DOCKET NO. 09-72457 and 09-72458

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HENRY SAMUELI and SUSAN F. SAMUELI, and

THOMAS G. and PATRICIA W. RICKS

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the United States Tax Court

REPLY BRIEF FOR PETITIONERS-APPELLANTS

Richard M. Lipton
Baker & McKenzie LLP
130 E. Randolph Drive
Chicago, IL 60601
(312) 861-7590

Robert S. Walton
Baker & McKenzie LLP
130 E. Randolph Drive
Chicago, IL 60601
(312) 861-2540

Attorneys for Petitioners-Appellants

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

DOCKET NO. 09-72457 and 09-72458

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HENRY SAMUELI and SUSAN F. SAMUELI, and

THOMAS G. and PATRICIA W. RICKS

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT

REPLY BRIEF FOR PETITIONERS-APPELLANTS

SUMMARY OF ARGUMENT

In focusing this case on the applicability of section 1058,[1] the Tax Court erred and the parties erred. This Court should not to err in the same way. Section

[1] Unless otherwise indicated, all "section" or § references are to the Internal Revenue Code of 1986 (26 U.S.C.) (the "Tax Code"), as amended, or to the Treasury regulations (26 C.F.R.) ("Treas. Reg.") issued thereunder, in effect during the years at issue.

1058 is ultimately a red herring in this case, as it is irrelevant to the proper treatment of the transaction at issue. The Taxpayers[2] are subject to the same tax consequences regardless of whether the Transaction meets the nonrecognition requirements of section 1058. If section 1058 does not apply to the Transaction, as the Commissioner contends, the result is long term capital gain and interest deductions just as reported on the Taxpayers' tax returns. If section 1058 does apply to the Transaction, as the Taxpayers contend, the result is the same long term capital gain and interest deductions. As is clear from the stipulated facts, the Transaction had economic substance and it is these facts that govern the tax treatment of the Transaction.

The Tax Court and the Commissioner incorrectly interpreted the requirements of section 1058(b)(3) for a nontaxable securities lending transaction, and then they compounded the error by not considering the tax consequences if the transaction is a taxable securities lending transaction. Instead, the court recharacterized the securities lending agreement as something else (a forward contract) without any explanation or authority for why the failure to qualify for nonrecognition results in a recharacterization contrary to the stipulated facts, which do not justify such a leap of logic.

---

[2] Unless otherwise defined herein, all capitalized terms are defined in the Opening Brief filed in this Court by the Petitioners-Appellants' in the above captioned consolidated cases on October 23, 2009.

Before this court, the Commissioner recognized that the Tax Court's analysis was untenable and abandoned the logic of the Tax Court's opinion. In its place, the Commissioner argues for a new test that is also not supported by the text of section 1058. The Commissioner failed to address on brief the justification for the Tax Court's recharacterization of this transaction or the Taxpayers' argument that the same treatment applies with or without section 1058. Also, the Commissioner failed to address the Taxpayers' entitlement to interest deductions due to Refco's forbearance of the use of money.

The Taxpayers purchased the Securities on margin. The Taxpayers then lent the Securities to Refco in a securities lending transaction in which the Taxpayers gave the Securities to Refco in exchange for Refco's promise to return the identical securities at the end of the lending period (the "Contractual Right"), along with any income payments made on the Securities during the lending period. Refco posted cash collateral for the benefit of the Taxpayers. The Taxpayers agreed to pay the Variable Rate Fee for Refco's forbearance of the use of the cash collateral. The Taxpayers paid Refco the Variable Rate Fee over the life of the securities lending transaction. At the end of the Transaction, Refco paid cash to settle the securities lending transaction and offset its obligation against the obligation of the Taxpayers to repay the cash collateral plus the Variable Rate Fee. As a result, the Taxpayers had a significant taxable gain (and cash profit).

