CASE NOS. 11-9001 & 11-9002

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

ANSCHUTZ COMPANY AND PHILIP F. AND NANCY P. ANSCHUTZ,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from Decisions Entered on November 23, 2010 in the U.S. Tax Court,
Case Nos. 18942-07, 19083-07
The Honorable Joseph R. Goeke

OPENING BRIEF OF APPELLANTS ANSCHUTZ COMPANY AND PHILIP F. AND NANCY P. ANSCHUTZ

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Oral Argument Requested

April 29, 2011

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Petitioner-Appellant Anschutz Company states that it has no parent company. There is no publicly held corporation that owns ten percent or more of the stock of Anschutz Company.

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Pursuant to Tenth Circuit Rule 28.2(C), Petitioners-Appellants Anschutz Company and Philip and Nancy Anschutz state that there have been no prior appeals in this case, and there are no known related cases pending in this Court.

JURISDICTIONAL STATEMENT

Pursuant to 26 U.S.C. §§ 6213(a) and 7442, the United States Tax Court had jurisdiction to redetermine the tax deficiencies asserted by the Commissioner of Internal Revenue (the "Commissioner").

The Tax Court entered its decisions in these cases on November 23, 2010 (the "Decisions"). *See* Attachments A-60; A-62. This Court has jurisdiction to review the Decisions pursuant to 26 U.S.C. § 7482(a)(1).

Pursuant to 26 U.S.C. § 7483, Anschutz Company and Philip F. and Nancy P. Anschutz timely filed notices of appeal on January 13, 2011, within 90 days of the entry of the Tax Court's Decisions.

The Decisions, from which this appeal is taken, were final orders and disposed of all parties' claims.

STATEMENT OF ISSUES

1. Did the Tax Court err in concluding that forward contracts between the Anschutz Corporation ("TAC") and an investment bank limited TAC's risk of loss or opportunity for gain in shares of stock that TAC pledged as security, where TAC was not required to use the pledged shares to satisfy its obligations under the contracts or any other agreement between TAC and the bank?

2. Did the Tax Court err in holding that TAC made a taxable sale of pledged shares of stock, when TAC later loaned those shares to the investment bank and had the unilateral right—which it actually exercised—to recall the borrowed shares on short notice?

3. Did the Tax Court err in failing to respect the independence of the rights and obligations arising under forward contracts and contracts to loan stock where the forward contracts remained unaltered and in full force and effect during periods in which there were no stock loans?

STATEMENT OF THE CASE

During 1999-2001, TAC needed funding because it was making large investments in the entertainment business.[1] TAC, a corporation founded by Philip F. Anschutz ("Mr. Anschutz") in 1959, had maintained a long-term business strategy to accumulate (and not to sell) substantial stock positions in widely-traded public corporations in the natural resources and railroad businesses. By 2000, TAC held substantially appreciated positions in the stock of several of those corporations including Union Pacific Resources Group, Inc. ("UPR") and Union Pacific Corp. ("UPC"). While TAC avoided sales of long-held shares for funding purposes, it had from time to time used such shares as collateral for commercial bank loans.

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[1] TAC was a wholly-owned subsidiary of Anschutz Company. (Op. 2.) Mr. Anschutz owned all stock of Anschutz Company, and he ultimately controlled its strategic decisions. Anschutz Company elected, effective on August 1, 1999, to be an S corporation pursuant to Internal Revenue Code sections 1361 and 1362. (Op. 3.) (The Internal Revenue Code (the "Code") is found in Title 26 of the United States Code.) Under Code section 1361(b)(3)(B), TAC was a "qualified subchapter S subsidiary," which meant that TAC was treated as part of Anschutz Company rather than as a separate corporation for tax purposes under Code section 1361(b)(3)(A.) (Stip. ¶ 10.)

References to "Op." are the Tax Court's slip opinion in this case, 135 T.C. No. 5 (July 22, 2010), reproduced in the attachments at A-1. References to "Stip." are to one of the three stipulations in evidence before the Tax Court. Finally, "Ex." refers to an exhibit admitted in evidence.

Several investment banks proposed that TAC consider a financing approach more flexible than commercial bank borrowing: use of its appreciated stockholdings in UPR and UPC as collateral to raise the needed funds by means of "prepaid variable forward contracts."

A "forward contract" is an agreement to sell shares of stock in a specified company at a future date (in this case several years later). (Op. 7.) The forward contracts proposed by the banks were "prepaid" because the purchasing bank would make its payment to TAC upfront, upon execution of the contract. (*Id.*) The upfront cash payment would be significantly less than the value of the stock pledged by TAC at the outset, but it would significantly exceed the amounts that TAC could raise through bank loans using the same amounts of the same stock as collateral. The contracts were "variable" because a formula determined the number of shares that TAC had to deliver at maturity and varied the number of deliverable shares depending on the market value of such shares at delivery. (Op. 7, 9, 59.) To secure its future delivery obligations, TAC had to pledge the maximum number of deliverable shares. However, TAC could choose to deliver at maturity any identical shares of the designated company or to pay an equivalent sum of cash (*i.e.*, it did not have to deliver the shares that it pledged).[2]

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[2] "Identical shares" means stock of the same corporation and class as those pledged at inception, not the specific lot of pledged shares. (Op. 7 n.4.) If TAC

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If TAC made a "cash settlement" of a forward contract at maturity by paying the bank the cash value of the shares deliverable at maturity, it would neither deliver nor sell any shares at all. Thus, until maturity, it would be unknowable under any such prepaid variable forward contract whether any shares at all would be sold, how many shares (if any) would be sold, what particular shares (if any) would be sold, and whether TAC would realize gain or loss. TAC chose to enter into ten such forward contracts with Donaldson, Lufkin & Jenrette Securities Corp. ("DLJ") during 2000 and 2001 with respect to shares of UPR and UPC.[3]

Rev. Rul. 2003-7, 2003-1 C.B. 363, 364 (Att. A-81), confirmed that a prepayment and pledge of shares under a prepaid variable forward contract "did not cause a sale or other disposition of the shares" and thus that the prepayment

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chose to deliver shares at maturity (rather than cash), it could purchase shares on the open market for delivery in satisfaction of its obligation. (Tr. 105:20-107:2.)

[3] As in the Tax Court's opinion, references to "DLJ" unless otherwise specified include Donaldson, Lufkin & Jenrette Securities Corp., that corporation's parent, Donaldson, Lufkin & Jenrette, Inc., and their subsidiaries. On November 3, 2000, DLJ was acquired by Credit Suisse First Boston, Inc. ("CSFB"), but the acquisition did not materially affect the terms of the stock transactions at issue. Thus references to DLJ herein (unless otherwise specified) also include CSFB and its subsidiaries. (Op. 6 n.3.)

was not subject to tax when received.[4] Instead, taxation was deferred to a future time (typically the maturity date) when the information would be available to determine whether a sale would then occur, and, if so, whether gain or loss would be recognized.

DLJ borrowed shares that TAC had pledged to secure its obligations under the forward contracts. Rev. Rul. 2003-7's fact pattern did not address stock loans of pledged shares. Under multiple, long-standing authorities, however, including Code sections 1036 and 1058 (Att. A-64, A-65), Treas. Reg. § 1.1001-1(a) (Att. A-67), and Rev. Rul. 57-451, 1957-2 C.B. 295 (Att. A-70), a stock lender is not currently taxable on the transfer of loaned shares to a borrower, provided that the lender can recall from the borrower an equal number of identical shares on short notice. Three to nine weeks after TAC and DLJ entered into each of the ten forward contracts, DLJ borrowed most (but not all) of the shares pledged to secure TAC's performance of the forward contracts and paid TAC agreed fees for the borrowings. In 2006, TAC recalled a portion of the borrowed shares and, in 2009,

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[4] A revenue ruling is "an official interpretation by the Service that has been published in the Internal Revenue Bulletin." Treas. Reg. § 601.601(d)(2)(i)(a). (Treasury Regulations are found in Title 26 of the Code of Federal Regulations.) Revenue Rulings "are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose." *Id.* § 601.601(d)(2)(v)(d). The Commissioner is bound to follow revenue rulings in judicial proceedings. *Rauenhorst v. Comm'r*, 119 T.C. 157, 171 (2002); *see also Dover Corp. v. Comm'r*, 122 T.C. 324, 350 (2004).

recalled all the rest (and, in each case, returned to DLJ unearned borrowing fees). (Op. 27.) The recalls, and DLJ's consequent redeliveries to TAC, of all the shares that DLJ borrowed did not terminate, accelerate, or otherwise modify any of the ten forward contracts between DLJ and TAC. Those contracts remained in full force and effect.

The Commissioner, however, determined that TAC's loans of pledged shares to DLJ should be treated not as nontaxable stock loans but as early deliveries of shares to DLJ under the forward contracts and should be taxed as sales of the pledged shares when they were borrowed in 2000-2001. The Commissioner sought to tax Anschutz Company and Mr. Anschutz in those years as if TAC had received the full market value of the borrowed shares. (Op. 30.)

Philip and Nancy Anschutz and the Anschutz Company timely filed petitions in the Tax Court contending that TAC's forward contracts with DLJ and its share loans to DLJ did not result in sales in 2000 and 2001. (Op. 30-31; Stip. ¶¶ 17-18.) After a two-day trial, the Tax Court held that TAC sold its pledged shares to DLJ when DLJ borrowed them in 2000 and 2001. The Tax Court held that the proceeds on which tax would be calculated were the cash payments that TAC received from DLJ during 2000 and 2001. Accordingly, the Tax Court determined that Anschutz Company had tax deficiencies of $35,555,065.00 and $41,580,239.00 for taxable years 2000 and 2001, respectively, and that Philip and

Nancy Anschutz had deficiencies of $7,151,834.00 and $10,190,555.00 for taxable years 2000 and 2001, respectively.[5] (Decisions, Att. A-60, A-62.) The taxpayers appealed, and this Court consolidated their appeals on February 4, 2011.

The Tax Court's rationale has led to perverse conclusions. First, the Tax Court said that the transactions that TAC and DLJ had agreed were recallable, nontaxable stock loans (and that they documented and executed as such) became taxable sales when the shares were borrowed in 2000 and 2001. (Op. 44.) Second, upon TAC's actual recalls in 2006 and 2009 of the shares that DLJ had borrowed, the Tax Court treated DLJ's returns of borrowed shares as "TAC borrowing shares from DLJ" (Op. 48), despite TAC having no obligation whatsoever under the parties' agreements or otherwise to return the recalled shares to DLJ.

