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UNITED STATES TAX COURT

REPORTS

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UNITED STATES TAX COURT
WASHINGTON, D.C.

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REPORTS

OF THE

UNITED STATES TAX COURT

TBL LICENSING LLC F.K.A. THE TIMBERLAND COMPANY, AND SUBSIDIARIES (A CONSOLIDATED GROUP), PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 21146-15. Filed January 31, 2022.

F1, a foreign corporation, transferred to F2, its foreign subsidiary, the sole member interest in DE, an entity disregarded for Federal tax purposes. DE owned P, a domestic limited liability company then treated as a corporation for Federal tax purposes. P owned intangible property, within the meaning of I.R.C. § 936(h)(3)(B). P then elected to be disregarded as a separate entity for Federal tax purposes. P and R agree that F1's transfer of DE to F2 and P's election to be disregarded constituted a "reorganization" within the meaning of I.R.C. § 368(a)(1)(F) and that, as part of that reorganization, P constructively transferred intangible property to F2. For the taxable years 2011 through 2017, US1, a domestic corporation and indirect parent of F1 and F2, included in its income deemed annual payments under I.R.C. § 367(d)(2)(A)(ii)(I) attributable to that constructive transfer. *Held*: In order for the operative nonrecognition rules of I.R.C. §§ 354, 356, and 361 to apply to a reorganization described in I.R.C. § 368(a)(1)(F), the transaction—however actually effected—should be treated as involving (1) a transfer of the old corporation's assets to the new corporation, in exchange for stock of the new corporation and the new corporation's assumption of any liabilities of the old corporation, and (2) the old corporation's distribution to its shareholders of the stock of the new corporation in cancellation of their stock in the old corporation. *Held*, *further*, the constructive distribution by P to F1 of F2 stock that occurred as part of the reorganization by which F2 acquired P was a "disposition" within the meaning of I.R.C. § 367(d)(2)(A)(ii)(II). *Held*, *further*, P's constructive distribution of F2 stock to F1 necessarily followed the constructive transfer of intangible property by P to F2 that occurred as part of the reorganization; consequently, in the absence of a provision in the regulations to the contrary, P is required to recognize gain in the intangible property under I.R.C. § 367(d)(2)(A)(ii)(II). *Held*, *further*, no provision in the regulations allows reporting of deemed annual payments under I.R.C. § 367(d)(2)(A)(ii)(I) rather than immediate gain recognition under I.R.C. § 367(d)(2)(A)(ii)(II) by reason of P's constructive transfer of intangible property. Because P was no longer recognized as a separate entity for Federal tax purposes after the reorganization, it could not report the deemed annual payments described in I.R.C. § 367(d)(2)(A)(ii)(I), and US1 was neither the U.S. transferor of the intangible property nor the recipient of the FS2 stock. *Held*, *further*, the fair market value of transferred intangible property, for the purpose of determining gain that must be recognized under I.R.C. § 367(d)(2)(A)(ii)(II), should be determined on the basis of the property's entire expected useful life, without regard to the 20-year limit imposed, for some purposes, by Temp. Treas. Reg. § 1.367(d)-1T(c)(3).

James P. Fuller, *Kenneth B. Clark*, *Larissa B. Neumann*, *Julia V. Ushakova-Stein*, and *Sean P. McElroy*, for petitioner.

John E. Budde, *Gretchen A. Kindel*, *Kimberly B. Tyson*, and *James M. Cascino*, for respondent.

OPINION

HALPERN, Judge: In a notice dated May 11, 2015, respondent advised petitioner that he had determined a deficiency of $504,691,690 in the income tax of the affiliated group of corporations of which petitioner had been the common parent for the group's taxable year ended September 23, 2011. We must decide whether petitioner is required to recognize ordinary income under section 367(d)(2)(A)(ii)(II)[1] as a result of a constructive transfer of intangible property to TBL Investment Holdings GmbH (TBL GmbH), a Swiss corporation, and, if so, whether, in determining the amount of that income, the prop-

[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code (Code), Title 26 U.S.C., in effect for the year in issue, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect for the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

erty should be treated, as a matter of law, as having a useful life limited to 20 years. Each party has moved for summary judgment. In addition, respondent has submitted a Motion in Limine seeking to exclude stipulations set forth in the parties' Stipulations of Fact and exhibits offered by petitioner. Respondent has also submitted a Motion to Strike material included in the Memorandum petitioner submitted in support of its Motion for Summary Judgment. For the reasons explained below, we will grant respondent's Motion for Summary Judgment and deny petitioner's Motion for Summary Judgment. Because we conclude that the materials subject to respondent's Motion in Limine or Motion to Strike neither demonstrate petitioner's entitlement to summary judgment nor call into question respondent's entitlement to summary judgment, we will deny as moot respondent's Motion in Limine and Motion to Strike.

Background

The events that gave rise to the dispute before us occurred as part of a postacquisition restructuring carried out after a business combination involving VF Corp. (VF) and the Timberland Co. (Timberland). Through its subsidiaries, VF designs, manufactures, and sells apparel and footwear under brands such as Lee, Wrangler, Nautica, Vans, and the North Face. Timberland's business involved the design, development, manufacture, marketing, and sale of footwear, apparel, and accessories under its own brand and others, such as SmartWool.

The VF and Timberland businesses were combined on September 13, 2011, by means of a merger into Timberland of an acquisition subsidiary of TBL International Properties, LLC (International Properties). In the merger, the former Timberland shareholders received cash in exchange for their Timberland stock.

VF had organized International Properties in August 2011 as a limited liability company under Delaware law. The parties have stipulated that International Properties "has been a disregarded entity from the time of its formation."

Petitioner is also a Delaware limited liability company whose sole member interest was owned, throughout the events in issue, by International Properties. The parties have stipulated that "[p]etitioner was treated as a corporation for U.S. federal income tax purposes at all times during the taxable year at issue."

Before the merger in which International Properties acquired Timberland, VF transferred its membership interest in International Properties to VF Enterprises S.à.r.l. (VF Enterprises), an indirect foreign subsidiary of VF. As part of the postacquisition restructuring, petitioner came to own Timberland's intangible property, including trademarks, foreign workforce, and foreign customer relationships.

On September 22, 2011, after the close of the merger by which International Properties acquired the Timberland stock and after petitioner had acquired Timberland's intangible property, VF Enterprises contributed to TBL GmbH the sole member interest in International Properties.[2] About a week later, petitioner elected under Treasury Regulation § 301.7701-3(c)(1)(i) to be disregarded as an entity separate from its owner, effective September 24, 2011.

On the Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation, included with its Federal income tax return for the taxable year ended September 23, 2011, petitioner reported that the trademarks it acquired from Timberland had a fair market value of $1,274,100,000. Respondent assigned the same value to the trademarks in computing the deficiency in issue.

The parties have stipulated that Lee Bell, Inc. (Lee Bell), an indirect domestic subsidiary of VF and indirect parent of VF Enterprises, reported income under section 367(d)(2)(A)(ii)(I) in specified amounts for the taxable years 2011 through 2017. The stipulation does not attribute those amounts to petitioner's constructive transfer of intangible property to TBL GmbH, but the materials the parties have submitted in support of and opposition to the pending Motions for Summary Judgment demonstrate that each accepts that the inclusions in Lee Bell's income relate to that transfer.[3] The parties also

[2] The record provides no indication that TBL GmbH owned any material assets before it acquired the sole member interest in International Properties. The parties stipulated that VF Enterprises capitalized TBL GmbH with cash equal to "the minimum capital amount for a GmbH under Swiss law."

[3] For example, respondent acknowledges that the income reported by Lee Bell is "attributable to the IP." And petitioner states that Lee Bell included

stipulated that Lee Bell never owned the intangible property that petitioner constructively transferred to TBL GmbH.

Discussion

I. *Introduction*

Petitioner and respondent agree that, in the restructuring that followed the acquisition of Timberland by VF Enterprises, through International Properties,[4] petitioner came to own Timberland's intangible property and then made a constructive transfer of that property to TBL GmbH, a subsidiary of VF Enterprises. They agree that petitioner's constructive transfer of intangible property occurred as part of a "reorganization" described in section 368(a)(1)(F). And they agree that, because petitioner—then treated as a U.S. corporation—constructively transferred intangible property to a foreign corporation in a transaction that would otherwise qualify for

deemed annual payments in income "[a]s a result of the Outbound F Reorganization" by which TBL GmbH acquired petitioner.

[4] The parties apparently disagree as to how the Timberland acquisition was financed. In the Memorandum it submitted in support of its Motion for Summary Judgment, petitioner proposed a finding of fact that VF Enterprises "funded the acquisition of Timberland from existing sources of cash, collecting receivables, and through related party borrowings." Respondent objects to petitioner's proposed finding. Respondent alleges that VF was the ultimate source of the funds VF Enterprises used to acquire Timberland. And the materials petitioner cites in support of its proposed finding are among those covered by respondent's Motion in Limine and Motion to Strike. Respondent's principal policy objection to the transaction in issue, however, seems to be that, in his view, the transaction involved the use of "untaxed foreign earnings and profits to acquire an unrelated domestic target." We see no respect in which the application of section 367(d) to the transaction should turn on whether it occurred as part of a larger transaction that may have involved a tax-free repatriation of foreign earnings. In any event, if VF was the ultimate source of the funds used to acquire Timberland, as respondent alleges, we do not see how the transaction could be viewed as having effected a repatriation of earnings of VF Enterprises that had not previously been subject to U.S. tax. More generally, each party's Motion for Summary Judgment necessarily rests on the premise that the case presents "no genuine dispute as to any material fact." Rule 121(b). Therefore, each party has implicitly represented that any factual dispute concerning the source of the funds VF Enterprises used to acquire Timberland is not material to the legal issue before us. And we, as well, see no respect in which the financing of the acquisition would affect the question of how section 367(d) applies to the transaction in issue.

nonrecognition treatment under section 361(a), section 367(d) applies to the transfer. The parties disagree, however, on the consequences of section 367(d)'s application.