If the Transaction does not meet the requirements for nonrecognition of section 1058, the Taxpayers' transfer of the Securities in 2001 pursuant to the securities lending agreement results in a taxable disposition under section 1001. The Taxpayers recognize no gain or loss on the transaction as the fair market value of the Securities at the time of the transfer equaled their basis. In the transfer, the Taxpayers received a section 1012 cost basis in the Contractual Right to receive securities identical to the Securities at the end of the securities lending agreement. The cost basis in the Contractual Right is equal to the value of the Securities at the time of the transfer. At the termination of the Transaction, the Taxpayers are taxed under sections 1001 and 1234A, which in combination treat the termination of the Contractual Right as a disposition of the underlying Securities and result in capital gain. The Taxpayers, as cash basis taxpayers, receive a deduction for the Variable Rate Fees paid in 2001 and 2003, which was interest paid for Refco's forbearance of the use of the cash collateral.

On the other hand, if the Transaction does meet the requirements for nonrecognition under section 1058, the Taxpayers do not recognize gain or loss on the transfer of the Securities in 2001 under the securities lending agreement (section 1058(a)), the Taxpayers' holding period for the Securities ignores the transfer under the securities lending agreement (section 1058(c)), and the Taxpayers recognize a long-term capital gain on the cash settlement of the

Transaction in 2003 (sections 1001, 1058, and 1234A). Similarly, the Taxpayers receive a deduction for the Variable Rate Fees when paid in 2001 and 2003, as interest paid for Refco's forbearance of the use of money.

Thus, the Taxpayers properly reported the tax consequences of the Transaction. The tax result is the same whether the Transaction meets the requirements of section 1058 (which it did) or not. The Tax Court erred in following the Commissioner's erroneous logic in the Notices of Deficiency. The decision of the Tax Court should be set aside and the case remanded for further proceedings in the Tax Court.

ARGUMENT

I. SECTION 1058 IS IRRELEVANT TO THE PROPER TREATMENT OF A TAXABLE SECURITIES LENDING TRANSACTION.

Section 1058 is a red herring in this case. It is irrelevant to determining whether or not a securities lending transaction has occurred; rather, its sole purpose is to provide the conditions for when gain or loss from the conveyance of securities in a securities lending transaction is not taxable.

A. All Parties in This Litigation Have Been Led Down the Wrong Path in Focusing on Section 1058.

1. The Notices of Deficiency Focused on the Applicability of Section 1058.

Starting with the Commissioner's misleading Notices of Deficiency, every party in this litigation has followed an irrelevant and inapposite path. In the Notices of Deficiency, the only explanation of the redetermination given by the Commissioner was as follows:

> Since the Securities Lending Agreement did not meet the requirements of I.R.C. Section 1058(b)(3), the transaction cannot be treated as a securities loan within the scope of Section 1058. Accordingly, the transactional steps that took place in October 2001 are recharacterized. Instead of a securities loan, there was a purchase of the securities by the taxpayers from the broker and an immediate resale of the same securities back to the broker, with no gain or loss realized by the taxpayers. When the arrangement terminated in January 2003, the steps are similarly recharacterized: instead of the return of borrowed securities, there was a purchase of the securities by the taxpayers, followed by an immediate sale back to the broker, with the taxpayers realizing short term capital gain of $13,541,604.
>
> Alternatively, if the transaction is treated as including a securities loan to which section 1058 applies, section 1258 will cause the capital gain to be treated as ordinary income.

(ER 44.) As is clear from this explanation, the Commissioner's redetermination was based on the Transaction's alleged failure to meet the requirements of section 1058(b)(3). The Commissioner never analyzed or even mentioned the treatment of *taxable* security lending agreements. Rather, absent any authority, the Commissioner recharacterized the Transaction as a purchase and sale of the

Securities in both 2001 and 2003, without any mention of some later imagined forward contract.

2. The Taxpayers Addressed the Issue Raised by the Commissioner.

Based on the misleading Notices of Deficiency, the Taxpayers responded to and addressed the section 1058 issue focused on by the Commissioner. The Taxpayers argued that the Transaction met the section 1058 requirements for nonrecognition (which it does), an issue that has no bearing on the proper treatment of a *taxable* securities lending agreement. As discussed in the Opening Brief, and in further detail below, the Taxpayers correctly reported their income under the rules applicable to *taxable* securities lending transactions.