The Tax Court erred in concluding that TAC sold shares of pledged stock in 2000 or 2001; TAC was not obligated to settle its forward contracts with DLJ until 2009 and 2010. The borrowed shares that the Tax Court treated as "sold" in 2000 and 2001 were all returned by DLJ to TAC in 2006 and 2009 (pursuant to DLJ's stock loan obligations to redeliver borrowed shares to TAC).

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[5] The Commissioner also argued that there had been a current sale under Code section 1259, but the Tax Court rejected this argument. (Op. 52-59.) The Commissioner has not cross-appealed.

STATEMENT OF THE FACTS

Forward Contracts Offered a Superior Way for TAC to Raise Needed Funds

Beginning in the 1960s, Mr. Anschutz, through TAC, invested in and operated companies engaged in oil exploration and developing natural resources. (Op. 5.) In the 1990s and early 2000s, TAC also began investing in and operating railroad companies (and Mr. Anschutz sat on the boards of such companies). (Op. 5; Stip. ¶¶ 27, 39.) TAC typically held large blocks of stock so that it could have meaningful input in the direction of those companies over substantial periods of time. (Op. 5; Tr. 50:20-51:17, 53:5-22.) In the late 1990s and early 2000s, TAC needed substantial amounts of cash to fund the acquisition, development, and expansion of new ventures primarily in the entertainment business, including the formation of Regal Entertainment Group and an investment in the Staples Center (Los Angeles), and sports franchises. (Op. 5; Tr. 65:8-25, 164:5-9.)

Anschutz Company was a private company and did not want to go public, so it could not raise funds in the public markets by selling its own shares. (Tr. 54:17-55:4, 164:10-20.) Consistent with its past practice, TAC did not want to sell the appreciated stock positions that it had held for long periods of time. (Tr. 67:5-8, 164:14-16.) Selling that stock in 2000 and 2001 had three serious drawbacks. First, TAC would not enjoy any future appreciation on the stock. Second, its influence on those corporations' affairs would be diminished. (Stip.

¶¶ 39, 174-175; Tr. 76:4-6 ("it's the ability to vote that's the most important in a transaction"), 131:12-19.) Third, because Anschutz Company had recently converted from a C corporation to an S corporation, it would have to pay an additional "built-in gains" tax on sales of any stock that TAC held when Anschutz Company became an S corporation. As Anschutz Company's only shareholder, Mr. Anschutz would also be taxable on the same gain (reduced by any Code section 1374 tax paid by Anschutz Company). (Op. 3-5; Tr. 68:4-69:2.) If proceeds of sales were subjected to this double tax regime, the tax payments would seriously deplete the net funds available to be used in the business; however, the contracts between DLJ and TAC did not require delivery of any shares that TAC held in 1999 (and only property that TAC held in 1999 was subject to the corporate level tax because that is when TAC elected S corporation status).[6]

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[6] Unlike C corporations (which pay federal income taxes on their income), as a general rule S corporations are not themselves subject to federal income taxes on their income. (Op. 32.) Instead, income of an S corporation is attributed each year directly to the corporation's owners based on their proportionate ownership share of the S corporation. (*Id.*) Pursuant to Code section 1374, however, an S corporation that was a C corporation before it made its S corporation election is subject to a corporate-level tax on "built-in gains," *i.e.*, taxable dispositions of assets the corporation held on the date of the S corporation election which had a value in excess of their cost (or other tax) basis. The "built-in gains tax" applies only if the dispositions occur within ten years after S corporation status is elected and involve assets held at the time of the election. *See* Code section 1374(d)(3)(A).

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Several major investment banks offered TAC another way to obtain the funding needed—by entering into prepaid variable forward contracts (sometimes abbreviated in the Tax Court opinion as "PVFCs") using its appreciated and long-held UPR and UPC stock as collateral. (Op. 5-6; Tr. 57:22-59:7.) Forward contracts proposed to TAC offered several advantages over bank loans. The forward contracts could be structured to have longer terms (up to 13 years) than the two-to-four-year terms that were typical for TAC's bank loans. (Tr. 113:5-9, 164:21-165:6, 166:2-167:3.) A longer period of committed financing was a significant advantage to TAC's business. (Tr. 165:1-167:3.) Further, bank lenders had also required TAC to post portions of its stock holdings as collateral to secure repayment of their loans. If the value of stock pledged for a bank loan declined, TAC would be required to post additional collateral. (Tr. 167:4-17.) If the value of the stock collateral went below a certain threshold, TAC would have to repay the loan immediately. (Tr. 167:18-25.)

In contrast, a forward contract would never require TAC to post additional collateral even if the value of the stocks pledged to secure TAC's

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Mr. Anschutz, as Anschutz Company's sole shareholder, reported and paid tax on the income of Anschutz Company (including TAC) shown on Anschutz Company's 2000 and 2001 federal S corporation income tax returns in the 2000 and 2001 joint individual federal income tax returns that he filed with his wife, Nancy, who is a party to this case solely by reason of the filing of joint returns. (Op. 3 n.1.)

deferred delivery obligation declined precipitously. (Tr. 167:4-168:20.) In addition, TAC could obtain more funding using the forward contracts because it could obtain a higher percentage of the value of the stock pledged as collateral (75%) than it could obtain in a bank loan (typically 55-65%). Forward contracts did not limit TAC's ability to borrow from other banks as did traditional bank loans nor did they impose typical bank loan financial covenants concerning, for example, working capital, liquidity, and quality of collateral.[7] (Tr. 168:8-169:12.) Forward contracts also offered TAC the ability to defer selecting a settlement option for a substantial period of time, preserving financial flexibility.

<u>TAC Entered into Forward Contracts and Stock Loan Contracts with DLJ</u>

(a) The Forward Contracts Provided TAC with Needed Funds for its Business Operations

During 2000 and 2001, TAC entered into ten prepaid variable forward contracts (the "Forward Contracts") with DLJ with respect to common stock of UPR, Anadarko Petroleum Corp. ("APC"), and UPC (referred to generically in this brief as "Reference Companies" or a "Reference Company").[8] (Op. 12, 20-21, 24.)

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[7] TAC has executed more than 120 variable prepaid forward contracts since the late 1990s, which greatly reduced TAC's need for traditional bank loans. (Tr. 126:5-10, 169:22-170:8.)

[8] On July 14, 2000, UPR and APC merged. (Op. 22.) The Forward Contracts for UPR shares remained in effect with appropriate adjustment under their terms for the merger. (*Id.*) APC was the Reference Company in place of UPR in Forward Contracts with an effective date after the date of the merger.

The Forward Contracts had maturity dates in 2009 and 2010 and had terms ranging from eight years, eight months to ten years, two months.[9] Pursuant to these ten Forward Contracts, TAC received a total of $350,968,652 in prepayments from DLJ during 2000 and 2001. (Op. 26.)

Although the documents governing the Forward Contracts are lengthy, the transactions they establish are straightforward. In each Forward Contract, TAC promised to make delivery of Reference Company stock or cash on a future maturity date.[10] The number of shares of the Reference Company (UPR, APC, or UPC) deliverable at the end of the contract varied depending upon the market value of such shares of Reference Company stock at maturity. (Op. 7.) TAC

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[9] (Op. 20-26; Exs. 21-P-26-P, 28-P-30-P, 32-P.) The longest Forward Contract term was August 8, 2000 to October 8, 2010 (Ex. 24-P); the shortest was January 16, 2001 to September 10, 2009 (Ex. 30-P). The Tax Court's reference to ten to eleven year terms (Op. 18) does not reflect the actual terms of the Forward Contracts as shown in these exhibits.

[10] DLJ could accelerate the maturity dates specified in the Forward Contracts if TAC filed for bankruptcy, if TAC's economic position deteriorated as specified, or if DLJ could not hedge its position. (Op. 18.) The stocks of UPR, APC, and UPC were widely traded and available, so that it was not difficult to borrow shares of any of the three companies to execute the short sales by which DLJ hedged its position. (Op. 19 n.6; Tr. 137:10-23, 321:22-323:11.) Both DLJ and TAC considered the possibility that DLJ could not hedge such widely-traded shares to be "highly unlikely." (Tr. 137:3-9, 228:18-229:16 ("[I]t was basically unimaginable that we would find a circumstance where these [acceleration] triggers would be invoked.").) Through the date of trial, the Forward Contracts had not been accelerated. (Tr. 295:8-11.)

could deliver any identical shares of the Reference Company at maturity—or it could deliver cash and avoid selling any shares.[11]

In addition to the business advantages of financing that had a longer term than bank loans, the maturity dates of the Forward Contracts provided TAC with the additional flexibility to settle in 2009 or 2010 with long-held shares of APC and UPC without triggering a second, corporate level of tax under Code section 1374. (Tr. 68:9-69:2.) But even in the event of an unlikely accelerated maturity of the Forward Contracts (*see* note 10 *above*), those contracts provided TAC with ample flexibility to avoid a second corporate level of tax by settling with cash or other Reference Company shares acquired after 1999.

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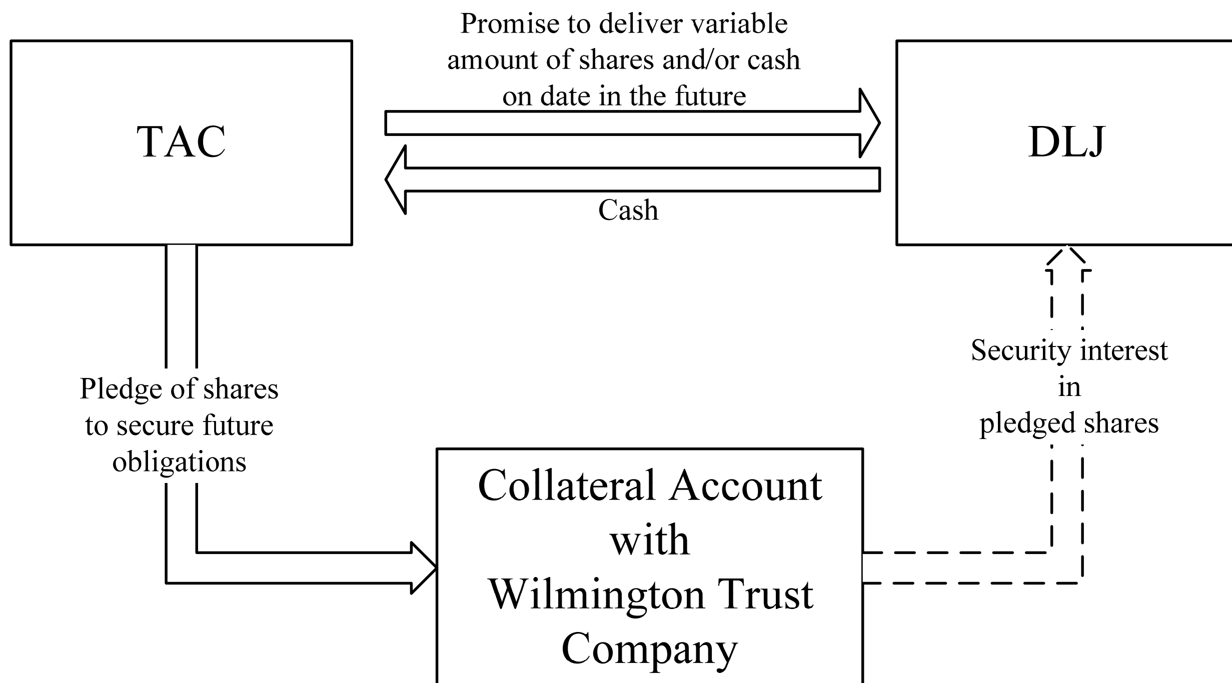
[11] Some of the Forward Contracts expressly permitted TAC to settle its obligations at maturity in cash, and others did not. (Op. 21, 24, 25; Tr. 213:20-214:19; Exs. 11-P, 12-P, 18-P.) DLJ would accept cash payment from TAC in lieu of actual share delivery even if the particular Forward Contract did not expressly permit it. (Op. 27; Tr. 110:4-7 ("DLJ would always be willing to cash settle these transactions . . . ."), 170:13-24 (TAC "could pay cash."), 216:13-18 (DLJ was "completely agnostic as to whether we received cash or shares at the back end."), 217:16-24.)