The rules of section 367 provide an overlay to the corporate nonrecognition provisions found in subchapter C of subtitle A, chapter 1 of the Code. When one of the parties to a transaction is a foreign corporation, affording the transaction the same nonrecognition treatment it would receive if the parties were domestic could lead to inappropriate results. When foreign corporations are involved, property can move in and out of the U.S. tax jurisdiction. Reflecting those changes in status requires adjustments to the normal nonrecognition rules. In particular, a U.S. person who makes an "outbound" transfer of property to a foreign corporation might be required to recognize gain even if, had the transfer been made to a U.S. corporation, it would have been entitled to nonrecognition treatment. Section 367(a), which applies to outbound transfers of most types of property, achieves that result by providing, subject to significant exceptions, that the foreign corporation that receives the property is not treated as a corporation. Outbound transfers of intangible property are not covered by section 367(a) but are instead addressed by section 367(d). Section 367(d) generally requires the U.S. transferor of intangible property to recognize gain in the form of ordinary income, but the timing of that income recognition varies depending on the circumstances. The principal dispute between the parties centers on the timing of the income recognition required by section 367(d).

II. *Recharacterizing the Transaction*

The parties' disagreement concerning the effect of section 367(d) turns, in part, on the proper characterization of the larger transaction of which petitioner's constructive transfer of intangible property was a part. The parties agree that the actual transaction should be recharacterized for Federal income tax purposes but disagree on how. Therefore, we begin our analysis by describing the actual transaction and deciding on the appropriate recharacterization.

A. *The Actual Transaction*

The actual events that gave rise to petitioner's constructive transfer of intangible property were quite simple. First, VF Enterprises, an indirect foreign subsidiary of VF, contributed to TBL GmbH, its own foreign subsidiary, the sole member interest in International Properties. At that time, International Properties owned the sole member interest in petitioner, and petitioner owned assets, including intangible property, that it had acquired from Timberland. Petitioner then elected to be disregarded as an entity separate from its owner, International Properties (which, in turn, was disregarded as an entity separate from TBL GmbH). That is the extent of the actual events that gave rise to the dispute before us. Those events did not include a transfer of intangible property. Upon the completion of those events, petitioner continued to own the Timberland intangible property. Yet, the parties agree that petitioner should be treated as having made a transfer of intangible property to which section 367(d) applies. Therefore, both parties accept that the actual transaction must be recharacterized in some fashion.

Adding further complexity, the necessary recharacterization must proceed in stages. The first stage takes into account various fictions resulting from application of the entity classification regulations.

B. *Impact of the Entity Classification Regulations*

As a domestic "eligible entity" with a single owner, International Properties would have been classified as a disregarded entity unless it had made an election to be classified as a corporation.[5] *See* Treas. Reg. § 301.7701-3(b)(1)(ii). We infer from the parties' stipulation that International Properties has always been disregarded that it made no election to be classified as a corporation.

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[5] The regulations use the term "eligible entity" to refer to a "business entity" other than a state law corporation or other entity that is required to be classified as a corporation for Federal tax purposes. Treas. Reg. § 301.7701-3(a). An entity is a business entity if it is recognized for Federal tax purposes and not classified as a trust "or otherwise subject to special treatment under the Internal Revenue Code." Treas. Reg. § 301.7701-2(a). Thus, limited liability companies like International Properties are generally eligible entities.

As a domestic eligible entity, petitioner would have been classified, in the absence of an election to the contrary, as either a partnership or a disregarded entity, depending on the number of its owners. *Id.* subpara. (1). We thus infer from the parties' stipulation that petitioner was treated as a corporation throughout the taxable year in issue (ended September 23, 2011) that petitioner initially filed an election under Treasury Regulation § 301.7701-3(c)(1)(i) to be classified as an "association" (and thus as a corporation). *See* Treas. Reg. § 301.7701-2(b)(2) (including within the definition of "corporation" any "association (as determined under § 301.7701-3)").

Because International Properties was disregarded as an entity separate from its owner and petitioner was, on September 22, 2011, classified as a corporation, VF Enterprises' contribution to TBL GmbH of the sole member interest in International Properties should be treated, in the first instance, as a contribution of "stock" in petitioner.

Next, we consider the effects of what we infer to have been petitioner's second entity classification election: the election that became effective on September 24, 2011, to be disregarded as an entity separate from its owner. As a general matter, an eligible entity cannot make more than one entity classification election every five years. Treas. Reg. § 301.7701-3(c)(1)(iv). That limitation, however, does not apply to "[a]n election by a newly formed eligible entity that is effective on the date of formation." *Id.* Because the parties accept the validity of petitioner's election to be a disregarded entity, we assume that its prior classification as a corporation resulted from an election that was effective on the date of its formation.

The regulations provide a series of constructs to explain an entity's change in classification for Federal tax purposes. Treasury Regulation § 301.7701-3(g)(1)(iii) supplies the construct for cases in which an entity with a single owner that had been classified as an association elects to be disregarded. In that event, "the following is deemed to occur: The association distributes all of its assets and liabilities to its single owner in liquidation of the association." Treas. Reg. § 301.7701-3(g)(1)(iii).

Taking into account only the constructs required to explain the Federal tax classifications of the participating entities, the actual transaction would be recharacterized as a (1) contribution by VF Enterprises to TBL GmbH of the stock of petitioner (then a corporation), followed by (2) petitioner's distribution of all of its assets and liabilities to TBL GmbH in liquidation. Under that construct, petitioner *would* be treated as having transferred intangible property. But that transfer—a liquidating distribution to TBL GmbH—would not have been a transfer to which section 367(d) applies. Section 367(d) applies to a transfer of intangible property by a U.S. person to a foreign corporation only if the transfer takes the form of "an exchange described in section 351 or 361." For an exchange to be described in section 351 or 361, it must be a transfer of property in exchange—at least in part—for stock of the recipient. Under the construct supplied by the entity classification regulations, petitioner would not be treated as having received TBL GmbH stock in exchange for the transferred intangible property. Instead, petitioner would be treated as having distributed the intangible property in liquidation—in cancellation of its own stock. Because the parties agree that petitioner made a transfer of intangible property to which section 367(d) applies, it follows that our recharacterization of the actual transfer remains incomplete.

C. *Further Recharacterization Under the Reorganization Rules*

The next stage of recharacterization results from the application of the reorganization rules to the transactions imputed under the entity classification regulations. The parties stipulated that "[t]he contribution by VF Enterprises S.à.r.l. of TBL International Properties LLC to TBL Investment Holdings GmbH . . . combined with the check-the-box election for Petitioner to be treated as a disregarded entity . . . was an F reorganization under Section 368(a)(1)(F)." Section 368(a)(1)(F) includes within the definition of "reorganization" "a mere change in identity, form, or place of organization of one corporation, however effected." In 2015, the Treasury Department issued regulations that elaborate on that sparse statutory definition. Treas. Reg. § 1.368-2(m). By its terms, however, paragraph (m) of Treasury Regulation § 1.368-2 "applies to transactions occurring on or after September 21, 2015." *Id.* subpara. (5). The regulations thus do not apply to the transaction in issue. For periods before the current regulations were effective, elaboration on the statutory definition was left to the courts. One leading case stated:

> Although the exact function and scope of the (F) reorganization in the scheme of tax-deferred transactions described in section 368(a)(1) have never been clearly defined, it is apparent from the language of subparagraph (F) that it is distinguishable from the five preceding types of reorganizations as encompassing only the simplest and least significant of corporate changes. The (F)-type reorganization presumes that the surviving corporation is the same corporation as the predecessor in every respect, except for minor or technical differences . . . . For instance, the (F) reorganization typically has been understood to comprehend only such insignificant modifications as the reincorporation of the same corporate business with the same assets and the same stockholders surviving under a new charter either in the same or in a different State, the renewal of a corporate charter having a limited life, or the conversion of a U.S.-chartered savings and loan association to a State-chartered institution.
>
> The decisions involving subparagraph (F) or its counterpart in prior revenue acts consistently have imposed at least one major limitation on transactions that have been claimed to qualify thereunder: if a change in stock ownership or a shift in proprietary interest occurs, the transaction will fail to qualify as an (F) reorganization.

Berghash v. Commissioner, 43 T.C. 743, 752 (1965) (footnote omitted), *aff'd*, 361 F.2d 257 (2d Cir. 1966).

The parties' stipulation that VF Enterprises' contribution to TBL GmbH of the sole member interest in International Properties and petitioner's election to be a disregarded entity resulted in a reorganization described in section 368(a)(1)(F) is consistent with the caselaw interpreting that section. Accordingly, we see no reason to set aside the parties' stipulation. TBL GmbH emerged from the construct imposed by the entity classification regulations as "the same corporation" as petitioner "except for minor or technical differences." *Id.* VF Enterprises' transfer to TBL GmbH of the stock of petitioner and the deemed liquidation of petitioner into TBL GmbH simply "reincorporat[ed]" petitioner's business. *Id.* After the transactions, TBL GmbH owned "the same assets" and had "the same stockholder[]" as petitioner. *Id.* Petitioner's business survived in a new legal form, incorporated in Switzerland rather than Delaware.