3. The Tax Court Erred in Only Analyzing the Section 1058 Issue.

The Tax Court likewise erred in only analyzing the section 1058 issue. The Tax Court spent twelve pages discussing whether section 1058(b)(3) applied to the Transaction. Based on the decision that section 1058(b)(3) did not apply to the Transaction, the Tax Court concluded, in two paragraphs (without analysis), that the Transaction should be treated as the purchase and sale of the Securities in both 2001 and 2003. The Tax Court opinion stated:

> We conclude that the Transaction was not a securities lending arrangement subject to section 1058 and that the underlying

> transfers of the Securities in 2001 and 2003 were therefore taxable events.…We agree with respondent that the economic reality of the Transaction establishes that the Transaction was not a securities lending arrangement as structured but was in substance two separate sales of the Securities without any resulting debt obligation running between petitioners and Refco from October 2001 through January 15, 2003.

Samueli v. Commissioner, 132 T.C. No. 4 at 25. The Tax Court failed to explain, discuss or analyze *why* this is the "economic reality" rather than a *taxable* securities lending agreement. The court simply made conclusory statements that the transfers in 2001 and 2003 were "in substance" a purchase and sale, but provides no authority or analysis for this conclusion. The Tax Court completely failed to address the essential issue in this entire case: the proper treatment of a *taxable* securities lending agreement.

4. The Commissioner's Brief Erred in Focusing on the Applicability of Section 1058.

While the Taxpayers attempted to focus this Court on the essential issue in their Opening Brief (see Opening Brief – Section III: The Transaction Qualifies as a Securities Lending Agreement Even if it Does Not Qualify for Non-Recognition Under Section 1058 at 39-48.), the Commissioner's Answering Brief only addressed the application of section 1058. The Commissioner's brief stated:

> As we shall demonstrate, however, the transactions at issue here failed to meet the requirement of I.R.C. § 1058(b)(3) that the agreements 'not reduce the risk of loss or opportunity for gain

> of the transferor of the securities in the securities transferred.' As a consequence, the transaction did not qualify for nonrecognition treatment, and thus should be taxed as if the taxpayers had acquired and disposed of the securities twice, once in October 2001 and then in January 2003.

(Answering Brief at 35.) Similar to the Tax Court, the Commissioner makes the leap from failure to meet the requirements of section 1058 to treatment as a purchase and sale in both 2001 and 2003, without any support for this conclusion in the Tax Code or any other authorities.

B. The Taxpayers Properly Reported the Transaction Based on the Correct Treatment of a *Taxable* Securities Lending Agreement Under the Tax Code.

If the Transaction is viewed as a *taxable* securities loan, then the Taxpayers' treatment of the Transaction on their tax returns was correct.

1. Cash Settlement of the Contractual Right Results in Long-Term Capital Gain.

On October 17, 2001, the Taxpayers purchased the Securities from Freddie Mac. (ER 69, Stip. ¶ 23.) On October 19, 2001, and pursuant to the Agreement, the Amendment and the Addendum, the Taxpayers transferred the Securities to Refco and "**obtained the right to receive identical securities at the termination of the transaction**" (i.e., the Contractual Right). (ER 71, Stip. ¶¶ 29 & 32 (emphasis added).) As noted by Congress, the Commissioner acknowledged in Rev. Rul. 57-451 that "a securities lending transaction involves the substitution of

the broker's contractual obligation for the lender's stock." S. Rep. No. 95-762 (1978) at pp. 5-6. The stipulated facts of this case confirm that just such a substitution occurred. Assuming that this transaction is a *taxable* securities loan, then the transfer is taxable under section 1001.

Section 1001(a) provides that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized." Under section 1012, "[t]he basis of property shall be the cost of such property." The Taxpayers purchased the Securities in 2001 for $1.64 billion and had a basis in the securities equal to their cost. The subsequent transfer of the Securities to Refco in 2001 was, by Commissioner's own admission, for $1.64 billion. Under section 1001, this does not result in the recognition of any gain or loss because the amount realized was equal to basis. However, contrary to the Commissioner's assertion and as stipulated in the facts, the transfer was not for cash but, rather, for the Contractual Right, i.e., the right to receive identical securities at the termination of the transaction. Under section 1012, the basis of the Contractual Right is the value of the Securities: $1.64 billion. As collateral against the obligation that Refco would return identical securities to the Taxpayers, as

required by the Contractual Right, Refco transferred an amount of cash equal to the value of the Securities to the Taxpayers. (ER 87, ¶ 3.2.)