There is no economically significant difference between cash settlement and delivery of shares purchased at the time of delivery. Both involve the same cash outlay. (Tr. 106:4-107:3, 110:8-21, 170:22-24.) Neither would involve a sale of pledged shares. (Tr. 105:15-19.) The record also demonstrated that TAC had settled similar contracts in the past with cash and had the economic capacity to make cash or stock settlements with shares purchased at or near the maturity dates. (Tr. 62:17-24, 110:18-111:9.)

On the effective date of each Forward Contract, DLJ paid TAC an up-front cash payment equal to 75 percent of the market value of the number of shares of the particular Reference Company that TAC pledged to secure its future delivery obligation ("75% Payment"). (Op. 9.) To assure DLJ that TAC would be able to make delivery at the maturity date, TAC was required to pledge the maximum number of shares of Reference Company stock that it could be required to deliver under each Forward Contract. (Tr. 113:15-22; Ex. 9-P at § 5.01(a), (d).) The pledged shares were held in collateral accounts with Wilmington Trust Company ("Wilmington Trust") as trustee. (Op. 9.) The diagram below illustrates the Forward Contracts (and is based on Exhibit 125-P in the Tax Court proceedings):



At maturity, the agreed settlement formula determined how many shares TAC had to deliver to DLJ or, alternatively, the amount of cash due.[12] (Ex. 9-P at §§ 2.02(b), 2.03.) Under the Forward Contracts, DLJ had no obligation to make any further payment to TAC beyond the initial 75% Payment. (Ex. 9-P at § 2.02(a); Tr. 104:18-24, 212:1-4.)

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[12] A hypothetical used by the Tax Court (with modifications to conform to the settlement formula that the parties agreed to in this case) illustrates the operation of the settlement formula for a hypothetical transaction in which TAC holds and pledges 100 shares of X Corp, trading at $10 per share on the effective date. (Op. 7-8.) If the variable prepaid forward contract called for delivery at maturity nine years later of a maximum of 100 shares and a minimum of 66 2/3 shares of X Corp., DLJ would make an upfront payment of $750 to TAC (100 x $10 x 75%). TAC would pledge 100 shares of X Corp. *Scenario 1*: At the maturity date, if X Corp. stock is trading below $10, at, *e.g.*, $7 per share, TAC delivers to DLJ either 100 shares of X Corp. or $700 in cash (the maturity date value of 100 X Corp. shares in this scenario). *Scenario 2*: If the X Corp. shares are trading anywhere between $10 and $15 on the maturity date, TAC delivers to DLJ shares of X Corp. the number of which is worth $1000 (or $1000 cash). *Scenario 3*: If the X Corp. shares are trading at exactly $15 on the maturity date, TAC delivers to DLJ 66 2/3 shares (or $1000 cash). *Scenario 4*: If the X Corp. shares are trading for more than $15 per share at maturity, TAC delivers the maximum number of X Corp. shares (*i.e.*, 100) less the number of X Corp. shares with a maturity date value of $500 (or the cash equivalent). For example, if the maturity date value of an X Corp. share were $20 per share, TAC would deliver 75 shares of X Corp. or $1500 cash (75 x $20). TAC keeps its 75% Payment ($750) in all scenarios (provided it makes the share or cash deliveries required). Unlike in the Tax Court's example, there was no circumstance under the Forward Contracts in this case in which the upfront payment equaled 100% of fair market value at the time of the upfront payment. Exs. 116-P through 118-P illustrate the functioning of the variable formula in the actual Forward Contracts.

Each Forward Contract had five core terms. First, TAC kept the upfront 75% Payment (provided it satisfied its obligations to DLJ at maturity). (Op. 28, 46-47; Ex. 9-P at § 2.02(a)-(b).) Second, if at maturity the fair market value of the Reference Company shares had increased above their value at the inception of the Forward Contracts, TAC kept all such appreciation up to 50 percent. (Op. 29; Ex. 9-P at § 2.02(b).) Third, DLJ was entitled to any appreciation in the Reference Stock in excess of 50 percent.[13] (*Id.*) Fourth, if the market value of pledged shares decreased, TAC was not required to pledge more shares. (Tr. 167:4-168:7.) Fifth, TAC could deliver any shares of the Reference Company or cash at maturity; it had no obligation to deliver pledged shares.[14] (Tr. 105:4-10, 287:7-23, 296:3-6.) Accordingly, during the term of each Forward Contract, DLJ bore the risk (which it hedged) that the value of Reference Company stock at maturity might be less than its value at the effective date of a Forward Contract, but DLJ was entitled to any appreciation in such value in excess of 150% of the effective date value. (Op. 9, 28-29.) *See* pages 19-21 *below*.

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[13] Mechanically, the formula variations described as "Second" and "Third" in text were given effect by reducing the maximum the number of shares of Reference Company stock that TAC could be required to deliver to DLJ at maturity by the number of such shares that equaled in value the amount of appreciation that TAC was entitled to retain.

[14] Through the date of trial, neither DLJ nor TAC knew which settlement options TAC would elect to settle each of the Forward Contracts. (Tr. 105:4-10, 289:20-290:5, 296:3-6.) See note 11 concerning cash settlement.

DLJ and TAC documented their agreements through a series of transaction documents. First, on May 9, 2000, they entered into a Master Stock Purchase Agreement (the "Master Agreement"). (Op. 6, 13; Ex. 9-P.) The Master Agreement set the general terms for the Forward Contracts (including the settlement formula) and allowed the parties to enter into multiple Forward Contracts with minimal additional negotiation and documentation. (Tr. 89:14-24.) There were three transaction schedules, one covering UPR and APC stock and two covering UPC stock. (Op. 11, 13; Exs. 11-P-12-P, 18-P.) Each transaction schedule was then further divided into smaller agreements called "tranches" (Op. 12), each of which was an individual Forward Contract. Each Forward Contract specified the maximum and minimum number of shares of the particular Reference Company deliverable at maturity and had its own pricing schedule, which detailed the precise transaction terms (such as number of shares pledged, effective date price, and maturity date) for that specific Forward Contract. (Op. 14-15.)

The parties also executed Pledge Agreements establishing collateral accounts with Wilmington Trust that would hold the shares that TAC pledged. (Op. 11.) As discussed in the next section, DLJ and TAC also entered into stock loan contracts (the "Stock Loan Contracts") permitting DLJ to borrow shares in the Wilmington Trust pledge accounts. (Op. 12.)

DLJ and TAC entered into Forward Contracts with respect to UPR stock beginning on May 9, 2000 (which became APC stock after the merger). (Op. 20-21.) Forward Contracts with respect to UPC stock followed beginning on December 5, 2000 continuing into 2001. (Op. 23-26.) On the effective date of each Forward Contract, DLJ made the up-front 75% Payment, and TAC pledged the appropriate number of Reference Company shares with Wilmington Trust. (Op. 16, 20-26; Tr. 104:2-6.)

(b) DLJ's Decision to Hedge its Exposure Led to the Stock Loans in this Case

As each Forward Contract became effective, DLJ sold shares of the Reference Company's stock that it did not own (a trade known as a "short sale") to hedge DLJ's position under each Forward Contract.[15] A properly executed hedge "protected DLJ from a decrease in stock value during the term" of the Forward Contracts. (Op. 15; Tr. 259:23-260:3 (DLJ sought to achieve "a net neutral position with respect to the price risk of the stock.").) DLJ expected to make money on the Forward Contracts by paying TAC only 75% of the value of Reference Stock at inception and by making frequent trades of Reference Company stock over the term of those contracts in the course of adjusting its

[15] At the commencement of each Forward Contract, DLJ sold short a substantial portion (but not all) of the maximum number of deliverable shares of each Reference Company subject to that Contract. (Tr. 209:9-19, 263:12-264:10, 268:12-18.)

hedges.[16] DLJ's hedging activity was for its own account as principal; TAC had no participation in DLJ's hedges or its profit or loss from trading in borrowed shares. (Tr. 261:2-9.)

To establish its initial hedge, at or near the effective date of each Forward Contract, DLJ engaged in short sales of Reference Company stock in the open market. To make good delivery on its short sales, DLJ borrowed the requisite number of shares from third-party stock lenders (and not from TAC) who charged DLJ a fee and required it to post collateral during the period the shares were borrowed. (Op. 18-19; Tr. 248:20-249:4.) DLJ borrowed shares from such third parties for the first three to nine weeks of each Forward Contract's term. (Tr. 120:9-17, 219:17-23; Ex. 115-P.) UPR, APC, and UPC shares were widely traded and available, so it was neither difficult nor expensive for DLJ to borrow the shares needed for its hedge in public markets (rather than from TAC) both at inception of each Forward Contract and later (when TAC recalled shares). (Op. 19 n.6; Tr.

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[16] As the price of Reference Company shares changed during the term of a Forward Contract, the number of shares deliverable by TAC could also change. These price movements required adjustments as frequently as daily to keep DLJ's hedge position matched to the number of shares deliverable by TAC under the Forward Contracts. To effect these adjustments in its hedge, DLJ had to buy or sell shares, and DLJ witnesses testified that DLJ hoped to profit by such frequent trades. (Tr. 206:24-207:24, 238:18-246:10, 312:19-22.)

