Nos. 11-9001 & 11-9002

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

ANSCHUTZ COMPANY; PHILIP F. ANSCHUTZ;
NANCY P. ANSCHUTZ,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISIONS OF THE
UNITED STATES TAX COURT (Judge Joseph R. Goeke)

ORAL ARGUMENT IS REQUESTED

BRIEF FOR THE APPELLEE

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ACRONYM GLOSSARY

DLJ	Donaldson Lufkin & Jenrette Securities Corp.
IRS	Internal Revenue Service
TAC	the Anschutz Corp.
VPFC	variable prepaid forward contract

STATEMENT OF RELATED CASES

Pursuant to 10th Cir. Rule 28.2(C)(1), counsel for the Commissioner hereby state that they are not aware of any related cases before this Court.

STATEMENT OF THE ISSUE

Whether the Tax Court correctly found that taxpayers' transfer of stock was a sale for federal income tax purposes.

STATEMENT OF THE FACTS

A. Background

This case concerns a transaction that has been marketed to wealthy taxpayers (such as taxpayers[1] and amicus Liberty Media) as a method for monetizing appreciated stock without triggering the tax that would be due if the stock was transferred in a straightforward sale. The transaction has two primary components: a prepaid variable forward contract (PVFC) and a share-lending contract. In a stand-alone PVFC, the forward-seller receives a lump-sum payment (representing the bulk of the stock's current value) in exchange for the promise to deliver a variable amount of the stock at issue at a future settlement date. Generally, a forward-purchaser does not gain possession of the stock until the settlement date. In a stand-alone share-lending contract, a stock owner lends stock in exchange for cash

[1] Taxpayers are Philip Anschutz and his wholly owned company, Anschutz Co. Nancy Anschutz is a party solely because she filed a joint tax return with Philip Anschutz.

collateral and the contractual promise by the borrower to return the stock. The transaction in this case combined the forward and share-lending contracts so that the forward-purchaser/stock-borrower gained use and possession of the stock at the beginning of the transaction, and the forward-seller/stock-lender obtained a cash payment in lieu of cash collateral. The central issue is whether taxpayers transferred ownership of the stock when they delivered the shares to the forward-purchaser.

To determine ownership of stock for tax purposes, courts have examined all the facts and circumstances, focusing on who had (i) title; (ii) possession; (iii) the right to vote; (iv) the "risk of decreased value"; and (v) "the benefit of increased value of the securities." *Cruttenden v. Commissioner*, 644 F.2d 1368, 1374-1375 (9th Cir. 1981). Applying this test (referred to as the benefits-and-burdens test) to a PVFC, the IRS has ruled that such a contract did not constitute a current sale, because the shares that were pledged to secure the taxpayer/forward-seller's contractual obligation were not delivered to the forward-purchaser until the contract settled. Rev. Rul. 2003-7, 2003-1 C.B. 363, 363-364 (citing *Cruttenden*). The ruling warned taxpayers, however, that a

"different outcome" might be reached if the taxpayer was required to "deliver pledged shares" to the forward-purchaser. *Id*. at 364. Accordingly, a few years after Revenue Ruling 2003-7 was issued, the IRS clarified that VPFCs that incorporated share-lending arrangements would result in a current sale of the subject shares. IRS Coordinated Issue Paper — Variable Prepaid Forward Contracts Incorporating Share Lending Arrangements (Feb. 6, 2008), available at 2008 WL 852615.[2] As the IRS explained, the share-lending arrangement required the taxpayer to deliver the pledged shares to the forward-purchaser who thereby attained substantial indicia of stock ownership (including risk of loss and opportunity for gain). *Id*.

B. The parties

Philip Anschutz is a successful businessman who, in the late 1990s, began investing in real estate and entertainment ventures.

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[2] The IRS issues Coordinated Issue Papers to provide guidance regarding "complex and significant industry wide issues." *Sugarloaf Funding, LLC v. Dep't of the Treasury*, 584 F.3d 340, 343 n.3 (1st Cir. 2009) (citation omitted).

(Op5.)[3] Mr. Anschutz needed substantial amounts of cash to fund those ventures. (*Id.*)

To obtain that cash, Mr. Anschutz decided to use appreciated stock that was owned by one of his companies, the Anschutz Corp. (TAC), a wholly owned subsidiary of Anschutz Co. (Op3-6.) TAC held large blocks of stock that had extremely low bases and would, if sold, generate enormous capital gains. (Op5, 30.) Those capital gains would be subject to both a corporate-level tax owed by Anschutz Co., and an individual tax owed by Mr. Anschutz. Normally, an S corporation (like Anschutz Co.) and its qualified subsidiaries (like TAC) are not subject to federal income tax. § 1363(a). Like partnerships, the income and loss of S corporations generally flow through to their shareholders. If a C corporation converts to S-corporation status, however, and holds appreciated assets at the time of its conversion, then the corporation is

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[3] "Op" refers to the Tax Court's opinion (attached to taxpayers' brief). "Br" refers to taxpayers' brief. "AmBr" refers to amicus Liberty Media's brief. "Doc." refers to the documents in the original record as numbered by the Clerk of the Tax Court. "Tr" refers to the trial transcript. "Ex" refers to the trial exhibits. "Stip." refers to the Stipulated Facts (Doc. 12, 24, 25). All "§" references are to the Internal Revenue Code of 1986 (26 U.S.C.) as in effect during the years at issue. All dollar figures are approximations.

liable for a corporate-level tax to the extent of any built-in gain. § 1374(a). That tax applies to built-in gain recognized during the 10-year period following the corporation's conversion to an S corporation. § 1374(d)(7). Anschutz Co. converted from a C corporation to an S corporation on August 1, 1999, and, at the same time, elected to treat TAC as a qualified subchapter S subsidiary. (Stip. ¶¶ 9-10.) If TAC's appreciated stocks were sold before the 10-year period under § 1374(d)(7) expired, then Anschutz Co. would be liable for the corporate-level tax on the resulting built-in gain. The parties agree that if (as the Tax Court found) TAC sold stock in 2000-2001, then a corporate-level tax would properly be imposed on Anschutz Co. for the net recognized built-in gains arising from those sales, and an individual-level tax would properly be imposed on Mr. Anschutz for the flow-through gains. (Op33-34.)

To avoid the corporate-level tax, and defer the individual-level tax, taxpayers pursued a plan to monetize the appreciation in TAC's stock by engaging in a transaction that purported to be something other than a current sale. (Op6; Tr68-69, 196-197; Exs6, 103.) The transaction was presented to taxpayers by Donaldson Lufkin &

Jenrette Securities Corp. (DLJ), an investment bank.[4] (Op5-6; Stip. ¶ 49; Ex6.) To monetize the gain inherent in TAC's appreciated stock holdings, TAC entered into long-term sale and lending transactions with DLJ, memorialized by a Master Stock Purchase Agreement. (Op6; Exs9, 103.)

C. Master Stock Purchase Agreement

The Master Stock Purchase Agreement between TAC (as seller) and DLJ (as buyer) was entered into on May 9, 2000. (Op13; Ex9.) It provided for the establishment of stock transactions whereby TAC would (i) receive an up-front cash payment in exchange for its obligation to deliver a variable amount of securities at a future maturity date (VPFC), (ii) pledge as collateral for that obligation the maximum number of shares that TAC would have to deliver on the maturity date (Pledge Agreement), and (iii) loan the pledged shares to DLJ until the maturity date (Share Lending Agreement). (Exs6, 9.) The VPFCs were designed to mature on various dates in 2009 and

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[4] A subsidiary of DLJ was TAC's counter-party in the stock transactions. In 2000, DLJ was acquired by Credit Suisse First Boston. (Stip. ¶ 47.) For simplicity, we (like the Tax Court and taxpayers) refer to DLJ, its subsidiaries, and its successor-in-interest as DLJ.

2010, all after the expiration date of the 10-year period during which Anschutz Co. would be liable for the corporate-level tax on the stock's built-in gain. (Stip. ¶ 10; Ex114.)

Pursuant to the Master Stock Purchase Agreement, the parties established three stock transactions, each with its own VPFC Transaction Schedule, Pledge Agreement, and Share Lending Agreement (the Stock Transactions, described below).[5] (Stip. ¶¶ 50-105.) The Master Stock Purchase Agreement attached a form Transaction Schedule, Pledge Agreement, and Share Lending Agreement as exhibits, and, once they were executed, they "amended and supplemented" the Master Stock Purchase Agreement. (Ex9 §§ 4.01(b)-(f), (l)(4)-(6), 5.01(g)(i), (v), 8.01(c)-(e), exhibits A-D.)

The separate components of the Master Stock Purchase Agreement could not exist without each other. The VPFCs were not effective until the parties entered into the Pledge Agreement; and the Pledge Agreement, in turn, required the parties to enter into the Share

[5] The three Stock Transactions were further broken down into ten tranches, each with its own Pricing Schedule and Notice of Borrowing. (Op12.)

Lending Agreement. (Op44-45; Tr143-144; Ex9 § 5.01, exhibit C § 2.01(e).)

1. VPFCs

The VPFCs were implemented through the Master Stock Purchase Agreement (which contained the general terms that governed all of the VPFCs), three supplementary Transaction Schedules, and ten Pricing Schedules (which set the specific terms, such as price and maturity date, for each VPFC). (Op12-16.) The VPFCs required TAC to deliver to DLJ a variable number of shares (within a defined range) on a future maturity date in exchange for DLJ providing TAC an up-front cash payment. (Op9.) The up-front payment that DLJ paid TAC equaled 75 percent of the fair market value of the maximum amount of stock subject to each contract. (Op16.) To settle the VPFCs, TAC could use the pledged shares in the collateral accounts (described below), identical shares, or (for one of the ten tranches) cash. (Op21, 24, 29; Tr108, 214.)

To establish the pricing used in the transactions, DLJ was required to execute short sales of the stock at issue. (Op14; Stip. ¶ 140.) To do so, DLJ borrowed shares of the stock from an unrelated

third party and sold them in the open market. (Op18-19; Stip. ¶ 141.) When planning the transactions, the parties understood that DLJ would use the shares that it borrowed from TAC through the Share Lending Agreements (described below) to close the short sales. (Op45; Ex6; Tr247-249.)

