (14) Notice 2001–16, 2001–9 I.R.B. 730 (transactions involving the use of an intermediary to sell the assets of a corporation (identified as “listed transactions” on January 18, 2001));
- (15) Notice 2001–17, 2001–9 I.R.B. 730 (transactions involving a loss on the sale of stock acquired in a purported § 351 transfer of a high basis asset to a corporation and the corporation’s assumption of a liability that the transferor has not yet taken into account for federal in-come tax purposes (identified as “listed transactions” on January 18, 2001)); and
- (16) Notice 2001–45, 2001–33 I.R.B. 129 (certain redemptions of stock in transactions not subject to U.S. tax in which the basis of the redeemed stock is purported to shift to a U.S. taxpayer (identified as “listed transactions” on July 26, 2001)).

Power Point Presentations for all of the above can be found at
http://lmsb.irs.gov/hq/pqi/quality/taxshelter_ppt.htm

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I.D.2. Listed Transactions, Continued

**(1) Rev. Rul.
90-105
(Deferred
Contribution
Plan)**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC § 401(k) and (m).

Summary of Transaction:

This is a transaction in which a taxpayer claims deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year

Shelter Transaction Result:

Deductions were claimed for the entire amount of elective and matching contributions to the Plan even though a portion of the deduction related to Post-Year End Contributions.

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I.D.2. Listed Transactions, Continued

**(1) Rev. Rul.
90-105
(Deferred
Contribution
Plan)**

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM's, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the Technical Advisor (TA) for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

- a. If the payment of the contributions is attributable to compensation earned after the end of the taxable year, under Treas. Reg. §1.404(a)-1(b), the Post-Year End Contributions could not be deductible.
- b. If the taxpayer uses the accrual method of accounting, the requirements of IRC § 461(a) also have to be met.

Rev. Rul 2002-46 (which is discussed later in this ATG) describes a transaction substantially similar to Rev. Rul. 90-105.

[Link to Rev. Rul. 90-105](#)

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev Rul 90-105.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Rev%20Rul%2090-105.pdf)

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I.D.2. Listed Transactions, Continued

**Notice 95-34
(VEBA)**

Summary of the Transaction's Tax Consequences

This is a transaction based on an improper interpretation of IRC § 419A(f)(6) for 10-or-more employer plans.

Summary of Transaction:

In general, contributions to a welfare benefit fund are deductible when paid, but only if they qualify as ordinary and necessary business expenses of the taxpayer and only to the extent allowable under IRC §§ 491 and 419A.

IRC § 491A(f)(6) provides an exemption from IRC §§ 419 and 419A for certain "10-or-more employer plans". For a plan to qualify for this exemption, each employer can contribute no more than 10 percent of the total contributions and the plan cannot be experience rated for individual employers.

Notice 95-34 applies to a variety of 10-or-more employer plan abuses. In some transactions, promoters create trusts that enroll at least 10 employers but which formally or informally are experience rated for each participating employer. Thus, some plans maintain separate accounting of the assets attributable to the contributions by each employer. In other situations, an employer's contributions to the plan are related to the claims experience of that employer's employees.

Shelter Transaction Result:

Deductions for the payments to these funds are improper, thereby reducing the employer and employee's income because only limited amounts contributed to the proper plans are includible in the employee's income.

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I.D.2. Listed Transactions, Continued

Notice 95-34
(VEBA)

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM's, court cases, etc. which may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for the transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled "Technical Advisors"

The IRS will challenge the plans for one or more of the following reasons:

- a. The arrangements are actually providing deferred compensation.
- b. The arrangements may be, in fact, separate plans maintained for each employer or may be experience rated with respect to individual employers in form or in operation. See e.g. Booth v. Commissioner, 108 T.C. 524 (1997) (concluding the plan at issue was an aggregation of separate welfare benefit plans, each of which had an experience rating arrangement with the contributing employer)
- c. The employer contributions may represent prepaid expenses that are nondeductible under other sections of the Code
- d. The employer's contributions are nondeductible because they are shareholder expenses. See e.g. Neonatology Assoc. P.A. v. Commissioner, 115 T.C. 43 (20002), aff'd, 2002 U.S. App. LEXIS 15236 (3d Cir. July 11, 2002) (the amounts contributed to the plan were not ordinary and necessary business expenses and the amounts were dividends of the plan participants rather than compensation).

[Link to Notice 95-34](#)

<http://www.benefitslink.com/IRS/notice95-34.shtml>

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I.D.2. Listed Transactions, Continued

(3) Notice 95-53 (Lease Strips)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 269, 351, 382, 446, 482, 701, 704, 7701 and Treas. Reg. § 1.61-8(b).

Summary of Transaction:

These transactions are designed to improperly separate income from related deductions by allocating rental or other income from property or service contracts to a tax-neutral party (someone who is not subject to federal income tax or has available net operating losses) while allocating the deductions related to this income (such as depreciation or rental expenses) to someone who expects to have income subject to federal income tax.

As described in Notice 95-53, stripping transactions are multiple-party transactions that take a variety of forms. In one typical version, the tax neutral party purports to accelerate the income from a stream of future rents by selling the right to the rents to a bank. The tax-neutral party then transfers its interest in the leased asset to someone who expects to have income subject to federal income tax in a transaction in which the transferee receives the tax neutral's basis in the asset. The transferee then claims depreciation on the asset. In another typical version, the tax-neutral party transfers a leasehold interest consisting of an obligation to pay rent and the proceeds of a rent sale. In this version, the transferee uses the proceeds from the rent sale to pay the rent obligation and reports real deductions.

Shelter Transaction Result:

- a. Tax-neutral party reports the income from property or service contracts.
- b. Another party claims the rental expense or depreciation deductions related to that income to shelter income that would otherwise be subject to federal income tax.

