Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Christine F. Smith
(Financial Products Specialist)

from: Christina A. Morrison, Branch Chief, CC:FIP:B06
(Financial Institutions & Products)

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subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES:

1. Should the entire amount of cash paid to Trust on the three forward contracts (including so-called premium payments in and final payments in) be recognized and included in the calculation of taxable gain under section 1001 of the Internal Revenue Code (the "Code") in when the Variable Forward Contracts are settled?

2. Alternatively, should the entire amount of cash paid to Trust on the three forward contracts be recognized and included in the calculation of taxable gain under section 1259?

TAX YEAR

and all 100 percent controlled entities (collectively, "Taxpayer") . All issues discussed herein apply to the prospective tax treatment for the consolidated income tax return.

Facts:

On , Trust ("Trust"),

), entered into three variable forward contracts (called contracts) with Bank , with respect to shares of Common Stock –). Upon entering the forwards, the Trust received prepayments totaling $ ($, $, and $).[1] The Trust did not report taxable income on the receipt of the prepayments. The expiration dates of the variable forward contracts were: 1) , 2) and 3) . Both the ISDA Master Agreement between Bank and Trust dated , and the associated three Confirmations dated for the variable forward contracts were provided by Taxpayer.

Also on , the Trust entered into a Pledge Agreement with Bank under which shares of Common Stock were pledged as collateral and placed in a separate collateral account for Bank . Although the original Pledge Agreement would have allowed rehypothecation with Taxpayer's consent, according to Taxpayer it did not consent at any time to a rehypothecation of the shares and that Bank did not in fact rehypothecate the shares. The Pledge Agreement was amended on to include reference to the Credit Agreement dated , and in addition, to delete the "rehypothecation" clause. Taxpayer has provided an email dated from the for Bank stating that Bank did not rehypothecate the shares while they were pledged to Bank . See Exhibit A. Bank Collateral Account statements have been partially provided to date. The amended Pledge Agreement has also been provided, but the original stock certificates on the shares placed in the Collateral Account have not been provided.

On , Corporation had entered into a Guaranty with Bank in which it would unconditionally guarantee to Bank and its successors prompt payment when due of all present and future obligations and liabilities arising out of or relating to all Transactions including, without limitations, under any Master Agreement or ISDA Master Agreement relating to or governing any

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[1] Taxpayer refers to the payments received in as "premium payments," but refers to its contract as a "forward" contract. Premium payments normally are received on options, but not forward sales contracts. If Taxpayer received payment upon execution of its contracts, they normally would be characterized simply as "prepayments" or prepaid sale proceeds. Regardless of the characterization, they are treated the same upon settlement of the contract. To avoid confusion, such payments will be referred to as "prepayments."

"Transaction" with Trust and Bank . Both Guaranty Agreements were provided by Taxpayer.

According to two Final Term Sheets dated from Bank to the Trust, signed by both the Trust and Corporation, as guarantor, consented to the hedging of the shares.

The final floor price for each unit was $ and the final cap price was $. The quoted trading prices at the forward maturity dates ranged from $ to $ per share for and from $ to $ per share for .

Similarly, the obligation to deliver shares under the forward contracts was transferred several times during the term of the forwards, but always within members of the consolidated group. At the date of the closing, , the parent company, was itself the party ultimately responsible under each of the forward contracts.

On , a Credit Agreement was executed between , as Borrower, and Bank , as Lender. Under the Credit Agreement, the Borrower was to repay any outstanding balance to the Lender on the maturity date, .
Each loan was to bear interest on the outstanding principal at a rate per annum equal to the reference rate for such period plus percent. Depending on the language of the loan, the Borrower could pay monthly or quarterly. The Lender committed to make Loans in an aggregate principal amount at any one time not to exceed $ (the "Commitment"). Taxpayer has provided one promissory note for $ and has stated that this is the only executed promissory note. The initial amount borrowed on the closing date was to be $. Each borrowing, other than the initial loan amount, would be in an amount of $ or more made upon the Borrower's irrevocable notice to the Lender, which could be given

by telephone. The Borrower at any time could, upon notice to the Lender, make voluntary prepayments on the loan in full or in part in $ increments including accrued interest. According to the Loan Schedule, Taxpayer borrowed $ on . This amount was repaid with interest on .