The average price per share that DLJ received on its short sales was used to establish the amount of TAC's up-front payment for the stock. The amount of the up-front payment was calculated by multiplying the average price by the maximum number of shares subject to each transaction and then computing 75 percent of that sum. (Op16; Exs11,12, 18.) For example, if the average price that DLJ received was $50 and there were 1 million shares at issue, the up-front payment would be calculated as follows: ($50 x 1 million) x .75 = $37.5 million.

The average price that DLJ received on its short sales was also used to determine how many shares DLJ would be entitled to when the VPFCs settled. That determination was based on a formula in the Master Stock Purchase Agreement, and (depending on the stock's value on the settlement date) could range from the maximum number of

shares at issue to an amount that was a third less than the maximum. (Op27-28; Ex9 §§ 2.02, 3.01; Ex114.) To set that range, the settlement formula established (i) the Downside Protection Threshold Price for the shares, which was equal to the average price that DLJ received on its short sales at the beginning of the transaction, and (ii) the Threshold Appreciation Price, which was equal to 150 percent of the Downside Protection Threshold Price. (Op15.)

The Downside Protection Threshold Price represents the lowest value that TAC could receive for its shares on the settlement date, and thus locked in a value per share that TAC would get credit for when the VPFCs settled. (Op15, 28, 49; Ex32.) For example, if the average price per share that DLJ received on the short sales for a certain stock was $50, then, 10 years later, on the settlement date, each share of stock would be deemed to be worth at least $50, even if the stock's actual value had plummeted to $1. In that circumstance, and for any situation where the stock's value at settlement was at or below the Downside Protection Threshold Price, DLJ was entitled only to the maximum amount of shares at issue and was not entitled to a return of

any portion of the up-front cash payment it had provided TAC at the beginning of the transaction. (*Id.*; Ex6; Tr97.)

If the stock appreciated above the Downside Protection Threshold Price, the settlement formula permitted TAC to enjoy a limited amount of the appreciation. Pursuant to that formula, TAC was entitled to receive the first 50 percent of the appreciation, and the remaining appreciation would accrue to DLJ. (Op9, 15-16; Ex9 §§ 2.02, 3.01.) If the stock's value on the settlement date was between the Downside Protection Threshold Price and the Threshold Appreciation Price, then TAC would be entitled to a number of shares that would be equal in value to the amount of that appreciation. (Op28-29; Ex6; Tr98-100.) If the value was greater than the Threshold Appreciation Price, then TAC would be entitled to a number of shares that would be equal in value to the first 50 percent of the stock's appreciation.[6] (*Id.*)

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[6] For example, if the share price at the transaction's inception was $50, and the price on the settlement date was $51-$75, TAC would receive a number of shares equal in value to the excess of the settlement price over $50 times the number of shares. If the settlement-day price was above $75, TAC would receive a number of shares equal in value to $25 ($75-$50) times the number of shares. If the price dropped below $50, DLJ would receive the maximum number

(continued...)

The PVFCs altered TAC's economic interest in the stock at issue by eliminating TAC's risk of loss in the stock and limiting its opportunity to gain from the stock. (Op15-16; Tr212-213.) TAC was protected from loss, because, if the stock's value declined during the term of the VPFC, TAC was not required to return any portion of the up-front payment and DLJ would bear the risk of loss. (Op49; Stip. ¶ 193.) No matter how low the stock's value decreased, the lowest value that TAC could receive for its shares on the settlement date was the Downside Protection Threshold Price. (Op15-16; Ex9 § 2.02; Ex6.) TAC's opportunity for gain was limited, because DLJ was entitled to all appreciation above the Threshold Appreciation Price. (*Id*.) During the trial, taxpayers' executives acknowledged these limitations. (Tr59, 168.) As Mr. Anschutz testified, the transaction was a "vehicle to protect my downside," and did not preserve unlimited upside but merely permitted him to "participat[e] in the upside." (Tr178.)

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[6](...continued)
of shares at issue in the VPFC.

2. Pledge Agreements

The Master Stock Purchase Agreement required TAC to pledge as collateral the maximum number of shares at issue in the PVFCs. (Op9; Tr113.) To implement that requirement, the parties executed Pledge Agreements for each transaction. (Stip. ¶¶ 79-104; Exs33, 36, 38.) The pledged shares were delivered to an independent third party, Wilmington Trust Co. (WTC), as the collateral agent. (*Id.*; Op16.) The Pledge Agreements were not effective until the parties entered into Share Lending Agreements. (Op9; Ex9 § 3.01.)

3. Share Lending Agreements

The Master Stock Purchase Agreement and the Pledge Agreements required WTC to enter into Share Lending Agreements with DLJ that allowed DLJ to borrow the pledged shares. (Op17; Tr144.) To implement that requirement, the parties executed Share Lending Agreements for each transaction. (Stip. ¶ 105; Exs39-41.) Once they did so, TAC received a prepaid lending fee that was equal to 5 percent of the value of the pledged shares.[7] (Stip. ¶ 109; Ex45.)

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[7] The Tax Court stated that the prepaid lending fee was equal to

(continued...)

The Share Lending Agreements provided that DLJ generally had "all incidents of ownership of the Loaned Shares, including the right to transfer them." (Exs39-41 § 7.) As planned by the parties, DLJ used the shares borrowed from TAC to settle its short-sale obligations. (Op47; Ex6.)

The terms of the share loans were structured so that DLJ could use the pledged shares to maintain its hedge position for the entire term of the PVFCs. (Ex147 at 18; Ex6.) Although TAC had the ability to recall the loaned shares, the parties did not anticipate that TAC would exercise that right.[8] (Op47.) If TAC were to recall the shares,

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[7](...continued)
5 percent of the value of the "shares lent." (Op10.) That statement is incorrect. The fee was 5 percent of the value of *all* of the pledged shares, regardless of how many were "lent," as taxpayers acknowledge (Br21). In two of the three transactions, however, the distinction is irrelevant, because DLJ borrowed all of the pledged shares. (Op23-26; Ex115.) In one transaction, DLJ borrowed most, but not all, of the pledged shares. (*Id*.)

[8] TAC recalled the stock in 2009, shortly before the trial in this case. (Exs130-133.) The recall was done solely to influence the outcome of the litigation, not for business reasons. (Op27, 47; Tr71-72.) Previously, during the 2006 tax audit, TAC had recalled a small portion of the stock in an effort to persuade the IRS that the Stock Transactions should not be treated as a sale. (Op27; Stip. ¶¶ 116-117.)
(continued...)

DLJ had the right to accelerate the PVFCs, unless TAC agreed to pay DLJ's excess costs to acquire substitute shares for hedging. (Op18, 45, 48; Ex9 §§ 6.06, 8.01(f); Tr73-74, 140, 254, 319-320.)

DLJ was not required to provide TAC any collateral for the 8.5 million shares it borrowed pursuant to the Share Lending Agreements. (Ex115; Stip. ¶ 142.) In a typical share-lending arrangement, the borrower is required to provide the lender collateral, usually an amount that exceeds the value of the lent shares. (Tr145, 319; Ex147 at 47.) Taxpayers' witnesses explained that collateral was not necessary here, because (i) DLJ provided TAC substantial up-front cash payments for the stock at issue in the VPFCs, and (ii) DLJ's obligations to deliver shares to TAC under the Share Lending Agreements were offset by TAC's obligations to deliver shares to DLJ under the VPFCs. (Tr124-125; Ex148 at 7.)

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[8](...continued)
Like the 2009 recall, the 2006 recall was done solely for tax reasons. (Op47; Tr129.) Pursuant to the transaction documents, TAC returned the unused portion of the prepaid lending fee, and paid DLJ's excess borrowing costs. (Op48; Exs145-146; Tr73-74, 140, 317-320.)

4. The Stock Transactions

The first Stock Transaction was executed on May 9, 2000. (Stip. ¶ 55.) It was divided into six tranches, and concerned a maximum of 4,037,903 shares of Anadarko Petroleum Corp. (APC) common stock.[9] (Op21-23; Stip. ¶¶ 72-73.) Those shares were pledged as collateral to secure TAC's future obligations under the VPFCs. (Op21; Ex27.) Most of the pledged shares were loaned to DLJ shortly after the transaction was executed. (Op21-23; Ex115.) TAC received an up-front payment of $152 million and a prepaid lending fee of $10 million for the stock at issue. (Op21-23; Exs27, 57.)

The second Stock Transaction was executed on December 5, 2000. (Op23; Stip. ¶ 59.) It was divided into three tranches, and concerned a maximum of 3 million shares of Union Pacific Corp. (UPC) common stock. (Op23-24; Stip. ¶¶ 59-60.) Those shares were pledged as collateral to secure TAC's future obligations under the VPFCs. (Op24; Ex31; Stip. ¶¶ 97-98.) All of the pledged shares were loaned to DLJ

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[9] The transaction originally involved Union Pacific Resources Group, Inc. (UPR) common stock. In July 2000, UPR merged with APC, and the UPR shares at issue converted to APC common stock. (Op20-22.)

shortly after the transaction was executed. (Op24-25; Ex62.) TAC received an up-front payment of $115 million and a prepaid lending fee of $8 million for the stock at issue. (Op24-25; Exs31, 62.)

The third Stock Transaction was executed on April 5, 2001. (Op25; Stip. ¶ 67.) It consisted of one tranche, and concerned a maximum of 2 million shares of UPC common stock. (*Id.*) Those shares were pledged as collateral to secure TAC's future obligations under the VPFC. (Op25; Ex31; Stip. ¶ 104.) All of the pledged shares were loaned to DLJ shortly after the transaction was executed. (Op26; Ex62.) TAC received an up-front payment of $84 million and a prepaid lending fee of $6 million for the stock at issue. (Op25-26; Exs31, 62.)

