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DEPARTMENT OF THE TREASURY
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE DISTRICT COUNSEL,

FROM: Jeffrey L. Dorfman, Chief, CC:INTL:Br5

SUBJECT:

This Field Service Advice responds to your memorandum dated March 14, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

District Counsel =
Taxpayer =
Parent =
Finance Sub X =
Finance Sub U =
Corporation A =
Country X =
Country A =
Y =
S =
SS =
UU =
T =
U =
D =
E =
F =
Z =
A =

ISSUE

Whether the interest expense and currency gain arising from a loan between the Taxpayer and Finance Sub X (the "Loan") may be disregarded for federal income tax purposes as lacking economic substance.

CONCLUSION

The interest expense deducted by the Taxpayer under section 163 (a)[1] and currency gain arising from the Loan should be disregarded for federal income tax purposes as lacking economic substance. Knetsch v. United States, 364 U.S. 361 (1960); Goldstein v. Commissioner, 364 F.2d 734 (2nd Cir. 1966).

FACTS

The Taxpayer is a wholly-owned subsidiary of Parent, a large publicly-traded foreign corporation organized in Country X. Parent has business operations all over the world and directly or indirectly owns many subsidiaries, including subsidiaries organized in the United States such as the Taxpayer.

The Taxpayer is a U.S. holding company that owns a number of U.S. operating subsidiaries. During the years in issue, the Taxpayer and its subsidiaries carried on a number of different businesses in the United States and filed consolidated federal income tax returns.

Parent owns two subsidiaries, Finance Sub X and Finance Sub U, that raise capital for Parent and its other subsidiaries. Finance Sub X and Finance Sub U are organized under the laws of Country X and the United States, respectively. Because it is owned directly by Parent, Finance Sub U is not includible in the consolidated federal income tax return filed by the Taxpayer.

Parent also owns Corporation A, a foreign subsidiary organized and doing business in Country A. Corporation A sold property to an unrelated party in exchange for SS of Country A currency (which was equal to about UU U.S. dollars). Corporation A loaned the Country A currency it received to Finance Sub X. On Date E, Finance Sub X loaned the Country A currency to the Taxpayer for Y months at S interest rate, a very high rate of interest. (Hereinafter, this transaction is referred to as the "Loan.") The Loan was repaid on F, a few weeks after its due date.

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[1] All section references are to the Internal Code Revenue Code or Treasury Regulations in effect during the years at issue.

The Loan had an unusually high interest rate because the Loan was denominated in the currency of Country A. The Taxpayer claims that commercial loans between unrelated parties denominated in Country A currency accrued interest at a rate similar to the interest rate charged on the Loan at the time the Loan was made.

On the date of the Loan, the Taxpayer did not need to borrow funds from Finance Sub X to finance its business activities because the Taxpayer was adequately capitalized and generated sufficient funds internally to meet its needs. In addition, the Taxpayer had access to funds through various credit lines with commercial banks. Under its credit lines, the Taxpayer could borrow up to U U.S. dollars, which is an amount greater than the amount borrowed through the Loan. The interest rate on any loans made under the credit lines would have been substantially less than the interest rate on the Loan.

The Taxpayer claims to have transferred most of the Loan proceeds to Finance Sub U to repay U.S. dollar denominated debts owed to Finance Sub U. The debts repaid by the Taxpayer were earning interest at a rate of T percent, a dollar interest rate substantially less than the foreign currency related interest rate payable on the Loan. Finance Sub U appears to have used the funds received from the Taxpayer to retire commercial paper issued to the public which was also accruing interest at a rate of T percent.

At the time of the Loan, Finance Sub X owed money to Finance Sub U. Finance Sub X did not use the funds borrowed from Corporation A to repay these debts. Instead, Finance Sub X loaned these funds to the Taxpayer and the Taxpayer repaid debt owed to Finance Sub U as set forth above.

On the date of the Loan, the Parent and its subsidiaries (including the Taxpayer) had an informal foreign exchange exposure practice and policy in place (which was later reduced to writing) providing that an operating company should engage in foreign exchange transactions only if needed (i) to meet requirements of commercial trading activity and (ii) to manage the expected future cash flows arising from the activity to a rolling twelve-month basis. As discussed above, the Loan was denominated in the currency of Country A. The Taxpayer and its subsidiaries did not have any business operations or activities requiring the use of Country A currency and did not have any financial instruments (other than the Loan) or payables or receivables denominated in Country A currency.

