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to: Senior Team Coordinator
(Large & Mid-Size Business)

from: Senior Counsel
(CC:CORP:B06)

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subject: Disallowance of losses under § 267

LEGEND

Parent =

LLC1 =

LLC2 =

LP =

INC =

Bank =

Bank Sub =

\$a	=
\$b	=
\$c	=
\$d	=
\$e	=
\$f	=
\$g	=
\$h	=
i%	=
j%	=
k%	=
l%	=
m%	=
n%	=
o%	=
p%	=
q%	=
r	=
s	=
t	=
u	=
v	=

This Chief Counsel Advice responds to your request for assistance. In accordance with I.R.C. § 6110(k)(3), this advice may not be used or cited as precedent.

ISSUE

Whether § 267 and the regulations thereunder disallow the loss that Parent recognized on its transfer of distressed securities to its wholly owned subsidiary, INC, in exchange for INC stock, where INC contributed the securities to a partnership related to INC and Parent, and Parent sold some of the INC stock received in the exchange to unrelated Bank Sub.

CONCLUSION

Parent's loss is disallowed under § 267 and the regulations thereunder.

FACTS

Parent formed LLC1, a wholly-owned disregarded entity, by contributing $a in distressed securities[1] and $b cash to LLC1. Parent also wholly-owned LLC2, classified as a disregarded entity. Parent transferred $c in distressed securities and $d in cash to LLC2. Parent's combined basis in the distressed securities it transferred is over $e.

Next, LLC1 and LLC2 formed LP, a Delaware limited partnership. (Although LP is formed as a state law partnership, it is a disregarded entity for federal tax purposes since its "partners" are disregarded entities owned by the same corporation.) LLC1 transferred the securities and $f in cash it received from Parent in exchange for a i% limited partnership interest in LP. LLC1 transferred the remaining $g for a j% general partnership interest in LP. LLC2 transferred the securities and cash it received from Parent in exchange for a k% limited partnership interest in LP.

LLC2 then transferred its k% limited partnership interest to INC, its wholly owned Delaware shell corporation. LLC1 also contributed its i% limited partnership interest in LP to INC in exchange for two newly created classes of INC preferred stock, r shares of Class A voting preferred stock (Class A stock) and s shares of Class B non-voting preferred stock (Class B stock). LLC1 retained a j% general partnership interest in LP. When these contributions took place, LP converted from a wholly-owned disregarded entity to a partnership because INC is a separate taxable entity. Lastly, LLC1 sold the Class A stock to a subsidiary of Bank (Bank Sub) for $h.

According to the taxpayer, INC's Class A stock owned by Bank Sub has l% of the voting power, and represents m% of the value, of the total stock in INC. INC's common stock owned by LLC2 has l% of the voting power, and represents k%-m% of the value, of the

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[1] The documents actually refer to Participation Interests and Participation Securities, etc. The Participation Interests are intended to provide the economic and functional equivalent of direct ownership of specific securities including, without limitation, the full benefits and burdens of ownership of the securities. The Field has not challenged the taxpayer's transfer of the Participation Interests as transfers of the securities. For purposes of this memorandum, we will refer to the transfers of the Participation Interests as the transfer of the securities.

total stock in INC.[2] INC's Class B stock owned by LLC1 consists of approximately n%-o% of the value of the total stock in INC. The only asset INC owns is a p% limited partnership interest in LP.

The parties also structured put and call rights under which INC has the right to repurchase the Class A stock after t years, and Bank Sub has the right to sell the Class A stock to INC after u years. In any event, INC must redeem the Class A stock after v years. Bank Sub's amounts in liquidation and redemption are based on the amount of Bank Sub's initial investment, the amount of accrued but unpaid cumulative quarterly dividends, and the Participation Amount (based on a formula tied to m% of the fair market value of the assets of INC). To date, the securities in LP have appreciated in value. Parent, INC, and Bank Sub also executed the Stockholder's Agreement under which the parties agreed that, for so long as Bank Sub is a stockholder of INC, LP will be controlled by Parent.