292:8-293:21 ("[T]here was a significant amount of shares that were available to be borrowed . . . [at] the cheapest rate for shares to be borrowed . . . .").)

(c) DLJ's Borrowing of Pledged Shares from TAC in 2000 and 2001

To reduce its cost of hedging, DLJ negotiated with TAC to be able to borrow the pledged shares of Reference Company stock without posting collateral. DLJ believed that such an uncollaterized share borrowing would allow it to earn greater profits than if DLJ were required to continue borrowing Reference Company stock from third parties and to post collateral with those third parties with respect to those borrowings.[17] (Tr. 221:11-222:20.) TAC had the right to recall borrowed shares back to the Wilmington Trust collateral accounts at any time upon written notice, and DLJ had the right to return borrowed shares at any time. (Exs. 39-P-41-P at § 6.)

To borrow the pledged shares without collateral, DLJ agreed to pre-pay TAC a borrowing fee of five percent of the market value of the pledged Reference Company shares.[18] (Op. 10, 17.) Because DLJ did not post collateral for the shares it borrowed from TAC, its parent guaranteed DLJ's obligations to TAC under the Stock Loan Contracts, and the borrowing fee was higher than for

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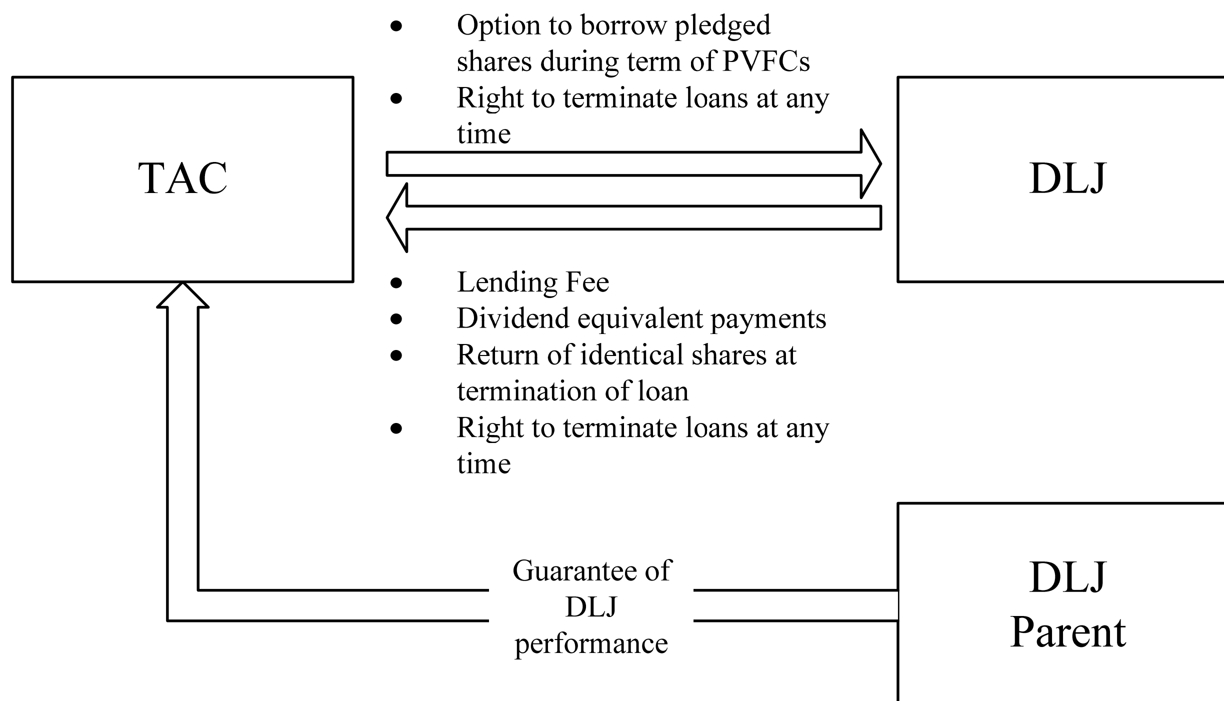
[17] DLJ was indifferent as to the source of borrowed shares to maintain DLJ's short sale hedges. (Tr. 248:6-19, 269:20-24, 289:13-19.)

[18] Anschutz Company reported the prepaid five percent borrowing fees as ordinary income in its 2000 and 2001 tax returns. (Stip. ¶ 186.)

collateralized stock loans. (Tr. 122:25-123:13, 124:21-125:22, 248:14-25, 249:17-250:8.) After its acquisition of DLJ, CSFB continued the guarantee. (Op. 6 n.3, 17.) If TAC recalled the borrowed shares before the maturity date of the Forward Contract to which the shares were pledged, TAC would be required to return to DLJ the unearned portion of the prepaid lending fee on a pro rata basis. (Op. 18.)

The Master Agreement required TAC to enter into Pledge Agreements with Wilmington Trust, and those agreements required Wilmington Trust (as TAC's agent) to execute Stock Loan Contracts with DLJ with respect to pledged shares that were held in the Wilmington Trust pledge accounts. (Op. 17; Exs. 9-P, 39-P-41-P.) The Stock Loan Contracts gave DLJ the option to borrow all, some, or none of the pledged shares. DLJ did not borrow any shares from TAC until three to nine weeks after each Forward Contract became effective in 2000 and 2001. (Ex. 115-P; Tr. 247:9-22.) DLJ then decided how many shares to borrow and in fact did not borrow all of the pledged shares. (Op. 17; Tr. 121:1-15; Ex. 115-P.) The Stock Loan Contracts provided (i) for procedures for the transfer of the shares that DLJ borrowed from the Wilmington Trust pledge accounts, (ii) for DLJ's periodic substitute payments to TAC equal to dividends and distributions with respect to the shares borrowed, and (iii) for payment of borrowing fees, *i.e.*, the

five percent prepaid fees discussed above.[19] (Op. 10, 17; Exs. 39-P-41-P at §§ 1-6, 8.) The diagram below illustrates the Stock Loan Contracts (and is based on Exhibit 127-P in the Tax Court proceedings):



Neither TAC nor DLJ treated DLJ's borrowing of shares in 2000 and 2001 as a "settlement" of TAC's obligations under any Forward Contract to deliver shares in

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[19] TAC included in its taxable income each year the dividends on unborrowed pledged shares and the substitute payments (equal to dividends) made by DLJ on the pledged shares that were borrowed. (Tr. 115:5-12; Stip. ¶ 187.) Beginning in 2003, TAC could elect and did elect to use the substitute payments it received to reduce the number of shares (or amount of cash) it would be required to pay at settlement of the Forward Contracts. (Tr. 118:11-14; Exs. 83-P-86-P.) This election did not change TAC's reporting of such substitute payments as income because TAC used such payments to reduce TAC's future delivery obligations under the Forward Contracts. (Tr. 118:15-19, 237:22-25.)

2009 or 2010.[20] The Tax Court itself acknowledged that TAC's delivery obligations to DLJ remained variable (and of unknown amount) until the Forward Contracts' maturity dates. (Op. 51, 59.)

(d) TAC's Right to Recall Shares Borrowed by DLJ

Each Stock Loan Contract provided TAC and DLJ each with the right to terminate any share loan at any time on written notice. TAC's right to recall any borrowed shares was unconditional and unrestricted. (Tr. 128:7-13 (TAC had "an unfettered right to recall the shares at any time, for any reason."); Exs. 39-P-41-P at § 6.) TAC simply had to notify Wilmington Trust of its decision to recall borrowed shares, as it did in 2006 and 2009, and Wilmington Trust would then inform DLJ of the recall. (Op. 17; Tr. 126:17-127:21; Exs. 39-P-41-P at § 6.) Upon receiving a recall notice, DLJ was obligated to return the borrowed shares to TAC's collateral accounts at Wilmington Trust. Upon recall, TAC was required to return to DLJ the unearned, pro rata portion of the prepaid lending fees it had earlier received. (Op. 17-18; Tr. 127:24-128:6, 133:2-12; Exs. 39-P-41-P at § 5.)

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[20] (Tr. 122:17-20, 126:11-16 ("[T]he share lending obligation has no bearing on the ultimate delivery obligations under the prepaid forward contract."), 223:18-224:3, 289:3-12 (CSFB "didn't consider [share loans from TAC] settlement because the [Forward] [C]ontract[s] [are] still outstanding."), 295:8-11, 297:21-298:4.)

(e) TAC Recalled Shares Borrowed by DLJ in 2006 and 2009

In order to demonstrate that TAC could terminate a share loan without triggering the acceleration provisions in the Forward Contracts (or otherwise modifying those contracts), TAC recalled a portion of the shares it had loaned to DLJ in February 2006. (Tr. 129:6-13, 296:7-14.) DLJ promptly returned the recalled shares to TAC's collateral account at Wilmington Trust, and TAC never re-loaned those shares to anyone.[21] To demonstrate conclusively that TAC could recall all the shares that DLJ had borrowed without accelerating any of the Forward Contracts, TAC recalled all the remaining borrowed shares in January 2009, shortly before trial.[22] As the Stock Loan Contracts provided, TAC refunded the unearned portions of the prepaid lending fees with respect to the shares recalled. (Stip. ¶¶ 121, 128, 215-216.) In 2009, as in 2006, DLJ promptly redelivered the borrowed shares to TAC's agent, Wilmington Trust.[23] (Tr. 129:21-131:2.) The

[21] (Tr. 148:4-11, 153:9-18, 297:14-20, 298:9-12, 310:11-311:3; Stip. ¶¶ 120, 127; Ex. 71-P at AC0000802, Ex. 72-R, Ex. 74-P at AC0000919, Ex. 75-R.)

[22] (Tr. 130:10-131:2, 298:13-299:3; Stip. ¶¶ 117-120, 125-127, 209-212; Exs. 130-P-133-P.)

[23] Upon TAC's later recalls of shares borrowed by DLJ, DLJ had to borrow other Reference Company shares in the market to maintain its hedges. The recalls did not affect the Forward Contracts. (Tr. 139:17-22, 223:2-224:3, 225:11-16, 228:6-229:12, 289:15-19 ("[A]nd we are fairly indifferent as to from whom we are borrowing those shares."), 321:22-322:17 (The Reference Company stocks were "general collateral" that was "easy to borrow" and "very inexpensive to borrow.").)

