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Date:
July 21, 2010

LEGEND

Investors =

Corporation X =

Z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Country =

Government =

Act 1=

Act 2 =

Act 3 =

Fund =

Agency =

n% =

p% =

q% =

r =

Dear

This is in response to your request for a ruling under sections 165(a) and 1231 of the Internal Revenue Code dated February 12, 2010.

FACTS

The Investors are a series of trusts which are treated as partnerships for federal income tax purposes. On Date 1, the Investors purchased an aggregate investment of approximately n% of the stock of Corporation X. On Date 2, Government passed Act 1 which had the purpose of stabilizing the financial markets. As part of that legislation, Government established the Fund and the Agency. The Fund and the Agency are subject to legal and substantive supervision by Government financial department.

On Date 3, Government passed Act 2 authorizing the nationalization of Corporation X. Under Act 2, the Fund first was required to buy the shares of Corporation X, with nationalization to take place only after Fund had attempted to purchase the stock. Act 2 authorized Fund to squeeze out minority shareholders of a corporation if Fund acquired a minimum ownership of p% stock of such corporation. In all other cases a majority shareholder is required to acquire a higher minimum ownership of q%. In addition Act 2 authorized Fund to inject capital into targeted corporations in exchange for stock in order to dilute non-Fund ownership in the corporation.

Government and Fund took the following steps in order to acquire 100% of the stock of Corporation X.

1. Fund provided liquidity guarantees to Corporation X in addition to support provided by the Government central bank and a consortium of Country financial institutions.
2. Fund subscribed to new shares of Corporation X out of authorized capital of the company by excluding the subscription rights of all other shareholders.
3. Fund acquired additional shares of Corporation X stock through a public tender offer. Public documents stated that shareholders who did not accept the public tender offer would become subject to an expropriation of their shares at a lower price. Under the governing documents in place for the Investors, only a small percentage of the Investors' shares were sold in the public tender offer. Such shares are not the subject of this letter ruling.

4. A second capital increase was approved that resulted in Fund increasing its ownership in Corporation X to at least p%, following which, and pursuant to Government legislation granting Fund the legal right to do so with regard to Corporation X, it was resolved that all remaining Corporation X shares not already owned by Fund should be transferred to Fund in exchange for cash compensation determined according to the corporate statutes of Country and Government in an amount equal to r. The legislation granting Fund this right to compel transfer of Corporation X shares also provided for severe penalty provisions in the event of objection by minority shareholders.
5. On Date 4, pursuant to Government court action, the transfer of the shares to Fund took effect under the transfer resolution for the squeeze out of minority shareholders, including Investors. Minority shareholders became entitled to a cash settlement payment from Fund. The amount of the cash settlement payment was determined in accordance with the provisions of Act 3, which provides that the minimum level of cash compensation is equal to r.

Following the transfer of their shares to Fund, Investors and certain other minority shareholders filed suits against Corporation X in the courts of Country requesting that their shares of stock in Corporation X be returned to them. The suits note that the provisions relating to the recapitalization and the related modifications to the squeeze-out rules were newly introduced into the law of Country in the context of the measures aimed at stabilization of the financial markets and allege violations of the constitution of Country and several articles of the Z contract. Investors also filed suits against Fund requesting additional compensation for transferring their shares to Fund.

Investors request a ruling that they recognized a loss under section 165(a) of the Internal Revenue Code equal to the amount received in the transaction less their basis in the shares of Corporation X and that under section 1231(a)(3)(B) the loss is treated as a section 1231 loss.

Applicable Law

Section 165(a) of the Code provides that any loss sustained during the taxable year and not compensated for by insurance or otherwise may be deducted.

Section 165(b) states that the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

Section 1.165-1(a) of the Income Tax Regulations states that section 165(a) provides that, in computing taxable income under section 63, any loss actually sustained during the taxable year and not made good by insurance or some other form of compensation shall be allowed as a deduction subject to any provision of the internal revenue laws which prohibits or limits the amount of the deduction. This deduction for

losses sustained shall be taken in accordance with section 165 and the regulations thereunder.