The transactions at issue occurred on the same date pursuant to binding contracts executed while Parent owned all the stock in INC. The Service and the taxpayer agree that the transactions at issue should be viewed, for tax purposes, as follows: (1) Parent sold its distressed securities to INC in exchange for INC stock, (2) INC contributed the securities to LP under § 721, and (3) Parent sold Class A stock to Bank Sub.

<u>LAW AND ANALYSIS</u>

Section 267(a)(1) provides that no deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

Section 267(b) provides, in part, that the persons referred to in subsection (a) are: . . . (3) Two corporations which are members of the same controlled group (as defined in subsection (f) . . . (10) A corporation and a partnership if the same persons own—(A) more than 50 percent in value of the outstanding stock of the corporation, and (B) more than 50 percent of the capital interest, or the profits interest, in the partnership.

Treas. Reg. § 1.267(a)-1(a) provides that, except in cases of distributions in corporate liquidations, no deduction shall be allowed for losses arising from direct or indirect sales or exchanges of property between persons who, on the date of the sale or exchange, are within any one of the relationships specified in § 267(b). See § 1.267(b)-1.

Section 267(d) provides that if (1) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a)(1) (or by reason of §24(b) of the Internal Revenue Code of 1939); and (2) after December 31, 1953, the taxpayer sells or

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[2] There is a discrepancy in the facts between the documentation and the taxpayer's presentation of the facts, at least per the taxpayer's memorandum indicating that the common stock had approximately m% of the value.

otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain, then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer.

Section 267(f) provides, in part, that: (1) For purposes of this section, the term “controlled group” has the meaning given to such term by §1563(a), except that—(A) “more than 50 percent” shall be substituted for “at least 80 percent” each place it appears in §1563(a), and (B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of §1563; and (2) In the case of any loss from the sale or exchange of property which is between members of the same controlled group and to which subsection (a)(1) applies (determined without regard to this paragraph but with regard to paragraph (3))—(A) subsections (a)(1) and (d) shall not apply to such loss, but (B) such loss shall be deferred until the property is transferred outside such controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations.

Treas. Reg. § 1.267(f)-1 provides rules under § 267(f) to defer losses and deductions from certain transactions between members of a controlled group (intercompany sales).

Treas. Reg. § 1.267(f)-1(a)(1) provides rules under § 267(f) that apply to defer losses on intercompany sales between members of a controlled group.

Treas. Reg. § 1.267(f)-1(b) provides definitions and operating rules under which the definitions in 1.1502-13(b) and the operating rules of 1.1502-13(j) apply under this section with appropriate adjustments, including the following:

Treas. Reg. §1.267(f)-1(b)(1) provides that an intercompany sale is a sale, exchange, or other transfer of property between members of a controlled group, if it would be an intercompany transaction under the principles §1.1502-13, determined by treating the references to a consolidated group as references to a controlled group and by disregarding whether any of the members join in filing consolidated returns.

Treas. Reg. § 1.267(f)-1(b)(3) provides, in part, that corporations remain members of a controlled group as long as they remain in a controlled group relationship with each other, and corporations become nonmembers with respect to each other when they cease to be in a controlled group relationship with each other, rather than by having a separate return year (described in §1.1502-13(j)(7)).

Treas. Reg. § 1.267(f)-1(h) provides that if a transaction is engaged in or structured with a principal purpose to avoid the purposes of this section (including, for example, by avoiding treatment as an intercompany sale or by distorting the timing of losses or deductions), adjustments must be made to carry out the purposes of this section.

Treas. Reg. §1.1502-13(b)(1)(i) provides that, in general, an intercompany transaction is a transaction between corporations that are members of the same consolidated group immediately after the transaction.

Treas. Reg. § 1.1502-13(h) provides that if a transaction is engaged in or structured with a principal purpose to avoid the purposes of this section (including, for example, by avoiding treatment as an intercompany transaction), adjustments must be made to carry out the purposes of this section.