The Taxpayer could have reduced the interest rate paid on the Loan by entering into a currency hedging transaction. Economically, the hedging transaction would have lowered the effective interest rate on the Loan to a dollar rate if the Loan had been fully hedged on the issue date. The Taxpayer, however, did not enter into a hedging transaction.

It is our understanding that Finance Sub X was subject to tax on interest earned on the Loan in Country X at a rate no greater than A percent, an unusually low tax rate. Thus, the Taxpayer was able to reduce the amount of its federal income tax liability at the effective U.S. tax rate by deducting the interest paid on the Loan from its taxable income yet the corresponding tax on the interest income in Country X was computed at a rate far below the U.S. rate.

The Taxpayer does not have any documents produced at the time of the Loan explaining why it borrowed a large amount of funds denominated in a foreign currency at a high interest rate from Finance Sub X. The Taxpayer is not engaged in a business in which speculating in foreign currencies is a common practice. In fact, the Loan appears to be the only instance in which the Taxpayer engaged in a speculative foreign currency transaction.

Around the time the Loan was made, Parent was the subject of a takeover attempt. Credit agencies placed the debt of Parent and its subsidiaries on a “credit watch” because it was possible that Parent and its subsidiaries might borrow additional funds to defend against the takeover bid. In response to the takeover attempt, Parent increased the amount of the dividend it paid to its shareholders.

For financial reporting purposes, the Taxpayer reported a currency loss on the Loan at the end of the first taxable year the Loan was outstanding determined under a mark to market timing convention. On its federal income tax return, the Taxpayer claimed a deduction for the unrealized currency loss by treating the loss as additional interest expense paid on the Loan. The Taxpayer later agreed that no deduction is allowed for any unrealized currency loss on the Loan at the end of the first tax year the Loan was outstanding and that the currency loss should have been reflected as a difference between book and tax income on Schedule M-1 of its federal income tax return. When the Loan was repaid, the Taxpayer recognized a relatively small currency gain that had the economic effect of reducing the overall cost of the Loan by about D percent.

LAW AND ANALYSIS

Section 163(a) generally provides that a deduction is allowed for interest paid or accrued within the taxable year on indebtedness. However, no deduction is permitted for interest paid or accrued on loan arrangements that lack economic substance apart from anticipated tax consequences. Goldstein v. Commissioner, 364 F.2d 734, 740 (2nd Cir. 1966); Knetsch v. United States, 364 U.S. 361, 366 (1960). We need to determine whether the interest deduction claimed by the Taxpayer on the Loan should be disallowed for lack of economic substance.

As a general rule, taxpayers have the right to arrange their affairs in order to minimize their taxes. Gregory v. Helvering, 293 U.S. 465, 469 (1935). The key question in analyzing a tax-motivated transaction is "whether what was done, apart from the tax motive, was the thing the statute intended." Id. In Gregory, the Court disregarded the potential tax consequences of a corporate reorganization despite the fact that the taxpayer had complied with all statutory requirements because the transaction had no valid economic purpose and on its face lay outside the intent of the statute. Subsequent to its decision in Gregory, the Supreme Court held that to be respected for federal income tax purposes, a transaction must have economic purpose beyond tax reduction. Knetsch v. United States, supra. Thus, a transaction must have economic substance to be respected for tax purposes. See ACM Partnership v. Commissioner ("ACM"), 157 F. 3d 231, 247 (3rd Cir. 1998), aff'g in relevant part 73 T.C.M. 2189 (1997).

A transaction between related parties is generally subject to special scrutiny, as use of legal formalities may give the appearance of substance where it would otherwise be lacking. Riverpoint Lace Work, Inc. v. Commissioner, 13 T.C.M. (CCH) 463, 466 (1954) (citations omitted); Shaffer Terminals, Inc. v. Commissioner, 16 T.C. 35, 362 (1951), aff'd per curiam, 194 F.2d 539 (9th Cir. 1952), citing Higgins v. Smith, 308 U.S. 473 (1940). In a related-party context, the concern is that:

> [A] person may reduce his income tax by transferring his money from one pocket to another even though he uses different trousers. A man with a half-dozen pockets might almost escape [tax] liability altogether. Alpha Tank & Sheet Metal Mfg. Co. v. United States, 116 F. Supp. 721, 723 (Cl.Ct. 1953).