In sum, TAC received over $350 million in up-front payments under the VPFCs. (Ex114.) There were no restrictions on TAC's use of those funds, and no obligation to repay those funds to DLJ at anytime. (Stip. ¶ 193.) TAC also received $24 million in prepaid lending fees under the Share Lending Agreements. (Op26; Ex115.) If the stock appreciated or paid dividends[10] by the settlement date, TAC would

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[10] Dividends paid on the pledged stock were credited to certain

(continued...)

receive additional consideration for its stock, in the form of "returned" shares, as DLJ explained to TAC when planning the Stock Transactions. (Ex6 at 1233; Ex69-70; Tr212, 274.)

D. Taxpayers' tax reporting

Taxpayers treated the Stock Transactions as open transactions, and not as closed sales of stock. Accordingly, taxpayers did not report any gain on their tax returns, even though TAC received over $350 million in cash for stock that had almost no basis. (Op29-30; Stip. ¶¶ 178-183.)

In 2007, the Commissioner issued notices of deficiency to taxpayers for 2000 and 2001, determining that TAC had entered into closed sales of stock regarding the shares transferred to DLJ under the Share Lending Agreements, had received an amount equal to 100 percent of the stock's value in 2000-2001, and was liable for § 1374's built-in-gains tax to the extent the value received exceeded TAC's low

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[10](...continued)
account balances relating to the final settlement payments under the Master Stock Purchase Agreement. (Tr114-118, 233-236.) Whether TAC would ever receive the benefit of those dividends turned on the stock's price on the settlement date. (Ex147 at 36-38.)

basis in the stock.[11] The Commissioner determined deficiencies in Anschutz Co.'s income tax for 2000 and 2001 in the amounts of $50 million and $64 million, respectively, and deficiencies in Mr. and Mrs. Anschutz's income tax for 2000 and 2001 in the amounts of $12 million and $18 million, respectively. (Op30; Stip. ¶¶ 15-16.)

E. Tax Court proceedings

After taxpayers filed petitions, a trial in these consolidated cases was held. The Commissioner's primary argument was that the Master Stock Purchase Agreement triggered a taxable sale under § 1001. In this regard, the Commissioner argued that the VPFCs and Share Lending Agreements were part of one integrated transaction, and that together they transferred the benefits and burdens of stock ownership from TAC to DLJ. (Doc. 31 at 47-68.) The Commissioner further argued that TAC received 100 percent of the stock's value, consisting of (i) the fixed cash payments (*i.e.*, the 75-percent up-front payment and

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[11] In the notices of deficiency, the capital gain computations were based on the actual number of shares transferred under the Share Lending Agreements (*i.e.*, approximately 8.5 million), not on the number of shares that were subject to the transactions (*i.e.*, approximately 9 million). (Op30.)

the 5-percent prepaid lending fee), and (ii) the present value of TAC's contingent future right to dividends and stock appreciation. (Doc. 28 at 178-179; Ex147.)

Taxpayers, in turn, argued that the VPFCs and the Share Lending Agreements were separate transactions, and that, standing alone, neither constituted a current sale for tax purposes. In this regard, taxpayers relied on the form of the transaction, which was structured as "forward sales" and "loans," not "present sales." (Tr28.) Citing Revenue Ruling 2003-7, taxpayers argued that the VPFCs could not be current sales because the parties would not know until the future settlement date how the contracts would be settled. (Doc. 29 at 64-66.) Taxpayers further argued that the Share Lending Agreements satisfied § 1058, which extends non-recognition treatment to certain share-lending arrangements. Under § 1058, a stock transfer will not be treated as a taxable sale if the agreement (i) provides for the return of identical securities, (ii) provides for the payment to the stock-lender of amounts equivalent to all dividends paid on the stock, and (iii) does not reduce the stock-lender's risk of loss or opportunity for gain in the securities transferred. § 1058(b). Recognizing that the Master Stock

Purchase Agreement reduced TAC's risk of loss and opportunity for gain in the transferred stock, taxpayers argued that the Share Lending Agreements had to be analyzed in isolation from the rest of the Stock Transactions, and that the reduction of TAC's risk of loss and opportunity of gain was not contained in the Share Lending Agreements themselves. (Doc. 29 at 79.)

F. Tax Court's opinion

The Tax Court held that the shares subject to the VPFCs and lent to DLJ pursuant to the Share Lending Agreements were sold for tax purposes in 2000-2001. (Op44.) Analyzing the Master Stock Purchase Agreement as a whole, the court found that TAC transferred to DLJ the stock's benefits and burdens of ownership, including (i) legal title; (ii) right to vote; (iii) possession; (iv) risk of loss; and (v) most of the opportunity for gain. (Op46.)

The Tax Court rejected taxpayers' contention that the VPFCs and Share Lending Agreements had to be analyzed in isolation. The court found that both contracts were components of one "integrated transaction," and that the two components were "clearly related and interdependent" and were "governed by the [Master Stock Purchase

Agreement]." (Op44, 46.) Because the contracts were "linked" by the parties, the court refused to "turn a blind eye to one aspect of the transaction in evaluating another." (Op48-49.)

The Tax Court also rejected taxpayers' contention that TAC's right to recall the stock precluded the benefits and burdens of stock ownership from transferring to DLJ. (Op47.) The court found that the stock sale occurred in 2000-2001, when the stock subject to the VPFCs was delivered to DLJ without any limitations on its disposal, and that TAC's right to recall the shares did not change the fact that DLJ had acquired the stock's benefits and burdens. (Op47.) The court further found that the share recalls (i) were tax motivated, and (ii) were in substance TAC borrowing shares from DLJ, noting that DLJ's substitute borrowing costs were paid by TAC pursuant to the Master Stock Purchase Agreement. (Op47-48.)

Finally, the Tax Court rejected taxpayers' reliance on § 1058. The court determined that the Master Stock Purchase Agreement violated § 1058(b)(3) because it reduced TAC's risk of loss with regard to the lent shares through its Downside Protection Threshold Price, which

guaranteed that no part of the up-front payment would have to be returned at settlement. (Op48-49.)

The Tax Court next addressed the amount of gain that taxpayers had to recognize. The court held that taxpayers must recognize gain in an amount equal to the cash payments TAC received from DLJ in 2000-2001 for the stock that was subject to the VPFCs and lent pursuant to the Share Lending Agreements. (Op50-52.) The court rejected the Commissioner's contention that TAC's gain included the present value of the future dividends and price appreciation that TAC might receive for the stock, finding that value could not be determined until the contracts were settled in 2009-2010.[12] (*Id*.)

The Tax Court entered decisions determining tax deficiencies consistent with its opinion. (Doc. 35.) This appeal by taxpayers followed. (Doc. 36.)

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[12] The Tax Court rejected the Commissioner's alternative argument that the transaction was a constructive sale within the meaning of § 1259. (Op52-59.) The Commissioner has not appealed that fact-specific ruling, or the court's redetermination of the amount of gain that taxpayers must recognize on the sale.

SUMMARY OF ARGUMENT

This case presents the factual question whether, as a matter of substance, taxpayers sold their appreciated stock for tax purposes. Seeking to monetize the gain in that stock, taxpayers entered into a multi-step transaction whereby (i) they received over $350 million from DLJ in 2000-2001, (ii) promised to deliver a range of stock to DLJ in 2009-2010, and (iii) loaned most of the pledged shares of stock at issue to DLJ during the interim. If the stock depreciates in value, taxpayers are still entitled to retain all of the cash and are required to deliver all of the shares (or their cash equivalent) to DLJ. If the stock appreciates in value, taxpayers again retain all of the cash and some of the shares at issue, in an amount equal to a limited portion of the appreciation. The Tax Court determined that TAC transferred essentially all of the indicia of stock ownership to DLJ in 2000-2001, and that therefore the stock was sold for tax purposes at that time.

1. Applying the well-established benefits-and-burdens test for determining stock ownership, the Tax Court correctly found (and the record supports) that, in 2000-2001, TAC transferred (i) legal title, (ii) the right to vote, (iii) possession, (iv) risk of loss, and (v) most of the

opportunity for gain in the stock, in exchange for over $350 million and the limited right to share in the stock's appreciation when the transaction settles in 2009-2010. In ruling that these factors supported the conclusion that a sale occurred in 2000-2001, the court properly analyzed both the VPFCs and the Share Lending Agreements as one integrated transaction. Taxpayers' contention that the contracts were independent conflicts with the transaction documents themselves and the trial testimony, which together demonstrate that the contracts were integrated in both form and substance.

2. There is no merit to taxpayers' contention that they can avoid the tax due on their stock sale on the basis of Revenue Ruling 2003-7 or § 1058. Revenue Ruling 2003-7 allowed a taxpayer to defer gain recognition on a lump-sum payment received under a VPFC, where the stock at issue was not going to be delivered to the forward-contract purchaser until the contract settled, if at all. Here, the stock at issue was delivered to the forward-contract purchaser at the beginning of the transaction. Taxpayers' reliance on § 1058 is similarly misplaced. Section 1058 extends non-recognition treatment to certain stock loans, but, by its terms, does not apply if — as here — the agreement

governing the parties' securities reduces the stock-lender's "risk of loss or opportunity for gain" in the transferred securities. § 1058(b)(3).

ARGUMENT

The Tax Court correctly determined that taxpayers' Stock Transactions were a sale for tax purposes

Standard of Review

This case concerns whether a forward contract that incorporates a share-lending arrangement is a current sale. That question "is essentially one of fact," and, as such, the Tax Court's resolution of the issue is reviewable only for clear error. *Bear v. Commissioner*, 650 F.2d 1167, 1170 (10th Cir. 1981).

This issue was raised in the parties' briefs (Doc. 28 at 102-103; Doc. 29 at 81), and decided by the Tax Court (Op44-50).

A. Introduction

This case involves a transaction whereby taxpayers sought to monetize their gains in appreciated stock, while seeking to avoid the substantial tax liability attendant upon a sale of such stock. To monetize those gains, taxpayers entered into an agreement to sell and lend the stock to DLJ in exchange for over $350 million. Taxpayers had

complete dominion and control over that cash in 2000-2001, and never had to return it to DLJ. Under the plain terms of § 61(a), which includes as gross income all "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion," taxpayers' gains were taxable in 2000-2001 unless they were "specifically exempted." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-431 (1955). In this regard, taxpayers generally must recognize any gain from the sale or other disposition of property, §§ 61(a)(3), 1001(c), and exceptions to that rule are to be "strictly construed," Treas. Reg. § 1.1002-1(b).