That the constructive transactions resulting from the application of the entity classification regulations effected a reorganization described in section 368(a)(1)(F) requires further recharacterization. Section 368(a) is only a definitional provision; it describes those transactions that qualify as reorganizations but does not itself prescribe their tax consequences. The operative rules are found elsewhere. Sections 354 and 356 provide nonrecognition treatment, in whole or in part, at the shareholder level, and section 361 provides nonrecognition treatment at the corporate level. Fitting an F reorganization within the operative nonrecognition rules requires that the transaction—however actually effected—be treated as a transfer of assets by the old corporation to the new in exchange for stock of the new corporation and the old corporation's distribution of that stock to its shareholders. Under that construct, the old corporation's asset transfer will qualify for nonrecognition treatment under section 361(a) and the stock distribution will qualify for nonrecognition treatment under section 361(c).[6] The shareholders' exchange of stock of the old corporation for that of the new will receive nonrecognition treatment under section 354(a).[7]

Treasury Regulation § 1.367(a)-1(f) confirms that the above construct applies at least to those reorganizations described in section 368(a)(1)(F) in which "the transferor corporation is a domestic corporation, and the acquiring corporation is a foreign corporation." In those circumstances

> there is considered to exist—
>
> (i) A transfer of assets by the transferor corporation to the acquiring corporation under section 361(a) in exchange for stock (or stock and securities) of the acquiring corporation and the assumption by the acquiring corporation of the transferor corporation's liabilities;

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[6] Section 361(a) provides: "No gain or loss shall be recognized to a corporation if such corporation is a party to a reorganization and exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization." Under section 361(c), a corporation that is a party to a reorganization does not recognize gain or loss on a distribution of "qualified property" in pursuance of the plan of reorganization. For purposes of section 361(c), the term "qualified property" includes "any stock in (or right to acquire stock in) another corporation which is a party to the reorganization . . . if such stock (or right) . . . is received by the distributing corporation in the exchange." § 361(c)(2)(B)(ii).

[7] Section 354(a) provides: "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities . . . in another corporation a party to the reorganization."

(ii) A distribution of the stock (or stock and securities) of the acquiring corporation by the transferor corporation to the shareholders (or shareholders and security holders) of the transferor corporation; and

(iii) An exchange by the transferor corporation's shareholders (or shareholders and security holders) of their stock (or stock and securities) of the transferor corporation for stock (or stock and securities) of the acquiring corporation under section 354(a).

Treas. Reg. § 1.367(a)-1(f)(1).

Although the Treasury Department adopted the rule quoted above in final form in September 2015, T.D. 9739, 2015-41 I.R.B. 528, the rule applies "to transactions occurring on or after January 1, 1985," Treas. Reg. § 1.367(a)-1(g)(4). The rule first appeared in proposed and temporary regulations issued in January 1990. T.D. 8280, 1990-1 C.B. 80.

The preamble to the 1990 temporary regulations states that they were intended to "clarify" that reorganizations described in section 368(a)(1)(F) include "exchanges under sections 354(a) and 361(a)." *Id.* at 80. The Treasury Department provided the guidance "to apprise taxpayers of the transfers occurring in a reorganization and to prevent tax avoidance in these transactions." *Id.*

As explained above, the construct described in Treasury Regulation § 1.367(a)-1(f) would be necessary, regardless of the jurisdictions in which the parties are incorporated, to allow for the application to the transaction of the operative nonrecognition rules provided in sections 354 and 361. Taxpayers would have no apparent incentive to argue for an alternative construct. Any construct that would avoid a section 367 transfer would also avoid a section 361(a) exchange, thereby calling into question the eligibility of the transaction for nonrecognition treatment in the first instance. The parties involved in an outbound F reorganization, however, might have argued that their transaction, having effected "only the simplest and least significant of corporate changes," *Berghash*, 43 T.C. at 752, did not involve any transfers or distributions at all—that the reorganization was a nonevent. Treasury Regulation § 1.367(a)-1(f) forecloses any such argument.[8]

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[8] An argument that an outbound F reorganization involves no actual or constructive exchanges or distributions would have been difficult to sustain in any event in the face of *United States v. Phellis*, 257 U.S. 156 (1921), and *Marr v. United States*, 268 U.S. 536 (1925). In those cases, the Supreme Court concluded that participating shareholders recognized income

Respondent relies on Treasury Regulation § 1.367(a)-1(f) to establish that the constructive events that the parties agree constituted an F reorganization included a distribution of TBL GmbH stock by petitioner to VF Enterprises. Petitioner describes respondent's reliance on that regulation as "erroneous[]." According to petitioner, "Treas. Reg. § 1.367(a)-1 applies to § 367(a), not § 367(d) or the § 367(d) Regulations."[9]

Petitioner's position, as we understand it, rests on paragraph (a) of Temporary Treasury Regulation § 1.367(a)-1T (captioned "Purpose and scope of regulations"), as adopted in 1986. Temporary Treasury Regulation § 1.367(a)-1T(a), when initially adopted, began as follows: "These regulations set forth rules relating to the provisions of section 367(a) concerning certain transfers of property to foreign corporations. This § 1.367(a)-1T provides general rules explaining the effect of section 367(a)(1) and describing the transfers of property that are subject to the rule of that section." T.D. 8087, 1986-1

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or gain from transactions in which New Jersey corporations reincorporated in Delaware. As Justice Brandeis observed in *Marr*, 268 U.S. at 541: "[T]he new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey." If a New Jersey corporation is "essentially different" from a Delaware corporation, so that a reincorporation from one state to the other would be a taxable transaction in the absence of an applicable nonrecognition rule, then, a fortiori, a Swiss corporation cannot be viewed as the same entity as a Delaware corporation (much less a Delaware limited liability company that has elected, for Federal tax purposes, to be treated as a corporation). A year after the issuance of the 1990 proposed and temporary regulations, the Court relied on *Phellis* and *Marr* to hold that "an exchange of property gives rise to a realization event so long as the exchanged properties are 'materially different'—that is, so long as they embody legally distinct entitlements." *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554, 566 (1991).

[9] Petitioner's submissions display a marked penchant for defined terms, demonstrated by the four-page glossary included with its motion for summary judgment. Petitioner's glossary defines "§ 367(d) Regulations" as "Temp. Treas. Reg. § 1.367(d)-1T that was in effect throughout the calendar year 2011." Respondent purports to "object[]" to petitioner's use of its own defined terms "on the ground that they are not neutral terms with neutral definitions to assist the reader, but rather carry embedded interpretations or connotations which skew their meaning." To the extent that our quotations of petitioner's arguments include petitioner's own defined terms, we intend those quotations only to indicate what petitioner argues. We recognize that the definitions petitioner offers of the terms of its own creation, like the arguments of parties generally, may not be "neutral."

C.B. 175, 177. When the Treasury Department added paragraph (f) to Temporary Treasury Regulation § 1.367(a)-1T in 1990, it did not revise paragraph (a). T.D. 8280, 1990-1 C.B. at 82. Therefore, petitioner apparently reasons, the rule that now appears in Treasury Regulation § 1.367(a)-1(f), when initially adopted, applied only for the purpose of implementing section 367(a) and had no application to section 367(d). And when the rule was adopted in its current form, the Treasury Department did not indicate an intent to broaden the provision's scope.

From a narrow, technical standpoint, petitioner's argument might have some merit. But the argument raises difficult questions that petitioner neither addresses nor even acknowledges. As noted above, the Treasury Department added paragraph (f) to Temporary Treasury Regulation § 1.367(a)-1T "to prevent tax avoidance" in outbound F reorganizations. T.D. 8280, 1990-1 C.B. at 80. The preamble to the 1990 amendments did not limit their purpose to preventing the avoidance of section 367(a). We can think of no reason why concerns about tax avoidance in outbound F reorganizations would be limited to those involving tangible property. Moreover, as respondent observes, petitioner's argument suggests that its transfer of intangible property was governed by a construct different from that applicable to its transfer of other property. Petitioner offers no explanation for why and how an outbound F reorganization would be treated as having been effected by two different and contrary constructs.

Even if we were to leave policy considerations (and perhaps common sense) aside and accept petitioner's technical argument that the construct provided in Treasury Regulation § 1.367(a)-1(f) does not apply to the F reorganization in issue, we would need to identify an alternative construct to explain the transaction. That construct would necessarily include an asset transfer described in section 361(a). (Otherwise, section 367(d) would not apply to the transaction in the first place.) Thus, petitioner would necessarily be treated as having transferred its intangible property to TBL GmbH in exchange for TBL GmbH stock. Upon the completion of the transaction, however, petitioner no longer owned any TBL GmbH stock. In fact, petitioner was no longer recognized as a corporation or any other type of entity for Federal tax purposes. As a result of its second entity classification election, petitioner was disregarded as an entity separate from TBL GmbH. Upon completion of the transaction, VF Enterprises owned all of the TBL GmbH stock. Therefore, any TBL GmbH stock constructively issued to petitioner must have found its way—by some means—to VF Enterprises. The circumstances do not allow for treating petitioner as having received consideration in exchange for the TBL GmbH stock that ended up with VF Enterprises. It follows that petitioner's constructive disposition of that stock necessarily took the form of a distribution by petitioner to VF Enterprises in respect of the stock of petitioner that VF Enterprises was treated as having owned while petitioner was classified as a corporation. If that distribution was not "in pursuance of the plan of reorganization," and therefore not covered by section 361(c), petitioner would have recognized gain on the distribution in an amount equal to the gain in the property it constructively transferred to TBL GmbH. *See* § 311(b) (requiring recognition of gain on distributions by a corporation of appreciated property), § 358(a)(1) (providing as a general rule that the basis of nonrecognition property received in a section 361 exchange equals the basis of the property exchanged).

