INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Parent =

Sub1 =

Sub2 =

Benefits =

Accounting Firm =

Consultant =

Administrator =

Purchaser =

A =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Year1 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

ISSUE:

Whether § 1.1502-20 disallows Parent's loss on its sale of Benefits voting preferred stock.

CONCLUSION:

Parent's loss is disallowed under § 1.1502-20 and other authorities discussed below.

FACTS:

Parent is the common parent of a consolidated group that includes Sub1, Sub2, and Benefits. Parent directly owns all the stock of Sub1 and Sub2. Prior to the events described below, Sub1 owned all the stock of Benefits. Benefits had been inactive for many years.

In response to a proposal made by representatives of Accounting Firm, a major accounting firm unrelated to Parent, Parent engaged in the following transactions:

On Date1, Benefits elected a new board of directors and amended its charter to authorize the issuance of 100 shares of voting preferred stock. The preferred stock was to be entitled to elect one of Benefits' six directors, representing less than 20% of the voting power of Benefits stock, taking into account the transactions described below. At the same time, Sub1, Benefits' common stock holder, made a capital contribution of $g, bringing the total paid in capital to $h, in order to ensure that the value of the common stock would remain significantly in excess of 80% of the value of Benefits, taking into account the transactions described below.

During the summer and fall of Year1, meetings were held with Consultant, an employee of Purchaser, a risk management firm unrelated to Parent. Employees of Accounting Firm also participated in the planning and meetings. The meetings focused on the administration of certain accumulated postretirement benefit obligations ("APBOs") of Parent, as well as tax and other objectives of the overall transaction.

As of Date2, Parent had APBOs of $a on its books; of that amount, $b was for retired employees of divested units of Parent group. The claims were administered by Administrator, an outside contractor.

On Date2, Sub2 borrowed $c from Parent in exchange for a note paying stated interest annually (the "Sub2 note"). The principal of the Sub2 note is due ten years from the date of the loan. Immediately thereafter, Parent contributed the Sub2 note to Benefits in exchange for the previously authorized 100 shares of Benefits voting preferred stock and Benefits' assumption of the $b APBOs described above. In addition, Parent agreed to provide Benefits with a $d million line of credit and certain administrative services. The actual payment of APBO claims was to be made by Parent and charged against the line of credit, which was to be paid down with the payments received on the Sub2 note.

On Date3, Parent sold the 100 shares of Benefits voting preferred stock to Purchaser for $e. The sales agreement guaranteed an annual dividend of f% and provided Parent a right of first refusal to reacquire the stock. In addition, Parent indemnified Purchaser against all risk from the ownership of Benefits voting preferred stock (other than the risk of losing its $e investment in Benefits).

On Date4, Consultant was elected as a director of Benefits.

Consultant apparently made proposals regarding the administration of the claims, including one made on Date5, proposing that the administration of Benefits' claims be taken over by Purchaser's parent corporation. Parent apparently considered, but never acted on, Consultant's proposals. Eventually, the discussions terminated and the claims remained administered by Administrator, the original contractor.

In a discussion with Internal Revenue Service representatives on Date6, A, Parent's Vice President of Taxation, stated that Parent engaged in the foregoing transactions to render the administration of the APBOs more efficient and cost effective through Consultant's involvement and Purchaser's investment in Benefits. A also stated that Parent anticipated its tax savings would far outweigh the savings on the claims administration.

On its Year1 Federal income tax return, Parent reported a capital loss of $b on the sale of the Benefits voting stock. Parent claimed the entire amount of that loss was allowable and filed the Statement of Allowed Loss as required by § 1.1502-20(c)(3).