The term "sale" is not defined in the Code, and "just as in any statute, is to be given its ordinary meaning." *Commissioner v. Brown*, 380 U.S. 563, 571 (1965) (citation omitted). "For tax purposes, sale is essentially an economic rather than a formal concept." *Gray v. Commissioner*, 561 F.2d 753, 757 (9th Cir. 1977). To determine "when a transfer of property is deemed to occur for tax purposes," the "test" applied is when "'the 'benefits and burdens' of ownership passed.'" *J.B.N. Tel. Co. v. United States*, 638 F.2d 227, 232 (10th Cir. 1981) (citation omitted). This test "is best applied on a case-by-case basis,

considering the total transaction involved." *Wagner v. Commissioner*, 518 F.2d 655, 657 (10th Cir. 1975).

Sometimes the indicia of stock ownership is shared by two parties. To determine who is the beneficial owner of stock for tax purposes, "the court looks to that party to the transaction who has the greatest number of the attributes of ownership." *Pac. Coast Music Jobbers, Inc. v. Commissioner*, 55 T.C. 866, 874 (1971), *aff'd*, 457 F.2d 1165 (5th Cir. 1972); *Ragghianti v. Commissioner*, 71 T.C. 346, 349-350 (1978), *aff'd by unpublished opinion*, 652 F.2d 65 (9th Cir. 1981). "Among the factors relevant to this determination are: (i) whether the purchaser bears the risk of loss and opportunity for gain; (ii) which party receives the right to any current income from the property; (iii) whether legal title has passed; and (iv) whether an equity interest was acquired in the property." *H.J. Heinz Co. v. United States*, 76 Fed. Cl. 570, 582 (2007). "[N]one of these factors is necessarily controlling; the incidence of ownership, rather, depends upon all the facts and circumstances." *Id.*; *see Dunne v. Commissioner*, 95 T.C.M. (CCH) 1236, 1242 (2008) (listing factors relevant for determining stock ownership).

The IRS has applied the benefits-and-burdens test to VPFCs and has permitted taxpayers to defer recognition of gain on the lump-sum payments received under such contracts, so long as the taxpayer does not transfer the stock to the counter-party prior to the forward contract's settlement date. *Compare* Revenue Ruling 2003-7, 2003-1 C.B. 363 *with* IRS Coordinated Issue Paper — Variable Prepaid Forward Contracts Incorporating Share Lending Arrangements, 2008 WL 852615. Similarly, the Code provides non-recognition treatment for certain share-lending agreements, so long as the agreement does not (among other things) reduce the taxpayer-lender's risk of loss in the stock. § 1058(b)(3).

The Tax Court determined that, on the facts of this case, TAC transferred the benefits and burdens of stock ownership to DLJ in 2000-2001, when TAC lent DLJ shares that were subject to the VPFCs, and that TAC therefore sold those shares at that time. In doing so, the court applied the well-established benefits-and-burdens test to a specific set of facts; it did "not enunciate a new rule of law." Sheppard, *Tax Court Bounces Anschutz's Prepaid [Forward] Contract*, Tax Notes at 455 (Aug. 2, 2010) ("*Anschutz* was decided on the facts."). Seeking to

avoid the court's factual determination, taxpayers and amicus Liberty contend that the cash that taxpayers received in 2000-2001 — which exceeds $350 million — is entitled to non-recognition treatment under either (i) Revenue Ruling 2003-7 (Br35-39; AmBr22), or (ii) § 1058 (Br41-48; AmBr18-21). Those contentions — premised on analyzing the VPFCs and the Share Lending Agreements as isolated, "independent" agreements (Br30; AmBr23-27), rather than as one integrated transaction, as the Tax Court found them to be — lack merit. Revenue Ruling 2003-7 does not apply if the VPFC incorporates a share-lending arrangement. And § 1058 does not apply if the agreement pursuant to which the stock is "loaned" also reduces the lender's risk of loss or opportunity for gain in the stock, as VPFCs typically do.

As demonstrated below, taxpayers and Liberty have failed to identify any error — let alone clear error — in the Tax Court's determinations (i) that the Master Stock Purchase Agreement (which includes both the VPFCs and the Share Lending Agreements) transferred the stock's benefits and burdens from TAC to DLJ in 2000-2001, and (ii) that the VPFCs and the Share Lending Agreements were part of one, integrated transaction. They have also failed to

demonstrate that either Revenue Ruling 2003-7 or § 1058 applies to shelter from tax the cash that TAC received in 2000-2001.

B. The Tax Court correctly found that TAC had transferred the benefits and burdens of the stock at issue to DLJ in 2000-2001

The Tax Court began with the well-established principle that, to determine whether the Master Stock Purchase Agreement transferred the incidents of ownership in the stock at issue to DLJ, the court had to look beyond the formal labels used by the parties and examine "all of the facts and circumstances surrounding the transfer, relying on objective evidence of the parties' intentions provided by their overt acts." (Op35.) "'In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding.'" *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978) (citations omitted). To determine whether the Master Stock Purchase Agreement constituted a current sale of stock, this Court should "look[] to the objective economic realities of [the] transaction rather than to the particular form the parties employed." *Id.* As this Court has emphasized, "it is not up to the taxpayers to have the final say on how [a transaction] is

characterized" for tax purposes. *Rogers v. United States*, 281 F.3d 1108, 1118 (10th Cir. 2002) (applying "benefits and burdens" analysis to determine that transaction styled as a "loan" was in substance a sale/stock redemption). "[C]ouching the transaction in terms of an executory contract to sell [stock] will not make it such, if in fact it is something else." *Bradford v. United States*, 444 F.2d 1133, 1144 (Ct. Cl. 1971).

Examining the transaction as a whole, the Tax Court concluded that the shares subject to the VPFCs and lent pursuant to the Share Lending Agreements were sold to DLJ for tax purposes in 2000-2001. In so concluding, the court found that, at that point in time, TAC transferred the following benefits and burdens of stock ownership in exchange for an up-front payment that exceeded $350 million: (i) legal title; (ii) the right to vote; (iii) possession; (iv) risk of loss; and (v) a major portion of the opportunity for gain. (Op44-48.) Those findings are fully supported by the record. Taxpayers' contention that TAC did not limit its risk of loss or opportunity for gain in the shares at issue lacks merit, as does their contention that TAC's recall right precludes the court's sale determination.

1. The record fully supports the Tax Court's findings that, in exchange for valuable consideration exceeding $350 million, TAC transferred to DLJ legal title, possession, the right to vote, the risk of loss, and a major portion of the opportunity for gain in the stock at issue

The record supports (and taxpayers do not dispute (Br13)) the Tax Court's finding that TAC received the bulk of the consideration for the transferred stock in 2000-2001 when it executed the Stock Transactions. The parties stipulated that TAC received at the inception of each VPFC up-front cash payments that amounted to $350,968,652.16 in total. (Stip. ¶ 200; Ex114.) TAC referred to that payment as the "purchase price" for the stock. (Tr103-104.) The parties further stipulated that there "were no restrictions or limitations on TAC's use of the 'Purchase Price' funds received from [DLJ] and TAC had no obligation to repay or return those funds to [DLJ] at anytime." (Stip. ¶ 193.) As taxpayers concede (Br16 n.12), TAC "keeps" that up-front payment, no matter what happens with the stock's value in the future. Therefore, the Master Stock Purchase Agreement permitted TAC to monetize its extensive appreciation in the stock at issue and — in the words of Mr. Anschutz — "realize cash."

(Tr179.) The fact that taxpayers received over $350 million at the inception of the transactions — a sum that they would never have to return to DLJ — evidences that the stock's benefits and burdens were transferred to DLJ at that time. *See Yelencsics v. Commissioner*, 74 T.C. 1513, 1527 n.12 (1980) ("significant downpayment" for stock was factor indicating that stock was sold).

The record also supports (and taxpayers do not dispute (Br48-49)) that the Master Stock Purchase Agreement transferred title, possession, and the right to vote to DLJ in 2000-2001 when DLJ "borrowed" the pledged shares. Those attributes of ownership were transferred from TAC to DLJ when the pledged shares were delivered to DLJ from the collateral account. (Exs39-41 §§ 3,7; Ex147 at 39.) Once the shares were delivered, DLJ exercised its right to dispose of the stock by using the shares to close out its initial short-sale transactions, as TAC and DLJ had planned when they negotiated the Master Stock Purchase Agreement. (Ex6; Tr247-249.)

The record also supports the Tax Court's finding that TAC transferred the risk of loss regarding the shares delivered to DLJ. After entering into the Master Stock Purchase Agreement, TAC fully

recouped its investment in the stock, and monetized the bulk of the stock's built-in appreciation, by obtaining from DLJ an up-front payment that greatly exceeded its low-basis in the stock.[13] (Ex147 at 8, 26-27.) No matter how far the stock price declines below the Downside Protection Threshold Price, TAC retains the up-front cash proceeds and need not provide DLJ anything more than the pledged shares. (Stip. ¶ 193; Ex6.) Indeed, if the value of the stock were to plummet to zero, TAC would nevertheless be entitled to retain the $350 million up-front payment that it received from DLJ. (*Id.*) This absence of the risk of loss is critical evidence that the benefits and burdens of ownership for tax purposes has been transferred. *See Rupe Inv. Corp. v. Commissioner*, 266 F.2d 624, 630 (5th Cir. 1959) (considering, in determining that taxpayer did not own stock for tax purposes, fact that taxpayer "was protected against risk of loss"); *Miami Nat'l Bank v.*

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[13] Taxpayers' contention that they will not know "whether TAC would realize gain or loss" until the VPFCs mature (Br5) is incorrect. Gain or loss is measured by comparing the amount realized from the sale (or other disposition) with the property's adjusted basis. § 1001(a). No matter what happens when the VPFCs are settled, taxpayers can experience no loss on the stock, because the up-front payments that TAC received on the Stock Transactions exceeded — by well over $300 million — TAC's low basis in the stock (Op30).