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I.D.2. Listed Transactions, Continued

(3) Notice 95-53 Proper Tax Treatment: (Lease Strips)

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's as signed to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

- a. Depending on the circumstances, the following Code and Regulation sections may also be applied: §269, §382, §446(b), §701, or §704,
- b. authorities that recharacterize certain assignments or accelerations of future payments as financings,
- c. assignment-of-income principles;
- d. the business-purpose doctrine,
- e. the substance-over-form doctrines (including the step transaction and sham doctrines),

[Link to Notice 95-53
http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 95-53.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%2095-53.pdf)

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I.D.2. Listed Transactions, Continued

**(3) Notice 95-53
(Lease Strips)**

f. The deductions are not allowable because the stripping transaction lacked economic substance and business purpose, because they are capital expenses, or because the transaction in which the other party obtained the asset did not qualify as a transaction in which the tax neutral party's basis transferred to the other party.

g. Andantch LLC v. Commissioner, T.C. Memo 2002-97 holding that lease strips lacked economic substance and Nicole Rose Corp. v. Commissioner, 117 T.C. 328 (2001) holding that intermediary transaction in which loss was created by a lease strip that lacked economic substance.

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I.D.2. Listed Transactions, Continued

**Transactions in
Part II of
Notice 98-5,
1998-1 (ADR
& other types)**

Summary of the Transaction's Tax Consequences

These are transactions based on the use of IRC §§ 901 through 907 and 960.

Summary of Transaction:

Used to generate foreign tax credits, the first class of transaction involves a transfer of tax liability through the acquisition of an asset that generates an income stream subject to foreign gross basis taxes such as withholding taxes. These transactions may include acquisitions of income streams through securities loans and acquisitions in combination with total return swaps.

The second class of transaction consists of cross-border tax arbitrage transactions that permit effective duplication of tax benefits. Duplicate benefits result when the U.S. grants benefits and, in addition, a foreign country grants benefits to separate persons with respect to the same taxes or income.

Shelter Transaction Result:

- a. In this first class of transactions, foreign tax credits are effectively purchased by U.S. taxpayer in an arrangement where the expected economic profit is insubstantial compared to the foreign tax credits generated.
- b. In this second class of transactions, the U.S. taxpayer exploits these inconsistencies where the expected economic profit is insubstantial compared to the foreign tax credits generated. These duplicate benefits generally can result where the U.S. and a foreign country treat all or part of a transaction or amount differently under their respective tax systems.

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I.D.2. Listed Transactions, Continued

**Transactions
in Part II of
Notice 98-5,
1998-1 (ADR
& other types)**

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

- a. Foreign tax credits will be disallowed under the authority of IRC §§ 901, 901(k)(4), 904, 864(e)(7), 7701(1), and 7805(a). See:
1. Compaq Computer Corp. v. Commissioner, 277 F.3d 778 (5th Cir. 2001) rev'g. 113 T.C. 214 (1999)
 2. IES Industries v. United States, 253 F.3d 350 (8th Cir. 2001) reversing in part and affirming in part 1999 U.S. Dist. LEXIS 22610 (N.D. Iowa 1999)

Link to Notice 98-5

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 98-5.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%2098-5.pdf)

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I.D.2. Listed Transactions, Continued

**(5) ASA
Investerings
Partnership**

Summary of the Transaction's Tax Consequences

This transaction involves IRC §453, which governs taxation of proceeds from an installment sale of property when the value of the installment payments is not known in advance.

Summary of Transaction:

Appellant domestic corporation (domestic appellant) anticipated huge capital gains from selling its interests in a particular company. To reduce the tax liability that would result, domestic appellant formed appellant partnership with two foreign corporations (foreign appellants) that were created specifically to facilitate domestic appellant's tax reduction plan. By design, foreign appellants, tax-exempt entities, owned vastly greater interest in appellant partnership when the income was received.

Shelter Transaction Result:

The partners' interests shifted so domestic appellant owned a vastly greater interest when losses were incurred.

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I.D.2. Listed Transactions, Continued

(5) ASA Investerings Partnership

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Appellant partnership was formed purely to reduce domestic appellant's tax liability; therefore, it was not a separate taxable entity and its income was attributable to domestic appellant. The Tax Court agreed with the Commissioner that ASA was not a valid partnership for tax purposes, and thus did not reach the economic substance argument. See:

1. Saba Partnership v. Commissioner, 272 F.3d 1135 (D.C. Dir. 2001) vacating and remanding T.C. Memo 1999-359
2. ASA Investerings Partnership v. Commissioner, 201 F.3d 505 (D.C. Cir.2000) aff'g T.C. Memo1998-305, cert.denied 531 U.S.871 (2000)
3. ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), aff'd. in part and rev'g in part T.C. Memo 1997-115m cert denied, 526 U.S. 1017 (1999)
4. Boca Investerings Partnership v. Comm., 167 F. Supp 167 F. Supp.2d 298 (D.C. 2001).

Link to Investerings Case

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/ASA Investerings - United States Court of Appeals.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/ASA%20Investerings%20-%20United%20States%20Court%20of%20Appeals.pdf)

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I.D.2. Listed Transactions, Continued

**(6). Treas. Reg.
§ 1.643(a)-8
(Charitable
Remainder
Trusts(CRT))**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 170, 2055, 2106, 2522, 644 and 643

Summary of Transaction:

Taxpayer (TP) contributes appreciated asset that has negligible basis to CRT. Asset is monetized by CRT (e.g., borrows, enters into a prepaid forward contract, issues a security secured by the asset) in a way that does not cause the CRT to recognize income for tax purposes. Cash is distributed to the taxpayer. Since CRT distributions are taxable income to TP only to the extent CRT has taxable income, Taxpayer has no taxable income on the distribution. CRT terminates and TP takes charitable deduction on the remainder interest of the CRT. After the CRT terminates, the contract that monetized the asset is terminated by the charity.