On balance, we find unpersuasive petitioner's argument about the scope of Treasury Regulation § 1.367(a)-1(f). Treasury Regulation § 1.367(a)-1(a) provides:

> Section 367(a)(1) provides the general rule concerning transfers of property by a United States person . . . to a foreign corporation. Paragraph (b) of this section provides general rules explaining the effect of section 367(a)(1). Paragraph (c) of this section describes transfers of property that are described in section 367(a)(1). Paragraph (d) of this section provides definitions that apply for purposes of sections 367(a) and (d) and the regulations thereunder. Paragraphs (e) and (f) of this section provide rules that apply to certain reorganizations described in section 368(a)(1)(F). Paragraph (g) of this section provides dates of applicability. For rules concerning the reporting requirements under section 6038B for certain transfers of property to a foreign corporation, see § 1.6038B-1.

While paragraphs (b) and (c) of Treasury Regulation § 1.367(a)-1 are limited to the interpretation of section 367(a), no such limitation applies to paragraph (f). Even if petitioner were correct that Temporary Treasury Regulation § 1.367(a)-1T(f) applied only for the purpose of implementing section 367(a), that temporary provision expired three years after its issuance. *See* § 7805(e)(2). Petitioner's transaction is governed not by the expired temporary provision but by the provision proposed in 1990 and adopted in final form in 2015. We reject as contrary to the stated purpose of the provision any inference that might otherwise be drawn from the failure to amend Temporary Treasury Regulation § 1.367(a)-1T(a) when the provision in question was initially adopted as paragraph (f) of that same regulation.[10]

In any event, we do not regard the applicability of Treasury Regulation § 1.367(a)-1(f) as dispositive. As we read that provision, it simply clarifies that the construct that necessarily applies to an F reorganization to allow for the application of the operative nonrecognition provisions of sections 354 and 361 applies without regard to whether the transaction is "inbound, outbound, [or] foreign to foreign." T.D. 8280, 1990-1 C.B. at 80. To ensure that the operative nonrecognition provisions apply, we would characterize the transaction that the parties agree to have been an F reorganization as involving both a transfer of property described in section 361(a) and a distribution of the stock of the acquiring corporation described in section 361(c). We would apply that construct regardless of whether Treasury Regulation § 1.367(a)-1(f) directs us to do so.

We thus need not address petitioner's argument that the circumstances surrounding the adoption of Treasury Regula-

[10] Petitioner has no cause for complaint about the retroactive effect of Treasury Regulation § 1.367(a)-1(f). Until a 1996 amendment of section 7805(b), regulations generally applied retroactively unless the Secretary of the Treasury exercised his discretion to apply them prospectively. As amended in 1996, section 7805(b) limits the extent to which regulations can apply retroactively. The amendment, however, applies only to regulations that relate to statutory provisions enacted on or after July 30, 1996. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101(b), 110 Stat. 1452, 1469. While Congress has amended section 367(d) several times since July 30, 1996, those amendments have no apparent bearing on the issue before us. Therefore, it is not clear whether the 1996 amendment of section 7805(b) limits the extent to which Treasury Regulation § 1.367(a)-1(f) can be applied retroactively. Moreover, respondent's application of Treasury Regulation § 1.367(a)-1(f) to the transaction in issue would not violate section 7805(b) even if that provision, in its current form, were applicable. The statute allows regulations to apply retroactively back to "the date on which any proposed or temporary regulation to which such final regulation relates was filed with the Federal Register." § 7805(b)(1)(B).

tion § 1.367(a)-1(f) require us to disregard it. Petitioner contends that "[t]he facts here lead to the reasonable inference that Respondent finalized Treas. Reg. § 1.367(a)-1 to support his argument that Treas. Reg. § 1.367(a)-1(f) applies in this case." On the basis of such an inference, petitioner argues that "Respondent's interpretation and application of Treas. Reg. § 1.367(a)-1(f) to the transaction at issue is therefore a litigating position that should be disregrded." In support of that argument, petitioner seeks to submit two sets of materials that are covered by respondent's Motion in Limine and Motion to Strike. First, petitioner proffered materials from the legal file relating to the adoption of Treasury Regulation § 1.367(a)-1(f) that it received in response to requests made under the Freedom of Information Act (FOIA). Second, petitioner seeks to submit the annual priority guidance plans for 2010–2011 through 2017–2018 published by the Treasury Department's Office of Tax Policy and the Internal Revenue Service (IRS).

It is perhaps unsurprising that petitioner is unable to point to any material obtained in response to its FOIA requests that acknowledges that respondent's schedule in adopting Treasury Regulation § 1.367(a)-1(f) was motivated by an effort to improve his position in the case before us. Petitioner's only citation of that material in the arguments it advanced concerning the Motions for Summary Judgment is to a "Case History" that states that the "case" (relating to the regulation project) was opened on May 15, 2015—four days after respondent issued the notice of deficiency in the present case. From that coincidence in timing, petitioner surmises that "Respondent was developing his litigation position . . . [when] he began the process for finalizing Treas. Reg. § 1.367(a)-1(f)." And on the basis of that surmise, petitioner then infers that respondent's purpose in adopting the regulation in final form when he did was to bolster his litigating position in the present case.

In his Motion in Limine, respondent observes that petitioner did not cite the so-called business plans in the Memorandum it submitted in support of its Motion for Summary Judgment. In its opposition to respondent's Motion in Limine, petitioner advised us that those documents are relevant, in its view, because of respondent's reliance on Treasury Regulation § 1.367(a)-1(f). Petitioner observes that "Treas. Reg.

§ 1.367(a)-1(f) was not on the IRS Priority Guidance Plan between 2010 and 2016." Thus, the annual business plans for that period, petitioner suggests, "help confirm that the three decades late, retroactive, and surprising finalization of Treas. Reg. § 1.367(a)-1(f) in the course of this litigation was not an ordinary, planned event."

The mere coincidence in timing between the initiation of the present case and the adoption in final form of Treasury Regulation § 1.367(a)-1(f) hardly establishes that the agency's purpose in finalizing the regulation when it did was to bolster its position in the case before us. Moreover, the rule had been proposed in 1990—long before petitioner engaged in the transaction in issue.

In any event, for the reasons explained above, our conclusion that the F reorganization included a constructive distribution of TBL GmbH stock does not depend on Treasury Regulation § 1.367(a)-1(f). Consequently, we need not address further petitioner's argument concerning the circumstances that precipitated the adoption of the regulation in final form.

D. *Conclusion: Result of Recharacterization*

We conclude that VF Enterprises' transfer to TBL GmbH of the sole member interest in International Properties and petitioner's election to be disregarded as an entity separate from TBL GmbH effected a reorganization described in section 368(a)(1)(F). As part of that reorganization, petitioner should be treated as having transferred its intangible and other properties to TBL GmbH in exchange for TBL GmbH stock and as having distributed that TBL GmbH stock to VF Enterprises in cancellation of the stock VF Enterprises had been treated as holding in petitioner during the time that petitioner was classified as a corporation for Federal tax purposes. We now turn to the question of how section 367(d) applies to those constructive transactions.

III. *Application of Section 367(d)*

Section 367(d)(1) applies, "[e]xcept as provided in regulations . . . if a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or 361." § 367(d)(1). The parties agree that petitioner's constructive transfer of property to TBL GmbH as part of the F reorganization was subject to section 367(d). Thus, the parties apparently agree that petitioner was a United States person, that the property petitioner constructively transferred to TBL GmbH in the F reorganization included intangible property, within the meaning of section 936(h)(3)(B), and that the transfer was an exchange described in section 361.

When section 367(d)(1) applies to a transfer,

> the United States person transferring . . . [the intangible] property . . . [is] treated as—
>
> (i) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and
>
> (ii) receiving amounts which reasonably reflect the amounts which would have been received—
>
> (I) annually in the form of such payments over the useful life of such property, or
>
> (II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.

§ 367(d)(2)(A). Section 367(d)(2)(C) provides: "For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income. For purposes of applying section 904(d) [related to the foreign tax credit], any such amount shall be treated in the same manner as if such amount were a royalty."

Given the parties' agreement on the application of section 367(d), it follows that they agree that petitioner is treated under section 367(d)(2)(A)(i) as having sold its intangible property for one or more contingent payments. Their disagreement centers on when petitioner should be treated as having received payment and thus when the resulting income should be recognized. The answer to that question turns on which of the two subclauses of section 367(d)(2)(A)(ii) applies.[11]

[11] Respondent accepts the framing of the issue presented in the text, but petitioner does not. Respondent describes the parties' dispute as being "over which rule of section 367(d)(2)(A)(ii) applies." That is how we see the dispute as well. Petitioner, however, contends that respondent's "statement of the issue . . . is an apparent attempt to dodge . . . specific provisions" in the applicable regulations. Petitioner suggests that the analysis should "start[] with" the regulations, rather than the statute that those regulations serve to interpret. Petitioner's reframing of the issue, however, would have no apparent consequence. Even if we were to start our analysis with

Respondent argues that subclause (II) applies, with the result that petitioner recognized all of the income from its deemed sale of intangible property for the taxable year in issue. Petitioner disputes the application of the immediate gain recognition rule provided in that subclause.