The sole issue addressed in this TAM is whether Parent may deduct its loss on the sale of Benefits preferred stock. Solely for purposes of determining the issue addressed in this TAM, we assume (but do not conclude) that Parent's transfer of the Sub2 note to Benefits in exchange for the Benefits voting preferred stock qualified as a § 351 exchange, that its basis in the stock is $c, and that its loss on the sale is $b. We express no opinion as to the tax treatment of the assumption of the APBO claims if Parent's acquisition of Benefits stock did not in fact qualify as a § 351 exchange. We also assume (but do not conclude) that the Sub2 note is a security within the meaning of § 1.1502-20(c)(2)(vi). Although the taxable years in which payments on APBO claims are made are not yet under audit and are not addressed in this TAM, on the facts presented, the requirements of Rev. Rul. 95-74, 1995-2 C.B. 36, are not satisfied; accordingly, under Holdcroft Transp. Co. v. Commissioner, 153 F.2d 323 (8th Cir. 1946), the later payments on the APBO claims would not be deductible.

LAW AND ANALYSIS:

1. Legal Authorities

a. Section 1.1502-20: Loss Disallowance Rule (LDR)

i. Section 1.1502-20(a): Disallowance of Loss

Section 1.1502-20(a) provides that no deduction is allowed for any loss recognized by a member with respect to the disposition of stock of another member. If stock is deconsolidated at a time when its basis exceeds its value, § 1.1502-20(b) requires a reduction in its basis to prevent the circumvention of § 1.1502-20(a).

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ii. Section 1.1502-20(c): Limitation on Amount of Loss Disallowed

Section 1.1502-20(c)(1) modifies the broad disallowance rule of § 1.1502-20(a) by providing that the amount of loss disallowed (and the amount of basis reduction) with respect to a share of stock is limited to the sum of:

(i) the subsidiary's extraordinary gain dispositions (i.e., the amount of income or gain, net of directly related expenses, that is allocated to the share from "extraordinary gain dispositions," as defined in § 1.1502-20(c)(2)(i));

(ii) the subsidiary's positive investment adjustments (i.e., the positive adjustments made pursuant to § 1.1502-32(b)(2)(i) through (iii) for each consolidated return year during which the subsidiary was a member of the group, determined without taking distributions into account) that are allocated to the share, but only to the extent such amount exceeds the amount described in § 1.1502-20(c)(1)(i) for the year; and

(iii) the duplicated loss with respect to the share or shares disposed of.

Section 1.1502-20(c)(2)(vi) provides that duplicated loss is determined immediately after a disposition or deconsolidation, and that it equals the excess (if any) of --

(A) The sum of --

(1) The aggregate adjusted basis of the assets of the subsidiary other than any stock and securities that the subsidiary owns in another subsidiary, and

(2) Any losses attributable to the subsidiary and carried to the subsidiary's first taxable year following the disposition or deconsolidation, and

(3) Any deferred deductions (such as deductions deferred under section 469) of the subsidiary, over

(B) The sum of --

(1) The value of the subsidiary's stock, and

(2) Any liabilities of the subsidiary, and

(3) Any other relevant items.

Section 1.1502-20(c)(2)(vi) further provides that such amounts include a subsidiary's allocable share of corresponding amounts with respect to all lower tier subsidiaries.

iii. Section 1.1502-20(e)(1): Application of LDR

Section 1.1502-20(e)(1) provides that the rules of § 1.1502-20 must be applied in a manner that is consistent with and reasonably carries out their purposes and, further, that if a taxpayer acts with a view to avoid the effect of the rules of § 1.1502-20, adjustments must be made as necessary to carry out their purpose.

b. Section 1.1502-13: Intercompany Transactions

All transactions between group members are subject to the provisions of § 1.1502-13. In addition, transactions involving Intercompany Obligations are subject to the provisions of § 1.1502-13(g). An Intercompany Obligation is an obligation between members, but only for the period during which both parties are members. For this purpose, the term "obligation" is defined broadly and includes any obligation of a member constituting indebtedness under general principles of Federal income tax law.

i. Section 1.1502-13(g): Intercompany Obligations

Section 1.1502-13(g)(3)(i) provides that, if a member realizes an amount (other than zero) of income, gain, deduction, or loss, directly or indirectly, from the assignment or extinguishment of all or part of its remaining rights or obligations under an Intercompany Obligation, the Intercompany Obligation is treated for all Federal income tax purposes as satisfied under § 1.1502-13(g)(3)(ii) and, if it remains outstanding, reissued under paragraph § 1.1502-13(g)(3)(iii).