Shelter Transaction Result:

Taxpayer receives cash equal to large part of the appreciation of asset that was distributed to CRT, has a charitable deduction equal to the discounted Fair Market Value of the remainder interest, and pays no income tax. In effect, the taxpayer has avoided paying gain on the sale of an appreciated asset and has also received a charitable deduction.

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I.D.2. Listed Transactions, Continued

**(6). Treas.
Reg. §
1.643(a)-8
(Charitable
Remainder
Trusts(CRT))**

Proper Tax Treatment:

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Distributions from the trust are treated as sales under IRC §1.643(a)-8.

Link to Treas. Reg. §1.643(a)8

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Prop Treas Reg 1-643\(a\)-8.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Prop%20Treas%20Reg%201-643(a)-8.pdf)

Link to Technical Advisor's Training Material

<http://abusiveshelter.web.irs.gov/Training/trainin.asp>

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I.D.2. Listed Transactions, Continued

(7) Rev. Rul.
99-14 (LILOs)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §162 and §163.

Summary of Transaction:

A Foreign Municipality (FM) owns outright a facility that it has historically owned and used. A U.S. Corporation leases the facility from the municipality under a head lease, and simultaneously subleases it back to the municipality with an option on the part of the sublessee to renew or buy its way out of the head lease. Corporation pre-pays a portion of its rent obligation under the head lease. The Corporation funded its prepayment of the head lease with bank loans. FM defeases some or all of its sublease rents by depositing a portion of corporation's prepayment in bank(s). The debt service on corporation's loans is offset by rents received from FM under the sublease, and the risks of nonpayment on the loan and the sublease were defeased by circular pledges of security. Also, the Corporation's exposure to the lease residual was rendered insignificant by the Municipality's option to purchase that residual and a pledge of securities that defeased the FM's option payment.

(Note: While the Revenue Ruling refers to a Foreign Municipality, there are Domestic municipalities that have done LILO transactions as well.

Shelter Transaction Result:

- a. Corporation takes an interest deduction;
- b. Corporation takes a rent deduction.

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I.D.2. Listed Transactions, Continued

(7) Rev. Rul.
99-14 (LILOs)

Proper Tax Treatment:

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- a. A taxpayer may not deduct, under sections §162 and §163, rent and interest paid or incurred in connection with a LILO transaction that lacks economic substance.

Link to Rev. Rul. 99-14

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev Rul 99-14.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Rev%20Rul%2099-14.pdf)

Link to Technical Advisor's Training Material

http://lmsb.irs.gov/hq/pftg/leasing/downloads/Training/lilo_reference_guide/li_lo_reference_guide_index.htm

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I.D.2. Listed Transactions, Continued

**Notice 99-59
(Boss)**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 301, 475(f), and Treas. Reg. § 301.7701-3(c).

Summary of Transaction:

TP contributes cash to a foreign corporation (FP) in exchange for common stock in that corporation. Another party contributes capital to FP for preferred stock. FP borrows money from bank and grants bank an interest in the securities acquired by FP with the borrowed funds. FP distributes the encumbered securities to TP. TP disposes its of stock in FP.

Shelter Transaction Result:

Distribution of the encumbered securities to TP and related fees and transaction costs has the effect of reducing the fair market value of FP's common stock to zero. Since the distribution on the common stock is subject to the bank debt, TP claims that under IRC § 301(b)(2), the amount of the distribution is zero for purposes of IRC § 301. Therefore, the distribution to TP is treated as neither a dividend nor as a reduction of stock basis under IRC § 301(c). However, the distribution is done with the understanding that FP (which still has assets) will repay the money borrowed from the bank. Thus TP takes the securities tax free and claims a loss on its disposition of FP common stock. When TP disposes of common stock, TP takes loss equal to the original basis in stock over the FMV of the common stock. The TP's disposition of the common stock may be based upon an election under Treas. Reg. § 301.7701-3(c), or by treating the partnership as a trader in securities through using an election under IRC § 475(f). TP claims a tax loss while suffering no economic loss.

[Link to Notice 99-59](#)

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 99-59.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%2099-59.pdf)

Link to Technical Advisor's Training Materials

http://lmsb.irs.gov/hq/pftg/p_ships/training.htm

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I.D.2. Listed Transactions, Continued

**Notice 99-59
(Boss)**

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Losses can be challenged under IRC §§ 269, 301, 331, 446 475, 482, 752, and 1001.

Link to Partnership Guide:

http://lmsb.irs.gov/hq/pftg/p_ships/downloads/Training/partnership_atg.pdf

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I.D.2. Listed Transactions, Continued

**(9) Treas. Reg.
§ 1.7701(1)-3
(Step Down
Preferred)**

Summary of the Transaction's Tax Consequences

These transactions are designed to allow a person (the sponsor) to avoid tax on substantial amounts of income (or to shelter substantial amounts of other income) by using a conduit entity whose income tax treatment artificially allocates the conduit entity's income to participants (holders of fast pay stock) that are not subject to federal income tax.

Summary of Transaction:

A corporate sponsor creates a subsidiary; often as a REIT, RIC or foreign corporation (conduit entity) (i.e. "Company"), which issues two classes of stock, fast pay preferred stock and common stock. Persons that are not subject to federal income tax hold the fast pay preferred stock. The corporate sponsor holds substantially all of the common stock (benefited shareholders). During the first 10 or so years of the transactions, income on the assets held by the REIT are treated as dividends that are paid to the holder of the fast pay preferred stock, while the holders of the common stock receive insignificant or no distributions and report no income. As an economic matter (but not as a tax matter) the fast pay shareholders' interest in the company declines as the dividends are paid on the stock. After approximately 10 years, the fast pay shareholders' interest in the company has declined to a de minimis amount without any reduction in their bases in the fast pay stock. According to an agreement made at the inception of the transaction, the income on the assets held by the REIT begin to be treated as dividends that are paid to the holder of the common stock rather than the fast pay preferred stock. Generally when this occurs, the Company is merged with the corporate sponsor and receives all of the company's assets.