Section 1.165-1(b) of the regulations states that to be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and except as otherwise provided in section 165(h) and section 1.165-11, relating to disaster losses, actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

Section 1.165-1(d)(1) of the regulations provides that as to the year of deduction a loss shall be allowed as a deduction under section 165(a) only for that taxable year in which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by indentifiable events occurring in such taxable year.

Section 1.165-1(d)(2)(i) of the regulations provides that if a casualty or other event occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or by an abandonment of the claim.

ISSUE 1. Does Investors' filing of a suit against X in courts of Country prevent the loss from being sustained in Year 1?

Section 165(a) provides for the deduction of losses sustained during the taxable year for which no compensation is received. In the case of individuals, section 165(c) limits the deduction to losses incurred in a trade or business or in any transaction entered into for profit. In order to be deductible, a loss must be evidenced by a closed and completed transaction, fixed by identifiable events, and actually sustained during the taxable year. Boehm v. Commissioner, 326 U.S. 287, 291- 292 (1945); section 1.165-1(b). A loss is only deductible for the taxable year in which such loss is sustained. Section 1.165-1(d)(1). The determination of whether a loss occurred during a particular taxable year is purely one of fact. Korn v. Commissioner, 524 F.2d 888, 890 (9th Cir.1975), affg. T.C. Memo.1973-258. A critical inquiry is to focus on the year that the taxpayer loses control over and possession of the property at issue. United States v. S.S. White Dental Mfg. Co., 274 U.S. 398 (1927).

Whether a reasonable prospect for recovery exists with respect to a claim for reimbursement of the loss is a question of fact to be determined upon examination of all of the facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or by an abandonment of the claim. The determination of whether reasonable certainty exists as to reimbursement is an objective inquiry into the facts and circumstances surrounding the loss as of the close of the taxable year in which the deduction is claimed. See Boehm v. Commissioner, 326 U.S. 287, 292-93 (1945); Ramsey Scarlett & Co. v. Commissioner, 61 T.C. 795, 811 (1974), aff'd, 521 F.2d 786 (4th Cir. 1975); Brown v. Commissioner, T.C. Memo. 1996-284.

Various cases and rulings discuss the timing of a loss caused by a seizure of stock by a foreign government. Such cases and rulings generally permit the loss in the year of the seizure, finding that there was not a reasonable prospect for recovery of the loss, in spite of the purported existence of claims for reimbursement. For example, in United States v. S.S. White Dental Mfg. Co., the Supreme Court held that a taxpayer creditor and stockholder of a corporation seized by the German government in 1918 could take a deduction for the loss of the taxpayer's investment in the year of seizure, even though in a later year the German government bound itself to make a payment to the taxpayer in respect of the seized property. In Fuchs v. Commissioner, 413 F.2d 503 (2d Cir. 1969), a loss caused by the seizure of rental properties by the Czechoslovakia government in 1953 was held to be deductible in 1953, notwithstanding that the taxpayer recovered a portion of her loss from a fund set up by the United States government in 1962. See also Colish v. Commissioner, 48 T.C. 711 (1967).

Revenue Ruling 62-197, 1962-2 C.B. 66, discusses when a loss is permitted to U.S. taxpayers whose property was seized by the government of Cuba. It states "It is the position of the Service that acts of confiscation, whether by way of seizure, intervention in, expropriation, or similar taking of property, by the Cuban Government constitute identifiable events which, in light of all of the circumstances, have resulted in closed and completed transactions notwithstanding promise of indemnification (emphasis added). An act of confiscation has occurred when the taxpayer has been deprived of ownership of property or the normal attributes of ownership, such as receipt of income and control over the operation or use of the property, with little or no chance of being compensated therefore."