Taxpayer borrowed an additional $ on . This amount was repaid with interest on .

On , the Credit Agreement dated was amended to change the Commitment by the Lender from $ to $. The affiliate borrowed $ on . Taxpayer has stated that the monies borrowed on this loan were held in cash to be available for general corporate purposes. With this loan, the total cash received to date by Taxpayer was approximately percent of the total cash settlement due from Bank at the floor price under the transactions.

Also, on , the parties amended the Pledge Agreement dated to secure the Commitment by the Lender pursuant to the revised Credit Agreement.

The $ borrowed from Bank on was repaid with interest in three subsequent payments on , , and . These dates correspond very closely to the expiration dates of the three variable forward contracts entered into on . The total loan repayment amount, including interest, was $. Cash Wire Advices were provided.

The variable forward contracts expired during three separate periods of : 1) from ; 2) from ; and 3) from . The expiration of the contracts resulted in Bank making aggregate cash settlement payments to of $ equal to the “floor” price of $ multiplied by the shares. Cash Wire Advices were provided.

Taxpayer elected physical settlement of the forward contracts, and rather than deliver the shares that it pledged to Bank , it borrowed shares from , and the borrowed shares were delivered to Bank in settlement. The shares held in the Collateral account were delivered to to be used as collateral on the short sale.

At , held shares. At , held shares .

has stated that it does not know when it will close out the short sale with . In fact, if were to recall the shares, states that it would try to find another broker and enter into another short sale to close out the position. It would rely on Rev. Rul. 2004-15, 2004-1 C.B. 515, as its authority. Only in the event it could not find another broker, would it close out the short sale with and recognize the additional gain that has been deferred up to that point.

Taxpayer's Position:

Taxpayer treated the settlement of the variable forward contracts in as open transactions. It has recognized capital gain of $ under section 1259. The fair market values of the shares used in its gain calculation was from $ to $ per share depending on the settlement date, and the fair market values used the shares was from $ to $ per share. The basis of the and shares included both Taxpayer's historical basis in the shares and capitalized interest paid to Bank pursuant to the Credit Agreement dated (amended on). The interest was not deducted on its or tax returns. Taxpayer asserts that a straddle was created at this time, and that the interest on the loan was properly capitalized under section 263(g) and added to the basis of the underlying stock. The straddle that was created involves a short position and a long position. The short position was the loan under the variable forward contracts secured by the underlying and shares. The long position was holding other and shares. Therefore, the capitalized interest was added to the basis of the and shares at the time of the section 1259 gain calculation under section 1092 straddle rules. See Exhibit B for Taxpayer's calculation of the section 1259 capital gain.

Taxpayer acknowledges that the delivery of the borrowed shares to settle the forwards is a short sale and a constructive sale of shares and shares under section 1259, but argues that the deemed gain is limited by the fair market value on the date of the short sale only for a limited amount of the cash proceeds received. designated these shares as the shares "deemed" sold for section 1259 purposes. Taxpayer is recognizing $ capital gain under section 1259 on the tax return. According to Taxpayer, however, because 's settlement of the forward is similar to a standard short sale transaction in which the short seller first contracts to sell the shares at a fixed price and then borrows the shares to settle the sale contract, Taxpayer claims that neither the $ prepayment nor any other payments under the forward contracts should be recognized in . Under section 1.1233-1(a)(1) of the Income Tax Regulations, a short sale is an open transaction that is not regarded as closed until the short seller covers by delivering securities to the securities lender. According to Taxpayer, the physical settlement of the forward with shares borrowed from is treated as a short sale, and the transaction should be treated as "open" until such time as Taxpayer delivers and shares to close out it short position.

The cash prepayment of $ is treated as additional proceeds on the sale of the and shares delivered to settle the forward. This is consistent with the treatment in Rev. Rul. 78-182, 1978-1 C.B. 265, of cash proceeds received. In that ruling, the cash proceeds paid by the purchaser and pledged as collateral for the stock borrowing were not included in income at the time of payment, but were carried in a deferred account until the short seller engaged in a closing transaction. Because Taxpayer's short sale transaction is still "open", the recognition of the prepayment is deferred. In addition, the $ paid at the time of settlement of the Contracts is not recognized and becomes part of the "open" transaction under the section 1259 constructive sale rules.

