Anschutz Co. v. Commissioner, 135 T. C. 78 (2010)

The U. S. Tax Court ruled that the Anschutz Company must recognize gain from its stock transactions involving prepaid variable forward contracts (PVFCs) and share-lending agreements (SLAs) with DLJ. The court determined that these transactions constituted a sale for tax purposes due to the transfer of benefits and burdens of ownership, despite the company's attempt to treat them as open transactions. The ruling clarifies the tax implications of such financial arrangements, impacting how similar transactions might be structured in the future to avoid immediate tax recognition.

Parties

Plaintiffs: Anschutz Company (Petitioner), Philip F. and Nancy P. Anschutz (Petitioners). Defendants: Commissioner of Internal Revenue (Respondent). The Anschutz Company was the trial-level plaintiff, and the case was appealed to the U. S. Tax Court, where they remained petitioners.

Facts

Philip F. Anschutz, the sole shareholder of Anschutz Company, used The Anschutz Corporation (TAC), a qualified subchapter S subsidiary of Anschutz Company, to hold stocks from various companies he invested in. In 2000 and 2001, TAC entered into a master stock purchase agreement (MSPA) with Donaldson, Lufkin & Jenrette Securities Corp. (DLJ) to sell shares of Union Pacific Resources Group, Inc. (UPR), Anadarko Petroleum Corp. (APC), and Union Pacific Corp. (UPC). The MSPA included both PVFCs, where DLJ made an upfront cash payment in exchange for TAC's promise to deliver a variable number of shares in the future, and SLAs, which allowed DLJ to borrow the shares subject to the PVFCs. The upfront payments were calculated at 75% of the stock's fair market value, and TAC received an additional 5% as a prepaid lending fee. TAC did not report any gain or loss from these transactions on its federal income tax returns.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency to Anschutz Company and Philip F. Anschutz for the tax years 2000 and 2001, determining that the MSPA transactions constituted closed sales of stock and thus were subject to built-in gains tax under section 1374. Anschutz Company and Philip F. Anschutz filed petitions with the U. S. Tax Court to contest these determinations. The Tax Court consolidated the cases and held a trial on February 9-10, 2009. The standard of review applied was de novo, as the case involved factual determinations and legal interpretations.

Issue(s)

Whether the transactions entered into by TAC under the MSPA with DLJ constituted a sale under section 1001 of the Internal Revenue Code, requiring the recognition of gain to the extent of the upfront cash payments received in 2000 and 2001?

Whether the transactions resulted in a constructive sale under section 1259 of the Internal Revenue Code?

Rule(s) of Law

Section 1001(a) of the Internal Revenue Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis. Section 1058(a) provides that no gain or loss shall be recognized on the transfer of securities pursuant to an agreement that meets the requirements of section 1058(b), which includes not limiting the transferor's risk of loss or opportunity for gain. Section 1259(a)(1) provides that a constructive sale of an appreciated financial position requires recognition of gain as if the position were sold at its fair market value on the date of the constructive sale.

Holding

The U. S. Tax Court held that the transactions under the MSPA constituted a sale under section 1001, requiring TAC and Anschutz Company to recognize gain to the extent of the upfront cash payments received in 2000 and 2001. The court further held that the transactions did not result in a constructive sale under section 1259.

Reasoning

The court analyzed the MSPA as an integrated transaction, finding that TAC transferred the benefits and burdens of ownership of the stock to DLJ, including legal title, all risk of loss, a major portion of the opportunity for gain, the right to vote the stock, and possession of the stock. The court rejected the argument that the SLAs and PVFCs were separate transactions, noting that the MSPA required the execution of both. The court also found that the SLAs did not meet the requirements of section 1058(b) because the MSPA limited TAC's risk of loss through the downside protection threshold, which guaranteed that TAC would not have to return any portion of the upfront payment even if the stock's value fell. The court determined that TAC must recognize gain only to the extent of the cash received in 2000 and 2001, rejecting the Commissioner's argument that TAC received value equal to 100% of the stock's fair market value. Regarding the constructive sale under section 1259, the court found that the PVFCs were not forward contracts for a substantially fixed amount of property, as the number of shares deliverable could vary by up to 33. 3%, which was deemed substantial.

Disposition

The U. S. Tax Court ordered that decisions would be entered under Rule 155, requiring the recognition of gain to the extent of the upfront cash payments received by TAC in 2000 and 2001.

Significance/Impact

The decision in Anschutz Co. v. Commissioner clarifies the tax treatment of complex financial transactions involving PVFCs and SLAs. It establishes that such transactions can be treated as sales for tax purposes if they transfer the benefits and burdens of ownership, even if the parties intended to treat them as open transactions. The ruling impacts the structuring of similar financial arrangements and may lead to increased scrutiny by the IRS of transactions that attempt to defer tax recognition. The case also highlights the importance of analyzing all aspects of an integrated transaction, rather than treating components as separate for tax purposes.