Commissioner, 67 T.C. 793, 800-801 (1977) (holding that taxpayer was owner of stock because he, and not the broker who held the stock under a subordination agreement, bore "the burden of any decrease in its value").

Finally, the record also supports the Tax Court's finding that TAC transferred much of the opportunity for gain regarding the pledged shares. Pursuant to the Master Stock Purchase Agreement's settlement formula, TAC is entitled to receive a limited and capped economic benefit if the stock's value appreciates. (Ex9 § 2.02; Ex119; Ex147 § 5.2.1.) TAC transferred to DLJ the unlimited economic benefit from stock-price appreciation above the Threshold Appreciation Price. (*Id*.) Thus, DLJ, not TAC, holds the right to an unlimited amount of stock-price appreciation, indicating that DLJ, and not TAC, held an equity interest in the stock. Where (as here) a transaction effectively caps a party's ability to participate in the profits and precludes "unlimited upside potential," then that party does not, in substance, have an ownership interest (even if it has some ability to profit if the transaction succeeds). *TIFD III-E, Inc. v. United States*, 459 F.3d 220, 228-229 (2d Cir. 2006).

The fact that TAC retained a limited future interest in the stock (if the stock appreciated or paid dividends) does not preclude the Tax Court's determination that a sale occurred when TAC delivered the shares to DLJ in 2000-2001. A "transfer of beneficial ownership can occur before the entire sale price has been paid." *Dunne*, 95 T.C.M. at 1243 (taxpayer sold stock where taxpayer contracted away most — but not all — of his interest in the stock's successes); *see Pac. Coast Music Jobbers, Inc. v. Commissioner*, 457 F.2d 1165, 1173 (5th Cir. 1972) (holding that "contracts of 1962 were, in practical effect and context, an installment sale of the business, with beneficial ownership of the stock transferred immediately and with the purchase price amortized over a period of five years"). Moreover, a sale can (as here) have consideration that consists of both a fixed portion and a contingent portion. *E.g.*, *Gralapp v. United States*, 458 F.2d 1158, 1160 (10th Cir. 1972) (taxpayers "sold, in 1960" interest in property for "sum certain received in 1960" and "contingent additional consideration" received in 1966 and subsequent years); *In re Steen*, 509 F.2d 1398, 1401-1403 (9th Cir. 1975) (stock sold for "specified purchase price" and future "contingency payment").

In this regard, the Tax Court's conclusion that TAC sold the shares in 2000-2001 is not "contradicted" (as taxpayers contend (Br50)) by its finding that the VPFCs — analyzed in isolation — created a variable delivery obligation when the contracts settled in 2009-2010 (Op59). As the court further found, those settlements would establish the amount of "TAC's entitlement to some appreciation in price and future dividends" for the stock it had previously sold. (Op51.) Therefore, the fact that the stock transfers in 2000-2001 were deliveries under the VPFCs does not mean (as taxpayers contend (Br51)) that there would be "nothing left to settle in 2009 and 2010"; on the contrary, in 2009-2010, the parties would settle the contingent portion of the stock-sale price. *See Steen*, 509 F.2d at 1404-1405 (fixed amount of consideration taxable in year of receipt, notwithstanding that additional, contingent consideration was too speculative to be immediately taxable).

Based on all of the above facts, the Tax Court correctly determined that, in substance, TAC effectively cashed out its equity in the stock in 2000-2001 in exchange for over $350 million and a

contingent contract right to share in a limited portion of the stock's future success on the settlement dates in 2009-2010.[14]

2. Taxpayers' contention that the Master Stock Purchase Agreement did not reduce TAC's risk of loss or opportunity for gain in the stock transferred to DLJ conflicts with the position that they took in the Tax Court and lacks any support

On appeal, taxpayers contend (Br47) that any reduction in risk or limitation on gain did not relate to the specific pledged shares delivered to DLJ in 2000-2001, because TAC could deliver other shares, or cash, to DLJ when the VPFCs were settled in 2009-2010. That contention conflicts with taxpayers' contrary concessions in the Tax Court and otherwise lacks merit.

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[14] Characterizing the transaction as a current sale does not mean that taxpayers entered into an "extraordinarily bad business deal" whereby TAC sold its stock for 80 percent of its value, as taxpayers contend (Br50). That contention ignores that taxpayers were entitled to future consideration if the stock appreciated in value or paid dividends, as the Tax Court found. (Op51.) Moreover, had taxpayers caused TAC to simply sell the stock for 100 percent of its value, the Company and Mr. Anschutz indisputably would have been subject to a total tax liability exceeding 20 percent of the stock's value. By structuring the stock sale as prepaid forward contracts, Mr. Anschutz sought to avoid the Company's tax liability entirely and defer his own for ten years.

In the Tax Court proceedings, taxpayers stated that "[i]t is not disputed or remarkable that the Subject VPFCs reduce TAC's risk of loss and opportunity for gain." (Doc. 29, Petitioners' Post-Trial Br. 79 n.18.) *See* Doc. 32, Petitioners' Answering Br. 120 ("That the Subject VPFCs altered TAC's economic interest in its stock, however, is unremarkable and without legal consequence."); Tr19 (petitioners' counsel concedes "TAC was protected against downside changes in the stock value and retained some" — but not all — "of the upside appreciation."). A party may not complain on appeal of errors that he himself invited. *John Zink Co. v. Zink*, 241 F.3d 1256, 1259 (10th Cir. 2001). Moreover, even if taxpayers had not asserted a contrary position in the Tax Court, arguments raised for the first time on appeal are generally deemed waived. *Proctor & Gamble Co. v. Haugen*, 222 F.3d 1262, 1270–1271 (10th Cir. 2000).

In any event, even if the argument had been properly preserved, it lacks merit because it conflicts with the record evidence. Taxpayers' own expert witness testified that "VPFC's are frequently used by . . . owners of large block of shares in order to obtain *downside protection* and funding against an appreciated share price." (Ex148 at 3-4

(emphasis added).) He further testified that "TAC transferred portions of the downside and upside position risk and dividend payouts" to DLJ. (*Id*. at 6.) Similarly, a DLJ witness testified that "DLJ was exposed to the downside in the stock and was entitled to receive upside beyond the point which Anschutz Company was sharing." (Tr212-213.) Indeed, Mr. Anschutz testified that he approved the transactions specifically because he "found them as a vehicle to protect my downside." (Tr178.) *See also* Tr59, 98, 242, 262-263.

What taxpayers' witnesses recognized — and taxpayers' appellate counsel ignores — is that "shares of stock" are "fungible." *Gail v. United States*, 58 F.3d 580, 585 n.7 (10th Cir. 1995). "A certificate of the same number of shares, although printed upon different paper and bearing a different number, represents precisely the same kind and value of property as does another certificate for a like number of shares of stock in the same corporation. It is a misconception of the nature of the certificate to say that a return of a different certificate or the right to substitute one certificate for another is a material change in the property right held by the broker for the customer. " *Richardson v. Shaw*, 209 U.S. 365, 378-379 (1908). Therefore, it is completely

artificial to discuss "which" specific shares transferred risk of loss and opportunities for gain to DLJ. The fact that taxpayers could settle the VPFCs with shares other than the pledged shares (so long as they were identical to the pledged shares) does not change the fact that, as a matter of economics, TAC reduced its risk of loss and opportunity for gain on the pledged block of stock.

Similarly, the fact that DLJ might accept cash to settle the VPFCs, in lieu of stock, does not mean (as taxpayers contend) that TAC has not transferred the risk of loss or opportunity for gain in the stock transferred to DLJ in 2000-2001.[15] As DLJ testified at trial, there would be no difference, as a matter of economics, if TAC settled in "cash or shares." (Tr216.) Indeed, taxpayers acknowledged this fact during the Tax Court proceedings, explaining that "[d]elivering cash or other shares would thus be economically indistinguishable from delivering the pledged shares." (Doc. 32, Petitioners' Answering Br. 146.) And it

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[15] The transaction documents required TAC to settle in stock, not cash, in 9 out of 10 of the VPFCs. (Op21, 24; Tr107-108, 214.) At trial, DLJ testified that it would disregard the parties' formal agreements and accept cash on the settlement dates, recognizing that cash would be the functional equivalent of the pledged stock. (Tr216-217.)

is the economic realities, not formal distinctions, that dictate whether a transaction is a sale for tax purposes. *E.g.*, *Beech Aircraft Corp. v. United States*, 797 F.2d 920, 922 (10th Cir. 1986) ("in matters of taxation, form must give way to substance, and the economic reality of the business arrangement rather than the outward form of a transaction will determine its tax consequences") (citation omitted). As a matter of economic reality, the cash-settlement option in a forward contract is properly viewed as providing forward-contract sellers (such as TAC) the "option to repurchase [their] shares at settlement by delivering cash in lieu of the shares." *Donoghue v. Centillium Communications Inc.*, No. 05-4082, 2006 WL 775122, at *5 (S.D.N.Y. Mar. 28, 2006).[16]

[16] Taxpayers contend (Br48) that "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)." That contention is not only legally irrelevant (as explained in the text), but it also conflicts with taxpayers' stated purpose for executing the Master Stock Purchase Agreement. In this regard, Mr. Anschutz testified that he entered into the Agreement because he needed cash in order to diversify his investments. (Tr178-179.)

Taxpayers' related suggestion (Br47) that the Master Stock Purchase Agreement somehow provided DLJ — and not TAC — "downside protection" makes no sense. In executing that Agreement, DLJ gave TAC over $350 million, and, as taxpayers acknowledge, TAC would never have to return any portion of that sum to DLJ (Br16 n.12). If the value of the stock plummeted to zero by the settlement date, DLJ — and not TAC — would suffer the consequences. Thus, the Tax Court did not (as taxpayers contend (Br47)) get it "exactly backwards" when it concluded that the Agreement provided TAC downside protection. In this regard, the Agreement's Downside Protection Threshold Price protects TAC, because, even if the stock's value is below that price, TAC was not obligated to return any portion of its prepayment or provide DLJ any additional shares (Ex9 § 2.02(b)(iii)), as the Tax Court explained (Op28, 49). In other words, it is the Downside Protection Threshold Price that sets the maximum number of shares that TAC is contractually obligated to deliver, no matter the market value of the stock at the settlement date.

