Samueli v. Commissioner, 147 T. C. 33 (U. S. Tax Court 2016)

In Samueli v. Commissioner, the U. S. Tax Court ruled that a leveraged securities transaction did not qualify as a securities lending arrangement under IRC section 1058. The court found that the agreement reduced the taxpayers' opportunity for gain in the transferred securities, contrary to the statute's requirements. This decision underscores the importance of adhering strictly to statutory conditions in securities lending and impacts how similar financial arrangements are structured to achieve desired tax treatment.

Parties

Plaintiffs: Henry and Susan F. Samueli, Thomas G. and Patricia W. Ricks. Defendants: Commissioner of Internal Revenue. The plaintiffs were the petitioners at the trial court level, and the defendant was the respondent.

Facts

In 2001, Henry and Susan Samueli, along with Thomas and Patricia Ricks, entered into a leveraged securities transaction facilitated by Twenty-First Securities Corporation (TFSC) and executed through Refco Securities, LLC. The transaction involved the Samuelis purchasing $1. 7 billion in principal of a U. S. Treasury STRIP from Refco using a margin loan, then immediately transferring the securities back to Refco under a Master Securities Loan Agreement (MSLA), an Amendment, and an Addendum. The Samuelis paid Refco a variable rate fee for the cash collateral received in exchange for the securities. The transaction was set to terminate on January 15, 2003, with earlier termination options on July 1 and December 2, 2002. On termination, Refco was to purchase the securities back from the Samuelis at a price determined by a LIBOR-based formula. The Samuelis reported significant tax benefits from the transaction, including interest deductions and capital gains.

Procedural History

The Samuelis and Rickses filed petitions in the U. S. Tax Court challenging the Commissioner's determination of tax deficiencies for 2001 and 2003. The Commissioner determined deficiencies related to the leveraged securities transaction, asserting that it did not qualify as a securities lending arrangement under section 1058 and disallowed interest deductions. Both parties moved for summary judgment, and the Tax Court granted the Commissioner's motion, holding that the transaction did not meet the requirements of section 1058 and disallowing the claimed interest deductions.

Issue(s)

Whether the leveraged securities transaction entered into by the Samuelis and Rickses qualified as a securities lending arrangement under IRC section 1058(b)(3), which requires that the agreement does not reduce the transferor's opportunity for

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gain in the securities transferred.

Rule(s) of Law

IRC section 1058(a) provides that no gain or loss shall be recognized on the exchange of securities under an agreement meeting the requirements of section 1058(b). Section 1058(b)(3) specifies that the agreement must not reduce the risk of loss or opportunity for gain of the transferor of the securities in the securities transferred. The court interpreted this to mean that the transferor must retain the ability to realize any inherent gain in the securities throughout the transaction period.

Holding

The Tax Court held that the leveraged securities transaction did not qualify as a securities lending arrangement under section 1058 because the agreement reduced the Samuelis' opportunity for gain in the securities transferred. The court further held that the Samuelis and Rickses were not entitled to deduct interest paid in connection with the transaction, as no debt existed.

Reasoning

The court's reasoning focused on the interpretation of section 1058(b)(3). It determined that the Samuelis' opportunity for gain was reduced because the agreement limited their ability to demand the return of the securities and realize any inherent gain to only three specific dates during the transaction period. The court rejected the petitioners' arguments that they retained the opportunity for gain throughout the transaction period and that they could have locked in their gain through other financial transactions. The court also considered the legislative history of section 1058, which aimed to codify existing law requiring that a lender in a securities loan arrangement retain all benefits and burdens of ownership and be able to terminate the loan upon demand. The court concluded that the economic reality of the transaction was two separate sales of the securities, rather than a securities lending arrangement, and thus disallowed the claimed interest deductions due to the absence of any debt obligation.

Disposition

The Tax Court granted the Commissioner's motion for summary judgment, holding that the leveraged securities transaction did not qualify as a securities lending arrangement under section 1058 and disallowing the claimed interest deductions. The court ordered the deficiencies determined by the Commissioner to be sustained.

Significance/Impact

The Samueli decision has significant implications for the structuring of leveraged securities transactions and the application of section 1058. It clarifies that

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agreements must allow the transferor to realize any inherent gain in the securities throughout the transaction period to qualify as securities lending arrangements. This ruling may affect how financial institutions and taxpayers structure similar transactions to achieve desired tax treatment. The decision also underscores the importance of the economic substance doctrine in tax law, as the court looked beyond the form of the transaction to its economic reality in determining its tax consequences.

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