A. *Did a "Disposition" Occur?*

Subclause (II) applies only in the event of a "disposition following [the] transfer" of intangible property. Respondent argues that petitioner's constructive distribution to VF Enterprises of the stock of TBL GmbH that it (constructively) received in exchange for its intangible property was a "disposition" within the meaning of subclause (II). In support of his position, respondent invokes the conference report on the Deficit Reduction Act of 1984, which states the conferees' intent "that disposition of (1) the transferred intangible by a transferee corporation, or (2) the transferor's interest in the transferee corporation will result in recognition of U.S.-source ordinary income to the original transferor." H.R. Rep. No. 98-861, at 955 (1984) (Conf. Rep.). As respondent reads the conference report, it establishes that, when subclause (II) refers to a "direct disposition," it means "a disposition of the IP [intangible property] itself by the transferee foreign corporation," and its reference to "indirect" dispositions encompasses "a disposition by the domestic corporation of an interest in, i.e., the stock of, the transferee foreign corporation that owns the IP."

Although petitioner alludes to the prospect that any distribution of TBL GmbH stock deemed to have occurred as part of the reorganization was not a "disposition" within the meaning of section 367(d)(2)(A)(ii)(II), it does not develop a coherent argument to that effect. Petitioner suggests that "[t]he deemed distribution is a constructive transaction that occurs only for purposes of applying certain reorganization rules." Petitioner offers no explanation, however, for why the constructive distribution should be taken into account in applying section 361(c) but not section 367(d). In fact, the deemed transfer of intangible property that petitioner accepts as the basis for section 367(d)'s application was just as much a construct of the reorganization rules as the deemed distribution. We see

the regulations, that analysis would be incomplete without considering the statute as well.

no reason to take one aspect of the reorganization construct into account in applying section 367(d) but not the other.

We agree with respondent's reading of the 1984 conference report and conclude, in the absence of any credible argument to the contrary, that petitioner's constructive distribution to VF Enterprises of the stock of TBL GmbH, the transferee foreign corporation, was a "disposition" within the meaning of section 367(d)(2)(A)(ii)(II).

B. *Did the Disposition "Follow" the Section 367(d) Transfer?*

We next take up the question of whether the disposition "followed" the section 367(d) transfer. Petitioner accuses respondent of "slic[ing]" the F reorganization "into its component parts . . . so that there is first a deemed asset transfer of the IP and then there is a separate, subsequent deemed indirect disposition of that same intangible property in the same reorganization transaction." Relying on the step transaction doctrine, petitioner asserts that, because any deemed distribution of TBL GmbH stock was, along with the section 367(d) transfer, part of a single reorganization, both steps should be treated as having occurred simultaneously.

We are unpersuaded by petitioner's step transaction argument. That the asset transfer and stock distribution were elements of a single overall reorganization does not require treating them as having occurred in precise simultaneity. As respondent observes, petitioner cannot have distributed the stock it received in exchange for its intangible property until it first received that stock: Its constructive exchange of intangible property for TBL GmbH stock necessarily preceded—if only by a moment—its distribution of that stock to VF Enterprises.[12] The stock distribution might not have "follow[ed]" the transfer of intangible property by much, but, as a matter of logic, it had to "follow[]."[13]

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[12] Petitioner accuses respondent of "conflat[ing] a deemed distribution with an actual distribution." "If a deemed event is created," petitioner reasons, "there is nothing illogical or improper about providing for simultaneity." We question the appropriateness of deeming circumstances whose actual occurrence would be impossible. Moreover, petitioner's reasoning would draw an unjustifiable distinction among F reorganizations depending on the manner in which they were implemented.

[13] We therefore view it as being of no moment that, as petitioner observes, "Treas. Reg. § 1.367(a)-1(f) . . . does not contain a timing sequence for when

The principal authority petitioner relies on in support of its step transaction argument, *Commissioner v. Clark*, 489 U.S. 726 (1989), is readily distinguishable from the present case. *Clark* involved the question of whether a shareholder's receipt of cash "boot" in a reorganization "ha[d] the effect of the distribution of a dividend" and thus should have been taxed as ordinary income rather than capital gain. *See* § 356(a)(2). The taxpayer in *Clark* had been the sole shareholder of Basin Surveys, Inc. (Basin). N.L. Industries, Inc. (NL), acquired Basin by means of a merger of Basin into an acquisition subsidiary of NL (a "forward triangular merger"). The taxpayer received both NL stock and cash in exchange for his Basin stock.

The Court reasoned that the question of whether the boot the taxpayer received was equivalent to a dividend "should be answered by examining the effect of the exchange as a whole." *Commissioner v. Clark*, 489 U.S. at 737. The Court found support for its reading of the statute in the "well-established 'step-transaction' doctrine." *Id.* at 738. It described that doctrine as providing that "interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction." *Id.*

Because it concluded that the characterization of the boot had to be made looking at the overall transaction, the Court rejected the Commissioner's analogy to a cash distribution before the reorganization. Had the taxpayer received the cash in redemption of part of his stock in the target corporation before the reorganization, his receipt of the cash would have been equivalent to a dividend because it would not have reduced his proportionate ownership of the target. The taxpayer would have owned fewer shares in the target but would still have owned 100% of the target's stock. *See* § 302(d) (treating redemptions not qualifying for exchange treatment under section 302(a) and (b) as distributions in respect of stock); *United*

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the distribution is deemed to occur." The relative timing of the three steps in the construct adopted in the regulation to explain an outbound F reorganization was apparently unimportant to the drafters of the regulation. Therefore, the regulation states only that the three components are "considered to exist." *Id.* But we need not rely on the specific terms of the regulation for the proposition that the U.S. transferor's distribution of stock of the transferee foreign corporation necessarily follows its receipt of that stock in exchange for the transferred intangible property.

States v. Davis, 397 U.S. 301, 307 (1970) (holding that a redemption of stock from a sole shareholder is always equivalent to a dividend). As the Court explained in *Clark*:

> Viewing the exchange in this case as an integrated whole, we are unable to accept the Commissioner's prereorganization analogy. The analogy severs the payment of boot from the context of the reorganization. Indeed, only by straining to abstract the payment of boot from the context of the overall exchange, and thus imagining that Basin made a distribution to the taxpayer independently of NL's planned acquisition, can we reach the rather counterintuitive conclusion urged by the Commissioner—that the taxpayer suffered no meaningful reduction in his ownership interest as a result of the cash payment.

Commissioner v. Clark, 489 U.S. at 738. Measuring the effect of the taxpayer's receipt of cash by the extent to which it required him to forgo an increased proportionate interest in NL, the Court concluded that the taxpayer was not required to recognize ordinary income as a result of his receipt of boot.

Respondent's position in the case before us is not contrary to *Clark*. Respondent accepts that petitioner's section 361(a) transfer of intangible property and its section 361(c) distribution of the stock it received in exchange for that property occurred as part of an overall reorganization. Respondent is hardly considering the asset transfer and stock distribution separately. Indeed, respondent has determined the tax consequences of petitioner's constructive transfer of intangible property taking into account the distribution of TBL GmbH stock that occurred as part of the same overall transaction. He simply recognizes that, as a logical matter, petitioner's receipt of the TBL GmbH stock in exchange for the transferred intangible property was a precondition to its distribution of that stock to VF Enterprises. The distribution could not have occurred until the exchange of property for stock had been completed: One cannot distribute what one does not have. Characterizing one step by reference to other steps that occur as part of a larger transaction does not require viewing the steps as having occurred simultaneously. Nothing in *Clark* suggests otherwise.[14]

Petitioner also invokes Treasury Regulation § 301.7701-3(g)(3)(i) in support of its claim that "[t]he Outbound F Reor-

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[14] *Clark* raised no issue of temporal sequence: It involved a single exchange of Basin stock for NL stock and cash.

ganization[15] and its deemed component parts . . . all occurred *simultaneously*." That section provides: "Any transactions that are deemed to occur under this paragraph (g) as a result of a change in classification are treated as occurring immediately before the close of the day before the election is effective." Petitioner reasons that its election to be disregarded "caused" the outbound F reorganization. Consequently, the constituent elements of that reorganization necessarily occurred "immediately before the close of" September 23, 2011, the day before its election to be disregarded became effective. If the constituent elements of the F reorganization all happened immediately before the close of that day, petitioner concludes, they must all have occurred simultaneously.

Again, petitioner's argument is flawed in several respects. First, the timing rule provided in Treasury Regulation § 301.7701-3(g)(3)(i) applies only to "transactions that are deemed to occur under this paragraph (g)." The transaction that would have been "deemed to occur" under Treasury Regulation § 301.7701-3(g)(1)(iii) as a result of petitioner's election to be a disregarded entity was petitioner's "distribut[ion of] all of its assets and liabilities to its single owner in liquidation." That liquidation, viewed in isolation, would have been subject to section 332, which addresses the liquidation of a subsidiary corporation into a parent corporation that owns at least 80% of the subsidiary's stock. But petitioner accepts that the transaction in issue "cannot possibly be characterized as a parent-subsidiary liquidation governed by § 332." So petitioner necessarily accepts that the transactions "deemed to occur" in the outbound F reorganization are not those described in paragraph (g) of Treasury Regulation § 301.7701-3. Instead, because petitioner's election to be disregarded resulted in a reorganization described in section 368(a)(1)(F), the construct that would otherwise have been supplied by the entity classification regulations is superseded by a construct necessary to apply to the reorganization the operative nonrecognition provisions of sections 354 and 361.