2006 and 2009 recalls of the borrowed shares had no effect on the Forward Contracts; TAC remained fully obligated to deliver shares (or the cash equivalent value) to DLJ pursuant to those contracts at maturity without regard to the recalls of shares loaned under the Stock Loan Contracts. (Tr. 126:11-16 ("[T]he share lending obligation [had] no bearing on the ultimate delivery obligations under the prepaid forward contract."), 223:9-224:3, 225:11-16 ("[TAC's] obligation under the prepaid forward contract was to deliver shares or to deliver value, regardless of how the stock lending arrangement operated."), 228:6-229:12, 289:3-19; Ex. 9-P at § 2.02(b).)

TAC had substantial business reasons for insisting that the Stock Loan Contracts provide it the right to recall borrowed shares on short notice. First, the stock recall rights ensured that TAC could vote those shares on important corporate matters such as mergers when necessary. (Tr. 77:6-13, 128:14-23, 224:15-225:3.) Second, the recall rights protected TAC if it became concerned about DLJ's (or its parent's or successor's) creditworthiness. (Tr. 128:14-129:5, 225:4-10.)

TAC's experience with stock loan agreements with other investment banks illustrates the importance to TAC's business of having recall rights. Between 2004 and 2006, TAC and Bear Stearns executed numerous forward contracts and share lending agreements with respect to Forest Oil and Mariner

Energy stock. (Stip. ¶¶ 166, 170-72; Exs. 92-P-95-P.) In February 2008, TAC recalled shares of Forest Oil stock that it had loaned to Bear Stearns to vote those shares in favor of a major merger. (Stip. ¶¶ 174-75; Tr. 131:12-19; Exs. 96-P-98-P.) Moreover, in March 2008, TAC became concerned about the creditworthiness of Bear Stearns. (Tr. 132:10-21.) TAC determined that it was no longer willing to take the credit risk of lending the securities to Bear Stearns; as a result, it recalled all borrowed shares from Bear Stearns. (Tr. 132:10-24; Stip. ¶ 177; Ex. 100-P.) Bear Stearns later collapsed and was sold to J.P. Morgan shortly thereafter.

Return Filings, Notices of Deficiency, and Tax Court Decisions

Consistent with the position later announced by the Commissioner in Rev. Rul. 2003-7 with respect to prepaid variable forward contracts, Mr. Anschutz and Anschutz Company did not treat TAC's Forward Contracts or Stock Loan Contracts as sales in 2000 and 2001 in their federal income tax returns.[24] (Op. 29.) There was thus no sale and hence no gain or loss to report on TAC's receipt of the

[24] Under Rev. Rul. 2003-7's analysis, no sale could occur under the Forward Contracts until maturity because it was not knowable in 2000 and 2001 whether TAC would choose to settle in cash (and deliver no shares), how many shares TAC would be obligated to deliver at maturity, and which shares (if any) TAC would elect to deliver at maturity. (*See also* Op. 59.) If TAC purchased shares for delivery, none of the pledged shares would be sold, and the cost basis of the newly-purchased shares would be unknown until such purchase. *See* note 38 *below*.

75% Payments in 2000 and 2001; a sale might never occur and, if it occurred, it would not occur before maturity of the Forward Contracts.

The Commissioner issued notices of deficiency that treated DLJ's borrowings of pledged shares in 2000 and 2001 as if those stock loans were final sales. (Op. 30.) Consequently, the Commissioner asserted that Anschutz Company was liable for the Code section 1374 built-in gains tax in 2000 and 2001 and that Mr. Anschutz was taxable on the gains that flowed through to his returns. (Op. 30-31.)

The taxpayers filed petitions in the Tax Court challenging the Commissioner's determination. The Tax Court entered the Decisions described above holding that DLJ's borrowings of pledged stock should be taxed as sales by the taxpayers, and the taxpayers appealed.

SUMMARY OF ARGUMENT

The Tax Court's Decisions in these consolidated cases contravene TAC's express contract rights, unreasonably limit the permissible scope of securities lending transactions whose freedom from tax consequences had previously been unquestioned, and undermine Code section 1058, which Congress intended to enhance the liquidity of the securities markets by facilitating securities loans.

In Rev. Rul. 2003-7, 2003-1 C.B. 363, the Commissioner determined that a shareholder's execution of a prepaid variable forward contract, receipt of prepayment, and pledge of shares to secure performance of that contract do not effect a sale at the time of any of those events. As in this case, the ruling concerned a forward contract in which a bank made an upfront payment in exchange for the shareholder's promise to deliver a variable number of shares (or equivalent value in cash) at a later maturity date.

The Forward Contracts in this case are substantially identical to the contract in Rev. Rul. 2003-7, save for one additional fact: TAC permitted DLJ to borrow shares that TAC had pledged (in such numbers as DLJ chose). Any shares that DLJ chose to borrow were subject to TAC's right of recall on short notice. The Tax Court erred in concluding that these recallable (and actually recalled) loans of pledged shares transformed the Forward Contracts into taxable sales of those pledged shares on the dates the stock loans were made.

Stock lending is a longstanding financial market practice, dating back well before the Supreme Court considered it in *Provost v. United States*, 269 U.S. 443 (1926). Stock lending is essential to the efficient functioning of the securities markets, providing market participants with additional liquidity. Although a stock lender always transfers legal title and all of the incidents of ownership of the borrowed shares to the stock borrower, the Commissioner has long agreed that no

taxable sale occurs when shares are borrowed. Rev. Rul. 57-451, 1957-2 C.B. 295 (applying Code section 1036's non-recognition mandate to stock loans). Approximately thirty years later, Congress reaffirmed that position when it enacted a safe harbor for securities lending in Code section 1058 in 1978.

The Tax Court's reversible legal errors in this case are:

(i) it misconstrued the Master Agreement (and other agreements between TAC and DLJ) as imposing restrictions on TAC's opportunity for gain or risk of loss in pledged shares that DLJ borrowed: in fact, no provision of any agreement that TAC and DLJ executed imposed any such restriction—TAC was never obligated to settle the Forward Contracts with pledged shares (and DLJ's borrowing of pledged shares did not impose any such obligation);

(ii) it failed to apply to TAC's stock loans well-established law that such loans are not taxable transfers by the stock lender; and

(iii) it failed to recognize that the Forward Contracts and Stock Loan Contracts created independent rights and obligations as confirmed by the Forward Contracts remaining unaltered and fully effective during substantial periods during which DLJ borrowed no shares from TAC.

Each of these errors requires reversal.

Neither the Forward Contracts nor the Stock Loan Contracts (whether viewed separately or a single transaction) limited TAC's gain or loss in any

pledged stock (including all the stock that DLJ borrowed). Fundamentally, no provision of any of the agreements committed TAC to deliver pledged shares (whether or not they had been borrowed) at the Forward Contracts' maturity dates in 2009 and 2010, or to make any settlement of these contracts in 2000 and 2001. Instead, each Forward Contract explicitly authorized TAC to deliver other identical shares in settlement of such contracts at maturity, and DLJ also made clear that TAC could have cash-settled all the Forward Contracts at their maturities without delivering any shares.

Each Stock Loan Contract required DLJ to redeliver, at TAC's demand, shares identical to the shares borrowed. DLJ borrowed only pledged shares that had no restrictions or encumbrances. Whatever economic burdens the Forward Contracts imposed on TAC at their maturities, those burdens were not connected to or imposed on the pledged shares and did not restrict TAC's exposure to profit or loss in those pledged shares because TAC was never obligated to settle at maturity with such shares. It was, therefore, legal error for the Tax Court to construe the Forward Contracts as limiting TAC's gain or loss in the pledged shares that DLJ borrowed.

Although the Tax Court acknowledged that the contracts between DLJ and TAC involved stock lending (Op. 44), it discussed only Code section 1058(b)(3) in its opinion and ignored other authorities that have long provided that

a loan of shares is not a taxable sale or disposition by the lender. Because TAC could deliver cash or other shares to settle the Forward Contracts, the Tax Court erred in treating those contracts as restricting TAC's gain or loss in the pledged shares that DLJ borrowed (thereby misapplying Code section 1058(b)(3)). It likewise erred in failing to apply the other authorities that made stock loans nontaxable to TAC as the share lender.

The Forward Contracts were in place for three to nine weeks before DLJ borrowed any pledged shares, establishing that the Forward Contracts could exist without DLJ borrowing TAC's pledged shares. After DLJ borrowed shares, TAC not only had the contractual right to recall borrowed shares on demand, but it also exercised that right in 2006 and 2009. After each such recall, the Forward Contracts remained in full force and effect—unaffected by the recalls. The Tax Court's statement that the Forward Contracts "could not occur" without DLJ borrowing shares from TAC (Op. 50) distorted the parties' agreements and the record: DLJ borrowed no shares from TAC during substantial periods over the lives of the Forward Contracts. That both TAC and DLJ saw economic advantage in entering into both Forward Contracts and Stock Loan Contracts offers no support for the conclusion that TAC "sold" the pledged shares that DLJ borrowed (and later returned to TAC).

It is undisputed that the Master Agreement required the parties to enter into both the Forward Contracts and the Stock Loan Contracts and that TAC and DLJ planned to enter into both transactions. But that requirement in no way derogated the independence of the rights and obligations arising under the Forward Contracts and the Stock Loan Contracts, and the record establishes that TAC had ample business reasons to insist on having the right to recall borrowed shares on short notice. Any borrowing of stock by DLJ was terminable at will by either DLJ or TAC.

The Tax Court recognized TAC's explicit, unilateral, and unrestricted contractual rights to make such recalls. (Op. 17-18.) Its disregard of those rights was legal error. What matters for application of the rule of nontaxability for stock lending is the undisputed fact that TAC could recall the shares on short notice, not that it did so or even why it did so. Here the record further demonstrates that TAC not only had recall rights under the Stock Loan Agreements, but it also actually exercised those rights and recovered the borrowed shares. None of the ten Forward Contracts were accelerated, terminated, or altered when TAC recalled the borrowed shares. Likewise, neither TAC nor DLJ treated the presence or absence of borrowings of pledged shares by DLJ as affecting, much less accelerating or terminating, their Forward Contracts.

Once the Tax Court's errors are recognized, this is a simple case. Rev. Rul. 2003-7 mandates the conclusion that the Forward Contracts did not result in sales of borrowed stock. Code sections 1036 and 1058, Treas. Reg. § 1.1001-1(a), Rev. Rul. 57-451, and other authorities mandate that the stock loans were not taxable sales. The Tax Court's contrary conclusion that the stock loans were "sales" cannot be reconciled with these authorities, and its Decisions in these consolidated cases should be reversed.