Shelter Transaction Result:

During the first 10 years of the transaction, the corporate sponsor that holds the common stock reports no income. However, the sponsor's investment has preformed economically like a zero-coupon investment that substantially increases in value as the exempt participants' interest in the Company declines. In the eleventh year or so of the transaction, the Company merges with the corporate sponsor and receives all of the company's assets. Since the Company's basis is high (value of assets have not decreased), the corporate sponsor avoids recognizing any gain.

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I.D.2. Listed Transactions, Continued

**(9) Treas. Reg.
§ 1.7701(1)-3
(Step Down
Preferred)**

Under §1.7701(1)-3, the multiple-party financing transaction may be recharacterized as a transaction directly between the benefited shareholders and the fast pay shareholders. The inception and resulting relationships of the recharacterized arrangement are deemed to be as follows:

(i) *Relationship between benefited shareholders and fast-pay shareholders.* The benefited shareholders are deemed to issue financial instruments (the financing instruments) directly to the fast-pay shareholders in exchange for cash equal to the fair market value of the fast-pay stock at the time of issuance.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Continued on next page

I.D.2. Listed Transactions, Continued

**(9) Treas. Reg.
§ 1.7701(1)-3
(Step Down
Preferred)**

Summary of the Transaction's Tax Consequences

(ii) *Relationship between benefited shareholders and corporation.* The benefited shareholders contribute to the corporation (“Company”) the cash they receive for issuing the financing instruments. Distributions made with respect to the fast-pay stock are distributions made by the corporation (“Company”) with respect to the benefited shareholders’ benefited stock.

(iii) *Relationship between fast-pay shareholders and corporation.* For purposes of determining the relationship between the fast-pay shareholders and the corporation, the fast-pay stock is ignored. The corporation (“Company”) is the paying agent of the benefited shareholders with respect to the financing instruments.

Link to Regulation §1.7701(1)-3

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/1-7701\(1\)-3.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/1-7701(1)-3.pdf)

Continued on next page

I.D.2. Listed Transactions, Continued

Rev. Rul. 2000-12 (Debt Straddles)

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §165 and §1275.

Summary of Transaction:

A taxpayer acquires two debt instruments that are structured so that the value of one will increase significantly at the same time that the value of the other one decreases by approximately the same amount. The taxpayer recognizes a current loss on the sale of the debt instrument that decreases in value while not recognizing the gain on the other debt instrument.

Shelter Transaction Result:

- a. On sale of the debt instrument that decreases in value, the taxpayer claims a tax loss.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

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I.D.2. Listed Transactions, Continued

Rev. Rul. 2000-12 (Debt Straddles)

- a. The sale of debt instrument with a decreased value does not produce an allowable loss under § 165. When the taxpayer sells this debt instrument before its maturity date but retains the other debt instrument, the taxpayer does not realize an actual economic loss because the purported loss on the sale of decreased value debt instrument is substantially offset by the unrealized gain in the other debt instrument. Such an artificial loss is not allowable for federal income tax purposes. In each situation the taxpayer cannot recognize the claimed loss on the sale of the debt instrument that decreases in value while not recognizing the gain on the other debt instrument.

(Note: Other variations would disallow loss under Treas. Reg. § 1.1275-6(c)(2) (integrate to form synthetic debt instrument), or the anti-abuse rule of Treas. Reg. § 1.1275-2(g) applies.)

Link to Notice 2000-12

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Rev. Rul. 2000-12.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Rev.%20Rul.%202000-12.pdf)

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I.D.2. Listed Transactions, Continued

Summary of the Transaction's Tax Consequences

This is a transaction based on IRC § 742.

**Notice 2000-44
(Son of Boss)**

Notice 2000-44, identifies a transaction, referred to as the "Son of BOSS". The Treasury news release stated that: "as in the BOSS Shelter, this new scheme uses a series of contrived steps (in this case involving interests in a partnership) to generate artificial tax losses designed to offset income from other transactions.

Summary of Transaction:

Notice 2000-44 describes a transaction in which a taxpayer subjects itself to a future economic obligation in exchange for cash. For example, taxpayer borrows cash or sells an option. Taxpayer then contributes the cash (or other property acquired with the cash) to a partnership in exchange for a partnership interest, plus the partnership's assumption of the obligation. The taxpayer claims a basis in its partnership interest equal to the cash or the adjusted basis of the property contributed to the partnership unaffected by the obligation assumed by the partnership.

Continued on next page

I.D.2. Listed Transactions, Continued

Notice 2000-44 (Son of Boss) **Shelter Transaction Result:**

On distribution of the partnership interest, the taxpayer claims a tax loss with respect to that basis amount, even though the taxpayer has incurred no corresponding economic loss.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that could may our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

- a. The purported losses resulting from the transactions described above do not represent bona fide losses reflecting actual economic consequences as required for purposes of §165. (The purported losses from these transactions (and from any similar arrangements designed to produce non-economic tax losses by artificially overstating basis in partnership interests) are not allowable as deductions for federal income tax purposes),
- b. The purported tax benefits from these transactions may also be subject to disallowance under other provisions of the Code and regulations such as §752, or under §1.701-2 or other anti-abuse rules. An example of a similar issue can be found in Salina Partnership v. Commissioner, T.C. Memo 2000-352

Link to Notice 2000-44:

<http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202000-44.pdf>

Link to Technical Advisor's Training Material:

http://lmsb.irs.gov/hq/pftg/p_ships/downloads/Training/partnership_atg.pdf

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I.D.2. Listed Transactions, Continued

**Notice 2000-60
(Stock
Compensation
Transaction)**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of IRC §§ 1032, 83(a), 331, 1001 and Treas. Reg. §1.83-6(d).