In evaluating the validity of a transaction, courts typically attempt to determine, first, whether a transaction genuinely occurred or whether it was merely "papered" in order to generate unwarranted tax benefits. Transactions that are determined to be factual shams are, of course, disregarded. See, e.g., Malden Knitting Mills v. Commissioner, 42 T.C. 769 (1964). A transaction that is determined to have genuinely occurred is analyzed next in terms of economic substance.

Generally, an economic substance analysis looks to the subjective business purpose and the objective profit potential of the transaction. See, Rice's Toyota World, Inc. v. Commissioner, 81 T.C. 184 (1983), aff'd in relevant part, 752 F. 2d 89 (4th Cir. 1985); United Parcel Service of America, Inc. v. Commissioner, T.C. Memo. 1999-268 (Aug. 9, 1999); ACM, supra at 247. These two aspects of an economic substance inquiry do not constitute a rigid two-step test, but rather represent related factors, both of which inform the analysis. ACM, supra at 247.

Various articulations of the subjective prong of the economic substance analysis have been set forth by the courts. E.g., ACM, 73 T.C.M. at 2217 (whether the transaction is “rationally related to a useful nontax purpose . . . in light of the taxpayer’s economic situation and intentions”); ACM, 157 F.3d at 253 (“whether the transaction was intended to serve any useful non-tax purpose”); Rice’s Toyota World, 752 F.2d at 91 (whether “ the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering in the transaction”);Friendship Dairies, Inc. v. Commissioner, 861 F.2d 494, 501 (7th Cir. 1988) (“Judges can’t peer into people’s minds or ‘weigh’ motives . . . Rather, the usual approach is to focus the analysis on whether any non-tax goals or functions were or plausibly could have been served by the action.”) The common thread of these articulations, however, is whether the transaction had a business purpose other than obtaining tax benefits.

Like the subjective prong of the economic substance analysis, the phrasing of the objective test has varied among the different courts. For example, the Tax Court in ACM articulated the objective prong as requiring that there be “a reasonable expectation that the non-tax benefits would be at least commensurate with the transaction costs.” 73 T.C.M. at 2217. The Third Circuit, on appeal of the same case, repeatedly searched for “any practical economic effects” of a transaction, other than the creation of income tax benefits by examining the taxpayer’s financial condition before and after the transaction. ACM,157 F. 3d at 248-252. Under the Fourth Circuit’s expression of the objective prong in Rice’s Toyota World, a transaction has no economic substance where “no reasonable possibility of profit exists.” 752 F.2d at 91. See also, Friendship Dairies, 90 T.C. at 1062; cf. Killingsworth v. Commissioner, 864 F.2d 1214, 1218 (5th Cir. 1989) (objective analysis involved examination of the “profit making potential”). While the specific articulation of the objective prong has differed among the courts, the fundamental principle is that a transaction must have real and practical economic effects other than the creation of income tax benefits to satisfy the objective aspects of the sham analysis. See, Sochin v. Commissioner, 843 F.2d 351, 354 (9th cir. 1988). Central to this notion is that where the profit derived from the transaction is “infinitesimally nominal and vastly insignificant when considered in comparison with the claimed [tax benefit],” the fact of the profit does not automatically preclude a finding that the transaction failed the objective prong of the economic substance analysis. See, e.g., Sheldon v. Commissioner, 94 T.C. 738, 768 (1990).

In Knetsch v. United States, supra, the Supreme Court held that certain indebtedness incurred by a taxpayer should be disregarded for tax purposes because the indebtedness was really a sham. The taxpayer entered into a series transactions with an insurance company. In form, the taxpayer purchased annuity bonds in exchange for a non-recourse note and prepaid interest on the note. The taxpayer also borrowed against increases in the cash value of the bonds and prepaid interest on the amounts borrowed. However, in reality, the taxpayer claimed large interest deductions in exchange for paying a fee to the insurance company. The taxpayer never acquired a meaningful beneficial interest in the annuity bonds. Thus, the Supreme Court held that no valid indebtedness existed between the taxpayer and insurance company, so no deduction was allowed for the purported interest expense.