Contrary to the stipulated facts and based on no analysis under any provision of the Tax Code, the Commissioner would have this court ignore the Contractual Right that the Taxpayers received. The stipulated facts are clear that the Taxpayers received a contractual right to have identical securities returned; the Taxpayers did not, as Commissioner contends, receive a contractual right "to transfer to Refco a sum, to be determined by a formula based on the LIBOR" in exchange for the Securities. (Answering Brief 50-51.) The Commissioner cannot simply recharacterize the nature of the right received because it produces a desired tax outcome.

Moreover, the Contractual Right was property held by the Taxpayers that was taxable as a capital asset under section 1221 (which defines capital assets), because none of the exceptions thereunder were applicable to the Transaction. In addition, section 1234A(1), in relevant part, provides that gain or loss attributable to the cancellation or termination of a right or obligation with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer shall be treated as gain or loss from the sale of a capital asset. The Contractual Right was and the Securities would be, if held by the Taxpayers, a capital asset.

Therefore, the gain from Refco's termination of the Taxpayers' Contractual Right to receive identical securities (and Refco's obligation to return identical securities) by paying the Taxpayers the fair market value of the Securities must be capital gain.

The Commissioner argues that the $1.69 billion the Taxpayers received in 2003 was not received in exchange for the Contractual Right but, rather, for the Securities themselves, because the sales ticket in 2003 indicated that Refco purchased the Securities from the Taxpayers on January 15, 2003. What the Commissioner fails to note is that the facts stipulate that only a single transaction occurred in 2003.

> At the termination of the transaction, Shiloh owed Refco $1,684,185,567. At the termination of the transaction, Refco owed Shiloh $1,697,795,219 for the Securities. Shiloh's amount owed to Refco and the amount Refco paid Shiloh for the Securities were settled via offset.

(ER 83, Stip. ¶ 76.)

The amount *owed* by the Taxpayers was the return of the cash collateral plus the unpaid Variable Rate Fees. The Taxpayers' obligation was not *for* the Securities pursuant to a forward contract. As is clear by the second and third sentences of the stipulation, when the parties agreed upon the facts of this case, they could make the distinction between a prior outstanding obligation *owed* and an amount paid *for* something new. The stipulated facts indicate that the parties

were intending to cash settle Refco's obligation to return the Securities, as is typically done in the ordinary course of a broker's business. The stipulated facts are clear that the Taxpayers never paid Refco for the Securities in 2003 and thus never took title to the Securities in 2003. The trade ticket from 2003 documents the termination of the securities lending transaction as a sale of the Securities from the Taxpayers to Refco.[3] (ER 83, Stip. ¶ 75.) However, the notation on the trade ticket as a sale of the Securities rather than the sale of the Contractual Right to the Securities cannot override the substance of the actual transaction as it occurred and as set forth by the stipulated facts.

Because the Taxpayers held the Contractual Right for more than twelve months, the termination of the Contractual Right in exchange for the fair market value of the Securities resulted in long-term capital gain of $50,916,509.[4]

---

[3] The parties' documentation was consistent with the application of section 1058 to the Transaction

[4] As also explained in Taxpayers' Opening Brief, even if the court concludes that a forward contract exists, rather than the Contractual Right to identical securities, the proper tax treatment of terminating a forward contract results in essentially the same tax consequences. See Opening Brief – Part V: The Tax Court Failed to Characterize Accurately the Tax Consequences of Terminating the Forward Contract at 57-61.

2. The Variable Rate Fees Paid to Refco for Use of the Cash Collateral Results in Deductible Payments for the Forbearance of Money.

As discussed above, the proper treatment of a *taxable* securities lending agreement results in the Taxpayers holding the Contractual Right, fulfillment of which was ensured by cash collateral. For use of the cash collateral, the Taxpayers were obligated to pay the Variable Rate Fee and upon fulfillment of the Contractual Right, i.e., the return of identical securities, the Taxpayers were required to return the cash collateral to Refco.