Section 1.1502-13(g)(3)(ii) provides that, if a creditor member sells intercompany debt for cash, the debt is treated as satisfied by the debtor immediately before the sale for the amount of the cash. For other transactions, similar principles apply to treat the intercompany debt as satisfied immediately before the transaction.

Section 1.1502-13(g)(3)(iii) provides that, if a creditor member sells intercompany debt for cash, the debt is treated as a new debt (with a new holding period) issued by the debtor immediately after the sale for the amount of cash. For other transactions, if the intercompany debt remains outstanding, similar principles apply to treat the debt as reissued immediately after the transaction.

The timing of the deemed satisfaction and the timing of the deemed reissuance together prescribe the transactional model pursuant to which the satisfaction and reissuance, as well as the actual transaction, are deemed to occur. The first step is the deemed satisfaction (immediately before the transaction), the next step is the actual transaction, and the last step is the deemed reissuance (immediately after the transaction). Under this model, at the time the actual transaction occurs, the Intercompany Obligation has been satisfied and the creditor holds only the deemed satisfaction proceeds.

Neither the Intercompany Transaction regulations nor the Preambles to the regulations address the intended scope of the term “realizes . . . indirectly.” It appears, however, that there is but a narrow range of transactions for which such a clause would be necessary. First, if a transaction actually involves an Intercompany Obligation, there is a direct realization and no need for the “indirect” clause. Second, if a transaction does not involve a member obligation directly, but rather an interest in the entity holding the obligation, most cases are otherwise covered by § 1.1502-13(g) and so would have no need for the “indirect” clause. For example, if a transaction involves a member obligation that is held by a person or entity that is not a member of the group, § 1.1502-13(g) has no application at all because the obligation is not an Intercompany Obligation. And, if the holder is a member but a disposition of its stock deconsolidates the holder, the regulation provides for a satisfaction of the obligation at fair market value, so again the “indirectly” clause is not needed. What remains are transactions in which the amount realized is a function of the inherent attributes of the obligation, but that neither involves the obligation directly nor effects a deconsolidation.

ii. Section 1.1502-13(j)(1): Successor Assets

Section 1.1502-13(j)(1) provides that any reference to an asset includes, as the context may require, a reference to any other asset the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of the first asset.

iii. Section 1.1502-13(h)(1): Anti-Avoidance

Section 1.1502-13(h)(1) provides that if a transaction is engaged in or structured with a principal purpose to avoid the purposes of § 1.1502-13, including, for example, by avoiding treatment as an Intercompany Transaction, adjustments must be made to carry out the purposes of this section.

c. Regulatory Policy and Objectives

i. Intercompany Transaction regulations

The consolidated return provisions are premised on the recognition that an affiliated group represents a single business unit and a determination that it should be taxed as such to the full extent possible. This is commonly referred to as the single entity theory of consolidated returns. The Preamble to § 1.1502-13 states that an important objective of the regulation is to promote the single entity theory and, for that reason, Intercompany Transactions are treated as transactions between divisions of one company to the greatest extent possible. Section 1.1502-13(a)(1) states that the Intercompany Transaction regulations are intended to ensure the clear reflection of the taxable income (and tax liability) of a consolidated group as a whole by preventing Intercompany Transactions from creating, accelerating, avoiding, or deferring consolidated taxable income (or consolidated tax liability). Section 1.1502-13(g) seeks to preserve location of economic gain or loss on member obligations and to prevent tax avoidance through the use of Intercompany Obligations.

ii. Loss Disallowance Rule

The purpose of LDR is to prevent the inappropriate deduction of loss. Its formula is designed to take into account several types of losses considered inappropriate. One is loss that enables consolidated taxpayers to circumvent the repeal of the General Utilities doctrine. Another is loss that is recognized on member stock but that is attributable to the member's unrecognized, or recognized but unutilized, losses that, in either case, would be preserved for later (duplicative) recognition or use. The Loss Duplication component of LDR addresses the latter.