Summary of Transaction:

P contributes cash to S in exchange for S common stock. X contributes cash to S in exchange for S preferred stock. P and X's bases in their S stock equals the cash they contributed to S. S purchases stock from P's shareholders. From time to time, S transfers P shares to P employees in satisfaction of P's stock based-employee compensation obligations (e.g., upon the exercise by an employee of a non-statutory option to purchase P stock). In a few years, S will sell any remaining P stock, and then S will liquidate or P will sell its S stock.

Shelter Transaction Result:

- a. When S transfers P stock to P employees, Treas. Reg. § 1.83-6(d) treats S, as a shareholder of P, as contributing the stock to P and P as using the stock to satisfy the obligation.
- b. S' basis in the transferred stock shifts to the P stock S continues to hold.
- c. Under, IRC § 1032, P reports no gain or loss from the deemed transfers of P stock to P employees;
- d. P takes deductions under IRC § 83(h) in the amount that the P employees include in income under IRC § 83(a) from their receipt of the P stock.
- e. When S liquidates or P sells its S stock, P claims a capital loss under IRC § 331 or IRC §1001.
- f. S also reports a capital loss on the sale of its remaining P stock immediately before S' liquidation or sale.

Continued on next page

I.D.2. Listed Transactions, Continued

Notice 2000-60 (Stock Compensation Transaction) Proper Tax Treatment:

- a. Transfers by S to the P employees are properly characterized as distributions by S to P with respect to P's stock, subject to the rules of §301 and §311,
- b. Compensatory transfers by P to P's employees are treated as distributions to the extent of earnings and profits and result in dividend treatment under §301(c)(1). To the extent that the amount of the distributions exceeds the earnings and profits of S, the distributions reduce P's basis in its S stock under §301(c)(2), thus reducing or eliminating P's purported loss with respect to the S stock upon S's liquidation or sale.
- c. Because the transfers of P stock by S to P are distributions and not capital contributions, S is not permitted to shift basis from the transferred P stock to S's remaining P stock and, therefore, S does not have a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.
- d. Alternatively, the steps can be ignored and the transaction can be treated as redemption by P of its stock followed by a compensatory transfer of treasury stock to its employees. No deduction is permitted for amounts paid to redeem stock, §162(k).
- e. Losses claimed by P & S are considered not to be bona fide (i.e. lack economic substance), and can be disallowed under §165(a).

[Link to Notice 2000-60](#)

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2000-60.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202000-60.pdf)

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I.D.2. Listed Transactions, Continued

Notice 2000-61
(Guam Trust)

Summary of the Transaction's Tax Consequences

Transactions claiming that IRC §641(b) applies to a trust as part of a scheme in which the trust seeks to be included under the single filing rules of IRC §935.

Summary of Transaction:

A trust is formed which purportedly meets (a) both U.S. and Guamanian statutory requirements for taxation as a resident, and (b) the IRC §1361(e) requirements for an electing small business trust (ESBT). Shares of a U.S. S corporation are then transferred to the trust. The trust files no income tax return in the United States, and under Guam law, the trust qualifies for a return of Guam taxes, provided 50 percent of the rebated taxes are kept on deposit in Guam for five years.

Shelter Transaction Result:

The shelter relies on a misinterpretation of the single filing rule of §935 to avoid filing a U.S. income tax return. A Guam return is filed, but the Guamanian taxes may be fully rebated. Therefore, according to the promoters, S corporation income flowing through such a trust would ultimately escape taxation in both the U.S. and Guam.

Continued on next page

I.D.2. Listed Transactions, Continued

**Notice 2000-61
(Guam Trust)**

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The single filing rule contained in IRC §935 applies solely to individuals who are resident in Guam or citizens of Guam and are not otherwise citizens of the United States, individuals who are U.S. citizens or residents and have income derived from Guam, and individuals who file joint returns with any of these persons.

IRC §935 was enacted to permit such **individuals** to file a single income tax return, in Guam, thus eliminating the administrative burdens associated with the filing of two income tax returns. It was recognized that the foreign tax credit generally eliminated the tax liability to one of the jurisdictions, and therefore, that §935 generally would not affect the amount of tax ultimately due.

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I.D.2. Listed Transactions, Continued

Nothing in the language of IRC §935, its legislative history, or the policy behind its enactment indicates that a trust is to be considered an individual for purposes of §935. The fact that under IRC §641(b) the taxable income of a trust is generally determined in the same manner as the taxable income of an individual has no bearing on whether a trust **is** an individual for purposes of IRC §935. Therefore, IRC §935 does not relieve a trust from any obligation it may have to file an income tax return for the taxable year with the United States and to pay to the United States any tax due.

Transactions in which it is claimed that §935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability may also be subject to challenge on other grounds.

Link to Notice 2000-61, 2000-49 I.R.B. 569

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2000-61.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202000-61.pdf)

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I.D.2. Listed Transactions, Continued

**Notice 2001-16
(Intermediary
Transactions)**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §337, §1.337(d)-4 and §1001.

Summary of Transaction:

These transactions generally involve four parties: seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and buyer (Y) who desires to purchase the assets (and not the stock) of T. Pursuant to a plan, the parties undertake the following steps. X purports to sell the stock of T to M. T then purports to sell some or all of its assets to Y.