Section 1563 contains multiple definitions of a “controlled group” of corporations, including a parent-subsidiary group, which is defined as one or more chains of corporations connected through stock ownership with a common parent corporation if--(A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d) (1)) by one or more of the other corporations; and (B) the common parent corporation owns (within the meaning of subsection (d) (1)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Section 1563 (c)(1)(A) provides that, for purposes of § 1563, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

Treas. Reg. § 1.267(f)-1(a)(2) provides that, under § 267, S's loss or deduction from an intercompany sale is taken into account under the timing principles of § 1.1502-13 (intercompany transactions between members of a consolidated group), treating the intercompany sale as an intercompany transaction. For this purpose: (i) The matching and acceleration rules of § 1.1502-13(c) and (d), the definitions and operating rules of § 1.1502-13(b) and (j), and the simplifying rules of § 1.1502-13(e)(1) apply with the adjustments in paragraphs (b) and (c) of this section to reflect that this section-- (A) Applies on a controlled group basis rather than consolidated group basis; and (B) Generally affects only the timing of a loss or deduction, and not its attributes (e.g., its source and character) or the holding period of property.

Treas. Reg. § 1.267(f)-1(c)(1) provides, in part, that under § 267, S's losses and deductions are deferred until they are taken into account under the timing principles of the matching and acceleration rules of § 1.1502-13(c) and (d) with appropriate adjustments . . . . For purposes of this section, the adjustments to § 1.1502-13(c) and (d) include the following: . . . (iii) *Transfer to a section 267(b) or 707(b) related person*.

Treas. Reg. § 1.267(f)-1(c)(1)(iii) provides that, to the extent S’s loss or deduction from an intercompany sale of property is taken into account under this section as a result of

B's transfer of the property to a nonmember that is a person related to any member, immediately after the transfer, under §267(b) or §707(b), or as a result of S or B becoming a nonmember that is related to any member under § 267(b), the loss or deduction is taken into account but allowed only to the extent of any income or gain taken into account as a result of the transfer. The balance not allowed is treated as a loss referred to in § 267(d) if it is from a sale or exchange by B (rather than from a distribution).

Treas. Reg. § 1.267(f)-1(j), Ex. 6., provides as follows:

> *Example 6. Section 721 transfer to a related nonmember.* (a) *Facts*. *S* owns land with a basis of $ 130. On January 1 of Year 1, *S* sells the land to *B* for $ 100. On July 1 of Year 3, *B* transfers the land to a partnership in exchange for a 40% interest in capital and profits in a transaction to which section 721 applies. *P* also owns a 25% interest in the capital and profits of the partnership.
>
> (b) *Timing.* Under paragraph (c)(1)(iii) of this section, because the partnership is a nonmember that is a related person under sections 267(b) and 707(b), *S*'s $30 loss is taken into account in Year 3, but only to the extent of any income or gain taken into account as a result of the transfer. Under section 721, no gain or loss is taken into account as a result of the transfer to the partnership, and thus none of *S*'s loss is taken into account. Any subsequent gain recognized by the partnership with respect to the property is limited under section 267(d). (The results would be the same if the P group were a consolidated group, and S's sale to B were also subject to §1.1502-13.)

In the instant case, Parent's sale of the securities to INC was an intercompany transaction (within the meaning of § 1.1502-13) and an intercompany sale (within the meaning of § 1.267(f)-1(b)(1)). Cf. Tracinda Corporation and Turner Broadcasting System, Inc. and Subsidiaries v. Commissioner, 111 T.C. 315 (1998) (holding that § 267(f) and the former regulations thereunder did not apply in the case of simultaneous sales by which MGM, the seller, left the group simultaneously with its sale of property and thus no longer owned the property sold, concluding that the buyer, Tracinda, and MGM were not members of the controlled group immediately after the transaction). Viewing Parent's sale of the securities to INC as an intercompany transaction and an intercompany sale is consistent with the purposes of §267 and the regulations thereunder. Under the facts of this case and the statutory and regulatory context governing the disallowance and deferral of losses under §267, it defeats the purposes of §267 to allow Parent the loss on the sale under a taxpayer argument that Parent and INC were not members of the same controlled group "immediately after" the transaction (within the meaning of § 1.1502-13) and that the sale was not an intercompany transaction or an intercompany sale. In the context of the statute and regulations at issue and their intended purposes, Parent and INC were members of the same controlled group at the time Parent executed the binding contract to effect the sale of the securities to INC, as well as immediately after the transaction in which Parent sold the securities to INC.