(1) Loss Duplication

Although an affiliated group is, economically, one business unit, subsidiary stock is generally treated as a separate and distinct asset on which gain or loss can be recognized. Under tax principles generally applicable to corporations, a disposition of a corporation's assets and its stock would produce gain or loss on both the assets and the stock. Outside the consolidated setting, where the group members are generally viewed as separate taxpayers, this duplication of gain and loss is not inappropriate. Once a group elects to file a consolidated return, however, the group is more generally viewed, and taxed, as a single entity. Under this single entity theory, the duplication of both gain and loss by transactions in member stock is an inappropriate distortion of the income of a consolidated group. To achieve a clear reflection of consolidated income, the consolidated group is more appropriately viewed as investing in the assets, not the stock, of the group members.

The Investment Adjustment rules of § 1.1502-32 eliminate duplication of both gain and loss within a consolidated group by adjusting a member's basis in subsidiary stock to reflect the subsidiary's income, gain, deduction, and loss. The Investment Adjustment system is effective in eliminating duplication when recognition occurs first with respect to a member's assets, but not when gain or loss is recognized first with respect to that member's stock. In that case, absent LDR, a group would be free to recognize loss on member stock while at the same time preserving the item that gave rise to such loss, which would permit the later (duplicative) use of the item, either within the group or in the hands of a transferee (subject to loss limitation rules and general tax avoidance principles). This ability to duplicate items through transactions involving member stock is inconsistent with the single entity theory on which the consolidated return provisions at issue here are founded.

(2) Exclusion of Stock and Securities from Loss Duplication

The Loss Duplication factor addresses a consolidated group's ability to deal in member stock in order to realize and yet preserve for later duplication the underlying unrecognized and unutilized losses of the member. The very structure of the Loss Duplication formula evidences this purpose: Loss Duplication is the excess of the member's tax attributes that will give rise to future deductions (inside basis, loss carryovers, deferred deductions) over the cost to the purchaser (stock value plus assumed liabilities). This excess represents the amount recognized by the transferor and preserved for recognition or utilization in the hands of the transferee.

Parent correctly observes that the Loss Duplication calculation excludes member stock and securities from the determination of inside basis. Such items are excluded because the calculation of Loss Duplication includes a member's allocable share of corresponding amounts with respect to its lower tier members. Because the Loss Duplication formula adopts a look-through approach, the inclusion of a lower tier member's stock would effect a double inclusion of the same economic interest (the stock and the underlying assets in the hands of the lower tier member). The exclusion of member securities is similarly meant to prevent the double inclusion of the same economic interests. But, this case involves the disposition of stock of a creditor which holds no stock of the debtor and so the debtor's assets are not otherwise reflected in the Loss Duplication calculation. Under these circumstances, there would be no double counting (in fact, under Parent's analysis, there is no counting at all), and so there is no reason for the exclusion.

Finally, because the Loss Duplication factor is intended to ensure proper inclusion of inside basis and unrealized expenses transferred to the purchaser, it is measured immediately after the sale, before any other transaction occurs.

2. Parent's Analysis of the Transaction

Parent determined the amount of its loss by subtracting its amount realized ($e) from its basis in the stock ($c). The stock basis was determined under § 358 by subtracting the amount of the liability assumption (for tax purposes, $0) from the basis in the property (the Sub2 note) transferred to Benefits in exchange for the stock ($c). The amount of the liability assumption was treated as zero because the applicable tax accounting rules do not take the liability into account until payment is made on the claims. See §358(d)(2), Rev. Rul. 95-74, supra.