3. TAC's recall right (which it exercised for tax purposes, not business purposes, years after it sold the stock) does not alter the fact that TAC had transferred the benefits and burdens of ownership to DLJ in 2000-2001

The fact that the Master Stock Purchase Agreement (through the incorporated Share Lending Agreements) provided TAC the formal right to recall the shares delivered to DLJ in 2000-2001 does not (as taxpayers suggest (Br52)) alter the conclusion that, in substance, TAC transferred the benefits and burdens of those shares to DLJ in 2000-2001. The Tax Court expressly found that "[t]he recalls were not a foreseeable economically motivated event when the transactions at issue were structured." (Op47.) Taxpayers have failed to show that finding to be clearly erroneous. When they entered into the Stock Transactions, the parties intended to leave the loan in place until the final, nominal settlement dates in 2009-2010. (Ex6.) The plan that DLJ presented to TAC provided that, although TAC had the right to terminate the Share Lending Agreements, it was anticipated that DLJ would return the shares "[a]t the expir[ation] of the Prepaid Forward Contract." (Ex6 at 1233.) Similarly, taxpayers' expert noted that the transaction documents provide that "[i]f DLJ cannot return borrowed

shares to TAC's pledge account on the settlement date, then TAC is permitted not to deliver shares to satisfy" the PVFCs. (Ex148 at 7.) That TAC actually recalled the stock before the settlement date is irrelevant. TAC did not recall the stock until 2009,[17] shortly before the trial in this case, almost a decade after DLJ had disposed of the stock to close out its short sales. (Tr247.) The recall was initiated solely to influence the outcome of this tax dispute, not for any legitimate business reason, as the court found (Op47) and the record supports (Tr129-130; Stip. ¶¶ 143-145). As one of taxpayers' executives acknowledged, "for economic purposes, I did not want to terminate the share lending agreements." (Tr71.) *See* Johnson, *Anschutz Will Cost Taxpayers More Than the Billionaire*, Tax Notes at 557 (Aug. 2, 2010) (noting that taxpayers' purported recall was merely an attempt to "pawn off falsehood as truth").

Even if the recall right had substance, that right would not alter the fact that TAC had transferred all of the benefits and burdens to

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[17] TAC recalled a small portion of the stock in 2006, during the IRS's audit of the Stock Transactions, in an effort to persuade the IRS to not issue a notice of deficiency. *See*, above, n.8.

DLJ in 2000-2001. (Op47.) Tax ownership is determined at the time the stock was transferred. *See* § 1058(b) (share lending is taxable event, even if stock-lender has right to the "return" of loaned shares, where (among other things) stock-lender has transferred its risk of loss in loaned shares); *Hope v. Commissioner*, 471 F.2d 738, 741-742 (3d Cir. 1973) (purchase price for stock was taxable in year of receipt where taxpayer had control over both the funds and the decision to rescind the sale). Once the pledged shares were delivered to DLJ, it acquired possession and title, the right to vote, the risk of loss, and the right to gain from appreciation in the stock's value. At that point in time, a sale occurred for tax purposes. Subsequent events could not change that economic reality. Moreover, although a recall would return the "borrowed" stock to the pledge account, it would not return to TAC the risk of loss on the stock or unlimited upside in the stock. Nor would a recall require TAC to return to DLJ the up-front payment exceeding $350 million it received in 2000-2001 (other than a pro-rata return of the prepaid 5 percent "lending fee"). Therefore, even after the recall, the critical components of beneficial ownership remained with DLJ.

In these circumstances, the Tax Court properly characterized TAC's tax-motivated "recalls" as TAC's "borrowing" of stock from DLJ. (Op48.) As the court explained, TAC transferred the benefits and burdens of ownership to DLJ in 2000-2001, and the recalls that occurred almost 8 years later "were in substance a separate event akin to TAC borrowing shares." (*Id.*) That characterization was supported by the "transaction documents," as the court found (Op48) and taxpayers ignore (Br54). Those documents effectively required TAC to pay DLJ's borrowing costs if the shares were recalled (Op48; Ex9 §§ 6.06, 8.01(f); Tr73-74), a highly unusual step in a share-lending arrangement. Sheppard, above, at 459.[18] The court's characterization of the recall as TAC's borrowing shares from DLJ is further supported by the fact that, after the recall, TAC was obligated to deliver shares (or their cash equivalent) to DLJ at the PVFCs' settlement dates.

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[18] Despite taxpayers' contention to the contrary (Br51 n.42), the Tax Court did account for the portion of the prepaid lending fee that TAC returned to DLJ when it recalled the stock. As the Tax Court found, TAC paid DLJ that portion, plus an additional amount, to compensate DLJ for its borrowing costs (Op48), which supports the court's finding that the share recalls were, in substance, TAC borrowing shares from DLJ.

(Ex9.) That delivery, in substance, would constitute a "return" of the shares that TAC had borrowed from DLJ through the tax-motivated recalls. But, regardless of how the recalls are characterized, the mere fact that taxpayers had a recall right, as a matter of law, does not preclude treating the Stock Transactions as a sale for tax purposes. *See* § 1058; *Hope*, 471 F.2d at 741-742.

C. The Tax Court's finding that the PVFCs and the Share Lending Agreements were part of one integrated transaction is fully supported by the record

In determining that a sale occurred when TAC transferred the pledged shares to DLJ in 2000-2001, the Tax Court correctly examined the entire Master Stock Purchase Agreement, not just the provisions related to the PVFCs. *See Associated Wholesale Grocers, Inc. v. United States*, 927 F.2d 1517, 1528 (10th Cir. 1991) ("'[t]axpayers cannot compel a court to characterize the transaction solely upon the basis of a concentration on one facet of it when the totality of the circumstances determines its tax status.'") (alteration in original; citation omitted); *True v. United States*, 190 F.3d 1165, 1174 (10th Cir. 1999) ("[W]e must look beyond the taxpayers' characterization of isolated, individual transactional steps, and also review the substance of each series of

transactions in its entirety."); *Pac. Coast*, 457 F.2d at 1169 (analyzing multiple agreements to determine that stock was, in substance, sold in 1962 rather than 1967). Although taxpayers and Liberty seek to isolate the PVFCs from the Share Lending Agreements (Br30; AmBr23-27), the Tax Court properly examined all the facts and determined that the documents formed one "integrated transaction." (Op44.) That determination is a factual finding that is fully supported by the record. *See Houck v. Hinds*, 215 F.2d 673, 676 (10th Cir. 1954) ("Whether for tax purposes several acts constitute separate and distinct transactions or are integrated steps in a single transaction is a question of fact."); *Steen*, 509 F.2d at 1402 (determination that multiple agreements were "integrated single transaction" that "should [be] read together" is a "factual determination" that is reviewed under clearly erroneous standard).

The PVFCs and the Share Lending Agreements were part of one integrated agreement, both in form and in substance. As a formal matter, the Master Stock Purchase Agreement (which contained the general provisions related to the PVFCs) expressly, and repeatedly, provided that it would be "amended and supplemented" by any Share

Lending Agreement that the parties entered into. (Ex9 § 4.01(b)-(f), (l)(4)-(6), § 5.01(g)(i), (v), § 8.01(c)-(e).) Indeed, a form Share Lending Agreement was attached to the Master Stock Purchase Agreement as an exhibit. (Ex9, exhibit D.)

In addition to their formal incorporation and integration into the Master Stock Purchase Agreement, the PVFCs and the Share Lending Agreements also were legally dependent upon each other. The Master Stock Purchase Agreement was conditioned on the parties entering into the Share Lending Agreements (Tr143-144), as taxpayers concede. *See* Br33 ("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."). In this regard, the Master Stock Purchase Agreement required the parties to enter into Pledge Agreements, whereby TAC would pledge as collateral for the PVFCs the maximum number of shares at issue (Tr143; Ex9 § 5.01); and, to be effective, the Pledge Agreements required the parties to enter into Share Lending Agreements. (Tr144; Ex9 § 1.01 (defining Share Lending Agreement); Ex33 § 2(e).) Indeed, DLJ was not required to pay TAC the up-front cash until TAC satisfied

that obligation under the Pledge Agreement. (Ex9 § 5.02.) And an incorrect statement by TAC regarding the Share Lending Agreements would trigger a default under the Master Stock Purchase Agreement. (Ex9 § 8.01(c).)

The PVFCs and Share Lending Agreements were also integrated as a matter of economic reality. As the Tax Court found, and the record supports, the PVFCs required DLJ to engage in short sales, and the parties planned that DLJ would cover those initial short sales with shares "borrowed" from TAC. (Op45; Ex6; Tr228, 247-249.) Moreover, TAC did not require DLJ to post collateral under the Share Lending Agreements for the 8.5 million shares of stock that it "borrowed" from TAC because it viewed DLJ's obligation to return the shares as offset by TAC's "obligations to deliver shares potentially under the master sell/purchase agreement." (Tr125.) Similarly, taxpayers' expert testified that the absence of collateral for the lent shares was "mitigated" by (i) the fact that "TAC received an upfront cash payment of 75 percent of the stock's initial value in each VPFC," and (ii) "TAC's requirement to deliver pledged shares to DLJ on the VPFCs' settlement dates." (Ex148 at 7.) Therefore, although it is customary to post

collateral in a free-standing share lending agreement, as taxpayers' executive acknowledged (Tr145), it was not done so here because the Share Lending Agreements were integrated with the PVFCs. Further evidencing the economic integration is the fact that, if TAC recalled the shares, the Master Stock Purchase Agreement effectively required TAC to pay DLJ's substitute borrowing costs (or risk DLJ exercising its right to accelerate the PVFCs). (Ex9 §§ 6.06, 8.01(f); Tr73-74, 140, 317-318.) That TAC is "picking up costs that are normally part of the broker's business practice of hedging its exposures . . . serves to further link the share loan to the forward contract." Sheppard, above, at 459.