As explained in the Opening Brief, the Variable Rate Fee should be treated as an interest payment deductible to the Taxpayers because it is a payment for the forbearance of the use of money by Refco. According to the Supreme Court, "interest" and "indebtedness" have well-known meanings and, "[i]n the business world, 'interest on indebtedness' means compensation for the use or *forbearance* of money." Deputy v. Dupont, 308 U.S. 488, 498 (1940) (emphasis added). See also Fontana Power Co. v. Commissioner, 127 F.2d 193, 194 (9th Cir. 1942) (same); Commissioner v. Raphael, 133 F.2d 442, 445 (9th Cir. 1943). The courts have interpreted "indebtedness" to require an existing, unconditional, enforceable obligation to pay a principal sum. Williams v. Commissioner, 47 T.C. 689, 692 (1967). During the loan period, the Taxpayers paid a fee for the unrestricted use of the cash collateral (i.e., Refco forbore the use of the funds). In addition, the

Taxpayers were required to repay the cash collateral (i.e., a principal sum) to Refco upon the termination of the loan. Thus, the Variable Rate Fee was interest paid by the Taxpayers to Refco for the forbearance of the use of money by Refco.

The Commissioner relies on Cahn v. Commissioner, 358 F.2d 492 (9th Cir. 1966), aff'g, 41 T.C. 858 (1964), to support its contention that there is no forbearance of money by Refco. However, the transaction in Cahn was not a securities lending agreement but, rather, a loan secured by the securities purchased. In that case, the taxpayers purchased securities from securities broker 1 with a loan from the lender. However, before the securities were delivered, the taxpayers instructed that the lender receive the securities in order to secure the loan. The lender then sold the securities for the purchase price to securities broker 2. The Tax Court determined that the transaction was a sham and, therefore, there was no bona fide loan to the taxpayer. Cahn v. Commissioner, 41 T.C. 858, 874 (1964) ("the record convincingly indicates that this was a sham"). This Court's decision turned on the fact that neither the taxpayers nor the lender were ever in control of the securities, holding the following.

> The Treasury notes in question were never under the dominion or control of either taxpayers or [lender]. The series of transactions was in effect nothing more than a smokescreen for the sale of notes from [securities broker 1] to [securities broker 2]. There was no bona fide loan from [lender] to [taxpayers].

Cahn, 358 F.2d at 494.

In the instant case, unlike in Cahn, the Transaction was a securities lending agreement between the two primary parties, each of which had control of the Securities at some point of the transaction, as evidenced by the trade tickets and the stipulated facts. (ER 70 & 83, Stips. ¶¶ 28 & 75.) Furthermore, as discussed in the Opening Brief, the Transaction had economic significance and did not consist of completely offsetting steps. (see Opening Brief – Part II.C: The Transaction Had Economic Substance at 42-45.) The Tax Court below recharacterized the substance of the Transaction, but the Tax Court did not hold the Transaction was a sham. Thus, the transaction described in Cahn is easily distinguishable from the instant Transaction and, contrary to the Commissioner's position, the Taxpayers rely on more than the "presence of a risk of gain or loss" factor set out in Cahn to establish that a bona fide debt existed. (Answering Brief at 57.)

II. THE TRANSACTION MEETS THE NONRECOGNITION REQUIREMENTS UNDER SECTION 1058.

A. The Proper Tax Treatment of the Transaction is the Same When Section 1058 Applies as When it Does Not Apply.

Section 1058 was added to the Code to provide that gains and losses realized in certain securities lending transactions would not be recognized for tax purposes. A taxpayer who transfers securities that meet the requirements of section 1058 is deemed to hold the securities during the entire period of the transfer. I.R.C. § 1058(c); Gen. Couns. Mem. 36948 (Dec. 10, 1976) ("Generally, in determining the

lender's holding period for the securities received in the exchange, its holding period for the securities 'loaned' will be included under Code § 1223(1) since it takes a substituted basis in the securities received."). Therefore, if the Transaction meets the requirements of section 1058, the transfer of the Securities by the Taxpayers to Refco in 2001 was nontaxable and the Taxpayers would be entitled to long-term capital gains upon the sale of the Securities in 2003 because they had held them for more than twelve months.