In Rev. Rul. 75-121, 1975-1 C.B. 70, the taxpayer's domestic subsidiary S, formed to own and operate property in a foreign country, was occupied by the government of that country contingent upon the investment of 100X dollars in capital improvements in S by the taxpayer, secured by the stock of S. The ruling holds that there is a loss when the taxpayer, after originally agreeing to make the investment, later determined such investment to be unfeasible, upon which the foreign government declared the stock of S to be forfeited. Rev. Rul. 76-41, 1976-1 C.B. 52, which, in part, clarified Rev. Rul. 75-121, stated that implicit in Rev. Rul. 75-121 is the requirement that

a seizure of stock in a domestic corporation results in a loss for purposes of section 165, 172 and 1231 only if the U.S. shareholder cannot expect to regain legal ownership of the stock through a U.S. court proceeding.

In Boehm v. Commissioner, the Court held that there was no prospect of recovery as to stock in a failing corporation in spite of a shareholders derivative suit that was filed against the corporation and its board of directors. The shareholders purchased stock for $32,440 in 1929. By 1932, the corporation had sustained large losses, and a receiver was appointed. The shareholders instituted a stockholder's derivative suit against the corporation and nine members of its board of directors. The suit was settled in 1937, and the shareholders took a loss for the stock at that time. The Court denied the loss, holding that the stock had become worthless in a previous year, even though the shareholders were pursuing a claim against the corporation. The Court determined that the shareholders had not shown that there was any value to the suit, as "there was no evidence in the stipulation of the merits of the suit, the probability of recovery or any assurance of collection of an amount sufficient to pay the creditor's claim … and to provide a sufficient surplus for stockholders so as to give any real value to their stock." 326 U.S. at 294.

Unlike the situation in Rev. Ruls. 75-121 and 76-41, the stock in this case is not stock in a U.S. subsidiary, and Investors cannot expect to regain legal ownership through a U.S. court proceeding. Under the reasoning of Boehm v. Commissioner, the mere fact of having filed a suit to recover their shares does not automatically establish that there is a valid claim for reimbursement or recovery. Under Boehm, it is necessary to consider the merits of the suit, including the probability of recovery. In this case, although Investors have instituted a suit in the courts of Country to regain their stock, in view of the circumstances under which Corporation X stock was transferred, the Investors have represented that they have no reasonable prospect of recovering their Corporation X shares as a result of these legal actions. Instead the legal actions were intended as an incentive to Fund to offer additional compensation for the stock. Based upon this, it is appropriate to consider the loss as sustained as of Date 4 when the stock was transferred to Fund pursuant to the forced sale.

ISSUE 2, Does the loss result from the involuntary conversion of the stock into other property or money under section 1231(a)(3)(A)?

Section 1231(a)(3)(B) provides that the term "section 1231 loss" means any recognized loss from a sale or exchange or conversion described in section 1231(a)(3)(A). Section 1231(a)(3)(A) provides that section 1231 gain means any recognized gain from "the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) into other property or money" of property used in a trade or business or any capital asset held for more than one year that is held in connection with a trade or business or a transaction entered into for profit.

Section 1.1231-1(e) of the regulations provides that “For purposes of section 1231, the terms ‘compulsory or involuntary conversion’ and ‘involuntary conversion’ of property mean the conversion of property into money or other property as a result of complete or partial destruction, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof.”

Rev. Rul. 72-1, 1972-1 C.B. 52, Situation 2, holds that a taxpayer (Y) owning stock in a foreign corporation (T) may deduct the loss caused by the nationalization of the stock of T whose assets were located in the foreign country, when there was no reasonable prospect for payment of such compensation, nor of recovery of Y’s interest in the corporation or indemnification by insurance or otherwise. In addition, the ruling notes that “If the prospect for compensation is favorable but Y is required, as a condition to receiving compensation, to enter into a formal contract of sale ... with country B in respect of Y’s stock in T, such a ‘sale’ will be viewed by the Service as merely an agreement as to the amount of compensation to be paid for the involuntary conversion of Y’s stock ….”

Rev. Rul. 75-121 holds that the taxpayer’s loss qualifies under section 1231 when S, a domestic subsidiary, formed to own and operate property in a foreign country, was occupied by the government of that foreign country, contingent upon the investment of 100X dollars in capital improvements in S by the taxpayer. The taxpayer agreed to make the investment, but later determined such investment to be unfeasible, and so notified the foreign government, upon which the foreign government declared the stock of S to be forfeited, with compensation under the pledged agreement.