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[15] In regard to the term "Outbound F Reorganization," petitioner's glossary states: "TBL (Petitioner) was reorganized into TBL GmbH, a Swiss controlled foreign corporation within the VF Controlled Group, in an outbound § 368(a)(1)(F) reorganization transaction." Regarding "VF Controlled Group," the glossary states: "VF is the ultimate U.S. parent company, and the direct or indirect owner, of an affiliated group of global corporations."

Even when applicable, the "end-of-the-prior-day" timing rule provided in Treasury Regulation § 301.7701-3(g)(3)(i) does not treat all of the transactions "deemed to occur under . . . paragraph (g)" as having occurred simultaneously. For example, Treasury Regulation § 301.7701-3(g)(1)(i) provides: "If an eligible entity classified as a partnership elects . . . to be classified as an association, the following is deemed to occur: The partnership contributes all of its assets and liabilities to the association . . . , and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners."[16] Under Treasury Regulation § 301.7701-3(g)(3)(i) the contribution of the partnership's assets and liabilities and its distribution of the stock of the association are both "treated as occurring immediately before the close of the day before the election is effective." Even so, the two steps are not treated as having occurred at the same time. The drafters of the regulation, in specifying that the partnership's liquidation occurs "immediately []after" its contribution to the corporation of its assets and liabilities, recognized that the second step could not have happened until completion of the first: The partnership could not have distributed to its partners the stock of the association until it first received that stock in exchange for its assets and liabilities. Both the contribution and the distribution may occur "immediately before the close of the day before" the partnership's election to be treated as a corporation becomes effective, but one step is more "immediately before" than the other. The distribution does not—and cannot—occur until after the contribution. The same is true of petitioner's distribution to VF Enterprises of the stock of TBL GmbH that it was treated as having received in exchange for its intangible property.

C. *Was the Disposition Within the Property's Useful Life?*

Under the terms of section 367(d)(2)(A)(ii)(II), a "disposition" requires the U.S. transferor of intangible property to recognize gain when it "follow[s]" the transfer. Although a disposition after the end of the property's useful life would "follow" the transfer, it would make no sense in that circum-

[16] A similar two-step construct applies when an entity classified as a corporation elects to change its classification to partnership. *See* Treas. Reg. § 301.7701-3(g)(1)(ii).

stance to require the U.S. transferor to recognize gain under subclause (II) after already having included in income all of the deemed annual payments contemplated by subclause (I). In recognition of that point, Temporary Treasury Regulation § 1.367(d)-1T(d)(1) requires a U.S. transferor to recognize gain under section 367(d)(2)(A)(ii)(II) upon disposing of stock of the transferee foreign corporation to a person unrelated to the U.S. transferor only if the disposition occurs "within the useful life of the intangible property." Petitioner relies on that regulation for a novel argument that, even if its distribution of TBL GmbH stock "follow[ed]" its section 367(d) transfer of intangible property, the distribution nonetheless did not require immediate gain recognition because it occurred before the intangible property's useful life began. As explained below, the authorities petitioner relies on do not support its argument.

Petitioner asserts that "[t]he useful life of property commences when the new owner places the property into service." Petitioner cites no authority specific to section 367(d) in support of that proposition. Instead, petitioner looks to a regulation dealing with depreciation allowances for intangible assets. Treasury Regulation § 1.167(a)-3 allows the cost of an intangible asset to be recovered over either 15 or 25 years. Treasury Regulation § 1.167(a)-3(b)(3) provides that a taxpayer who depreciates an intangible asset over the specified 15- or 25-year useful life "must determine the allowance by amortizing the basis of the intangible asset . . . ratably over the useful life beginning on the first day of the month in which the intangible asset is placed in service by the taxpayer." Petitioner draws out its argument as follows:

> The reorganization transaction in issue was completed immediately before midnight on September 23, 2011[,] pursuant to a check-the-box election that was effective on September 24, 2011. Therefore, the earliest that the useful life of the Timberland Intangible Assets[17] could begin with TBL GmbH was Saturday, September 24, 2011. However, since that

[17] Petitioner's glossary defines "Timberland Intangible Assets" as "[t]he Timberland and SmartWool intangible assets, consisting of trademarks, customer relationships, and foreign workforce, subject to the license of the domestic rights in the intangible assets to Vans, Inc., a member of the VF Consolidated Group." In regard to "VF Consolidated Group," petitioner's glossary states: "VF is the parent of an affiliated group of domestic corporations on behalf of which it files consolidated U.S. federal income tax returns."

was a Saturday, the earliest possible placed in service date here would be Monday, September 26, 2011.

Petitioner apparently reasons that, because any distribution it made of TBL GmbH stock to VF Enterprises occurred before September 26, 2011, the distribution did not occur within the useful life of the transferred intangible property and thus cannot have required immediate gain recognition under section 367(d)(2)(A)(ii)(II).

Treasury Regulation § 1.167(a)-3 manifestly has no bearing on the useful life of intangible property for purposes of section 367(d). Treasury Regulation § 1.167(a)-3 deals with cost recovery deductions allowable in respect of intangible assets—a question that would be irrelevant to a transferee foreign corporation that received intangible property in a section 367(d) transfer unless that foreign corporation were engaged in a U.S. trade or business or subject to the rules of subpart F of part III, subchapter N of chapter 1 of subtitle A of the Code (sections 951-965).[18] More specifically, Treasury Regulation § 1.167(a)-3 prescribes a general useful life of 15 years, although specified assets are assigned 25-year lives. By contrast, Temporary Treasury Regulation § 1.367(d)-1T(c)(3) as in effect for the taxable year in issue, provided: "For purposes of this section, the useful life of intangible property is the entire period during which the property has value. However, in no event shall the useful life of an item of intangible property be considered to exceed twenty years."[19]

Finally, even if we were to accept that (1) a disposition requires immediate gain recognition under section 367(d)(2)(A)(ii)(II) only if it occurs after the beginning of the useful life of the transferred intangible property and (2) the

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[18] Foreign corporations are generally subject to U.S. tax at the regular graduated rates on income effectively connected with a U.S. trade or business. *See* § 882(a)(1). The so-called subpart F provisions require significant U.S. shareholders of "controlled foreign corporations" (CFCs) to pay current U.S. tax on investment income and other types of mostly "portable" income earned through the foreign corporations.

[19] As discussed in more detail *infra* part V, the apparent intent of Temporary Treasury Regulation § 1.367(d)-1T(c)(3) was to limit the period during which a U.S. transferor was required to take deemed annual payments into account under section 367(d)(2)(A)(ii)(I). Temporary Treasury Regulation § 1.367(d)-1T(c)(3) was removed and reserved by T.D. 9803, 2017-3 I.R.B. 384.

useful life of the intangible property that petitioner transferred to TBL GmbH is defined by Treasury Regulation § 1.167(a)-3(b)(3), rather than Temporary Treasury Regulation § 1.367(d)-1T(c)(3), it would not follow that petitioner's distribution of TBL GmbH stock to VF Enterprises occurred before the useful life of the transferred intangible property began. Under the plain terms of Treasury Regulation § 1.167(a)-3(b)(3) the useful life of the intangible property in TBL GmbH's hands would have begun on September 1, 2011—the first day of the month in which TBL GmbH placed the property in service. Even accepting that petitioner's distribution of TBL GmbH stock occurred before the end of the day on September 23, 2011, that distribution would have occurred after the useful life of the intangible property, as defined by Treasury Regulation § 1.167(a)-3(b)(3), had already begun.[20]

D. *Failure of "No Disposition" Arguments to Explain Reporting*

Petitioner's various arguments that any "disposition" did not occur within the relevant period share a fundamental problem: They fail to explain the tax reporting undertaken in regard to petitioner's constructive transfer of intangible property. Under the terms of the statute, in the absence of a "disposition following [the section 367(d)] transfer," the annual payments described in section 367(d)(2)(A)(ii)(I) are to be reported by "the United States person transferring such property." Petitioner, then classified as a corporation, was the United States person who transferred the intangible property in issue. Lee Bell did not transfer the intangible property that TBL GmbH acquired in the F reorganization. Indeed, Lee Bell never owned that property.

[20] Petitioner's argument, if accepted, would mean that a U.S. transferor with the foresight to transfer intangible property late in the day on a Friday would have until the following Monday to dispose of the stock of the transferee foreign corporation without triggering gain recognition under section 367(d)(2)(A)(ii)(II). Petitioner makes no effort to explain how that prospect makes any sense. Therefore, we would be loath to accept the argument even without regard to its several technical problems.

E. *Conclusion*

For the reasons explained above, we conclude that petitioner's constructive distribution to VF Enterprises of the TBL GmbH stock was a "disposition," within the meaning of section 367(d)(2)(A)(ii)(II), and that the disposition "follow[ed]" petitioner's transfer of intangible property to TBL GmbH. Therefore, unless the regulations provide for a different result, petitioner was required to recognize its gain in the transferred intangible property "at the time of the disposition." § 367(d)(2)(A)(ii)(II).

IV. *Impact of the Regulations*

We find nothing in the regulations that would allow petitioner to avoid immediate gain recognition under section 367(d)(2)(A)(ii)(II). Because petitioner was no longer recognized as a separate entity for Federal tax purposes after the completion of the F reorganization that included the section 367(d) transfer, it could not report the deemed annual payments described in section 367(d)(2)(A)(ii)(I). And, as explained below, no provision in the regulations allows Lee Bell to assume responsibility for reporting those payments: Lee Bell was neither the U.S. transferor of the intangible property nor the recipient of the stock of TBL GmbH, the transferee foreign corporation.