ARGUMENT

Standard of Review: This Court reviews Tax Court decisions "in the same manner and to the same extent as decisions in the district courts in civil actions tried without a jury." 26 U.S.C. § 7482(a)(1). Thus, this Court reviews the Tax Court's "factual findings for clear error and its rulings of law *de novo*." *Martin v. Comm'r*, 436 F.3d 1216, 1220 (10th Cir. 2006). Where, as in this case, "parties primarily dispute the conclusions the Tax Court drew from the facts" and present questions of contract interpretation, this Circuit reviews "the Tax Court's application of the law to the facts de novo." *Anderson v. Comm'r*, 62 F.3d 1266, 1270 (10th Cir. 1995); *Level 3 Commc'ns, LLC v. Liebert Corp.*, 535 F.3d 1146, 1154 (10th Cir. 2008).

I. UNDER REV. RUL. 2003-7, THE FORWARD CONTRACTS DID NOT EFFECT A SALE IN 2000 OR 2001

Rev. Rul. 2003-7, 2003-1 C.B. 363, establishes that the Forward Contracts in this case did not effect a sale of pledged shares in 2000 and 2001. There, the Appellee Commissioner concluded that a forward contract nearly identical to the ones at issue here did not result in a sale of pledged stock when the contract was executed—and might never result in a sale of pledged shares if the contract was settled with other identical shares or cash.

As set forth in that ruling, a Shareholder of Y corporation entered into a forward contract to deliver publicly-traded shares of Y three years in the future. 2003-1 C.B. at 363. Under the contract, Shareholder received an upfront cash payment from an investment bank. In return, he became obligated to deliver "a number of shares of common stock of Y corporation to be determined by a formula."[25] *Id.* Shareholder pledged the maximum number of Y shares that he could be required to deliver to an independent third-party trustee. Y shares were worth $20 per share at inception of the forward contract. As in this case, Shareholder could settle the forward contracts with pledged Y corporation shares,

[25] Under the formula in the ruling, if the stock price fell, the bank bore all of the risk of loss. The shareholder kept all gain between $20 and $25, and the bank kept all gain above $25.

other Y corporation shares, or cash of equivalent value; he was not, however, required to use pledged shares to satisfy his delivery obligation. *Id*.

The ruling begins by stating that under Code section 1001(c), the entire amount of gain or loss on the sale or exchange of property must be recognized. The ruling observes that the words "sale or exchange" are not defined in the Code and that courts have considered a number of factors in determining whether a sale has occurred.[26] After reviewing *Miami National Bank v. Commissioner*, 67 T.C. 793 (1977), the ruling notes that

> a transfer of actual possession of stock or securities and legal title may not itself be sufficient to constitute a transfer of beneficial ownership when the transferor retains the unrestricted right and ability to reacquire the securities.

2003-1 C.B. at 364. The ruling next analyzes *Richardson v. Commissioner*, 121 F.2d 1 (2d Cir. 1941).[27] Focusing on that case, the ruling concludes that

> even if the shareholder intends to complete a sale by delivering identified stock, that intent alone does not cause a transaction to be deemed a sale [of the identified shares] as long as the taxpayer retains

[26] The regulations under Code section 1001 require an "exchange of property for other property differing materially either in kind or in extent." Treas. Reg. § 1.1001-1(a) (emphasis added). Under the Stock Loan Contracts, the shares that DLJ borrowed from TAC and the shares that DLJ returned to TAC were identical in kind and amount.

[27] In *Richardson*, the court emphasized that until the time of actual delivery, the taxpayer remained free to use shares that he had recently purchased for any purpose and to deliver other shares in satisfaction of his obligation to close his short sale.

> the right to determine whether the identified stock will in fact be delivered.[28]

2003-1 C.B. at 364.

Applying the reasoning of those cases to the forward contract under consideration, the ruling relies on four facts to reach its "no sale" conclusion:

- First, "on the Execution Date, Shareholder received a fixed payment without any restriction on its use and also transferred in trust the maximum number of shares that might be required to be delivered under the Agreement."
- Second, "Shareholder retained the right to receive dividends and exercise voting rights with respect to the pledged shares."
- Third, "legal title to, and actual possession of, the shares were transferred to an unrelated trustee rather than to Investment Bank."
- Fourth, "Shareholder had a right, unrestricted by agreement or economic circumstances, to reacquire the shares on the Exchange Date by delivering cash or other shares."

Id.

Based on these facts, the Commissioner ruled that "the execution of the Agreement did not cause a sale or other disposition of the shares."[29] 2003-1 C.B. at 364. Summarizing its holding, the ruling states:

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[28] Here, the record makes clear, TAC had made no decision through the date of trial about how it would settle the Forward Contracts; all its alternatives, including cash settlement and settlement with shares other than pledged shares, remained available. *See* notes 11 and 14 *above*.

> Shareholder has neither sold stock currently nor caused a constructive sale of stock if Shareholder receives a fixed amount of cash, simultaneously enters into an agreement to deliver on a future date a number of shares of common stock that varies significantly depending on the value of the shares on the delivery date, pledges the maximum number of shares for which delivery could be required under the agreement, retains an unrestricted legal right to substitute cash or other shares for the pledged shares, and is not economically compelled to deliver the pledged shares.

Id. at 365. TAC had all these rights under the Forward Contracts.[30] TAC also was not economically compelled to deliver pledged shares to settle the Forward Contracts. (Tr. 106:4-22.)

Under the ruling, a sale of stock would occur only if and when shares are actually delivered in settlement of the forward contract, with the result that a sale of shares could not occur before the settlement date—and would not occur even then if the shareholder elected to settle the contract with cash.[31] Accordingly,

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[29] The ruling also stated that the variability in the number of shares to be delivered provided sufficient risk such that the constructive sale rules of Code section 1259 were not applicable. The Tax Court agreed that the Forward Contracts in this case had a similar variable delivery obligation at maturity and did not trigger Code section 1259 (Op. 58-59), and the Commissioner has not appealed.

[30] For pledged, but unborrowed, shares, TAC had voting rights and was paid all dividends. As discussed in the next section, for borrowed shares, TAC received substitute payments from DLJ equal to dividends paid on borrowed shares, and could vote borrowed shares if it recalled them. This ability to recall on short notice to vote on significant matters was important to TAC's business. (Tr. 76:4-6, 128:14-23, 224:15-225:3.)

[31] In addition, in any stock sale, whether at maturity of a forward contract or otherwise, the taxpayer has the right to identify the shares being delivered, *i.e.*,

(cont'd)

the Forward Contracts, like the forward contract at issue in the Rev. Rul. 2003-7, did not result in a sale at inception. Indeed, neither the Commissioner (in his determinations of deficiencies in this case) nor the Tax Court (in its decision) treated unborrowed shares as if they were sold in 2000 and 2001 even though such shares were also pledged under the same Forward Contracts. (Op. 30.)

The only significant difference between the facts described in Rev. Rul. 2003-7 and the facts of this case is that TAC also entered into the Stock Loan Contracts with DLJ and, pursuant to those contracts, DLJ borrowed pledged shares during a portion of the time the Forward Contracts were outstanding. That difference from the ruling could not transform the Forward Contracts into taxable sales.

II. TAC'S LOANS OF PLEDGED STOCK TO DLJ WERE NEITHER SALES OF THOSE SHARES NOR DELIVERIES UNDER THE FORWARD CONTRACTS

Given the long-standing authorities mandating that stock loans are nontaxable, the fact that TAC also made stock loans to DLJ from pledged shares cannot result in a sale of the loaned shares.

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to designate the particular lot of shares (with a specific cost basis and holding period) being delivered, and an adequate identification of the shares delivered is determinative for purposes of tax basis and holding period. Treas. Reg. § 1.1012-1(c)(2).

A. Stock Loans Are Essential to the Functioning of the Securities Markets

Financial markets have relied on share lending to provide much-needed market liquidity for more than one hundred years. In enacting section 1058, Congress found that "loans of securities can have a favorable impact on the liquidity of securities markets." S. Rep. No. 95-762, 95th Cong., 2d Sess. (Apr. 25, 1978) (hereinafter "Senate Report"), 1978-2 C.B. 357, 360 (Att. A-74). Over time, investors such as mutual funds and non-profit entities with large blocks of publicly traded stock in their endowment funds loaned those shares (which they intended to hold for many years) to increase their return. This stock lending increased market liquidity by providing a means to avoid failed deliveries and to facilitate hedging transactions, thereby contributing to the efficient functioning of the stock market.

The Supreme Court analyzed securities lending more than 80 years ago in *Provost v. United States*, 269 U.S. 443 (1926). There, the Court explained that stock lending makes short sales possible.

> The loan of stock is usually, though not necessarily, incidental to a "short sale." As the phrase indicates, a short sale is a contract for the sale of shares which the seller does not own or the certificates for which are not within his control so as to be available for delivery at the time when, under the rules of the Exchange, delivery must be made. Under the rules of the New York Stock Exchange, applicable so far as the facts of this case are concerned, a broker who sells stock is required to make delivery of the certificates on the next business day. If he does not have them available, he must procure them for the purpose of making delivery. This he may do by purchasing or

> borrowing the required shares, delivery of the certificates to be made to the broker to whom he has already contracted to sell.

Id. at 451.

Provost also established that all stock loans entail the temporary loss by the lender of incidents of ownership of the shares borrowed, including legal title, rights to receive dividends and distributions from the stock issuer, and voting rights.[32] To maintain the lender's economic position with respect to the loaned shares, the borrower must make "substitute payments" equal to dividends or other distributions made with respect to the loaned shares. But during the pendency of the stock loan, the stock lender does not have title to the shares that have been loaned and cannot vote them. Instead, the lender possesses the borrower's contractual obligations (i) to return the borrowed shares on short notice, (ii) to make substitute payments equal to dividends, and (iii) in some instances, to pay a borrowing fee to the lender.