In Goldstein v. Commissioner, supra, the Second Circuit held that no interest deduction was allowed on debt incurred by a taxpayer with unrelated banks because the taxpayer did not borrow the money for a business purpose other than tax avoidance. The taxpayer won the Irish Sweepstakes and subsequently entered into a series of transactions designed to reduce the federal income tax due on her winnings. The taxpayer borrowed money from banks and bought government securities with the loan proceeds and prepaid interest due on the loans. The interest rate on the loans was 4 percent but the interest rate on the government bonds was about 2 percent. The court stated that no interest deduction is allowed unless it can be said that the loan arrangements had “purpose, substance, or utility apart from their anticipated tax consequences.” Goldstein v. Commissioner, supra at 740. The Second Circuit held that, although a valid indebtedness existed, no deduction was allowed because there was not a valid business purpose for the debt incurred other than tax avoidance.

In Knetsch v. U.S., supra, the loan was disregarded and no interest deduction allowed because the whole transaction was a fictitious sham lacking in any economic substance. In Goldstein v. Commissioner, supra, the loan was not disregarded as a fiction, but no deduction was allowed for interest because the taxpayer had no business purpose for borrowing the money other than tax avoidance. Thus, in the Knetsch and Goldstein cases, each court adopted a different approach based on the facts at hand for disallowing interest deductions, but both courts examined the objective profit potential of and subjective business purposes for the loan transactions to determine whether the transactions had economic substance.

For the reasons discussed below, we conclude that the Taxpayer is not allowed a deduction for interest paid on the Loan on grounds that: (1) no valid indebtedness was created because the Loan was a fictitious sham lacking in substance under Knetsch v. U.S., supra; and (2) the Taxpayer had no business purpose for borrowing the money other than to reduce its taxes under Goldstein v. Commissioner, supra. Although the Knetsch and Goldstein cases adopted different approaches for disallowing interest deductions, our analysis of the objective profit potential of and subjective business purposes for the Loan transaction set forth below shows that no deduction should be allowed under either approach.

Before beginning our analysis, we note that the formalities of making the Loan were followed and funds were actually transferred. Thus, the Loan was not a sham in fact. The issue is whether the Loan had economic substance. Because the Loan is between related parties, special scrutiny is warranted.

(1) Objective Profit Potential

The Taxpayer borrowed a large amount of funds from Finance Sub X, a related party, denominated in a foreign currency at a high interest rate. The Taxpayer used the funds it borrowed to repay debts that accrued interest at a significantly lower rate owed to Finance Sub U, another related party. On its face, no objective profit potential supports engaging in this transaction because the Taxpayer refinanced a low interest rate loan with a high interest rate loan. Other facts also strongly suggest that the Loan had no real or practical economic effects other than tax avoidance.

The Taxpayer did not need the funds it borrowed to finance its business operations and it had credit lines with commercial banks that could have been used to raise funds. The dollar interest rate paid on any loans made under these credit lines would been substantially lower than the interest rate paid on the Loan.

The Taxpayer borrowed from Finance Sub X in the currency of Country A. The Taxpayer had no business activities or operations in Country A, had no payables or receivables in Country A currency, and did not normally borrow money in foreign currencies. In fact, the Taxpayer appears to have violated its own internal corporate policy by borrowing the Country A currency and this appears to be the only time that the Taxpayer has borrowed money in any foreign currency.

The Taxpayer did not enter into a currency hedging transaction that would have lowered the effective interest rate it paid on the Loan to an interest rate approximately equal to the interest rate paid on the debts retired by the Taxpayer.[2] Had the Taxpayer fully hedged the Country A debt, however, the Internal Revenue Service could have integrated the instruments creating a synthetic dollar borrowing for tax purposes. Sec. 988(d); Notice 87-11,1987-1 C.B. 423. This would have eliminated the high interest deduction claimed by the Taxpayer.

Based on these facts, the Taxpayer does not have any objective profit potential for borrowing funds from Finance Sub X through the Loan. The lack of any objective profit potential strongly suggests that the Loan lacked economic substance.

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[2] Generally, foreign currency forward contracts are priced under an interest rate parity theory which takes into account the difference in interest rates in the currencies subject to the contract. See, Schwartz and Smith, The Handbook of Currency and Interest Rate Risk Management, 4-13, New York Institute of Finance (1990). Because of this pricing, the economic yield on a foreign currency denominated debt instrument that is fully hedged into dollars will reflect prevailing dollar interest rates on the day the hedge is entered into. The same is true if a currency swap is used to hedge. Thus, the Taxpayer could have borrowed the Country A currency and effectively reduced the high Country A interest rate to a dollar rate. However, it chose not to do so leaving it in the position of having replaced a low interest rate dollar debt with a high interest rate Country A debt.