Taxpayer is relying on PLR 200440005, section 1.1233-1, section 1259, Rev. Rul. 2004-15, and Rev. Rul. 72-478, 1972-2 C.B. 487 to continue to defer the gain under the short sale. It is relying on Rev. Rul. 78-182 to continue to defer the gain on the cash prepayment.

Law and Analysis:

I. Under Section 1001, Taxpayer Closed Out Its Forward Contracts and Received Cash, Resulting in an Income Recognition Event

Taxpayer claims that it executed a short sale taxable under section 1259, having the effect of keeping the forward open for tax purposes only, even though the forward contract is closed out for all other purposes. It is the Service's position that, while Taxpayer may have executed a short sale under section 1259, the short sale does not extend open transaction treatment of a settled forward contract that has otherwise closed. None of the short sale rulings and regulations cited by Taxpayer serve as authority for Taxpayer's position that its forward may be held open indefinitely merely because it was closed with borrowed shares.

Accessions to wealth are taxable. Section 61. Gain from the sale or other disposition of property shall be recognized and included in gross income. Sections 61(a)(3) and 1001(c). The amount realized is the sum of any money received plus the fair market value of any other property received. Section 1001(b). Gain or loss is recognized on closed-out or settled derivatives that have been converted into cash proceeds. Section 1.1001-1(a) (Except as otherwise provided in subtitle A of the Code, a taxpayer must recognize the gain or loss realized from the conversion of property to cash). Thus, a taxpayer that has converted a derivative such a variable forward contract into cash proceeds must recognize gain or loss absent a showing that the Code specifically exempts the gain or loss from such recognition.

This straightforward section 1001 analysis of transactions that closeout or convert derivatives into cash is reflected in numerous other provisions of the Internal Revenue Code and regulations. Those provisions all operate on the predicate that derivative

closeout or termination arrangements result in section 1001 dispositions upon which gain or loss is recognized. Indeed, it is a fundamental tenet of the tax law that derivative contracts become taxable upon their termination or settlement, no matter how effected. See e.g. sections 1256(c) (contracts marked to market), 1234 (options to buy or sell), 1234A (gains or losses from certain terminations), and 446 and section 1.446-3 (notional principal contracts). These provisions follow directly from the operation of section 1001, which treats the conversion of any form of property into cash as a realization event. See section 1.1001-1(a)(1).

In general, execution of a forward contract does not result in a taxable event under the common law open transaction doctrine until such time as the contract is closed, when gain or loss can be determined. See Joint Committee Enron Report, Part III, JCS-3-03 NO 11, 2003 WL 25599032 (I.R.S.) footnoting Alvin C. Warren, Jr., *Financial Contract Innovation and Income Tax Policy*, 107 HARV. L. REV. 460, 464 (1993). When a forward contract is closed, however, whether by settlement, termination, cancellation, delivery or offset, the only relevant question is how the event is to be characterized, not whether such closing is a taxable event. Section 1234A(1) provides, with limited exceptions, that gain or loss attributable to the termination of a right or obligation with respect to property which is a capital asset in the hands of the taxpayer shall be treated as gain or loss from the sale of a capital asset. Prior to the enactment of section 1234A, there was an open question as to whether termination of a forward contract other than by delivery of the subject property ought to result in ordinary or capital treatment. See Wolff v. Commissioner, 148 F.3d 186 (2nd Cir.1998) (comparing the "vanishing asset" line of cases and the "substance over form" line for determining whether a cancelled forward contract ought to be treated as ordinary or capital). Congress intended that section 1234A apply to a termination of a forward contract that is "economically equivalent to a sale or exchange of the contract." See S. REP. NO. 97-144 (PL 97-34) at 170. See also Wolff, 148 F.3d at 188 (termination of a forward contract is subject to section 1234A).