Additionally, LP was a nonmember that was a related person, under §§ 267(b) and 707(b), to Parent and INC. (A § 707(b) relationship exists between a partnership and a person where the person owns, directly or indirectly, more than 50% of the capital interests, or the profits interest, in such partnership.) Accordingly, under Treas. Reg. § 1.267(f)-1(c)(1)(iii), Parent's loss on the sale of the securities to INC in the intercompany sale is treated, upon INC's transfer of the securities to LP, as a disallowed loss that can only be used to offset any later gain on LP's sale of the securities. See also Treas. Reg. § 1.267(f)-1(j), Ex. 6. In other words, under the § 267 regulations, the loss is treated as if the loss had occurred on a sale transacted directly between related persons that is disallowed (rather than deferred under § 267(f)).

Purpose of §267

The instant case is the specific type of case to which §267 and the regulations thereunder were intended to apply. Section 267 and the regulations thereunder disallow or defer a loss on the sale of property between related parties where the seller retains control or ownership of the property sold. See Moore v. Commissioner, 17 T.C. 1030 (1951), aff'd, 202 F.2d 45 (5th Cir. 1953). As the Fifth Circuit stated in Moore, in rejecting a taxpayer's attempt to limit the application of the predecessor of § 267 to a transaction:

> What the statute aimed at and what it hit was the confection and carrying out as here of a sale at a loss taxwise when, because of ownership or control, there was no real sale and no real loss in the sense of a parting with real ownership and control of the property, the subject of the transaction.

202 F.2d at 47.

The transactions at issue resulted in Parent selling the securities at a loss to INC, a related person, but retaining control of the securities, as well as indirect ownership of approximately q%, by value, of the securities, through Parent's structured transfer of the securities to LP, a related person to Parent and INC. Moreover, the parties executed the Stockholder's Agreement in which the parties (including Bank Sub) agreed that Parent was to control LP after the sale of the Class A stock to Bank Sub.

Anti-avoidance rules under §1.267(f)-1(h) and §1.1502-13(h).

Even assuming arguendo that the instant case does not fall under Treas. Reg. § 1.267(f)-1(c)(1)(iii), we believe it falls under the anti-avoidance rules of §1.267(f)-1(h) and §1.1502-13(h). Treas. Reg. §1.267(f)-1(h) provides that if a transaction is engaged in or structured with a principal purpose to avoid the purposes of §267 (including, for example, by avoiding treatment as an intercompany sale or by distorting the timing of losses or deductions), adjustments must be made to carry out the purposes of §267.

We believe the facts in the instant case present a strong set of facts in which to apply the anti-avoidance rules, and the facts are even stronger than those set forth under §1.267(f)-1(j), Ex. 8. In Ex. 8 of those rules, P owns all of the stock of S and B, and the P group is a consolidated group. S has several historic assets, including land with a basis of $130 and value of $100. The land is not essential to the operation of S's business. In Year 1, S sells the land to B for $100. In Year 3, P transfers all of S's stock to newly formed X in exchange for a 20% interest in X stock as part of a transaction to which §351 applies. A principal purpose for P's transfer is to accelerate taking S's $30 loss into account. P has no plan or intention to dispose of the X stock. Ex. 8 states that P's transfer accelerates a loss that otherwise would be deferred, and an adjustment under the anti-avoidance rule of §1.267(f)-1(h) is required. Thus, S's loss is never taken into account.

Additionally, even if the sale between Parent and INC is not otherwise an intercompany transaction under the principles of Treas. Reg. §1.1502-13, we believe the sale should be treated as an intercompany transaction under the anti-avoidance rules of Treas. Reg. §1.1502-13. For example, Treas. Reg. §1.1502-13(h)(2), Ex. 4, provides an example in which members attempt to avoid intercompany transaction treatment by having one member contribute property to a partnership that distributes that property to another member five and one-half years later. The example indicates that the transactions will be recharacterized under anti-avoidance rules as an intercompany transaction between the two members. In the instant case, the transactions are also structured in an attempt to avoid intercompany transaction treatment and provide Parent with a loss in avoidance of the §267 rules. Moreover, Parent will reacquire the Class A stock in INC in t or u years (or, in any event, in v years) under the parties' arrangement.