B. Stock Loans Are Not Taxable Sales

The Senate Report on the addition of section 1058 to the Code, 1978-2 C.B. at 359, recognized that stock loans had been treated as nontaxable transfers for many years. That report specifically cited Rev. Rul. 57-451, 1957-2 C.B. 295,

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[32] "The procedure adopted and the obligations incurred in effecting a loan of stock and its delivery upon a short sale neither contemplate nor admit of the retention by either the borrower or the lender of any of the incidents of ownership in the stock loaned." 269 U.S. at 455.

and a widely-publicized letter ruling that the Commissioner issued to the New York Stock Exchange in 1948 as authorities evidencing such long-standing nontaxable treatment.[33] In Rev. Rul. 57-451, the Commissioner concluded that no taxable disposition of loaned common stock occurred where the borrower returned "certificates representing shares of stock of such kind and amount as to bring the then-completed exchange within the scope of section 1036 of the Code." 1957-2 C.B. at 296. Code section 1036 provides that no gain or loss is recognized "if common stock in a corporation is exchanged solely for common stock in the same corporation," while Treas. Reg. § 1.1036-1(a) clarifies that an exchange between individual stockholders is also covered by the provision. (Att. A-69.) Rev. Rul. 57-451 concluded a loan of common shares of a corporation followed by a return of the same number of common shares of the same company qualified for non-recognition for tax purposes under Code section 1036. As in Rev. Rul. 57-451, all

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[33] The 1948 ruling held that securities lending "is not a disposition of property which results in recognized gain or loss for federal income tax purposes; and that such a transaction does not affect the lender's basis for the purpose of determining gain or loss upon the sale or the disposition of the stock, nor the holding period of the stock in the hands of the lender." The 1948 ruling was published by both major tax services. *See* 5 CCH 1948 Stand. Fed. Tax Rep. ¶ 6136; 6 P-H 1948 Fed. Taxes ¶ 76,270; Senate Report, 1978-2 C.B. at 359. Under section 6110(k)(3), private letter rulings are not precedential authority; however, *Rowan Cos. v. United States*, 452 U.S. 247, 261 n.17 (1981), explains that although letter rulings have no precedential force, they can be used to interpret later Congressional action.

of the Reference Company shares subject to the Forward Contracts were common shares. (Op. 20, 21, 24.)

Treas. Reg. § 1.1001-1(a) requires that a taxable exchange of property must involve the receipt of other property "differing materially either in kind or in extent" to result in a taxable sale. I.R.S. General Counsel Memorandum 36,948 (Dec. 10, 1976), *available at* 1976 WL 39184,[34] explained the application of this provision to a securities loan:

> We agree that the transfer of securities [pursuant to a securities loan] may not be a taxable disposition, but it is in any event a disposition and not a loan. When the transferor is a taxable entity, the disposition will be nontaxable if, as in the usual case, the transferee satisfies its obligation by delivering to the transferor securities not differing materially in kind or extent.

G.C.M. 36,948 went on to state that the disposition "will still be nontaxable if stock is involved and Int. Rev. Code of 1954 § 1036 is satisfied." Although the foregoing authorities establishing the nontaxability of stock loans retain their vitality today and were cited to the Tax Court, its opinion does not discuss them or

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[34] General counsel memoranda ("G.C.M.") "are legal memoranda from the Office of Chief Counsel to the IRS prepared in response to a formal request for legal advice from the Assistant Commissioner (Technical)." *Tupper v. United States*, 134 F. 3d 444, 448 (1st Cir. 1998). While Code section 6110 limits the precedential authority of G.C.M.s, such memoranda "may be relevant . . . as indicating the IRS interpretation of its own regulations and procedures." *Vons Cos. v. United States,* 51 Fed. Cl. 1, 12 (2001).

explain why that Court disregarded them. (Petitioners' Post-Trial Brief dated April 27, 2009, Nos. 18942-07, 19083-07, at 74-78, 134.)

C. Code Section 1058's Safe Harbor Applies to the Stock Loans and Confirms that They Are Not Taxable

In the late 1970s, the Service started declining "to issue rulings as to whether a securities lending transaction constitutes a sale or exchange or whether the transaction interrupts the lender's holding period." Senate Report at 359. Congress responded swiftly to protect securities lending from taxation by enacting a safe harbor from taxable sale treatment in Code section 1058.[35] The Senate Report clearly articulated the Congressional purpose for adding Code section 1058:

> The amendment provides that the lending of securities to a broker and the return of identical securities does not constitute a taxable sale or exchange of the securities and thus does not interrupt the lender's holding period or affect the lender's basis.

Senate Report at 358.

Code section 1058 did not displace existing law discussed in section II.B above; rather, it was an additional safe harbor that Congress added to reinforce the protection of securities lending from tax liability. Under Code section 1058, a

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[35] Securities lending includes much more than loans of common stock. While section 1036 assures tax-free treatment on the exchange of common or preferred stock of the same corporation, its reach is limited to exchanges of the same class of stock. Accordingly, the enactment of section 1058 clarified that the exemption from recognition of gain or loss includes lending of any security (*e.g.*, corporate and government bonds).

securities loan is not treated as a taxable sale if it meets three requirements set forth in Code section 1058(b)(1)-(3):[36]

> (b) In order to meet the requirements of this subsection, an agreement shall—
>
> > (1) provide for the return to the transferor of securities identical to the securities transferred;
> >
> > (2) require that payments shall be made to the transferor of amounts equivalent to all interest, dividends, and other distributions which the owner of the securities is entitled to receive during the period beginning with the transfer of the securities by the transferor and ending with the transfer of identical securities back to the transferor; [and]
> >
> > (3) not reduce the risk of loss or opportunity for gain of the transferor of the securities <u>in the securities transferred</u>.

(Emphasis added.)

In addition to meeting the requirements of Code section 1036 and Treas. Reg. § 1.1001-1(a) for nontaxability (discussed on pages 41-44 *above*), the Stock Loan Contracts in this case also met all of the requirements of section 1058. Under the Stock Loan Contracts, DLJ was required to (and actually did) return shares to TAC identical to the ones it had borrowed. DLJ was required to (and actually did) make payments to TAC equal to any dividends or distributions on the borrowed shares. Because (i) DLJ was obligated to return to TAC unencumbered

[36] Code section 1058(b)(4) allows the Secretary of the Treasury to add additional requirements through regulation, but the Secretary has not done so.

shares identical to the ones it had borrowed, and (ii) TAC could settle the Forward Contracts with other shares or cash, TAC's risk of gain or loss in shares that DLJ borrowed was unaffected by DLJ's stock borrowing. Code section 1058(b)(3) requires that there be no reduction in "the risk of loss or opportunity for gain of the transferor of the securities in the securities transferred"—here, the borrowed shares. Neither the Commissioner nor the Tax Court has identified any such "reduction" with respect to borrowed shares.

The Tax Court recognized that Code section 1058 was a "safe harbor" but said that TAC's stock loans were outside it. (Op. 50.) The Tax Court erroneously concluded that the Master Agreement "eliminated TAC's risk of loss with regard to the lent shares." (Op. 48.) The Stock Loan Contracts required DLJ to return "free shares" (which the Stock Loan Contracts defined as unrestricted and unencumbered shares) to TAC on recall and thus did not impose any such restriction. (Tr. 105:4-10; Exs. 39-P-41-P at §§ 3, 6, 18.) Neither the Forward Contracts nor any other agreement between TAC and DLJ imposed such a restriction. (Tr. 210:22-25, 288:10-23.)

The Tax Court focused on the fact that even if the values of UPR, APC, and UPC stock dropped to $1 a share, TAC would not have to give back any portion of the upfront 75% Payments (Op. 49), but that was also the case with the forward contract in Rev. Rul. 2003-7 where the Commissioner acknowledged that

no sale occurred. Even had such a hypothetical price drop occurred, TAC had no obligation to deliver pledged shares to DLJ. The Tax Court also identified the "downside protection threshold" term in the Master Agreement governing the Forward Contracts as causing the Stock Loan Contracts to violate Code section 1058(b)(3) because that Court misconstrued that contract term as limiting TAC's risk on borrowed shares. But the contract term "downside protection threshold price" forms part of the definition of what DLJ, not TAC, will receive at maturity. The Court got it exactly backwards.[37]

While the Forward Contracts certainly created future economic obligations for TAC, those obligations did not limit its risk of loss or opportunity for gain in the pledged shares (which included all borrowed shares) in any way because TAC was not obligated to use those shares to satisfy the Forward Contracts at maturity. If TAC made a cash settlement at maturity of a Forward Contract, it would deliver no shares at all. Indeed, absent a decline in pledged

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[37] The Tax Court said that the "downside protection threshold price is so named because it represents the lowest value that TAC could receive for its shares on the settlement date." (Op. 15 (emphasis added).) TAC received the 75% Payment at inception of each Forward Contract and that is all it would ever receive from DLJ under that Forward Contract. The "downside protection threshold price" contract term determined what DLJ, not TAC, would receive at maturity; if the maturity date price was at or below that level (100% of the execution date value, with possible adjustments), TAC was obligated to deliver the maximum number of Reference Company shares (or their cash equivalent). (*See* Ex. 9-P at § 2.01(b)(i)-(iii) at AC0000015-16.)

share value at maturity below TAC's very low cost basis in such shares, it would always be to TAC's advantage to settle the Forward Contracts at maturity either by delivering cash or other shares with a higher basis (*i.e.*, recently purchased shares).[38] The Tax Court misapplied Code section 1058(b)(3) because it treated the Forward Contracts (not the Stock Loan Contracts) as limiting TAC's risk of loss and opportunity for gain in shares that DLJ borrowed. But even the Forward Contracts imposed no such restriction because they never required settlement with pledged shares at the maturity dates.

III. THE TAX COURT'S OPINION MISCONSTRUES THE CONTRACTS

The Tax Court analyzed the Master Agreement as a "whole" in which TAC "transferred the benefits and burdens of ownership, including: (1) Legal title to the shares; (2) all risk of loss; (3) a major portion of the opportunity for gain; (4) the right to vote the stock; and (5) possession of the stock." (Op. 46.) But the Tax Court failed to explain why these factors made the stock loans in this case taxable since rights (1), (4), and (5) are transferred to the borrower by <u>every</u> stock lender

[38] Consider again the hypothetical forward contract described in note 12 above. Suppose the pledged shares of X Corp. had a basis of $1 per share. In Scenario 1, if TAC delivers 100 pledged shares of X Corp. at maturity, it would recognize a taxable gain of $650 ($750 proceeds - $100 basis for 100 shares). If instead, TAC delivers 100 shares of X Corp. that it purchases in the market shortly before maturity at $7 per share—or if it simply delivers in cash the maturity date value of 100 shares ($700), its taxable gain would instead be $50 ($750 proceeds - $700 in stock with a $700 cost basis or cash delivered).

for the period of the loan in every stock loan.[39] *Provost v. United States*, 269 U.S. 443, 455 (1926); *see* note 30 *above*.