In determining the amount of such loss that is disallowed under §1.1502-20, Parent excluded the Sub2 note from its Loss Duplication calculation because the note is a member security and § 1.1502-20(c)(2)(vi)(A)(1) excludes from the Loss Duplication calculation the basis of stock and securities of another member. Thus, Parent calculated its loss disallowance amount as follows:

Extraordinary Gain Dispositions			$0
Positive Investment Adjustments			$0
Duplicated Loss Amount, the excess of:			
the sum of:			
inside asset basis (excluding Sub2 note)	$h		
NOLs	$0		
deferred deductions	$0		
subtotal:		$0	
over the sum of:			
FMV of stock	$h + e		
liabilities assumed	$0		
subtotal:		$e	
total duplicated loss amount:			$0
Total Loss Disallowance Amount:			$0

In taking the position that its loss on the Benefits stock is fully allowed, Parent appears not to take into account the provisions of § 1.1502-13(g). Presumably, this is because Parent takes the position that the sale of the Benefits stock does not result in the realization of any amount of income, gain, deduction, or loss with respect to the Sub2 note (and so § 1.1502-13(g) is simply not invoked). Alternatively, it may be that Parent concurs in the application of § 1.1502-13(g) to the sale of the Benefits voting preferred stock, but takes the position that the calculation of Loss Duplication is done after the reissuance of the Sub2 note, and so the Sub2 note is still disregarded under § 1.1502-20(c)(2)(vi)(A)(1).

3. Application of § 1.1502-13(g) to the Present Transaction

The Sub2 note, an obligation between members of Parent's group, is an Intercompany Obligation and therefore subject to § 1.1502-13(g). Thus, if gain or loss is realized--either directly or indirectly--from the assignment of rights under the Sub2 note, the provisions of § 1.1502-13(g) are invoked.

The loss at issue here was realized directly with respect to the Benefits preferred stock that was acquired by Parent in exchange for the Sub2 note and the assumption of the APBO liabilities. Solely for purposes of discussing the issues addressed in this TAM, we assume that the exchange qualified as an exchange described in § 351.[1] Under § 358, the basis of property received in a § 351 exchange is the same as that of the property exchanged, decreased by the amount of any money received by the taxpayer. For purposes of § 358, the assumption of a liability is treated as money received by the taxpayer in the exchange. Section 358(d). However, under tax accounting principles, at the time of the exchange, the APBO liabilities were not yet taken into account in the tax system. Parent's basis in the Benefits preferred stock was thus determined directly and wholly by reference to its basis in the Sub2 note. Accordingly, under § 1.1502-13(j)(1), where the context requires, any reference in § 1.1502-13(g) to an Intercompany Obligation (here, the Sub2 note) includes a reference to the Benefits preferred stock. Thus, any transaction in which an amount (other than zero) is realized on the Benefits preferred stock is subject to the provisions of § 1.1502-13(g).

The same result follows from the fact that § 1.1502-13(g) is not limited to transactions involving a direct realization on an Intercompany Obligation, but applies as well to amounts "realized . . . indirectly" with respect to an Intercompany Obligation. As discussed above, one of the few situations in which there would be a need for that clause is one in which the amount realized is a function of attributes derived from the Intercompany Obligation, but that neither involves the obligation directly nor effects a deconsolidation. Such is the case here. Parent's basis in the Benefits preferred stock reflects only the value of the Intercompany Obligation. Apart from the minimal capitalization, the only economic interest represented by the Benefits preferred stock--that is recognized in the tax system--is the Intercompany Obligation. Indeed, if the tax system did take into account any other item (e.g., the APBO liabilities, the only other interest implicated in the acquisition of the stock), there would be no loss at all. Furthermore, the transaction neither involves the Sub2 note directly nor effects a deconsolidation of Benefits. Under the circumstances, we conclude that this transaction is within the intended scope of the "indirect" clause and any amount realized on that stock must be considered an amount indirectly realized on the Intercompany Obligation.