If Parent's sale of the securities to INC is treated as an intercompany transaction under the anti-avoidance rules of §1.1502-13(h), Parent's loss on the sale of the securities to INC is disallowed under Treas. Reg. § 1.267(f)-1(c)(1)(iii). Alternatively, Parent's loss is disallowed under Treas. Reg. §1.267(f)-1(h). Under Treas. Reg. §1.267(f)-1(h), adjustments must be made to carry out the purposes of § 267.

<u>Sale between related persons for § 267 purposes</u>

Our understanding is that the taxpayer contends that Parent and INC are not treated as members of the same group "immediately after" the transaction (within the meaning of Treas. Reg. §1.1502-13) -- e.g., under step transaction principles. In taxpayer's view, §267(f) does not apply to Parent's sale of the securities to INC because Parent pre-arranged to sell the Class A stock to Bank Sub after it sold the securities to INC and had INC transfer the securities to Parent's controlled partnership.

However, if the taxpayer construes "immediately after" the transaction to mean the time after which the sale of the Class A stock to Bank Sub occurred, then "immediately after" the transaction for this purpose must also mean the time after which the transfer of the securities to LP occurred. Thus, even under this interpretation, it seems appropriate that the loss should be disallowed under §267. That is, Parent owned the securities immediately before the transactions, and LP, a related person to Parent and INC under §§267(b)(10) and 707(b), owned the securities "immediately after" the transactions.

Accordingly, if Parent's loss is not otherwise disallowed under Treas. Reg. § 1.267(f)-1(c)(1)(iii) or under the anti-avoidance rules (e.g., because the sale is not treated as an intercompany sale), we believe the loss should still be disallowed under the anti-avoidance rules of §1.267(f)-1(h) by treating the loss, *for §267 purposes*, as if the loss had occurred on a sale transacted directly between related persons. In cases not applying to deferred losses from intercompany sales under §267(f), courts have held that the §267 related party determination is made at the time of a binding contract. See Drake v. Commissioner, 3 T.C. 33, aff'd, 145 F.2d 365 (10th Cir. 1944); Federal Cement Tile Co. v. Commissioner, 40 T.C. 1028 (1963), aff'd, 338 F.2d 691 (7th Cir. 1964); Cf. Tracinda Corporation and Turner Broadcasting System, Inc. and Subsidiaries v. Commissioner, 111 T.C. 315 (1998). At the time of the binding contract to effect the sale, Parent is a related person to INC under §267(b)(3), and Parent and INC are related persons to LP under §§267(b)(10) and 707(b). Treating the loss, *for §267 purposes*, as if the loss had occurred on a sale transacted directly between related persons is consistent with Treas. Reg. § 1.267(f)-1(c)(1)(iii) (which treats a deferred loss as a disallowed loss where the property is transferred to a nonmember related person).[4]

If Parent or INC had directly sold the securities to LP, the loss would have been disallowed under §§ 267(a)(1) and 707(b). Moreover, if the transaction were structured so that Parent had sold the securities to INC and INC in turn then transferred the securities to LP without the accompanying sale of INC stock to Bank Sub, the loss clearly would have been disallowed under § 1.267(f)-1(c)(1)(iii). Accordingly, if the loss is not disallowed under § 1.267(f)-1(c)(1)(iii), adjustments must be made under § 1.267(f)-1(h) to ensure that Parent does not avoid the application of these sections by interposing Bank Sub in the transactions where its principal purpose in doing so was to avoid the application and purpose of these sections.