As to items (2) and (3), neither the Stock Loan Contracts nor the Forward Contracts contained any provision that limited TAC's opportunity for gain or risk of loss in borrowed shares. DLJ was obligated to return (and did return), at TAC's demand, every share it borrowed without any restriction or encumbrance. (Exs. 39-P-41-P at §§ 3, 6, 18.) The Tax Court apparently looked to the Forward Contracts instead of the Stock Loan Contracts for the gain and loss limitations to which it refers. But neither the Forward Contracts nor the Stock Loan Contracts required TAC to deliver the pledged shares (whether or not borrowed) at maturity to satisfy any of the Forward Contracts.[40] Thus, no

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[39] In the Tax Court's summary of the Commissioner's argument (but not in its own analysis) (Op. 35-36, 44-50), the Tax Court cited twelve factors for "determining whether a transaction transfers the accoutrements of stock ownership" listed in *Dunne v. Commissioner*, T.C. Memo. 2008-63. But those factors have nothing to do with the resolution of this case because a stock lender always loses the incidents of stock ownership when its stock is borrowed. The law is clear that this does not make a stock loan a taxable transfer.

[40] In addition to depriving TAC of its contract rights, the Tax Court's treatment of DLJ's borrowings as "sales" under the Forward Contracts ignored TAC's right under Treas. Reg. § 1.1012-1(c) to specify which of its shares are to be delivered at settlement (if it were to choose to settle with shares rather than cash). The Forward Contracts did not limit the risk of gain or loss in pledged shares because TAC had the right to deliver other shares (or cash) when it settled the Forward Contracts.

agreement restricted TAC's risk of loss or opportunity for gain in pledged shares.[41] *See* II.C *above*.

The Tax Court's conclusion that TAC "sold" pledged shares to DLJ when DLJ borrowed shares from TAC during 2000 and 2001 rests on faulty premises and is contradicted by its own findings. The Tax Court acknowledged that TAC's delivery obligations at maturity under the Forward Contract could vary by as much as 33%. (Op. 59.) It also acknowledged that the transactions between DLJ and TAC "called for share lending." (Op. 44.) But if DLJ's borrowings were "deliveries" in settlement of the Forward Contracts, no variability could have remained after those borrowings occurred in 2000 and 2001. Instead, TAC would have made an extraordinarily bad business deal: it would have sold about 95% of the pledged shares for 75% of their value just three to nine weeks into multi-year

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[41] The Tax Court cited its decision in *Samueli v. Comm'r*, 132 T.C. 37 (2009), (Op. 45-46) as supporting its decision that the contracts in this case, considered as a "whole," limited TAC's gain and loss in pledged shares. In *Samueli*, the Tax Court considered a loan of Treasury bonds that the loan document provided could be terminated on only three days out of the loan's 450-day term. The Tax Court held that this restriction was inconsistent with Code section 1058(b)(3) because it limited the lender's opportunity for gain or loss in the securities. *Samueli* does not support the Tax Court's analysis here. Moreover, Code section 1036 did not apply in that case because the borrowed securities were not common shares.

forward contracts.[42] The Tax Court itself acknowledged that no such settlement had occurred by reason of DLJ's borrowings when it stated that whether TAC "will ever receive that value [from DLJ] will not be determined until the contracts are settled."[43] (Op. 51.) But, if DLJ's borrowings in 2000 and 2001 were really "deliveries" under the Forward Contracts, there would have been nothing left to settle in 2009 and 2010.

Treating transfers in 2000 and 2001 to DLJ that the Tax Court acknowledged were stock loans (and which both TAC and DLJ consistently treated as such) as taxable sales is contrary to Code sections 1036 and 1058 as well as Treas. Reg. § 1.1001-1(a). It is also directly contrary to the parties' agreements and conduct. DLJ counted on the Forward Contracts enduring until their scheduled maturities so that it could profit from adjusting its hedges over that period. DLJ did not treat the Forward Contracts as "settled" in 2000 and 2001. (Tr. 289:3-12.)

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[42] The Tax Court and the Commissioner erroneously treat the 5% prepaid borrowing fee as part of the putative "sale" proceeds in 2000 and 2001 raising the payments from 75% to 80%. Neither accounts for the return of the unearned portions of the fee when borrowed shares were recalled. (Op. 10, 18.)

[43] Here again, however, the Tax Court demonstrates its misunderstanding of the parties' agreements. DLJ had no delivery obligations to TAC when the Forward Contracts matured in 2009 and 2010; its 75% Payments made at the inceptions of the Forward Contracts were the only payments it owed TAC under these contracts. Thus there was nothing that TAC could or would receive from DLJ at maturity of the Forward Contracts. What remained variable until the 2009 and 2010 maturity dates was the number of Reference Company shares that TAC was obligated to deliver to DLJ (or their cash equivalent).

DLJ certainly did not agree to accept TAC's delivery of borrowed shares as a "settlement" of the Forward Contracts that would terminate TAC's future delivery obligations. TAC could recall those shares at will (and did recall them well before the Forward Contracts matured). *See* pages 25-27 *above*. The Tax Court neither identified any legal basis for treating shares loaned as shares sold nor explained how TAC's obligations to make future deliveries to DLJ—which it acknowledged (Op. 51, 59)—could continue to exist if TAC sold shares under the Forward Contracts in 2000 and 2001.

The Tax Court's observations that share lending was "vital" (Op. 45) and that the Forward Contracts "could not occur without" share borrowing by DLJ (Op. 50) are irrelevant. The legally relevant facts are (i) that DLJ could readily borrow from market sources the shares it needed for its hedge (Op. 19 n.6), (ii) that DLJ did not have to borrow any shares from TAC at all, as illustrated by the substantial periods during the terms of Forward Contracts when DLJ borrowed no shares from TAC (Tr. 130:10-131:2, 296:7-17, 298:13-299:3), and (iii) if DLJ did borrow shares from TAC, TAC had the unilateral right to recall those shares on short notice (Tr. 128:7-13 (TAC had "an unfettered right to recall the shares at any time, for any reason.").) The presence or absence of borrowing had no effect on the Forward Contracts. *See* note 20 *above*.

The Tax Court conceded that TAC could and did recall all the shares that DLJ borrowed but it disregarded the recalls because, in its view "the recalls were accomplished only to influence the tax analysis."[44] (Op. 47.) But a proper federal tax analysis must first properly discern the nature of the parties' property rights and that determination here is a matter of contract law. "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed." *Morgan v. Comm'r*, 309 U.S. 78, 80 (1940).[45] Misreading the contract rights as the Tax Court has done ineluctably results in erroneous federal tax conclusions. According to the Tax Court, once TAC lent shares to DLJ, "those lent shares were gone and could not be recovered." (Op. 47.) That is directly contrary to what § 6 of each Stock Loan Contract provided. (Exs. 39-P-41-P.) TAC had the contractual right to recall borrowed shares, and it exercised that right. The record is devoid of evidence that would permit the Tax Court to derogate the parties' contract rights. Moreover, the record establishes that

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[44] The Tax Court dismissed Forward Contracts without borrowing by DLJ as a "hypothetical transaction . . . not before the Court" (Op. 50), but the record establishes that all the Forward Contracts were in full force and effect during significant periods of time during which there were no stock loans. Thus the existence of the Forward Contracts without stock loans is not at all "hypothetical" in this case.

[45] *See also Drye v. United States*, 528 U.S. 49, 58 (1999) (quoting *Morgan*); *In re Krause*, No. 10-3012, ___ F.3d ___, 2011 WL 1206178, at *2 (10th Cir. Apr. 1, 2011) (quoting *Drye* quoting *Morgan*).

TAC did recover all the shares that DLJ borrowed in the same way that any other stock lender recovers lent shares—by requiring redelivery of identical shares. *See, e.g.*, Code section 1058(b)(1) and Rev. Rul. 57-451.

The Tax Court then said that "[t]he transaction documents support a finding that the share recalls were really TAC borrowing shares from DLJ." (Op. 48.) But this pronouncement is not based on any evidence; no provision in any transaction document supports that assertion, and the Court identified none. Instead, the Stock Loan Contracts and record make clear that, after recall, TAC had no obligation to deliver the recalled shares back to DLJ (nor does any other transaction document create such an obligation). No recalled shares were reloaned to DLJ. (Tr. 298:9-12, 310:6-312:7.)

CONCLUSION

The Forward Contracts are nontaxable under Rev. Rul. 2003-7. DLJ's borrowings of shares are likewise not taxable to TAC under Code sections 1036 and 1058 and Treas. Reg. § 1.1001-1(a). As the Tax Court itself recognized (Op. 51, 59), nothing that occurred in 2000 or 2001 "settled" TAC's 2009 and 2010 delivery obligations under the Forward Contracts. At the inceptions, TAC and DLJ contemplated executing both the Forward Contracts and Stock Loan Contracts; later, DLJ borrowed most of the shares that TAC pledged under the Forward Contracts, but those facts do not change either result: neither execution of the

Forward Contracts nor TAC's stock loans to DLJ were taxable. The parties' rights and obligations under the Stock Loan Contracts met all the statutory and regulatory requirements for nontaxability. TAC was never obligated to deliver the pledged shares to settle the Forward Contracts; consequently, the Forward Contracts restricted neither TAC's risk of loss nor its opportunity for gain in borrowed shares. TAC's recalls of borrowed shares did not affect, modify, alter, accelerate, or terminate any Forward Contract.

None of the transactions between TAC and DLJ in 2000 or 2001 resulted in taxable sales by TAC of borrowed stock in those years because all those transactions were not taxable under Rev. Rul. 2003-7 or the stock loan authorities. Accordingly, Appellants Anschutz Company and Philip and Nancy Anschutz respectfully request that this Court reverse the Decisions of the Tax Court.

STATEMENT OF COUNSEL AS TO ORAL ARGUMENT

Given the importance of this case to Appellants, and the impact the case has on the securities lending industry, counsel believes that oral argument would be helpful to the Court in this case.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the foregoing brief complies with the word limit set forth in Fed. R. App. P. 29(d) and 32(a)(7)(B) because, according to the word count feature of Microsoft Word 2003, the brief contains a total of 13,814 words, excluding the sections listed in Rule 32(a)(7)(B)(iii). I further certify, pursuant to Tenth Circuit Rule 32(a), that the foregoing brief has a typeface of 14 points.

DATED: April 29, 2011

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CERTIFICATE REGARDING PRIVACY REDACTION AND VIRUS SCAN

I hereby certify that a copy of the foregoing brief, as submitted in Digital Form via the court's ECF system, has been scanned for viruses with the Trend Micro OfficeScan version 10.0 Service Pack 1, Virus Pattern 8.125.00 dated April 28, 2011, and, according to the program, is free of viruses. In addition, I certify that no privacy redactions were required.

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing brief will be served through the CM/ECF system and by first class mail on the following counsel of record for Respondent-Appellee on April 29, 2011.

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