Taxpayers' contention (Br30) that the PVFCs and the Share Lending Agreements were "independent" conflicts with this record evidence. That, hypothetically, DLJ could have borrowed the stock from another source is not "legally relevant," as taxpayers contend (Br52). The parties chose to have DLJ "borrow" the stock from TAC, the forward-seller, and when DLJ did so, the combination of the PVFCs and the Share Lending Agreements transferred the stock's benefits and burdens to DLJ. The hypothetical transaction posited by taxpayers is legally irrelevant to the issues before the Court. *See Frank Lyon*, 435

U.S. at 576 ("transaction must be given its effect in accord with what actually occurred and not in accord with what might have occurred"); *Commissioner v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974) ("This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, and may not enjoy the benefit of some other route he might have chosen to follow but did not.") (citations omitted). What *is* legally relevant is that the PVFCs transferred most of the indicia of stock ownership to DLJ, except possession and control. Once those remaining indicia were transferred pursuant to the Share Lending Agreements, DLJ became the owner for tax purposes.

The fact that DLJ delayed borrowing the stock for several weeks is not (as taxpayers and Liberty contend (Br52; AmBr25)) meaningful. *See Helvering v. Ala. Asphaltic Limestone Co.*, 315 U.S. 179, 184-185 (1942) ("Transitory phases of an arrangement frequently are disregarded . . . where they add nothing of substance to the completed affair."). As noted above, it was part of a pre-arranged plan that DLJ would borrow the stock. (Ex6.) Moreover, there was no business or

regulatory reason for delaying the borrowing of the stock, as a DLJ witness conceded at trial. (Tr273.) And, by focusing on the brief delay, taxpayers seek to divert the Court's attention from the fact that DLJ "borrowed" most of the stock at issue for almost 8 years.[19] (Stip. ¶¶ 209-212; Ex115.)

In sum, the Tax Court did not (as taxpayers and Liberty contend (Br48-53; AmBr9)) misconstrue the contracts but rather properly construed them together to determine whether, as a matter of substance, taxpayers transferred the benefits and burdens of stock ownership to DLJ in 2000-2001. Taxpayers' attempt to isolate the Share Lending Agreements from the rest of the Stock Transactions for tax purposes, while linking them in every possible way for legal and economic purposes, is meritless.

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[19] That the Agreement permitted, but did not require, DLJ to borrow the shares (as Liberty notes (AmBr24)), ignores the undisputed fact that the parties planned from the beginning that DLJ would borrow the pledged shares at issue, and use them to close out its short sales. (Ex6; Tr247-249.)

D. Taxpayers' reliance on Revenue Ruling 2003-7 is misplaced

Consistent with the Tax Court's benefits-and-burdens analysis herein, the IRS has issued guidance to taxpayers that PVFCs that incorporate share lending will be treated as current sales for tax purposes. IRS Coordinated Issue Paper — Variable Prepaid Forward Contracts Incorporating Share Lending Arrangements, 2008 WL 852615. As the IRS explained, when a PVFC incorporates a share-lending arrangement, the taxpayer is required to deliver the pledged shares to the purchaser who thereby attains substantial indicia of ownership (including most of the risk of loss and opportunity for gain). *Id.* In that situation, taxpayers are required to pay tax to the extent that they have monetized their appreciated stock.

The Coordinated Issue Paper concluded that Revenue Ruling 2003-7 was distinguishable. As noted above, Revenue Ruling 2003-7 applied the benefits-and-burdens test to a specific PVFC, and concluded that the contract at issue in the ruling did not constitute a current sale. The arrangement in the ruling did not (unlike here) involve a share-lending arrangement whereby the taxpayer delivered the pledged

shares to the purchaser/borrower, who was thus able to possess and use the shares prior to the PVFC's settlement date. The Ruling's conclusion was premised on the critical fact that "the legal title to, and actual possession of, the shares were transferred to an unrelated trustee rather than to Investment Bank [*i.e.*, the counter-party to the PVFC]." 2003-1 C.B. at 364. Indeed, the ruling repeatedly noted that the shares that were pledged to secure the taxpayer's contractual obligation would not be delivered to the purchaser until the contract was settled. *Id*. at 363-364.

Taxpayers and Liberty both concede that Revenue Ruling 2003-7 "did not address stock loans of pledged shares" (Br6; *see* AmBr22). They nevertheless contend that Revenue Ruling 2003-7 provides non-recognition treatment for any PVFC, no matter the factual circumstances of the case. That contention conflicts with IRS rules regarding all Revenue Rulings, as well as the specific language of Revenue Ruling 2003-7 itself.

As a matter of law, Revenue Rulings are limited to the specific facts considered in the ruling, and represent the IRS's conclusion as to the application of the law to the "entire state of facts involved." Treas.

Reg. § 601.601(d)(2)(v). Revenue Rulings are thus "limited in scope" by the specific facts noted in the ruling. *Id*. Accordingly, taxpayers are "cautioned against reaching the same conclusion" unless the facts and circumstances are "substantially the same." *Id*.

Moreover, Revenue Ruling 2003-7 expressly warned taxpayers that a "different outcome" might be reached if the taxpayer was required to "deliver pledged shares." 2003-1 C.B. at 364. The IRS did not intend to extend non-recognition treatment to situations where the taxpayer's forward-contract counter-party obtained use and possession of the stock before the contract settled. Under the Master Stock Purchase Agreement's share-lending arrangement, TAC was required to deliver the pledged shares (without any transfer restrictions) to DLJ in 2000-2001. (Exs39-41 § 7.) Thus, taxpayers' Master Stock Purchase Agreement is outside the intended scope of Revenue Ruling 2003-7.[20]

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[20] Taxpayers assert (Br49 n.40) that they have the right to identify the shares being delivered. In substance, taxpayers exercised this right by selecting specific stock to be pledged as collateral, knowing that the pledged stock would be delivered to DLJ. Therefore, when TAC specified exactly which shares it would use as the pledged shares, it exercised its "right under Treas. Reg. § 1.1012-1(c) to specify which of its shares are to be delivered" to DLJ (Br49 n.40).

Not only does taxpayers' interpretation of Revenue Ruling 2003-7 conflict with the language of the ruling, and Treasury Regulation § 601.601(d)(2)(v), it also conflicts with the IRS's interpretation of the Ruling, as set out in the publicly available Coordinated Issue Paper addressing PVFCs that incorporate share-lending arrangements. The IRS's reasonable interpretation of its own Ruling is entitled to deference. *See Auer v. Robbins*, 519 U.S. 452, 461 (1997) (agency's interpretation of its own regulations is "controlling unless 'plainly erroneous or inconsistent with the regulation'") (citation omitted); *Polm Family Foundation, Inc. v. United States*, __ F.3d __, No. 09-5401, 2011 WL 1706959, at *3 (D.C. Cir. May 6, 2011) (IRS's reasonable interpretation of its own regulations is "controlling," even if "the interpretation appears for the first time in a legal brief").

The IRS's determination that a sale occurred when the stock was delivered to DLJ is not only supported by the authorities cited in the Revenue Ruling (such as *Hope*), but it is also supported by tax policy. If it is possible (as taxpayers urge) to provide the forward-purchaser full possession and control over stock — in addition to the opportunity for gain and risk of loss — without triggering a taxable event, there is no

incentive for the taxpayer to *ever* take the final steps that would create tax liability. Taxpayers would just extend indefinitely the effective settlement of a forward contract. *Cf.* IRS CCA201104031, 2011 WL 267711 (rejecting taxpayers' attempt to indefinitely defer settlement of forward contract through delivery of borrowed shares and the execution of a short sale).

The IRS's limiting interpretation of Revenue Ruling 2003-7 protects against such abuses, and implements the well-established principle that exclusions and exemptions from income must be "narrowly construed." *Umbach v. Commissioner*, 357 F.3d 1108, 1111 (10th Cir. 2003). It also recognizes that "Congress intended through § 61(a) . . . to bring within the definition of income any 'accessio[n] to wealth.'" *United States v. Burke*, 504 U.S. 229, 233 (1992) (citation omitted). Here, taxpayers received an enormous accession to wealth — exceeding $350 million — in 2000-2001, and taxpayers were entitled to keep that amount no matter what happened to the stock's future value. Taxpayers cannot avoid treating that amount as income in the year of

receipt by relying on a ruling that plainly is factually distinguishable, as the IRS itself made clear in the Coordinated Issue Paper.[21]

E. Taxpayers' Stock Transactions did not qualify for non-recognition treatment under § 1058

Taxpayers and Liberty also contend (Br44-48; AmBr18-23) that the stock transfers in 2000-2001 satisfy the requirements of § 1058, which exempts certain transfers of securities from recognition of gain or loss. Like their reliance on Revenue Ruling 2003-7, taxpayers' and Liberty's reliance on § 1058 is misplaced, as the Tax Court correctly determined.

1. Tax treatment of securities loans

By way of background, § 1058 was enacted in 1978 to clarify when a loan of stock would be treated as a taxable event or when it would be granted non-recognition treatment. Pub. L. 95-345, § 2(d)(1), 92 Stat. 482. Prior to its enactment, there had long existed, in the "stockbrokerage business," a transaction "commonly known . . . as the

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[21] As taxpayers acknowledge (Br27), TAC entered into the transactions at issue *before* the IRS issued Revenue Ruling 2003-7. Therefore, taxpayers have not — and cannot — claim that they relied on the ruling in executing these transactions.

'loan' of shares of stock." *Provost v. United States*, 269 U.S. 443, 449 (1926). In these securities "loans," the lender conveys the securities to the borrower, who in turn "deposits with the lend[er] the[ ] full market price" of the securities as collateral. *Id.* at 451. That deposit is adjusted daily "until the loan is returned" to reflect the stock's changing value. *Id.* at 451-452. The lender and borrower are obligated by contract to mimic the benefits and burdens of ownership in the securities (including the distribution of dividends), so that economically it is "as though the lender had retained the stock." *Id.* at 452.