In this transaction, upon settlement of the forward contract, Taxpayer was required to deliver an amount of shares equivalent to all of the pledged shares and in return was entitled to receive the floor price because the value of the shares had fallen below the floor price. In lieu of delivering the pledged shares, Taxpayer closed its forward contracts as of the settlement dates by delivering borrowed shares, and in return simultaneously received the full floor price in cash as required under its contracts. Taxpayer's closing of the forward contracts irrefutably converted Taxpayer's forward contract (which itself is property) into cash under section 1.1001-1(a). This disposition required Taxpayer to do a final accounting of the results of that transaction.

A forward contract often may be settled with either cash or property. Depending on the manner of settlement, the tax consequences to the forward seller may differ. Under a cash settlement, the forward seller will receive payment equal to the forward price less the fair market value of the shares at the time of settlement. Since forward seller's basis in the contract typically is zero, the seller will report the full payment as taxable gain under section 1001. Under a property settlement, the forward seller transfers the

underlying stock for payment of the full forward price. The forward seller is then taxed on gain equal to the forward price less the basis in the stock transferred.

In this case, Taxpayer attempted to create a third settlement option which it hoped would defer indefinitely recognition of the built-in gain in the forward simply by delivering borrowed shares. Taxpayer argues that short sale authorities permit it to indefinitely keep the forward open. The application of short sale authorities to the closing of a forward is inappropriate and unsupported.

Generally, courts define a short sale of securities as a sale of securities that the short seller does not own. Richardson v. U.S., 121 F.2d 1, 4 (2nd Cir. 1941); Provost v. U.S., 269 U.S. 443, 450 (1926); Bingham v. Commissioner, 27 B.T.A. 186, 189 (1932). The securities sold short are generally borrowed from a securities lender, and the short seller has the obligation to replace the borrowed securities. The short seller recognizes gain or loss on the transaction based on the difference between the amount realized from selling the borrowed shares (typically for fair market value) and the cost basis in the shares delivered back to the securities lender to close out the short sale. The proceeds of the short sale typically are pledged as collateral to the stock lender. See Provost, 269 U.S. at 451 ("If [the short seller] borrows [the shares], he deposits with the lending broker their full market price; and until the loan is returned, this deposit is maintained, by means of daily payments back and forth between the borrower and the lender, at the varying level of the market value of the shares loaned.") The net effect is that the traditional short seller does not receive use of the cash proceeds until the stock loan is repaid.

Profit or loss in a normal on-market short sale is not accounted for until the replacement shares are delivered to close out the short sale. The statutory and regulatory support for open transaction treatment follows directly from early case law, as illustrated by the court in Bingham. Adopting realization principles, the court commented, "A short sale imports a subsequent covering purchase. It leaves open the accounts of both the customer and broker. No profit or loss exists until the covering purchase the obligation of the short sale is discharged." Bingham, 27 B.T.A. at 189. Consequently, the court determined that the offsetting obligation created upon entering a short sale precluded immediately taxing the short sale proceeds because the transaction had yet to be completed. The court also confirmed that short sales should be governed by the same realization principles as are applied to straight sales, such that gain or loss is determined by the difference between the amount realized and the applicable cost basis.

Taxpayer seeks to ignore the closing of its economically independent forward position and treat it as morphing (without triggering gain) into a short sale. Taxpayer takes this approach even though the transactions were economically discrete and gain or loss on the forward was determinable. To the extent Taxpayer incurred an "offsetting obligation" when it borrowed shares, that new liability was only equal to the fair market value of the stock at the time of the short sale. Taxpayer never incurred an offsetting

obligation for the full amount it was entitled to receive under the forward. This may provide a reason (putting aside section 1259 for the moment) to avoid immediate recognition on the sale of the borrowed shares, but it can have no effect on the gain resulting from closing the forward. Taxpayer economically captured the full cash-settled value of its forward contract far beyond the obligation it incurred on the short sale. Taxpayer's rights and obligations with respect to its forward contracts are very different from those relating to its short sale. At the time the forward contracts were executed, the settlement formula under the agreements ensured that Taxpayer had no risk of loss below the floor price and would share in any appreciation in the shares between the floor price and the upside price.