Generally, a “seizure,” for federal tax purposes, occurs when a governmental authority enters into physical possession of property without authority of a court order with compensation to be determined later and is limited to the taking of property for public use. Rev. Rul. 79-269, 1979-2 C.B. 297. An act of confiscation, whether by way of seizure, intervention in, expropriation, or similar taking of property occurs when a foreign government deprives a taxpayer of ownership of property or the normal attributes of ownership, such as receipt of income and control over the operation or use of the property, with little or no chance of being compensated therefore. Rev. Rul. 62-197, 1962-2 C.B. 66, <u>clarified by</u> Rev. Rul. 64-149, 1964-1 C.B. 233, <u>modified by</u> Rev. Rul. 69-498, 1969-2 C.B. 31. Compensation may be received in some instances of seizure by a foreign government. Rev. Rul. 72-1, Situation 2. The expropriation or confiscation of property by a foreign government is considered a loss under 165 and an involuntary conversion for purposes of section 1231. <u>See</u> Rev. Rul. 72-1, 1972-1 C.B. 52. <u>See also</u> Rev. Rul. 62-197, Situation 3.

At times, forced sales of stock have been held to be involuntary conversions. However, other cases and rulings have held that forced sales of stock do not qualify as involuntary conversions. In Rev. Rul. 79-269, 1979-2 C.B. 297, a sale of stock by a

trustee in bankruptcy of a customer's securities held in a margin account of a bankrupt brokerage firm was not considered an involuntary conversion. Sale of stock by one of two 50% shareholders under a state "deadlock" statute was held not to be an involuntary conversion. Dear Publication & Radio v. Commissioner, 274 F2d 656, affg. 31 T.C. 1168. American Natural Gas Co. v. U.S., 150 Ct. Cl. 572, held that a sale of public utility stock by SEC order was not an involuntary conversion.

The acquisition of stock in this case by Fund was pursuant to the squeeze-out provisions of Government law. The circumstances of this sale differ from the cases cited above in which a forced sale was not considered an involuntary conversion. While the cases cited above resulted in the forced sale of stock pursuant to a government order, those sales did not result in the acquisition by the government or a government controlled entity of the stock, and the stock was not acquired for a public purpose. Rather, they resulted in another private party acquiring the stock. In this case, the forced sale resulted in acquisition of stock by Fund, an instrumentality of Government, for a public purpose, the stabilization of the economy of Country. Pursuant to the provisions of Act 2, described above, Fund first was required to buy the shares of Corporation X, with nationalization to take place only after Fund had attempted to purchase the stock. Act 2 authorized Fund to squeeze out minority shareholders of a corporation if Fund acquired a minimum ownership of p% stock of such corporation. In addition, Act 2 authorized Fund to inject capital into targeted corporations in exchange for stock in order to dilute non-Fund ownership in the corporation. As described above, Fund acquired p% of the shares of Corporation X. On Date 4, all remaining Corporation X shares not already owned by Fund were transferred to Fund in exchange for cash compensation. This was pursuant to the express provisions of Act 2, described above, which directed that Fund should acquire the shares of Corporation X either by purchase or by nationalization, if necessary.

Under Revenue Ruling 72-1, this should be treated as an involuntary conversion of the stock of Corporation X through seizure or confiscation even though the stock was purchased under the laws of Government, and the shareholders of Corporation X received compensation equal to r. The terms of Act 2 make it clear that it was the intention of Government to acquire the stock of Corporation X for public purposes. The provisions of Act 2 first instructed Fund to acquire the shares through purchase, and if that was not possible, authorized the nationalization of Corporation X.

Therefore, it is held that Investors recognized a loss under section 165(a) of the Internal Revenue Code as of Date 4, equal to the amount received in the transaction less their basis in the shares of Corporation X and that under section 1231(a)(3)(B), the loss is treated as a section 1231 loss.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christopher F. Kane
Chief, Branch 3
(Income Tax & Accounting)