Shelter Transaction Result:

- a. Y claims a basis in the T assets equal to Y's purchase price. Under one version of this transaction, T is included as a member of the affiliated group that includes M, which files a consolidated return, and the group reports losses (or credits) to offset the gain (or tax) resulting from T's sale of assets.
- b. In another form of the transaction, M may be an entity that is not subject to tax, and M liquidates T (in a transaction that is not covered by § 337(b)(2) of the Internal Revenue Code or §1.337(d)-4 of the Income Tax Regulations, resulting in no reported gain on M's sale of T's assets.

Continued on next page

I.D.2. Listed Transactions, Continued

Notice 2001-16 (Intermediary Transactions)

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

Intermediary transactions do not produce the tax consequences claimed by the parties because, depending upon the facts of the specific transaction:

- a. M is an agent for X, and consequently for tax purposes T has sold assets while T is still owned by X,
- b. M is an agent for Y, and consequently for tax purposes Y has purchased the stock of T from X
- c. The transaction is otherwise properly recharacterized (e.g., to treat X as having sold assets or to treat T as having sold assets while T is still owned by X);
- d. Alternatively, the Service may examine M's consolidated group to determine whether it may properly offset losses (or credits) against the gain (or tax) from the sale of assets.

[Link to Notice 2001-16](#)

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2001-16.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202001-16.pdf)

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I.D.2. Listed Transactions, Continued

**Notice 2001-17
(Contingent
Liability)**

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of Code and Reg. Sec.: §351, and § 357.

Summary of Transaction:

This transaction involves the transfer of a high basis asset to a corporation in exchange for stock of the transferee corporation, and the transferee corporation's assumption of a contingent liability (such as a liability for deferred compensation or other deferred employee benefits or an obligation for environmental remediation) that the transferor has not yet taken into account for Federal income tax purposes. The value of the stock of the transferee equals the value of the asset transferred reduced by the liability assumed by the transferee.

Continued on next page

I.D.2. Listed Transactions, Continued

Notice 2001-17
(Contingent
Liability)

Shelter Transaction Result:

- a. The transaction is intended to qualify as an exchange under IRC §351, with the intent that the basis of the stock that the transferor receives from the transferee corporation will be equal to the basis of the transferred asset, unreduced by the liability assumed by the transferee corporation.
- b. The transferor typically sells the stock of the transferee corporation for its fair market value within a relatively short period of time after the purported IRC §351 exchange and claims a tax loss in an amount approximating the present value of the liability assumed by the transferee corporation.
- c. Transferee corporation may claim a §162 deduction with respect to payments on the contingent liability as they become fixed.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

- a. Disallow losses claimed by the transferor for transfers after October 18, 1999, by asserting that such losses are disallowed because the transferor's basis in the stock received is reduced under IRC §358(h) (reducing stock basis by the amount of certain liabilities).
- b. For transfers on or before October 18, 1999, as well as for transfers after October 18, 1999 that are not subject to IRC §358(h), the Service will disallow such losses for one or more reasons, including but not limited to the following:

Continued on next page

I.D.2. Listed Transactions, Continued

**Notice 2001-17
(Contingent
Liability)**

- 1) that the purported IRC §351 exchange lacks sufficient business purpose to qualify as an IRC §351 exchange;
- 2) that the transfer of the asset to the transferee corporation is not, in substance, a transfer of property in exchange for stock within the meaning of IRC §351, but instead is either an agency arrangement for the transferor or simply a payment to the transferee for its assumption of a liability;
- 3) that the purported IRC §351 exchange constitutes an acquisition of control of the transferee corporation for the principal purpose of tax avoidance within the meaning of IRC §269(a) and thus the purported loss should be disallowed under IRC §269(a);
- 4) that the principal purpose of the transferee's assumption of the liability was a purpose to avoid federal income tax or was not a bona fide business purpose within the meaning of IRC §357(b)(1), and thus the assumption of the liability should be treated as money received by the transferor that reduces its basis in the transferee stock;
- 5) that the purported loss on the sale of the stock of the transferee corporation is not a bona fide loss actually sustained by the transferor, as required by Treas. Reg. §1.165-1(b); and
- 6) that the overall transaction lacks sufficient economic substance to be respected for federal income tax purposes, see ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), cert. denied, 526 U.S. 1017 (1999).

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I.D.2. Listed Transactions, Continued

c. In addition, any deduction claimed by a transferee corporation for payments on a liability assumed in a transaction similar to that described above may, depending on the facts of the particular case, be subject to disallowance on one or more of several possible grounds, including that the payments are not for ordinary and necessary business expenses of the transferee corporation. (Rev. Rul. 95-74, 1995-2 C.B. 36).

(7) that the liability is not within the scope of IRC §557 (c)(3) and IRC §358(d)(2) does not prevent the application of IRC §358(d)(1) to reduce basis by amount of the liability in the exchange.

Link to Notice 2001-17

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/Notice 2001-17.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202001-17.pdf)

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I.D.2. Listed Transactions, Continued

**Notice 2001-45
(IRC §§302/318
basis shift)**

This is a transaction based on the use of Code and Reg. Sec. §302, and §318.

Summary of Transaction:

A taxpayer acquires warrants in foreign corporation (FC). The warrants, if exercised, will give taxpayer a greater than 50 percent interest in FC. FC acquires a substantial amount of stock in a corporation at the same time the taxpayer acquires a de minimis amount of stock in the same corporation along with an option to acquire an additional amount of stock equivalent to the amount held by FC. The corporation redeems the stock held by the related party. Through the attribution rules of IRC §318, FC is not treated as suffering any equity reduction and so the redemption is taxed as a dividend to FC. Under Treas. Reg. §1.302-2(c), the basis in the stock previously held by the related party will now attach to the de minimis amount of shares held by the FC.