When the contracts were settled, Taxpayer had locked in its gain in the shares at the floor price of $ per share ( ) even though the current fair market value of the shares was only $ per share. Unlike a traditional short sale at market, when Taxpayer delivered the borrowed shares to Bank , it did not merely receive proceeds equal to the $ per share fair market value. Rather, Taxpayer was able to deliver shares worth $ in satisfaction of its forward and to receive the price guaranteed under the forward contract. The effect is that Taxpayer chose to obtain shares (worth $ per share) to close its highly profitable forward contract by borrowing those shares. It could have gotten much the same result by going into the market and buying those same shares at $ per share or simply cash settling the forward.

Section 1001 imposes a tax on Taxpayer upon the closing of its forward contract. In this case, however, Taxpayer may actually have been made worse by its aggressive attempt to indefinitely defer all of the gain in the cash conversion of its forward contract. Had Taxpayer cash settled the contract, or sold it to a third party, it would have gain equal to the cash value of the contract which amounts to the floor price less the fair market value of the stock at settlement. To the extent Taxpayer is left holding an open short sale position, Taxpayer should be taxed on that particular position separately. This result is consistent with Taxpayer's section 1259 position. Fully consistent with the economic substance of the transactions, the remainder of the proceeds represent amounts received upon termination of the forward and equal what Taxpayer would have received had it cash settled the contract (floor price less fair market value). This amount will be taxed under section 1001 as gain recognized upon termination of a forward.

As indicated, this treatment is consistent with the economic substance of the transaction. The vast amount of cash paid ($ per share) itself indicates that the economic results are inconsistent with the claim for short sale treatment. Finally, Taxpayer's attempt to indefinitely defer gain recognition by delivering borrowed shares lacks economic substance and should be recharacterized. Taxpayer admittedly executed the borrowing solely for tax benefits and did not have a separate business purpose for closing the forward with a borrowing rather than its cash settling or actually delivering the pledged shares.

II. Taxpayer Cannot Rely on the Open Transaction Doctrine to Prevent Recognition of Amounts Realized under the Forward Contracts

Under the open transaction doctrine, a taxpayer is relieved from reporting income that may never be received. This doctrine is applied rarely and only under special circumstances. See A.M. 2007-004, discussing Burnet v. Logan, 283 U.S. 404 (1931), X-1 C.B. 345. In Burnet v. Logan, Mrs. Logan was permitted to use a cost recovery method of accounting under which she would recognize gain over time on the sale of property for a contingent price because it was unknown at the time whether she would recognize gain or loss. See also section 1.1001-1(c)(1)(Even though property is not sold or otherwise disposed of, gain is realized if the sum of all the amounts received which are required by section 1016 and other applicable provisions of subtitle A of the Code to be applied against the basis of the property exceeds such basis.)

Taxpayer's transaction cannot be held open under Burnet v. Logan because there is a fixed amount of gain that is determinable and Taxpayer's retention of the cash is not contingent on any future performance or event. In fact, the forward contract is completely closed and fully executed. The gain realized by Taxpayer is attributable to the forward contract closing with Bank , and not to a stock borrowing transaction with followed by a sale of those borrowed shares. See section 1.1001-1(c)(1). It is an unquestionable accession to wealth that can be readily accounted for. There is no exception to section 1001 that allows that accession to wealth to go untaxed once realized; Taxpayer's receipt of cash and claim of open transaction treatment for an indefinite, unlimited period of time are inherently inconsistent.

III. Taxpayer's Reliance on Published Guidance on Short Sales is Misplaced

Taxpayer asserts that it relies on PLR 200440005 as well as guidance with respect to short sales, including Rev. Rul. 2004-15 and Rev. Rul. 72-478 for support of its position that the forward contracts were not closed by delivery of borrowed shares. As discussed below, Taxpayer's reliance is misplaced.

a. Taxpayer Cannot Rely on PLR 200440005

In PLR 200440005, a taxpayer entered into a nonprepaid variable forward contract which was to settle in 3 years time. At the end of 3 years, instead of delivering the pledged shares, taxpayer borrowed shares from a third party and delivered those. PLR 200440005 ruled that the contract was not closed out by delivery of borrowed shares; instead of recognizing the gain attributable to the contract because of the floor price, taxpayer was treated as having constructively sold the pledged shares at the then-fair market value, which was less than the floor price. As support for its conclusion, the ruling cited Rev. Rul. 2004-15 (borrowing shares to close out an initial short sale does not close the short sale) and Richardson v. Commissioner, 42 B.T.A. 830, 844 (1940)

aff'd 121 F.2d 1 (2nd Cir. 1941). The ruling failed to consider, however, the economic substance of the transaction and that property was converted to cash for purposes of section 1001.