We will now consider whether the Taxpayer had one or more valid subjective business purposes for borrowing money from Finance Sub X through the Loan.

(2) Subjective Business Purpose

The Taxpayer claims it had three business purposes for borrowing funds through the Loan: (1) Parent and its subsidiaries needed to retire outside debt because the takeover attempt had caused Parent and its subsidiaries to be placed on a "credit watch;" (2) Parent needed to raise capital to defend against the takeover; and (3) Economically, the Taxpayer was attempting to lower the effective interest rate of the Loan by speculating through an unhedged foreign currency position.

First, the Taxpayer claims that credit agencies had placed the debt of Parent and its subsidiaries on "credit watch" status because it was possible that Parent and its subsidiaries might borrow additional funds to fight-off a takeover attempt. The Taxpayer claims that Parent and its subsidiaries might have needed to pay a higher interest rate on debt owed to third parties because their debt was placed on credit watch status, so they sought to reduce the amount of third-party debt. The Loan allowed the Taxpayer to repay debt owed to Finance Sub U, so Finance Sub U could retire some of the commercial paper it had issued to third parties. Thus, the Taxpayer argues that the Loan was entered into to eliminate the risk that Finance Sub U might have to pay a higher interest rate on some of its commercial paper.

Finance Sub U borrows money from the public by issuing commercial paper and loans those funds to Parent and its subsidiaries charging them the same interest rate as it pays on the commercial paper. The Taxpayer borrowed funds from Finance Sub X through the Loan and used the Loan proceeds to repay some debt owed to Finance Sub U. Finance Sub U appears to have used the Loan proceeds to retire some of its commercial paper. The interest rate on the Loan was substantially higher than the interest rate on the commercial paper and the debt retired by the Taxpayer.

We do not believe that the Loan was entered into to facilitate repayment of debt owed to outside creditors for two reasons. First, Finance Sub X did not need to loan money to the Taxpayer to enable Finance Sub U to repay its commercial paper because Finance Sub X also owed money to Finance Sub U. Finance Sub X could have simply transferred money directly to Finance Sub U, without first loaning the money to the Taxpayer. Second, the interest rate paid on the Loan was substantially higher than any interest rate the Taxpayer might have been required to pay on the repaid debt due to the "credit watch." No reasonable businessman would refinance debt at close to double the interest rate on the underlying debt even if that underlying debt was subject to a credit watch resulting in a marginally higher rate.[3] For these reasons, we do not believe that the Taxpayer borrowed high interest rate funds to mitigate the adverse effects of the “credit watch.”

Second, the Taxpayer claims the Loan was entered into to raise funds needed by Parent to fight a takeover attempt. A loan between members of an affiliated group does not increase the funds available to the group as a whole. Moreover, the Loan actually reduced the amount of funds available to the Parent’s affiliated group to fight the takeover because those funds were ultimately used to retire commercial paper issued by Finance Sub U.

The only way that the Loan might have increased the amount of funds available to Parent to fight the takeover bid was by reducing the tax liability of the Parent’s affiliated group. The Taxpayer’s U.S. income tax liability was reduced due to the interest deduction it claimed on the Loan. Finance Sub X’s Country X income tax liability did not increase substantially from the interest income received on the Loan because the interest income was subject to a special low tax rate in Country X. These facts further support the conclusion that the only reason the Taxpayer engaged in the Loan transaction was to arbitrage the tax systems of the U.S. and Country X.

Finally, the Taxpayer claims that it intended to lower the effective interest rate paid on the Loan by speculating on the movement of foreign currencies. Specifically, the Taxpayer claims it planned to reduce the overall cost of the Loan by speculating that Country A currency would decline relative to the U.S. dollar over the term of Loan generating a currency gain that would effectively reduce the interest rate paid on the Loan.

The Taxpayer could not have anticipated with any degree of assurance that a currency gain would offset the high interest rate paid on the Loan. Many factors affect currency movements, some of which are difficult to predict, and weak currencies can be very volatile.[4] Moreover, we have strong reservations that the forward rate (which is computed by reference to interest rate differentials and

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[3] We note that the “credit watch” did not, in fact, raise the interest rate that Finance Sub U had to pay on its commercial paper.