Shelter Transaction Result:

Due to the increase in basis of the stock, the taxpayer will be able to generate a substantial capital loss on a sale of the shares on the open market. The key to this shelter is minimizing the impact of the dividend income to the related party.

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

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I.D.2. Listed Transactions, Continued

**Notice 2001-45
(IRC §§302/318
basis shift)**

The Service intends to disallow losses claimed (or to increase taxable income or gains) to the extent a taxpayer derives a tax benefit that is attributable to stock basis purportedly shifted from the redeemed shares. Reasons for disallowance may include, but are not limited to, the following: (1) the redemption does not result in a dividend (and consequently there is no basis shift) because, viewing the transaction as a whole, the redemption results in a reduction of interest in the redeeming corporation to which § 302(b) applies; (2) the basis shift is not a “proper adjustment” as contemplated by § 1.302-2(c); and (3) there is no attribution of stock ownership or basis shift because the steps taken to achieve those results are transitory and serve no purpose other than tax avoidance.

Link to Notice 2001-45

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/notice_2001-45.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/notice_2001-45.pdf)

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I.D.2. Listed Transactions, Continued

**Additional
Transactions**

Since the publication of Notice 2001-51, the following additional abusive tax Shelter transactions have been identified as Listed Transactions.

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I.D.2. Listed Transactions, Continued

**Notice 2002-21
(Inflated Basis
(CARDS))**

This is a transaction based on the use of Code and Reg. Sec. §1012.

Summary of Transaction:

In general, the transaction involves the use of a loan assumption agreement to claim an inflated basis in assets acquired from another party. This inflated basis is claimed as a result of a U.S. taxpayer acquiring assets in exchange for becoming jointly and severally liable on indebtedness of the transferor of the assets (Transferor). Taxpayer agrees to pay the principal amount of the loan while transferor continues to make the interest payments. Thus the stated principal of the liability assumed by the taxpayer is substantially in excess of the fair market value of the assets transferred. Transferor may not be subject to U.S. tax or otherwise may be indifferent to the federal income tax consequences of the transaction.

Shelter Transaction Result:

Taxpayer claims that, as a result of its assumption of joint and several liability on the Loan, the entire principal amount of the Loan is included in Taxpayer's basis in the Conveyed Assets. As a result, Taxpayer claims a loss for federal income tax purposes in an amount equal to the excess of the stated principal amount of the Loan over the fair market value of the Conveyed Assets. If the Conveyed Assets are nonfunctional currency, Taxpayer claims an ordinary loss. This is often referred to as Synthetic Foreign Currency Zero-Coupon Borrowing. It is also referred to as Custom Adjustable Rate Debt (CARDS).

Continued on next page

I.D.2. Listed Transactions, Continued

Notice 2002-21 (Inflated Basis (CARDS))

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The notice states that the taxpayer's basis in the assets transferred is equal to the fair market value of such assets upon their acquisition by the taxpayer rather than the stated principal amount of the indebtedness. The purported tax benefits from these transactions are subject to challenge under provisions of the Code and regulations, including but not limited to § 988 and, in the case of individuals, IRC §§165(c)(2) 465. In the case of a corporation filing a consolidated return, Treas. Reg. § 1.1502-45 may be considered.

Link to Notice 2002-21

<http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/Notice%202002-21-CARDS.pdf>

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I.D.2. Listed Transactions, Continued

Rev. Rul. 2002-46 Deferred Contribution Plan

Summary of the Transaction's Tax Consequences

This is a transaction based on the use of the Code and Reg. Sec: §§ 401(k) and 401(m)

Summary of Transaction:

These are transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by the plan participants after the end of the taxable year. It is substantially similar to the transaction described in Rev. Rul. 90-105, 1990-2 C.B. 69.

Shelter Transaction Result:

Deductions are claimed for the entire amount of elective and matching contributions to the Plan even though a portion of the deduction related to Post-Year End Contributions. Prior to the end of the taxable year, Taxpayer amended the plan and passed a board of directors' resolution setting forth a minimum contribution for the plan year that included the Post-Year End contributions. (The plan amendment and the board of directors' resolution are the only facts that distinguish this revenue ruling from 90-105.)

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

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I.D.2. Listed Transactions, Continued

Rev. Rul. 2002-46 Deferred Contribution Plan

If the payment of the contributions is attributable to compensation earned after the end of the taxable year, under Reg. Sec. §1.404(a)-1(b), the Post Year End contributions could not be deductible. (Because of the plan amendment, they have met IRC §461(a), unlike in Rev. Rul. 90-105)

Link to Rev. Rul. 2002-46

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/rev_rul_2002-46 \(L19\) - IRS.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/rev_rul_2002-46_(L19)_-IRS.pdf)

NOTE: See Notice 2002-48 for certain variation to Rev. Rul. 90-105 that are not abusive.

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I.D.2. Listed Transactions, Continued

**Notice 2002-35
(Notional
Principal
Contract &
Method of
Accounting)**

This is a transaction based on the misinterpretation of Code and Reg. §§ 446 and 1.446-3.

Summary of Transaction:

In general, the transaction involves the use of a Notional Principal Contract (NPC) to claim current deductions for periodic payments made by a taxpayer while disregarding the accrual of a right to receive offsetting payments in the future. The NPC has a term of more than one year, and the taxpayer is required to make periodic payments to the counter party (CP) at regular intervals of one year or less based on a fixed or floating rate index. In return, the CP is required to make a single payment at the end of the term of the NPC that consists of a noncontingent component and a contingent component. The noncontingent component may be based on a fixed or floating interest rate. The contingent component may reflect changes in the value of a stock index or currency.