Attempt to Circumvent the § 267(f) Rules

On paper, Bank Sub had 50% of the voting power in INC stock; however, the facts indicate Bank Sub's 50% voting power was illusory and designed to circumvent §267(f). Cf. Alumax v. CIR, 165 F.3d 822 (11th Cir. 1999) (concluding that voting power must mean not only the power to elect a certain percentage of votes on the board of directors, but also the extent to which the directors, and the board itself, have the authority to manage the corporation's business). For example, INC's only asset was its

[4] This approach is also consistent with Treas. Reg. § 1.267(b)-1. Treas. Reg. § 1.267(b)-1(b) provides, in part, that: "[a]ny transaction described in section 267(a) between a partnership and a person other than a partner shall be considered as occurring between the other person and the members of the partnership separately. Therefore, if the other person and a partner are within any one of the relationships specified in section 267(b), no deduction with respect to such transactions between the other person and the partnership shall be allowed. . . to the other person to the extent the related partner acquires an interest in any property sold or exchanged with the partnership by such other person at a loss."

p% interest in LP, and LP's only assets were the securities and the cash transferred to it. Subsidiaries of Parent (which was the general partner of LP and the majority shareholder of INC) were the investment managers that were to control the investments in LP. Additionally, Bank Sub executed the Stockholder's Agreement with Parent and INC, under which the parties agreed that, during the time that Bank Sub owned INC stock, Parent's disregarded entities were to control the LP. Furthermore, LP knew what it was going to do with the securities: LP was to sell all the securities over a u-year period and place the money in government securities. Also, Bank Sub's Class A stock constituted only about m% of the total value of the stock in INC, and Bank Sub was to receive a Participation Amount based on a formula tied to m% of the value of INC's assets.

Consequently, even though Bank Sub purportedly had l% of the voting power of the stock in INC, it is questionable whether Bank Sub's ownership of the Class A stock in INC should prevent INC from being a controlled group member, for purposes of §§ 1563 and 267(f). If Bank Sub's Class A stock had less than l% of the voting power of the stock in INC so that Parent's stock in INC had more than l% of the voting power of the stock in INC, INC was clearly a controlled group member for purposes of § 1563 and § 267(f), notwithstanding the sale of the Class A stock to Bank Sub.

Additionally, even though Parent structured the Class B stock as nonvoting stock that was limited and preferred as to dividends, there is also an issue of whether the Class B stock should be treated as stock for purposes of §1563(c)(1)(A). For example, Parent structured the Class B stock to represent approximately n-o% of the value of the stock in INC, and Parent owned all the common stock in INC (representing approximately k%-m% of the value of the stock in INC). If the Class B stock is treated as stock for purposes of §1563(c)(1)(A), INC was clearly a controlled group member for purposes of §1563 and § 267(f), notwithstanding the sale of the Class A stock to Bank Sub.

Overall, under the facts of this case and the statutory and regulatory context governing the disallowance and deferral of losses under §267, it defeats the purposes of § 267 to allow Parent the loss on the sale of the securities.

Taxpayer arguments

The taxpayer argues that INC was not a member of the consolidated group or controlled group "immediately after" the transaction (within the meaning of §1.1502-13) because, at the time of Parent's exchange of the securities with INC, Parent had a binding contract to sell the Class A stock to Bank Sub.

Parent's transfer of its distressed securities to INC in exchange for INC stock was not a §351 exchange because, as a consequence of Parent's binding contract to sell the Class A stock, Parent was not considered "in control" of INC immediately after the exchange. See e.g., Intermountain Lumber Co. v. Commissioner, 65 T.C. 1025 (1976); Rev. Rul. 79-194, 1979-1 C.B. 145. For purposes of §351, control (as defined in §368(c)) means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

However, §§351 and 267 have different purposes, and even though a transferor's binding contract to sell the transferee stock received in the exchange may cause the transferor to fail to control the transferee in applying §351, the transferor's binding contract and later sale of the transferee stock may not cause the transferor to fail to control the property transferred in the exchange in applying §267.

Section 351 provides rules that address whether a transaction is a tax-free exchange under which a taxpayer recognizes no gain or loss on property transferred to a controlled corporation, whereas §267 provides rules that address whether a loss that is recognized on a sale of property should be allowed. Where a taxpayer recognizes a loss on property transferred to a corporation in a transaction that does not qualify under §351, the taxpayer does not obtain the loss unless §267 (among other provisions) allows the loss.