Accordingly, for Federal income tax purposes, the sale of the Benefits preferred stock is treated as follows: under § 1.1502-13(g)(3)(ii), Sub2 is treated as having satisfied its Intercompany Obligation for $c immediately before Parent's sale of the Benefits voting preferred stock. Thus, at the time of the sale, Benefits held the $c proceeds of Sub2's deemed satisfaction of the obligation, not the obligation itself. Immediately after the sale, before any other transaction occurs or is deemed to occur (including the deemed reissuance of the note), the Loss Duplication factor is calculated as follows:

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[1] The exchange of the Sub2 note by Parent for Benefits preferred stock is not within the scope of § 1.1502-13(g) because, under the facts presented, the exchange of the Sub2 note for the Benefits preferred stock produced an amount of income, gain, deduction, or loss equal to zero.

Extraordinary Gain Dispositions			$0
Positive Investment Adjustments			$0
Duplicated Loss Amount, the excess of:			
the sum of:			
inside asset basis (including Sub2 note)	$h + c		
NOLs	$0		
deferred deductions	$0		
	subtotal:	$i	
over the sum of:			
FMV of stock	$h + e		
liabilities assumed	$0		
	subtotal:	$j	
		total duplicated loss amount:	$c
Total Loss Disallowance Amount:			$c

Treating the Sub2 notes as reissued after the determination of the Duplicated Loss amount furthers the § 1.1502-13(g) goal of eliminating the effects of Intercompany Obligations on consolidated taxable income.

In addition, calculating the Loss Duplication amount immediately after the sale of the Benefits stock, yet before the reissuance of the note, furthers the § 1.1502-20(c)(1)(iii) goal of limiting a group's ability to recognize a loss on member stock while at the same time preserving the member's unrecognized, or recognized but unutilized, losses that gave rise to the stock loss. If the reissuance here were deemed to occur before the Loss Duplication calculation were made, the assets deemed held by Benefits at the time of the sale, viz., the proceeds of the satisfaction at the time of the transfer, would not be included. Consequently, the measure of the amount of loss attributable to future operations would be inappropriately diminished.

Further, because the transaction in which the preferred stock was issued was structured to give rise to the loss at issue here, the loss disallowance amount is allocated entirely to the preferred stock. See § 1.1502-20(c); § 1.1502-20(e)(3), Example 1.

As provided in § 1.1502-13(g)(3)(iii), the Sub2 note is then deemed reissued to Benefits.

4. Application of Anti-Avoidance Provisions to This Transaction

Any interpretation and application of a regulation must be guided by the policy concerns and objectives of the regulation. But, in the case of the consolidated return provisions at issue here, such inquiry is not only mandated by principles of statutory and regulatory interpretation, it is mandated by the provisions themselves.

Beginning in 1991, the consolidated return regulations underwent a major revision that produced, among other things, the LDR and Intercompany Transaction regulations applicable to the present case. These regulations differ substantially from the prior ones in that they rely less on inflexible, mechanical rules and more on a flexible, principle driven approach. The reason for this change was to render the regulations more capable of readily and timely accommodating changes in tax law, as well as other economic and policy considerations. Because the regulations rely heavily on broad principles, direction in the interpretation and application of these provisions was provided to ensure they would be applied always in a manner that furthers their policy.

