Perlin v. Commissioner, 86 T. C. 875 (1986)

A commodity straddle is presumed to be entered into for profit if the trader is a commodities dealer or regularly engaged in trading regulated futures contracts, unless the IRS can rebut this presumption.

Summary

In Perlin v. Commissioner, the Tax Court addressed whether commodity straddle transactions were sham transactions and if they satisfied the "entered into for profit" requirement under Section 108 of the Tax Reform Act of 1984. The petitioners, experienced traders, engaged in silver, soybean, and T-Bond straddles. The court found these transactions to be bona fide and not prearranged shams, thus possessing economic substance. Applying a rebuttable presumption that the transactions were entered into for profit, the court analyzed transaction costs, trading patterns, and tax consequences, ultimately upholding the presumption as unrebutted by the IRS. This decision impacts how tax professionals evaluate the validity and tax treatment of commodity straddle transactions.

Facts

Petitioners Paul Perlin and Henry and Ellen Hershey engaged in commodity futures trading, forming Hillbrook Farm, Inc. , a subchapter S corporation. Perlin, a seasoned commodities trader, conducted four straddle transactions: a Silver Straddle in 1978, a Soybean Straddle in 1979, and two T-Bond Straddles in 1979 and 1980. The transactions involved buying and selling futures contracts in different delivery months to profit from price differentials. The IRS challenged these transactions as sham transactions lacking economic substance and questioned whether they were entered into for profit under Section 108 of the Tax Reform Act of 1984.

Procedural History

The IRS issued notices of deficiency to the petitioners, asserting that the commodity straddle transactions were not valid for tax purposes. Petitioners filed petitions with the Tax Court, which reviewed the transactions to determine their validity and compliance with Section 108. The court found the transactions to be bona fide and not prearranged, and further analyzed whether they satisfied the "entered into for profit" requirement.

Issue(s)

1. Whether the commodity straddle transactions were sham transactions devoid of economic substance?
2. Whether the commodity straddle transactions satisfied the "entered into for profit" requirement of Section 108 of the Tax Reform Act of 1984?
3. Whether petitioners are liable for additional interest pursuant to Section 6621(d)?

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Holding

1. No, because the transactions were bona fide and not prearranged shams, thus possessing economic substance.
2. Yes, because the transactions were presumed to be entered into for profit as the petitioners were commodities dealers, and the IRS failed to rebut this presumption.
3. The court did not reach this issue as the transactions satisfied the requirements of Section 108.

Court’s Reasoning

The court determined that the transactions were not prearranged or fictitious, as they were executed through competitive open-outcry bidding and cleared through the Chicago Board of Trade Clearing Corp. The court applied a rebuttable presumption under Section 108(b) that the transactions were entered into for profit, given the petitioners’ status as commodities dealers. The IRS attempted to rebut this presumption by arguing high transaction costs, deviation from regular trading patterns, and disproportionate tax results. However, the court found the transaction costs to be minimal relative to potential profits, the trading patterns consistent with the petitioners’ activities, and the tax results not relevant for rebutting the presumption. The court invalidated part of the IRS’s temporary regulation that considered disproportionate tax results as a factor, as it conflicted with the statute’s purpose.

Practical Implications

This decision clarifies that commodity straddle transactions by professional traders are presumed to be entered into for profit, placing the burden on the IRS to rebut this presumption. Tax professionals should consider transaction costs and trading patterns when evaluating similar cases. The ruling may encourage more aggressive trading strategies by commodities dealers, as it upholds the validity of straddles for tax purposes. Subsequent cases have applied this ruling to uphold the validity of commodity straddle transactions, reinforcing its impact on tax practice in this area. The decision also highlights the importance of understanding legislative history and the specific language of tax statutes when challenging IRS regulations.

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