[4] “[C]hanges in the spot values of a particular currency are only minimally related to changes in interest rates. Such things as trade and capital flows, the political climate, sovereign credit risk, and market psychology have a much greater impact on spot rates than interest rates do. [footnote omitted.] Consequently, if a U.S. taxpayer has an unhedged position in a foreign currency, he is speculating on all of those factors and he has not locked in a guaranteed exchange gain or loss.” O’Neill and Lee, Federal Income Tax Treatment of Foreign Currency Transactions After The Tax Reform Act of 1986, 33 Tax Notes 185, 186 (Oct. 13, 1986)

generally prevents arbitrage in the foreign currency markets) is such an accurate predictor of currency movements that a reasonable businessman would rely on it to project with confidence that the high interest rate on a short term, weak currency borrowing would be significantly offset by a continued weakening of the currency.[5] Thus, we do not believe that a reasonable businessman would have borrowed a large amount of funds in a weak foreign currency at a high interest rate with a reasonable expectation that a speculative currency gain would materialize to reduce the effective interest rate paid on the Loan.

For financial reporting purposes, the Taxpayer reported a currency loss on the Loan at the end of the first tax year the Loan was outstanding computed under a mark-to-market timing convention. On its federal income tax return, the Taxpayer improperly reported the currency loss as additional interest expense, increasing the effective interest rate of the Loan by about Z percent. The failure to report the currency loss on Schedule M-1 of its tax return suggests that the Taxpayer may have been trying to conceal the Loan transaction. Although the Taxpayer eventually recognized a small currency gain when the Loan was repaid, the effective interest rate on the Loan, even after considering the currency gain, remained substantially higher than a dollar interest rate.

As discussed above, the Taxpayer is not engaged in a business in which speculating in foreign currencies is common. In fact, the Loan appears to be the only instance in which the Taxpayer borrowed funds in a foreign currency. This is consistent with the fact that the Taxpayer appears to have violated its own internal corporate policy by borrowing funds in a foreign currency. The Taxpayer has not been able to provide any contemporaneous documents showing any business purpose for the Loan, including currency speculation. It is incredible to believe that the Taxpayer would engage in a highly speculative foreign currency transaction involving a large amount of funds in violation of company policy and have no contemporaneous documents explaining its reasons for doing so. Thus, we do not believe that the Taxpayer engaged in the Loan transaction to speculate on foreign currency movements.

Furthermore, from an economic perspective, it is questionable whether a party is “speculating” in a foreign currency when the party on the other side of the transaction is related to the Taxpayer. The Taxpayer and Finance Sub X are both owned by Parent and any movement in the value of the foreign currency of Country A relative to the U.S. dollar would not have had any economic impact on the Parent’s affiliated group, as a whole. In analyzing whether the Taxpayer has a valid business purpose in the context of an economic substance analysis, it is appropriate to ask whether, considering the transaction as a whole, the Taxpayer had the potential to profit economically through speculating in the foreign currency.

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[5] See Note 4.

In this case, the Parent's affiliated group, as a whole, could not profit from any movement in the value of Country A currency relative to the U.S. dollar because members of the group were on both sides of the same transaction.

In summary, the Taxpayer borrowed a large amount of funds at a high interest rate denominated in a foreign currency from a related party to repay dollar denominated debts owed to another related party that were accruing interest at a much lower interest rate. The Taxpayer claims that it engaged in the Loan transaction hoping a foreign currency gain would effectively reduce the high interest rate on the Loan. Nothing in the facts presented supports this claim.

Accordingly, we conclude that the Loan was not entered into for a business purpose other than tax avoidance and that the Loan lacked economic substance. Knetsch v. United States, supra; Goldstein v. Commissioner, supra. Thus, no deduction should be allowed for interest paid on the Loan and the currency gain should be ignored for federal income tax purposes.[6]

Please call Steven Jensen at 202-622-3870, if you have any further questions.

JEFFREY L. DORFMAN

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[6] We recognize that other legal theories such as step transaction and section 482 are possible theories that could apply to the Loan transaction. However, because the Loan did not have any economic substance, we do not consider whether the Loan may also be ignored under other legal theories.