The Request for Technical Advice sets forth the argument that Parent's loss on the sale of its Benefits stock should be disallowed under § 1.1502-20(e)(1). We concur. Accordingly, in addition to and independent of the technical grounds set forth above, Parent's loss is disallowed for the following reasons.

a. § 1.1502-20(e)(1): Reasonable and Consistent Application of LDR

As stated above, the purpose of LDR is to disallow inappropriate losses on member stock. One type is that which results from a basis increase due to gain that was already reflected in the seller's cost of the stock (as is the case where there has been recognition of built-in gain). Another is that which reflects either unrecognized loss or recognized but unused loss. The loss on the Benefits stock is solely attributable to the economic recognition of the diminution of value resulting from known, but unpaid, operating expenses that are not yet taken into account for tax purposes. Such a loss falls squarely within the latter category. If the Sub2 note is excluded from the Loss Duplication calculation, which is neither necessary nor appropriate here (as there would otherwise be no double counting of assets), the loss is effectively removed from the reach of LDR. Such a result would enable taxpayers to eliminate Loss Duplication amounts by simply creating intercompany debt, rendering LDR, at least as to Loss Duplication amounts, an elective provision.

For these reasons, we conclude that any application of the Loss Duplication rule that does not take into account the basis of the Sub2 note is neither consistent with nor reasonably carries out the purposes of LDR. Therefore, the mandate of § 1.1502-20(e) requires that, irrespective of any language in § 1.1502-20(c)(2)(vi)(A)(1) seemingly to the contrary, the Sub2 note must be included in the Loss Duplication calculation.

b. § 1.1502-20(e)(1): View to Avoid the Purposes of LDR

Parent had sophisticated tax planning advice from outside accounting and investment firms, including the firm that served as the purchaser/accommodation party. These parties proposed the plan, and then advised and assisted Parent in carrying it through to completion. Parent admits the anticipated tax savings far exceeded the projected cost savings on the claims administration; thus there is no question the transaction was primarily tax motived. Furthermore, while Parent states a business purpose for the transfer of the APBOs to Benefits (although we note that the proposed changes to the claims administration could have been accomplished without the transfer to Benefits and that, ultimately, no such changes were in fact made), no business purpose at all has been advanced for the use of the Sub2 debt. Indeed, the $c transferred to Sub2, which is Parent's indirect but complete funding for the payments on the APBO claims, could have been transferred to Benefits directly; any funding needs of Sub2 could have been met by a line of credit (similar to that established for Benefits) or other intragroup arrangements. The only purpose for the complicated financial arrangements, including the issuance of the Sub2 debt, is to provide Parent with an immediate basis in the stock that would, absent LDR and general tax avoidance principles, permit Parent to accelerate and duplicate its liabilities that otherwise may not yet be taken into account.

Accordingly, we conclude that Parent structured this transaction and acted with a view to avoid LDR, in a situation clearly within its intended scope, and that the resulting loss must therefore be disallowed.

c. § 1.1502-13(h)(1): A Principal Purpose to Avoid the Purposes of the Intercompany Transaction Regulations

As set forth in § 1.1502-13(a), the purpose of the Intercompany Transaction regulations is to ensure the clear reflection of taxable income (and tax liability) of a consolidated group by preventing Intercompany Transactions from creating, accelerating, avoiding, or deferring consolidated taxable income (or consolidated tax liability). Where a transaction is engaged in or structured with a principal purpose to avoid the purposes of § 1.1502-13, including by avoiding treatment as an Intercompany Transaction, adjustments will be made to carry out the purposes of § 1.1502-13.

Parent states that the transfer of the APBO claims to Benefits was to facilitate certain changes in the administration of the claims, including the attention and investment of Purchaser. Yet, this transaction was neither necessary nor sufficient to accomplish those objectives. In fact, the only apparent accomplishments were the creation of high basis, low value stock and the sale of that stock in a transaction expected to escape characterization as a transaction with respect to an Intercompany Obligation. By avoiding that characterization of the transaction, Parent would have avoided the satisfaction and reissuance provisions of § 1.1502-13(g). Having avoided the provisions of § 1.1502-13(g), Parent would argue that, at the time the Loss Duplication calculation was made, Benefits held the Sub2 note, a member security excluded from the Loss Duplication calculation. Under this analysis, Parent would avoid any disallowance of the loss on the stock, effectively accelerating the tax benefit of the future payments on the APBO claims. Acceleration of a deduction not yet permitted to be taken into account under generally applicable tax accounting rules by moving assets and liabilities between members of a consolidated group is wholly inconsistent with the purpose of clearly reflecting the group's consolidated taxable income.

