



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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MEMORANDUM FOR: KAREN CHANDLER, CC:LM:MCT:WAS:

FROM: Donna Marie Young, STR, CC:PSI:3

SUBJECT:

You have asked us to review the draft Forms 870-P for the above-named taxpayer. We believe the determinations reached in this case are appropriate. However, we recommend that additional language be included in the Explanation of Adjustments portion of the Forms 870-P to further explain our reasons for such determinations and to strengthen our litigating position. Accordingly, we propose that the language included in bold in the CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS section of this memorandum be used in the Explanation of Adjustments portion of the Forms 870-P. Because the Appeals Transmittal Memorandum and Supporting Statement sufficiently describe the facts, issues, law and analysis, and conclusions, we do not repeat that information here.

This memorandum constitutes Chief Counsel Advice. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

#### DISCLOSURE STATEMENT

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respect to the case AND the issues discussed in the document require inspection or disclosure of the Chief Counsel Advice.

### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This case is an abusive tax shelter, similar to the shelter outlined in Notice 2000-44, 2000-36 I.R.B 255, wherein the Service announced that non-economic losses arising from transactions purporting to create substantial positive basis would not be allowed for federal income tax purposes. Because of the egregious nature of the transaction, we recommend that the Service adopt the following approach in challenging the transaction:

1. The transaction had no economic substance
2. The transaction violated the intent of subchapter K, and §1.701-2 of the Income Tax Regulations (the partnership anti-abuse rule) applies; and,
3. The short sale obligation must be treated as a liability for purposes of §752.

This case, although similar to Salina Partnership LP, FLP Group, Inc. v. Commissioner, T.C. Memo. 2000-352, is factually distinguishable from Salina and is a stronger case for the Service. The resolution of this case should not depend on the outcome of any appeal in Salina.

The Service should argue that the transaction violated the intent of subchapter K and that §1.701-2, the partnership anti-abuse rule, applies. Section 1.701-2(a), (b), (c), and (d) applies to all transactions involving a partnership that occur on or after May 12, 1994. Thus, the regulation applies to both of the short sale transactions because the first transaction did not close until after May 12, 1994, and the second transaction occurred, in its entirety, after May 12, 1994.

Except as discussed below, no other changes are suggested for either the or Forms 870-P (other than our prior recommendation that the figures be verified prior to issuance of the Forms 870-P as our office was unable to do so based on the information before us). We also suggest that the taxable year end be verified, i.e., or . For purposes of this memorandum, we continue to use the year end as contained in the information before us.

We propose that the following paragraph be used in the Explanation of Adjustments portion of the Forms 870-P explaining the adjustment to the Partnership Basis:

**It is determined that the [redacted] was formed to facilitate a series of transactions lacking economic substance and comprising an abuse of the Internal Revenue Code. It is also determined that the [redacted] was formed or availed of with a principal purpose to reduce substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of subchapter K. Section 1.701-2 of the Income Tax Regulations. Alternatively, it has been determined that [redacted] obligation to return U.S. Treasury bills to [redacted] is a liability within the meaning of I.R.C. Section 752. Accordingly, the partners' bases in the partnership are reduced by \$ [redacted].**

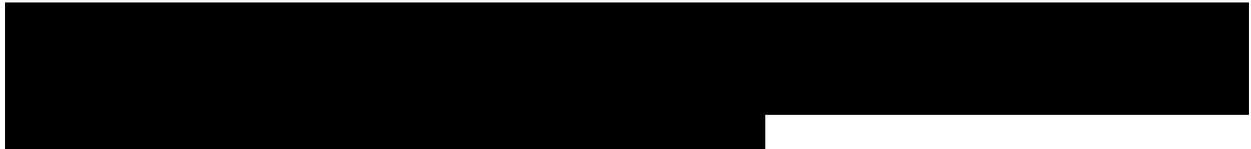


Accordingly, we propose that the following two paragraphs be used in the Explanation of Adjustments portion of the Forms 870-P explaining the loss on the [redacted]:

**It is determined that the loss on the sale of the [redacted] is fictitious and was created through a series of transactions lacking economic substance and comprising an abuse of the Internal Revenue Code. These transactions violated the intent of subchapter K. Section 1.701-2 of the Income Tax Regulations applies to deny the loss. Accordingly, it is determined that [redacted] realized a gain of \$ [redacted] rather than a loss of \$ [redacted] reported on [redacted] return. Further, [redacted] gross income is increased by \$ [redacted] for the taxable year ending [redacted].**

Alternatively, it is determined that obligation to return U.S. Treasury bills to the meaning of I.R.C. Section 752. As of , the partners' bases in is a liability within should have been reduced by the \$ obligation. On , technically terminated under I.R.C. Section 708(b)(1)(B). assets, (primarily ) acquired the partners' bases. Accordingly, it is determined that the tax basis of the reported on the return as \$ was \$ .

We have no suggested changes to the Interest Expense explanation.



Please call if you have any further questions.