B. Section 1058 Contains No Customary Notice Requirement.

The Tax Court erred in its unattainable and unworkable interpretation of Section 1058(b)(3), which even the Commissioner rejected on brief. The Tax Court held that the opportunity for gain is reduced by any agreement that limits a taxpayer's ability to sell securities "at *any time* that the possibility for a profitable sale arose." Samueli, 132 T.C. No. 4 at 21 (emphasis added). The Commissioner summarized this holding as providing that "[u]nder the express terms of the statute, to qualify for nonrecognition of gain treatment provided therein there must not be *any reduction* in the security's holder's opportunity for gain." (Answering Brief at 42 (emphasis added).)

Now, however, the Commissioner realizes that this standard is unattainable, noting that "Congress obviously did not intend to include any minor reduction that

might result from the customary notice requirements." (Answering Brief at 41.) The Commissioner directly and unambiguously now rejects the Tax Courts analysis that any reduction in the opportunity to recognize gain disqualifies a taxpayer from the application of section 1058. Instead, the Commissioner now attempts to add a "customary notice" requirement not contained in the statutory language (and which the Commissioner previously sought but failed to add by regulation). In fact, the Commissioner admits that "Congress was well aware…at the time that it enacted § 1058 that it was customary in securities lending transactions to impose upon the lender the obligation to provide the borrower with a short period of advance notice (typically three to five days) that he wanted the return of his securities." (Answering Brief at 40.)

The Taxpayers are in agreement with the Commissioner that Congress was aware of the customary notice period, and believe that this keen awareness led Congress to include a five-days' notice requirement in section 512(a)(5)(B). However, Congress intentionally did not include a similar requirement under section 1058. The Treasury Department, also aware that Congress knowingly did not include such a notice provision in section 1058, issued proposed regulations

that would have created such a notice period.[5] As noted by the American Bar Association's Committee on Financial Transactions:

> The five-day return rule of the proposed regulations effectively excludes from Section 1058 arrangements to lend securities for a fixed term exceeding five days since it would not be possible for the lender to receive securities on demand, and within 5 days, if a fixed term must be observed. The rule is statutorily required for exempt organizations that wish to escape unrelated business taxable income classification. I.R.C. section 512(a)(5)(B)(ii)….
>
> Alternatives to the five-day return rule were suggested shortly after the proposed Treasury regulations were issued. One suggestion was that the rule be stricken from the final regulations, at least as it applies to loans of securities other than loans of stock. The rationale is that the five-day return rule would be more consistent with current commercial practice as permitted by the SEC if it only applied to stock loans and not to loans of securities that were not stock.
>
> The proposed regulations seem to promulgate the five-day return rule under Section 1058(b)(3). With respect to Section 1058(b)(3), which precludes the securities loan agreement from reducing the lender's possible gain or loss from the time the security is borrowed, a facts and circumstances test would be more appropriate.

ABA Committee Reports on Securities Lending Transactions, 91 TNT 107-33 Section IV.1.E.2 (1991) (internal citations omitted). Thus, the American Bar Association's interpretation supports the Taxpayers' view that Congress intended a

[5] Prop. Reg. § 1.1058-1(b)(3) states that a securities lending agreement must "[n]ot reduce the lender's risk of loss or opportunity for gain. Accordingly, the agreement must provide that the lender may terminate the loan upon notice of not more than 5 business days."

five-days' notice requirement for section 512(a)(5)(B) but not for section 1058. The ABA reasoned that, because the five-days' notice requirement is only customary in certain markets, the proper test should be one of facts and circumstances. In fact, the proposed regulations, and thus the only statutory or regulatory mention of a five-days' notice requirement under section 1058, were withdrawn by the Treasury.

Thus, it is clear that both Congress and the Treasury were aware of the customary five-days' notice period for stocks, knew how to make such a notice period an explicit requirement, and made informed decisions not to include that requirement in section 1058. Congress' and Treasury's choice of words must be presumed to be deliberate, and the effects should be respected. See, e.g., United States v. Bucher, 397 F.3d 929, 932 (9th Cir. 2004) ("As with legislation, we presume the drafters [of a regulation] said what they meant and meant what they said."). Nonetheless, the Commissioner is now asking this court to read into the statute a "customary notice" provision in order to make the Tax Court's unworkable standard work, rather than reading the statute as written, i.e., without a customary notice requirement.