A. *Propriety of Lee Bell's Reporting*

1. *Temporary Treasury Regulation § 1.367(d)-1T(c)(1)*

Petitioner contends that Lee Bell's inclusion in income of deemed annual payments was "proper[]" under the terms of Temporary Treasury Regulation § 1.367(d)-1T(c)(1). That section essentially restates the annual inclusion rule of section 367(d)(2)(A)(ii)(I). The regulation provides: "If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, then such person shall be treated as having transferred that property in exchange for annual payments contingent on the productivity or use of the property." Temp. Treas. Reg. § 1.367(d)-1T(c)(1).

Temporary Treasury Regulation § 1.367(d)-1T(c)(1) does not require or allow Lee Bell to include in income the annual payments described in section 367(d)(2)(A)(ii)(I) as a result of petitioner's constructive transfer of intangible property to TBL GmbH. As noted above, Lee Bell was not the United States person that transferred intangible property subject to section 367(d).

Petitioner contends that its interpretation of Temporary Treasury Regulation § 1.367(d)-1T(c)(1) was reasonable because "Lee Bell indirectly owned the transferred Timberland Intangible Assets and was a reasonable U.S. person to include the Annual section 367(d) Payments[21] as it was the first U.S. person that owned both TBL (Petitioner) and TBL GmbH." Petitioner's professedly reasonable interpretation of the regulation, however, is contrary to its plain terms. Temporary Treasury Regulation § 1.367(d)-1T(c)(1) does not require the deemed annual payments to be reported by the U.S. transferor of intangible property or, instead, a "reasonable" substitute. When applicable, it requires annual income inclusions by the U.S. transferor. Because Temporary Treasury Regulation § 1.367(d)-1T(c)(1) simply restates the statutory annual inclusion rule provided in section 367(d)(2)(A)(ii)(I), that regulation cannot be read to override the immediate gain recognition rule provided in section 367(d)(2)(A)(ii)(II). Both subclauses of section 367(d)(2)(A)(ii) must be given effect: Each is an alternative to the other. Subclause (I) requires the U.S. transferor, in the absence of a "disposition," to include in income deemed annual payments that reflect the "productivity, use, or disposition" of the transferred intangible

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[21] In regard to the term "Annual § 367(d) Payments," petitioner's glossary states:

> Section 367(d) and Temp. Treas. Reg. § 1.367(d)-1T provide that in an exchange described in §§ 351 or 361 in which a United States person (U.S. transferor) transfers IP to a foreign corporation (transferee foreign corporation) the United States person transferring the IP (the U.S. transferor) will be treated as having sold the IP in exchange for payments that are contingent on the productivity, use, or disposition of the IP. The U.S. person is treated as receiving or having received these amounts (I) annually over the useful life of the property ("***Annual § 367(d) Payments***"), or (II) in the case of a disposition following such transfer [the temporary regulations define this as "a subsequent transfer during the transferred IP's useful life" to an unrelated person], at the time of the disposition ("***Lump-Sum Exception***").

property. § 367(d)(2)(A)(i) and (ii)(I). And subclause (II) provides that, in the event of a disposition, the U.S. transferor must recognize gain at the time of the disposition—essentially taking into account at that time the deemed payments that it would otherwise have taken into account over the remaining useful life of the transferred intangible property. § 367(d)(2)(A)(ii)(II). For petitioner to avoid immediate gain recognition, it must find a provision, applicable to its circumstances, that allows continued reporting of deemed annual payments notwithstanding its "disposition" of TBL GmbH stock. Temporary Treasury Regulation § 1.367(d)-1T(c)(1) is not that provision.

2. *Temporary Treasury Regulation § 1.367(d)-1T(e)(3)*

Petitioner also claims that Lee Bell's reporting complied with Temporary Treasury Regulation § 1.367(d)-1T(e)(3). In relevant part that section provides:

> If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the transferred intangible property, that U.S. transferor subsequently transfers any of the stock of the transferee foreign corporation to one or more foreign persons that are related to the transferor within the meaning of paragraph (h) of this section, then the U.S. transferor shall continue to include in its income the deemed payments described in paragraph (c) of this section in the same manner as if the subsequent transfer of stock had not occurred.

Petitioner views it as "quite obvious[]" that Temporary Treasury Regulation § 1.367(d)-1T(e)(3) would apply if its constructive distribution of TBL GmbH stock to VF Enterprises were treated as a disposition because, it contends, VF Enterprises was "related" to petitioner. "Under the circumstances of this case," petitioner alleges, "the inclusion of Annual § 367(d) Payments by Lee Bell constituted compliance with Temporary Treas. Reg. § 1.367(d)-1T(e)(3)."

We disagree. Lee Bell's reporting of the deemed annual payments as a result of petitioner's section 367(d) transfer of intangible property could not have "compl[ied]" with Temporary Treasury Regulation § 1.367(d)-1T(e)(3) because—to reiterate—Lee Bell was not the U.S. transferor of the intangible property. Under the plain terms of the regulation, it is of no consequence that Lee Bell is, in petitioner's description, "a closely related U.S. party" that might be viewed as a "reasonable proxy" for petitioner. Temporary Treasury Regulation § 1.367(d)-1T(e)(3) does not contemplate the reporting of deemed annual payments by U.S. persons who are "reasonable proxies" for the U.S. transferor.

Petitioner argues that "Temp. Treas. Reg. § 1.367(d)-1T(e)(3) . . . does not limit the inclusion of Annual § 367(d) Payments to the initial 'U.S. transferor.'" We find petitioner's reference to an "initial 'U.S. transferor'" puzzling. A section 367(d) transfer occurs only once. It can have only one U.S. transferor—not an "initial" U.S. transferor who may be replaced (or joined) by another. In specified circumstances, a U.S. person related to the U.S. transferor of intangible property in a section 367(d) exchange must assume the obligation to report the deemed annual payments described in section 367(d)(2)(A)(ii)(I). *See* Temp. Treas. Reg. § 1.367(d)-1T(e)(1). Temporary Treasury Regulation § 1.367(d)-1T(e)(1) applies when the U.S. transferor of the intangible property "transfers the stock of the transferee foreign corporation to U.S. persons that are related to the transferor within the meaning of paragraph (h) of this section." Nothing in Temporary Treasury Regulation § 1.367(d)-1T(e)(1), however, describes as a "subsequent U.S. transferor" the related U.S. person who receives the stock of the transferee foreign corporation from the "initial" U.S. transferor. Moreover, that regulation does not apply to the present case because VF Enterprises, even if "related" to petitioner within the meaning of Temporary Treasury Regulation § 1.367(d)-1T(h), was not a "U.S. person." *See* § 7701(a)(30) (defining "United States person" to include domestic but not foreign corporations), § 7701(a)(4) ("The term 'domestic' when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any State.").[22]

[22] If petitioner's shareholder had been a U.S. person, Temporary Treasury Regulation § 1.367(d)-1T(e)(1) would have allowed petitioner to avoid immediate gain recognition under section 367(d)(2)(A)(ii)(II). Therefore, contrary to petitioner's claim, respondent's position that the section 361(c) distribution that necessarily occurs in an outbound reorganization is a "disposition" within the meaning of section 367(d)(2)(A)(ii)(II) does not mean that immediate gain recognition is required "in every outbound § 361 reorganization."

More generally, Temporary Treasury Regulation § 1.367(d)-1T(e)(3), as we read it, *does* "limit the inclusion of Annual § 367(d) Payments to the . . . 'U.S. transferor.'" When applicable, that section provides that "*the U.S. transferor* shall continue to include in its income the deemed payments described in paragraph (c) of this section." Temp. Treas. Reg. § 1.367(d)-1T(e)(3) (emphasis added). As petitioner observes, "[t]he regulation does not contain limitation language." "[I]t does not say that the income inclusion contemplated by the section can '*only* be by the U.S. transferor' or that the Annual § 367(d) Payments must be included "'*exclusively* [by] the U.S. transferor.'" But "limitation language" of the type petitioner posits is unnecessary. When the regulation provides that, in specified circumstances, the U.S. transferor must continue to include in its income the deemed annual payments described in section 367(d)(2)(A)(ii)(I) and gives no indication that any other person would be allowed to take on that reporting obligation, the regulation should be read to "limit" the required income inclusions to the U.S. transferor.[23] As paragraph (e)(1) of Temporary Treasury Regulation § 1.367(d)-1T demonstrates, when the drafters of the regulation intended to allow or require a person other than the U.S. transferor to take on the reporting obligation they knew how to say so.

Petitioner contends that its "reasonable interpretation of Temp. Treas. Reg. § 1.367(d)-1T(e)(3), requiring Lee Bell to include the Annual § 367(d) Payments, is consistent with Respondent's administrative practice." In its motion for summary judgment, petitioner singled out Priv. Ltr. Rul. 9731039 (Aug. 1, 1997) as illustrative of that practice. Petitioner's reply to respondent's response to its motion refers to an earlier ruling: Priv. Ltr. Rul. 9024004 (June 15, 1990).

Petitioner sought to include copies of each of those rulings along with the parties' First Stipulation of Facts. In his Motion in Limine, respondent asked to "exclude" the proffered

[23] While Temporary Treasury Regulation § 1.367(d)-1T(e)(3) does not include the limiting language petitioner imagines, it also does not provide that the deemed annual payments must continue to be reported by (1) the U.S. transferor or (2) in the event that the U.S. transferor is no longer recognized as a separate entity for Federal tax purposes following its disposition of the stock of the transferee foreign corporation, then by any other U.S. taxpayer of the U.S. transferor's choosing that is sufficiently related to the U.S. transferor.

copies of the rulings. Respondent objected to the "admission" of the private letter rulings because "they are not relevant or material to any issue in the case." Respondent observes that neither ruling was issued to petitioner or addressed a transaction in which petitioner engaged. Those rulings, respondent argues, "do not have any tendency to make a fact more or less probable in Petitioner's case than it would be without such evidence."

