

## Part III - Administrative, Procedural, and Miscellaneous

### Loss Importation Transaction

#### Notice 2007-57

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which a U.S. taxpayer uses offsetting positions with respect to foreign currency or other property for the purpose of importing a loss, but not the corresponding gain, in determining U.S. taxable income. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

#### FACTS

In one variation of the loss importation transaction, a U.S. taxpayer (Taxpayer) is a shareholder of an S corporation (S Corporation). S Corporation acquires control of a foreign entity (Foreign Entity) by purchasing from a foreign shareholder stock of Foreign

Entity meeting the requirements of § 1504(a)(2). When S Corporation purchases the Foreign Entity stock, Foreign Entity is classified as a corporation for U.S. tax purposes under § 301.7701-2(b)(2) and § 301.7701-3(b)(2)(i)(B) of the Procedure and Administration Regulations, and is a controlled foreign corporation (CFC) within the meaning of § 957(a).

Foreign Entity enters into substantially offsetting positions in foreign currency. Next, Foreign Entity disposes of or closes out some positions in the foreign currency for a gain while retaining the offsetting loss positions. Foreign Entity is not itself subject to U.S. taxation on the gains from the offsetting options. Foreign Entity may use the proceeds from these dispositions or closings out to enter into new positions in foreign currency. By entering into the new positions in foreign currency, Foreign Entity can effectively preserve the retained loss positions in the foreign currency and virtually eliminate further economic risk.

After realizing gains from disposing of or closing out some of the offsetting positions, Foreign Entity elects to be disregarded as an entity separate from its owner for U.S. tax purposes. Based on the effective date of this election, Foreign Entity is not a CFC for an uninterrupted period of 30 days during Foreign Entity's taxable year, and S Corporation is not required to include any of Foreign Entity's subpart F income in its gross income. See § 951(a). The gains are not otherwise subject to U.S. taxation. See, e.g., §§ 881 and 882. The election results in the distribution of all of Foreign Entity's assets and liabilities to its shareholder in a deemed liquidation of Foreign Entity. See Treas. Reg. § 301.7701-3(g)(1)(iii). After the election, some or all of the loss positions in the foreign currency are allowed to expire, are disposed of, or are closed

out, and some or all of the gain positions are allowed to expire, are disposed of, or are closed out, resulting in an aggregate net loss. S Corporation passes Taxpayer's pro rata share of the loss through to Taxpayer. Taxpayer purports to have sufficient basis in its S Corporation stock or in its indebtedness to S Corporation to enable Taxpayer to claim the loss.

Variations exist in the types of entities and forms of loss importation used in the transaction described above. For example, in one variation of the transaction, a C corporation may be used instead of an S corporation; or a foreign entity with more than one owner may elect to be classified for U.S. tax purposes as a partnership, rather than as an entity disregarded as separate from its owner. Further, the importation of the loss may be accomplished by other methods, such as a corporate reorganization described in § 368(a) or a transfer to which § 351 applies. Variations also exist in how the offsetting positions may be used in the transaction described above. For example, taxpayers may use positions with respect to property other than foreign currency.

## DISCUSSION

The transactions described in this notice are designed so that taxpayers may claim losses without taking into account the corresponding gains attributable to the offsetting positions in foreign currency or other property. In the loss importation transaction described above, taxpayers are attempting to exploit the entity classification rules and § 951(a) in order to claim losses without taking into account the corresponding gains attributable to the offsetting positions in foreign currency. The Service may challenge these transactions by, for example, disallowing the loss or allocating the loss to the CFC. The Service may assert one or a combination of arguments including, but

not limited to, arguments under §§ 165, 269, 482, and 988. In addition, the Service may assert that the transaction fails one or more judicial doctrines, such as the economic substance doctrine.

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as “listed transactions” for purposes of §§ 1.6011-4(b)(2) and §§ 6111 and 6112 effective June 20, 2007, the date this notice was released to the public. Independent of their classification as listed transactions, transactions that are the same as, or substantially similar to, the transactions described in this notice may already be subject to the requirements of § 6011, § 6111, § 6112, or the regulations thereunder.

Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A which applies to returns and statements due after October 22, 2004. Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to an extended period of limitations under § 6501(c)(10). Persons required to disclose or register these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on persons involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or § 6662A.

The Service and Treasury recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the

type of transactions described in this notice. These taxpayers should take appropriate corrective action and ensure that their transactions are disclosed properly.

**DRAFTING INFORMATION**

The principal author of this notice is Megan Stoner of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Stoner at (202) 622-3070 (not a toll-free call).