For this and other reasons, taxpayers are expressly cautioned against relying on private letter rulings ("PLRs") issued to other parties. The second to last sentence in PLR 200440005 states: "This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent." Nevertheless, taxpayers often rely on PLRs issued to other taxpayers. They do so at their own risk. While the Service strives to give taxpayers consistent treatment, a PLR is effectively a policy statement based on very specific facts, and the conclusions may change based on a different or clearer perception of an issue and its ramifications, errors in law, as well as changes in policy over time.

The question as to whether a taxpayer may rely on administrative rulings issued to other taxpayers was most recently addressed on a motion for summary judgment in an unpublished opinion in Schering- Plough Corp. v. U.S., F.Supp.2d, 2007 WL 4264542 (D.N.J. 2007, December 3, 2007). Holding in the government's favor, the court declined to permit the taxpayer to claim disparate treatment on the basis of the IRS' issuance of a favorable field service advice (FSA) to another taxpayer on a similar interest rate swap.

The taxpayer argued that it was entitled to rely on this FSA under the authority of International Business Machines Corp. v. U.S., 343 F.2d 914 (Ct. Cl. 1965), cert denied 382 U.S. 1028 (1966). In that case, the court found that the IRS was obligated to grant IBM the same favorable PLR that it had granted to a competitor on the same tax issue and that declining to grant the same PLR was an abuse of discretion under section 7805(b). The court in Schering Plough noted however that the Court of Claims itself limited IBM to its facts in Bornstein v. U.S., 345 F.2d 558 (Ct. Cl. 1965), where it indicated that the holding in IBM was based on the fact that both taxpayers had requested PLRs, and only one received it. The Schering Plough court found it significant that the taxpayer had not requested a PLR and thus was not in a position to justifiably rely on the prior FSA.

Similarly, Taxpayer never requested a PLR similar to PLR 200440005 and thus its reliance on the ruling is misplaced.

b. Taxpayer Cannot rely on Rev. Rul. 2004-15 or Rev. Rul. 72-478

Taxpayer takes the position that the delivery of the borrowed shares under the shows that its forward contracts remain open for tax purposes and thus gain is not recognized at this time. Taxpayer also admits, however, that the delivery of the borrowed shares also closes out its forward contracts with Bank and that Taxpayer has no continuing obligations under this transaction with Bank .

Taxpayer has not provided sufficient legal authority that would enable it to defer the recognition of gain, by treating the transaction as open for tax purposes, on a forward contract that has otherwise been settled by its terms. During a telephone call with the IRS and Chief Counsel employees, on , Taxpayer indicated that its constructive sale position is supported by section 1.1233-1(a)(1), the short-against-the-box treatment under Rev. Rul. 72-478, short sales treated as open by delivery of borrowed shares under Rev. Rul. 2004-15, and PLR 200440005. Moreover, Taxpayer has indicated that it has no intention to deliver the pledged shares; rather it plans to continually borrow shares in order to keep the position open until a time when it is beneficial to close out. Taxpayer has repledged the pledged shares to as collateral for the stock borrowings. Therefore, Taxpayer's open transaction treatment results in likely what will be permanent deferral on over $.

Taxpayer's reliance on published guidance addressing short sales, including Rev. Rul. 2004-15 and Rev. Rul. 72-478, is misplaced primarily because the transactions described in those rulings are not similar to, but are distinguishable from, the transactions involved in this case. Specifically, the guidance is limited to standard short sale transactions and is not applicable to the closing of a forward contract, which terminates all rights and obligations of the parties with respect to that contract.