In providing nonrecognition treatment under §351, the underlying assumption is that the stock received in the exchange is substantially a continuation of the old investment (property transferred) still unliquidated. See e.g.,Treas. Reg. §1.1002-1(c). There has been a mere change in the form of ownership of the transferor's interest in the property since the transferor in the §351 exchange controls the corporation that now owns the property. In disallowing a recognized loss under §267, the underlying assumption is that there has been "no real sale and no real loss in the sense of a parting with real ownership and control of the property" (see Moore supra) where a taxpayer sells the property, at a loss, to a related person and continues to control and indirectly own the property. The focus of §351 is on whether the transferor controls the transferee corporation, whereas the focus of §267 is on whether the seller, through a related party, continues to control the property sold.[5]

[5] Section 267 is also concerned about losses created by sales structured between related persons-e.g., §482 is not easily applied.

In the instant case, Parent recognized a loss on its exchange of property for the INC stock because, due to the binding contract to sell the Class A stock to Bank Sub, Parent was not considered in control of INC immediately after the exchange for purposes of § 351. However, Parent retained control and indirect ownership of the property sold to INC in the exchange through its pre-arranged transfer of the property to its related partnership, LP. Section 267 and the regulations thereunder disallow Parent's loss.

Certain Other Cases

The taxpayer may also argue that the government's position in the instant case is inconsistent with its positions in cases such as Falconwood Corporation v. United States, 422 F.3d 1339 (Fed. Cir. 2005), Aeroquip-Vickers, Inc v. Commissioner, 347 F.3d 173 (6th Cir. 2003), Walt Disney Inc. v. Commissioner, 4 F.3d 735 (9th Cir. 1993), and Salomon v. United States, 976 F.2d 837 (2nd Cir. 1992). We disagree. In Falconwood, the Federal Circuit interpreted the consolidated return regulations at issue to conclude that the consolidated group remained in existence after the downstream merger of the common parent, and corporations remained connected through stock ownership with the surviving entity, notwithstanding that the merger was part of a pre-arranged series of transactions that occurred on the same date that ended affiliation. The government's position in Falconwood was that the initial downstream merger could not be viewed in isolation, but rather, as part of a transaction as a whole under step transaction principles. The government's position in Falconwood was based on the facts and the context of the regulation at issue and its intended purpose.

Additionally, in Walt Disney, the Ninth Circuit held that the transfer of §38 property from one consolidated group member to another group member as part of a D reorganization in which the transferee member (and thus, the property) left the group constituted a disposition under former §47(a)(1) that generated ITC recapture. In that case, the transfer of the property from the transferor member to the transferee member was part of a transaction in which the transferee member left the group through a distribution to the transferor's shareholders. Under these facts and in the context of the statute and regulation at issue, the transfers at issue were viewed the same as a direct transfer of the property to a third party. If the transfers were not viewed this way, a consolidated group could easily circumvent the ITC recapture requirement. See 4 F.3d at 741.

The government's position in Walt Disney, set forth in Rev. Rul. 82-20, 1982-1 C.B. 6, was that the transaction should be viewed as a whole, and not as separate transactions, because the transfer of the §38 property from one group member to the other member was a step in the planned transfer of the property outside the group. As a result, former Treas. Reg. §1.1502-3(f)(2)(i) (relating to an exception for ITC recapture for certain transfers of §38 property from one group member to another member) did not apply. The government's position in Walt Disney was based on the facts and the context of the statute and regulation at issue and their intended purposes.

Additionally, the government's positions in Aeroquip-Vickers and Salomon, which are cases similar to Walt Disney, were also based on the facts and the context of the statute and regulation at issue and their intended purposes.

Lastly, the government's position in the instant case is based on the facts and the context of the statute and regulations at issue and their intended purposes. As discussed above, it defeats the purposes of §267 to allow Parent the loss under the facts of this case and the statutory and regulatory context governing the disallowance and deferral of losses under §267.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call if you have any further questions.

Sincerely,

Mary E. Goode
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