Accordingly, we conclude that Parent acted with a principal purpose of avoiding the purposes of the Intercompany Transaction regulations. Therefore, proper adjustment must be made to avoid the recognition of loss on the sale of Benefits preferred stock in this case.

5. General Tax Principles

In addition to the reasons set forth above, we believe that the facts of this case require a position adverse to that asserted by Parent because the transaction lacks a business purpose, was engaged in solely for tax avoidance purposes, and is lacking in economic substance. See Compaq Computer Corporation v. Commissioner, 113 T.C. No. 17 (September 21, 1999); United Parcel Service of America v. Commissioner, T.C. Memo. 1999-268; ACM Partnership v. Commissioner, T.C. Memo. 1997-115.

a. Business Purpose

Parent has offered several business purposes for the transfer of the APBOs, but the only reason offered for the use of an Intercompany Obligation to fund the APBOs is that the issuance of the Sub2 note was consistent with its centralized cash management system. While that may be true, it is not an affirmative reason for the issuance of the Sub2 note, and none has been offered.

Moreover, the facts of this case serve only to establish that in fact there was no business purpose for the loan transaction. The Sub2 note was issued in an amount determined necessary to satisfy the APBO claims. That note was then immediately transferred to Benefits in order that payments on the note could fund the payments of the APBO claims. But claims weren't paid by Benefits, they were directed to and paid by Parent on Benefits' behalf. The payments were then charged against a line of credit that Parent extended to Benefits to address discrepancies in timing between the payments on the claims and the receipt of payments on the Sub2 note. Together, these arrangements simply constitute Parent's arrangement for its payment of the APBO claims as they came due, a result not in keeping with its assertion that it has a centralized cash management program. The only purpose for this circular flow of cash was to make use of the Sub2 note to provide the basis on which Parent claims the loss at issue here. Parent's declaration that the anticipated tax savings (which wholly depended upon the use of the Sub2 note) were far in excess of any anticipated administrative savings only serves to evidence further Parent's lack of any business purpose beyond tax avoidance.

In light of the plan adopted and the position being taken by Parent, we conclude the only reasons for the use of the note were to create a loss asset and provide a foundation for Parent's position that LDR does not disallow that loss. Given the abusive nature of the transaction and the lack of a bona fide business purpose for the use of the note, Parent's loss must be disallowed.

b. Tax Avoidance

As discussed throughout this memorandum, there would be enormous tax advantages to the position advocated by Parent. Under Parent's theory, it would be entitled to an immediate deduction of $c (that would ordinarily be postponed until payment of the APBO claims) and, presumably, under a misguided reading of Rev. Rul. 95-74, the Parent group would be entitled to deduct that same amount again as payments are actually made on the APBO claims. Also as discussed throughout this memorandum, there is neither a basis in the applicable regulations nor a compelling policy objective to support Parent’s position. In fact, quite the contrary is true. Without a bona fide business purpose, and considering the anticipated tax savings far exceeded of the projected savings from the business objectives, we conclude the transaction has no purpose other than inappropriate tax avoidance and should be disregarded.

c. Lack of Economic Substance

Parent states that the purpose of the transaction was to isolate the APBOs and engage Purchaser in the administration of claims, drawing on its experience and expertise to make the administration of the claims significantly more efficient and economic. But, in fact, no changes were made, despite Consultant’s proposals. The only components of the original plan that were accomplished were those necessary for the plan’s tax planning component: the creation and sale of high basis, low value stock in a member the only real asset of which is an intercompany note (also created as part of the plan). Under the circumstances, we conclude that there was no economic substance to the transaction apart from tax planning. Accordingly, the sale of the stock should be disregarded as lacking economic substance apart from tax avoidance.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to Parent(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.