IV. Alternatively, Taxpayer is Required To Recognize as Income Cash Received Under the Forward Contracts Under Section 1259

The entire amount of cash paid to Trust on the three forward contracts should be recognized and included in the calculation of taxable gain under section 1259. Section 1259(a)(1) provides that if there is a constructive sale of an appreciated financial position, the taxpayer shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale (and any gain shall be taken into account for the taxable year which includes such date). Taxpayer has argued that the fair market value of its stock position is equal to the value of the stock in the market as of the closing date of the forwards.

Fair market value is defined as "'what a willing buyer would pay in cash to a willing seller'." See California Human Development Corp. v. U.S., 87 Fed.Cl. 282, 299 (Fed.Cl. June 5, 2009) aff'd 2010 WL 233-308 (Fed. Cir., June 9, 2010) (unpublished opinion) (cites omitted). There is no question here that Taxpayer was a "willing seller" and that Bank was a "willing buyer" when they negotiated the terms of the forward contracts. This alternative argument assumes that the forward contracts remain open. Nevertheless, under the terms of the forward contracts, as of the settlement dates, the forward price was fixed at the floor price for purposes of section 1259.

Once the value of the share units become fixed under section 1259, there is a constructive sale of the shares under section 1259(c)(1)(C) as well as the conceded constructive sale of the shares for purposes of section 1259(c)(1)(A), through the share lending arrangement with . In applying either of these provisions, Taxpayer

must recognize gain based on the fair market value of its appreciated shares, which is the value that Taxpayer is entitled to receive under its forward contracts, not what an unrelated, hypothetical taxpayer would receive for the constructive sale of the same shares. The value of the shares to Taxpayer is derived from its contract terms in its arrangements with Bank , at the time the contract is terminated with the Bank. Thus, under their deal, the fair market value of the shares is equal to the floor price. If another party stepped into the shoes of Taxpayer at the time of settlement, that party too would be entitled to the value of the shares as determined by the arrangements of the parties.

Government's Position:

It is the government's position that Taxpayer's contract settlements were dispositions of the contracts under section 1001, consistent with their treatment as sales for character purposes under section 1234A. The "dispositions" have thus occurred when the variable forward contracts expired from through when Bank settled with in the amount of $. As contended by Taxpayer, $ represents amounts constructively sold under section 1259. The balance of the cash received upon closing of the forward, $, includes both the upfront payment of $ and the remaining settlement payment. Taxpayer has attempted to defer $ by using the fair market value of the and stock under section 1259. has relied on PLR 200440005 to keep the transaction open by purportedly entering into a short sale and borrowing shares from to settle the forward contracts with Bank . Taxpayer has stated that there was a strong tax motivation to borrow the shares from to keep the sale transaction open short sale authorities. has no plans to return the borrowed shares to and close the transaction. Taxpayer has received all of the cash settlement in relation to the variable forward contracts. This is considered a closed transaction and a current sale.

Taxpayer's reliance on PLR 200440005 is misplaced. Private letter rulings are prepared for a particular tax situation and are not general advice for all taxpayers to follow. Taxpayers cannot use PLRs to support the tax treatment of their transactions. If a taxpayer wants to rely on a PLR it has to be their own PLR. could have requested a PLR, but did not do so. Not only can not rely on PLR 200440005, the conclusion of the PLR is not reliable.

Taxpayer's reliance on published guidance addressing short sales, including Rev. Rul. 72-478 and Rev. Rul. 2004-15, is misplaced primarily because the guidance is limited to short sales and is inapplicable to the closing of forward contracts that terminate all rights and obligations between the parties to the contracts. Rev. Rul. 72-478 is irrelevant to Taxpayer's forward contracts because the ruling is limited to short sales. Reliance by Taxpayer on Rev. Rul. 2004-15, is also misplaced as this ruling only applies to short sales. This transaction involves the settlement of variable forward contracts.

Alternatively, the entire amount of cash paid to Trust on the three forward contracts must be recognized and included in the calculation of taxable gain under section 1259

In short, Taxpayer has no tax authority for not recognizing gain with respect to the cash received upon settlement of its forward contracts.