Shelter Transaction Result:

The taxpayer deducts the ratable daily portion of each periodic payment for the tax year to which that portion relates. However, the taxpayer does not accrue income on the nonperiodic payment until the year the payment is received. The taxpayer intends to report as capital any gain realized on the termination of the NPC.

Continued on next page

I.D.2. Listed Transactions, Continued

**Notice 2002-35
(Notional
Principal
Contract &
Method of
Accounting)**

Proper Tax Treatment:

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM's, court cases, etc. that could change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors.

The notice states, that the requirement of § 1.446-3(f)(2)(i) that a nonperiodic payment must be recognized over the term of a NPC in a manner that reflects the economic substance of the contract must be applied separately to the noncontingent component of the contract, whether that component is based on a fixed or a floating interest rate.

In addition, depending on the facts of the particular case, the Service may challenge the purported tax results of these transactions on other grounds, including:

- recharacterizing one or more of the transactions under §§ 1.446-3(g)(2) or 1.446-3(i);
- determining that the swap expense, if any, was not incurred in the course of a trade or business and was therefore subject to the 2-percent floor limitation in section 67 of the Internal Revenue Code;
- disregarding the combination of the loans and the periodic payments as circular flows of cash;
- or applying other variations of the doctrine of substance-over-form.

Link to Notice 2002-35

http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed%20Transactions/notice%202002_35-Notional%20Prin%20Contracts.doc

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I.D.2. Listed Transactions, Continued

Notice 2002-50,
(Partnership
Tax Straddle)
IRB 1 (June 25,
2002)

This is a transaction based on the use of IRC §754.

Summary of Transaction

A Partnership Straddle Tax Shelter is a type of transaction used by taxpayers to generate tax deductions. The transaction was designed to use a straddle, a tiered partnership structure, a transitory partner, and the absence of a § 754 election to allow taxpayers to claim a permanent non-economic loss. The Service has determined in Notice 2002-50 that the tax benefits purportedly generated by these kinds of transactions are not allowable for federal income tax purposes. Notice 2002-50 also alerts taxpayers, their representatives, and promoters of these transactions of certain responsibilities that may arise from participating in these transactions.

The transaction involves the manipulation of partnerships through a series of steps to generate income tax deductions and is carried out in the following order. No IRC §754 election is in effect at any relevant time.

Step 1: Corporation acquires a majority interest in an upper tier partnership (UTP) at fair market value.

Step 2: UTP acquires a majority interest in a lower tier partnership (LTP) at fair market value.

Step 3: LTP enters into straddles on foreign currencies and may acquire other assets.

Step 4: LTP terminates the gain leg of a foreign currency straddle. LTP allocates a pro rata share of the gain to UTP, which in turn allocates a pro rata share of the gain to Corporation. This gain increases the basis of each partnership interest.

Step 5: Corporation sells its interest in UTP to Taxpayer at fair market value. This results in a loss to Corporation sufficient to offset the gain that was allocated to Corporation.

Step 6: Taxpayer purchases UTP's interest in LTP at fair market value. UTP realizes a loss on this sale, but the loss is disallowed under § 707(b)(1)(A) because Taxpayer owns more than 50% of UTP.

Continued on next page

I.D.2. Listed Transactions, Continued

**Notice 2002-50,
(Partnership
Tax Straddle)
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2002)**

Step 7: LTP engages in a transaction that is intended to increase Taxpayer's basis in the LTP interest. For example, LTP may incur a liability that Taxpayer guarantees. LTP then terminates the loss leg of the foreign currency straddle and allocates a pro rata share of the loss to Taxpayer.

Step 8: Taxpayer sells the interest in LTP at its fair market value and realizes gain (for example, from the relief of liability). Taxpayer then claims that this gain is offset under § 267(d) by the amount of the loss that was disallowed to UTP under § 707(b)(1)(A).

Continued on next page

I.D.2. Listed Transactions, Continued

**Notice 2002-50,
(Partnership
Tax Straddle)
IRB 1 (June 25,
2002)**

Proper Tax Treatment

The proper tax treatment shown below is the way IRS is treating this transaction as of the date this ATG was written. There may be new FSA's, TAM,s, court cases, etc. that may change our thinking on a particular issue. Also, the facts and circumstances of your case may warrant different treatment. Therefore, we strongly recommend that you contact the TA for this transaction before developing the issue. A listing of the names of TA's assigned to each listed transaction can be found in Part III Section B of this ATG entitled Technical Advisors

The Service intends to challenge the purported tax benefits from this transaction on a number of grounds:

First, the Service expects that the partnership anti-abuse rule contained in Treas. Reg. §1.701-2(b) will generally disallow the deduction claimed by the taxpayer upon the termination of the loss leg of the straddle. See Treas. Reg. § 1.701- 2(d) (Ex. 8) (disallowing duplication of a built-in loss deduction attributable to the absence of an IRC §754 election).

Second, the Service may challenge the allowance of the loss deduction based on other statutory provisions, including IRC § 988, and judicial doctrines, including the step transaction doctrine and the doctrines of economic substance, business purpose, and substance over form.

Third, the Service may assert that, where a loss is disallowed on the sale of a partnership interest under IRC §§ 267(a)(1) or 707(b)(1). IRC §267(d) must be applied under an aggregate approach rather than an entity approach. See Treas Reg. §1.701-2(e) (requiring aggregate treatment of partnerships for certain purposes). Because the gain realized by Taxpayer on the sale of its interest in LTP does not correspond to any increase in the value of the assets within LTP, the disallowed loss realized on the sale of LTP by UTP cannot be used to offset the gain under an aggregate approach.

Link to Notice 2002-50

[http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed Transactions/notice_2002_50.pdf](http://lmsb.irs.gov/hq/pftg/otsa/downloads/Listed_Transactions/notice_2002_50.pdf)