The appropriate taxation of the transfer of securities pursuant to such "loans" long has posed something of a problem. On the one hand, title to the securities is transferred from the lender to the borrower (and, upon return, transferred back to the borrower); but, on the other hand, the lender remains in almost the same economic position as if he had never transferred that title, and typically will regain title at the end of the loan. In the *Provost* case, the Supreme Court held that, because dominion over the securities changed hands as part of this "loan," both the "loan" and the "return" of the securities were "taxable

transfers" subject to a stamp tax on transfers of securities. *Id*. at 450, 459.

Despite the Supreme Court's conclusion in *Provost* that the "loan" and "return" of securities were taxable transfers under the old stamp tax, in 1948 the IRS informed the New York Stock Exchange in a private letter ruling that the "loan" and "return" of securities pursuant to a securities loan terminable on demand would not be treated as a disposition of property for income tax purposes. *See* S. Rep. No. 95-762, at 4 (1978) (quoting the ruling). Similarly, the IRS concluded in a 1957 Revenue Ruling that the delivery of securities by an optionee to a broker pursuant to a contract calling for return of identical securities at a later date was not a taxable disposition. Rev. Rul. 57-451, 1957-2 C.B. 295. But in 1960, the IRS ruled (on the basis of the Supreme Court's reasoning in *Provost*) that because the lender no longer holds title to the security, he is not the owner for tax purposes and that therefore payments he receives from the borrower in lieu of dividends are not treated as dividends. Rev. Rul. 60-177, 1960-1 C.B. 9. In 1972, a further administrative ruling called into question the breadth of the

1957 Revenue Ruling's applicability. *See* IRS GCM 34967, 1972 WL 32250 (July 31, 1972).

By 1978, Congress had become concerned that "uncertainty" regarding the tax treatment of securities loans was impeding the ability of brokers to borrow securities necessary to complete market transactions. S. Rep. No. 95-762, at 3, 5. Accordingly, to "clarify existing law," Congress enacted § 1058. *Id*. at 7. As a limited exception to § 1001(c)'s recognition requirement, § 1058 provides that gain or loss on transfers of securities under "certain agreements" need not be recognized. To fit within its narrow exception, "an agreement" must:

> (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 [of the transfer];
>
> (3) not reduce the risk of loss or opportunity for gain of the transferor of the securities in the securities transferred; and
>
> (4) meet such other requirements as the Secretary may

by regulation prescribe.[22]

§ 1058(b). Thus, not every share-lending arrangement is entitled to non-recognition treatment. To qualify for non-recognition treatment, the governing agreement must satisfy *each* of the above-listed requirements.

2. The Master Stock Purchase Agreement does not qualify for non-recognition treatment under § 1058 because it reduces taxpayers' "risk of loss" and "opportunity for gain" from the stock

The Tax Court correctly determined that the Master Stock Purchase Agreement failed to satisfy the third requirement. (Op48-50.) As explained in detail above (at pp. 34-44), the Master Stock Purchase Agreement reduced taxpayers' "risk of loss" and "opportunity for gain" from the stock and thus violated § 1058(b)(3)'s requirements.[23]

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[22] No final regulations have been issued.

[23] The Tax Court did not address the Commissioner's alternative argument that the Master Stock Purchase Agreement violated § 1058(b)(2), which requires that the agreement provide the stock-lender the economic benefit of "all" dividends paid on the lent stock. *E.g.*, Doc. 28 at 131-135. As noted above (n.10), the Master Stock Purchase Agreement did *not* preserve TAC's right to all dividends. *See* Ex148 at 6 (taxpayers' expert notes that TAC transferred "portions" of the "dividend payouts" to DLJ). Taxpayers' claim to the contrary (Br45) lacks record support.

Taxpayers' contention (Br48) (echoed by Liberty (AmBr18-22)) that 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" lacks merit because — as demonstrated above — the Tax Court properly found that the PVFCs and the Share Lending Agreements were both part of one integrated agreement, and that agreement limited TAC's risk of loss and opportunity for gain. The term "agreement" in § 1058 includes the parties' entire arrangement regarding the stock at issue and may be evidenced by multiple contracts. *Samueli v. Commissioner*, 132 T.C. 37, 41 (2009) (agreement consisted of "five written documents"), *appeal pending*, No. 09-72457 (9th Cir.). As this Court has explained, in interpreting another reference to "agreement" in the Internal Revenue Code, "[a]n 'agreement' is not limited to individually negotiated contracts," but "may also refer generally to 'a manifestation of mutual assent on the part of two or more persons.'" *Public Employees' Retirement Bd. v. Shalala*, 153 F.3d 1160, 1166 (10th Cir. 1998) (quoting Restatement (Second) of Contracts § 3); *see Steen*, 509 F.2d at 1403 ("Where two or more written agreements are contemporaneously

executed as part of one complete transaction, we have labeled 'elemental' the proposition that they must be construed together."). Section 1058's "agreement" thus incorporates the parties' entire arrangement regarding the transferred stock, not simply one step in that arrangement.

Taxpayers' Stock Transactions included multiple contracts, each a critical component of one integrated agreement, and each dependent on the other's provisions, as detailed above in Section C. Those contracts, taken as one integrated whole, constitute the parties' agreement for purposes of § 1058. (Op46, 49.) Indeed, the very provisions in the PVFCs that taxpayers' own expert recognized as necessary to make the Share Lending Agreements economically workable without a formal pledge of collateral (*i.e.*, DLJ's up-front cash payments and TAC's settlement obligations) are precisely the same terms that reduce TAC's exposure to loss and opportunity for gain. To hold otherwise would permit parties to circumvent § 1058's requirements by the simple

expedient of drafting two documents, one labeled "loan agreement" and the other containing terms that violate § 1058.[24]

Denying non-recognition treatment to a share-lending arrangement that is part of a stock-purchase agreement is fully consistent with Congressional intent. Although Congress enacted § 1058 to encourage share lending, share lending can — and does — occur without being incorporated with a stock-purchase agreement, as taxpayers and Liberty emphasize (Br52; AmBr12, 24). Therefore, the Tax Court's decision does not (as Liberty contends (AmBr5)) discourage security loans. Moreover, Liberty's related contention that the court's decision serves no "governmental interest" (AmBr5) ignores the $350 million in monetized gain that taxpayers obtained, but seek to disregard for federal tax purposes. The government has a critical interest in implementing Congress's mandate that all gains, except

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[24] Moreover, although there is no basis for restricting the term "agreement" in § 1058 to a single document, in this case a single document encompassed both the PVFCs and the Share Lending Agreements — *i.e.*, the Master Stock Purchase Agreement. The individual contracts — the Transaction Schedules, the Pledge Agreements, and the Share Lending Agreements — all amended, and were incorporated into, the Master Stock Purchase Agreement. (Ex9 §§ 4.01(b)-(f), 8.01(a) & (e), exhibits A-D.)

those specifically exempted, be taxed, and that all exemptions be "'narrowly construed.'" *Commissioner v. Schleier*, 515 U.S. 323, 328 (1995) (citation omitted).

3. Taxpayers' reliance on authorities other than § 1058 to establish a basis for non-recognition treatment for their purported share lending is misplaced

If a transfer of stock fails to comply with § 1058's requirements, then the transfer is a taxable event. *Samueli*, 132 T.C. 37. Although § 1058 "says nothing about tax ownership," it "indirectly supports the conclusion that a securities loan is an ownership change because it provides for nonrecognition treatment — something that would be needed only if the underlying transaction would (or at least could) otherwise be a realization event." Raskolnikov, *Contextual Analysis of Tax Ownership*, 85 Boston Univ. L. Rev. 431, 484 (2005). Liberty recognizes this basic principle, as did taxpayers in the Tax Court proceedings. *See* AmBr10 ("As long as the agreement that governs the stock loan complies with § 1058(b), the lender recognizes no taxable gain."); Doc. 29, Petitioners' Post-Trial Br. 76 (§ 1058 was enacted "to

clarify the basis on which tax-free treatment was derived").[25] Taxpayers' contrary suggestion on appeal (Br44) that there is some other basis upon which non-recognition could be predicated here lacks support.

In any event, the authorities cited by taxpayers (Br34) — § 1036,[26] Treasury Regulation § 1.1001-1(a),[27] and Revenue Ruling 57-451[28] — do not support their position here. Each of those authorities depends on the incorrect premise that DLJ and TAC exchanged "solely" stock for stock (Br42). As the Tax Court found, the Master Stock Purchase

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[25] Given taxpayers' representation to the Tax Court that § 1058 established the basis for non-recognition treatment, their complaint on appeal (Br31-32, 43-44) that the court discussed only § 1058 as a basis for non-recognition (and not other "authorities") is unfounded.

[26] Section 1036 provides that "[n]o gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation." § 1036(a).

[27] Treasury Regulation § 1.1001-1(a) provides that taxable income includes gain "realized from the conversion of property into cash." Treas. Reg. § 1.1001-1(a).

[28] In Revenue Ruling 57-451, the IRS determined that a taxpayer's deposit of stock with a broker, available for use in the broker's business, would qualify for non-recognition treatment under § 1036, where (among other things) the taxpayer did not receive any consideration in exchange for the deposit. 1957-2 C.B. 295.

Agreement and its supplemental documents were one integrated transaction, pursuant to which TAC exchanged the stock at issue for cash exceeding $350 million. Therefore, TAC in no way exchanged stock solely for stock, and thus its Stock Transactions do not qualify for non-recognition under the authorities they attempt to rely on. *Cf. Helvering v. Southwest Consol. Corp.*, 315 U.S. 194, 198 (1942) ("Congress has provided that the assets of the transferor corporation must be acquired in exchange 'solely' for 'voting stock' of the transferee. 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement.").

CONCLUSION

The Tax Court's decision is correct and should be affirmed.

STATEMENT REGARDING ORAL ARGUMENT

Counsel for the Commissioner are of the view that oral argument may be helpful in this case.

Respectfully submitted,

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JUNE 2011

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