C. The Contractual Right Kept the Taxpayers in the Same Economic Position as if they Held the Securities.

The Commissioner argues that the transactions at issue failed to provide the mechanism for keeping the lender in the same economic position they were in before lending the securities, because the ability to recognize gain was reduced. However, the Commissioner fails to take into consideration that the Securities at issue were zero-coupon bonds whose value does not widely fluctuate with windfall profits at some momentary period the Commissioner envisions. Thus, the Taxpayers were not in a substantially less advantageous economic position due to entering into the Transaction because the nature of zero-coupon bonds preserved the Taxpayers' opportunity for gain notwithstanding the restrictions on the dates of sale.

The Commissioner also argues that the stipulation stating that "[b]y limiting its ability to exit the transaction at any time, Shiloh increased its risk of loss" leads to the conclusion that the Taxpayers also reduced their opportunity for gain. (Answering Brief at 42 n. 16.) However, this stipulation can only be understood in the greater context of the variable rate financing arrangement, which was argued by the Commissioner and held by the Tax Court to be irrelevant to the risk of loss or opportunity for gain in the Securities transferred. The increased risk of loss arose because the Taxpayers were locked into the variable rate financing

arrangement. If the Variable Rate Fees increased (and had the potential to increase further) during the period between when the Taxpayers entered the financing arrangement and the first termination date, the Taxpayers' could not exit the Transaction and, thus, faced an increased risk of loss; the risk of loss was not increased by the restrictions on the dates of sale given the nature of zero-coupon bonds absent taking into account the variable rate financing arrangement.

III. THE TAX COURT FAILED TO ADDRESS SECTION 1258.

The Commissioner notes on brief that if this court disagrees with the Tax Court's analysis of section 1058, "the case should be remanded for consideration of the Commissioner's § 1258 argument." (Answering Brief at 60 n. 19.) The Taxpayers agree with the Commissioner that this court should remand the case for consideration under the applicable statutory provisions, including section 1258. The Tax Court erred by focusing on the satisfaction of the requirements in section 1058(b)(3), but the tax consequences of the Transaction are the same whether or not that provision is satisfied. In the process, however, the Tax Court adopted an unworkable interpretation of section 1058(b)(3), which is why this court must reverse the Tax Court's decision and remand the case for consideration under the appropriate legal standards.

CONCLUSION

For the reasons set forth above, the Decision of the Tax Court should be reversed and remanded.

Respectfully submitted,

s/ Robert S. Walton

Robert S. Walton
Richard M. Lipton
BAKER & McKENZIE LLP
130 East Randolph Drive
Chicago, IL 60601
(312) 861-2540

Counsel for Petitioners-Appellants,
Henry Samueli and Susan F. Samueli,
and Thomas G. and Patricia W. Ricks

Dated this 11th day of January, 2010

CERTIFICATE OF SERVICE

Ninth Circuit Case Numbers: 09-72457 and 09-72458

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on January 11, 2010.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

s/ Robert S. Walton

Robert S. Walton
BAKER & McKENZIE LLP
130 East Randolph Drive
Chicago, IL 60601
(312) 861-2540

Counsel for Petitioners-Appellants,
Henry Samueli and Susan F. Samueli,
and Thomas G. and Patricia W. Ricks

Dated this 11th day of January, 2010

CERTIFICATE OF COMPLIANCE

Certificate of Compliance Pursuant to Fed. R. App. P. 32(a)(7)(C) and Circuit Rule 32-1 for Case Numbers 09-72457 and 09-72458.

I certify that pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a typeface of 14 points or more and contains 5,125 words.

s/ Robert S. Walton
Robert S. Walton
BAKER & McKENZIE LLP
130 East Randolph Drive
Chicago, IL 60601
(312) 861-2540

Counsel for Petitioners-Appellants,
Henry Samueli and Susan F. Samueli, and Thomas G. and Patricia W. Ricks

Dated this 11th day of January, 2010