We agree with respondent that "admission of . . . [the private letter] rulings into evidence is inappropriate." But respondent misunderstands petitioner's purpose in submitting copies of the rulings. As petitioner explained in its opposition to respondent's Motion in Limine, "these exhibits were included in the record for the Court's convenience."

On the merits, respondent reminds us, citing section 6110(k)(3), that "Private Letter Rulings may not be used or cited as precedent." We have accepted, however, that "[p]rivate letter rulings may be cited to show the practice of the Commissioner." *Dover Corp. & Subs. v. Commissioner*, 122 T.C. 324, 341 n.12 (2004). Even so, two private letter rulings do not an established administrative practice make. *See Lucky Stores, Inc. & Subs. v. Commissioner*, 153 F.3d 964, 966 n.5 (9th Cir. 1998) (declining to allow taxpayer to rely on "several private letter rulings and one technical advice memorandum"), *aff'g* 107 T.C. 1 (1996). Moreover, the transactions addressed in the rulings petitioner cites appear to be distinguishable from its case.

Priv. Ltr. Rul. 9731039 involved a section 355 distribution by Distributing to its shareholders of the stock of New Controlled. New Controlled was a foreign corporation that had succeeded to Controlled, a domestic corporation, in a reorganization described in section 368(a)(1)(F). Before that reorganization, Controlled had transferred intangible property to its foreign subsidiary, Subsidiary. Among other things, the ruling held that Controlled's transfer of intangible property to Subsidiary was subject to section 367(d). It also held that "the transfer of the stock of Subsidiary from Controlled to New Controlled [in the F reorganization] is governed by § 1.367(d)-1T(e)(3)." And it held that "Distributing's distribution of its stock in New Controlled to Distributing's shareholders is governed by § 1.367(d)-1T(d) to the extent Distributing's shareholders are not related persons within the meaning of § 1.367(d)-1T(h).” Thus, in the transaction addressed in the ruling, the section 367(d) transfer of intangible property preceded the outbound F reorganization. In the outbound F reorganization, the U.S. transferor of the intangible property transferred the stock of the transferee foreign corporation that it had received in exchange for the intangible property. *That* transfer did not cause the U.S. transferor (Controlled) to go out of existence. If one froze the action at that point, one might say that Temporary Treasury Regulation § 1.367(d)-1T(e)(3) could apply. The U.S. transferor of the intangible property (Controlled) transferred the stock of the foreign transferee corporation (Subsidiary) to a related foreign person (New Controlled). After that specific step, Controlled could continue reporting deemed annual payments under Temporary Treasury Regulation § 1.367(d)-1T(e)(3). But in the very next step in the outbound F reorganization, Controlled distributed to Distributing the stock of New Controlled and, in so doing, went out of existence. Thus, upon completion of the outbound F reorganization, it would no longer be possible for Controlled to continue reporting deemed annual payments. It is therefore unclear what was meant by the holding that Controlled's transfer of Subsidiary stock to New Controlled was “governed by § 1.367(d)-1T(e)(3).” Perhaps Distributing was allowed to step (momentarily) into Controlled's shoes. But Distributing promptly distributed the stock of New Controlled to its shareholders, thereby requiring the recognition of gain under section 367(d)(2)(A)(ii)(II) and Temporary Treasury Regulation § 1.367(d)-1T(d), except to the extent that a shareholder of Distributing owned enough Distributing stock to be related to Distributing. That all or most of the gain in the transferred intangible property may well have been triggered before the completion of the overall transaction renders of little consequence the prospect that Temporary Treasury Regulation § 1.367(d)-1T(e)(3) might have allowed the reporting of deemed annual payments to continue between interim steps in that overall transaction.

Priv. Ltr. Rul. 9024004 involved a transaction in which Target, a domestic corporation, transferred its assets to Acquiring, a foreign corporation, in exchange for Acquiring voting stock and Acquiring's assumption of Target's liabilities.

Target then liquidated. The ruling held that the transaction "constitute[d] a reorganization within the meaning of section 368(a)(1)(C) of the Code." It also held that the goodwill included among the transferred assets would be "treated as having been transferred in exchange for annual payments contingent on the productivity or use of such property" and that "[s]uch payments" would be "imputed" to Target's shareholders. Because each of Target's three shareholders was a U.S. citizen who owned more than 10% of Target's stock, the conclusion that the shareholders could succeed to Target's obligation to report deemed annual payments was a straightforward application of Temporary Treasury Regulation § 1.367(d)-1T(e)(1). *See* § 267(b)(2); Temp. Treas. Reg. § 1.367(d)-1T(h). Petitioner alleges that "PLR 9024004 . . . shows that Respondent's consistent administrative practice was to fit transactions within the § 367(d) regulatory structure." That the transaction addressed in Priv. Ltr. Rul. 9024004 "fit . . . within the § 367(d) regulatory structure" does not establish that any provision therein allows petitioner to avoid the recognition of gain under section 367(d)(2)(A)(ii)(II).

Petitioner also observes that, "regardless of the interpretation of the phrase 'U.S. transferor,' no language in Temporary Treas. Reg. § 1.367(d)-1T(e)(3) provides for a lump-sum inclusion." Petitioner's observation is accurate but beside the point. The relevant question is not whether Temporary Treasury Regulation § 1.367(d)-1T(e)(3) requires petitioner to include in income the excess of the fair market value of the transferred intangible property over its basis. Instead, the question is whether that regulation section or any other allows petitioner, notwithstanding its "disposition" of TBL GmbH stock, to avoid gain recognition under section 367(d)(2)(A)(ii)(II) by continued reporting of the deemed annual payments described in section 367(d)(2)(A)(ii)(I).

B. *Petitioner's Inability to Comply with Temporary Treasury Regulation § 1.367(d)-1T(e)(3)*

That said, Temporary Treasury Regulation § 1.367(d)-1T(e)(3), when applicable, *does* allow a U.S. transferor to continue reporting deemed annual payments instead of recognizing immediate gain. Moreover, the conditions for the application of that rule—at least those expressly stated—have been met in the present case. Petitioner, a U.S. person, *did* transfer intangible property that is subject to section 367(d) and the rules of Temporary Treasury Regulation § 1.367(d)-1T to TBL GmbH, a foreign corporation, in an exchange described in section 361. And before the end of the useful life of that property, petitioner transferred the TBL GmbH stock that it received for the property to VF Enterprises, a foreign person whom the parties seem to accept was "related" to petitioner within the meaning of Temporary Treasury Regulation § 1.367(d)-1T(h).[24] Nonetheless, we conclude that Temporary Treasury Regulation § 1.367(d)-1T(e)(3) does not apply to petitioner's case. We reach that conclusion not because of a failure to satisfy the express conditions for the rule's application but instead because the rule cannot be applied. When applicable, Temporary Treasury Regulation § 1.367(d)-1T(e)(3) requires the U.S. transferor—not some other U.S. person of the taxpayer's choosing—to continue including in its income the deemed annual payments described in section 367(d)(2)(A)(ii)(I).

[24] A parent corporation and its subsidiary are related, within the meaning of Temporary Treasury Regulation § 1.367(d)-1T(h), if the parent owns at least 10% of the subsidiary's stock. Temporary Treasury Regulation § 1.367(d)-1T(h) cross-references section 267(b), (c), and (f) in defining related persons. Section 267(f), in turn, cross-references the "controlled group" rules of section 1563(a). Under the controlled group rules, a parent and its subsidiary are members of the same group if the parent owns at least 80% of the subsidiary's stock. For purposes of section 267(b)(3) and (f), however, the ownership threshold is reduced to 50%. And for purposes of Temporary Treasury Regulation § 1.367(d)-1T(h) the threshold is further reduced, to 10%. Temp. Treas. Reg. § 1.367(d)-1T(h)(2)(i). Because VF Enterprises was treated as having owned all of petitioner's stock before petitioner's distribution of TBL GmbH stock, VF Enterprises was related to petitioner before the distribution. The parties apparently agree that, at least in the circumstances of the present case, "relatedness," for purposes of Temporary Treasury Regulation § 1.367(d)-1T(h), is determined before the completion of the disposition in question. In other circumstances, however, that approach could lead to arguably inappropriate results. For example, a disposition of stock of the transferee foreign corporation in the form of a U.S. transferor's nonliquidating distribution of that stock to a distributee shareholder would sever the parties' relationship if the distribution were made in redemption of all of the stock in the U.S. transferor held by the distributee shareholder. Thereafter, both the U.S. transferor and the distributee shareholder would remain in existence but would have no ongoing relationship. In such a case, it might be inappropriate to allow continued reporting of deemed annual payments by either the U.S. transferor or distributee shareholder in lieu of immediate gain recognition.

Petitioner cannot comply with that provision because it is no longer recognized as a separate entity for Federal tax purposes.[25] By directing a U.S. transferor to "continue to include in its income the deemed payments described in paragraph (c)," Temporary Treasury Regulation § 1.367(d)-1T(e)(3) implicitly requires the U.S. transferor to remain a person with cognizable income. It is that implicit requirement that has not been met in the present case. After the deemed liquidation resulting from its election to be a disregarded entity, petitioner itself had no income in which to include the deemed annual payments.

In support of its argument that, if Lee Bell is not an acceptable substitute, it should itself be required to include in its own income the deemed annual payments described in section 367(d)(2)(A)(ii)(I), petitioner observes that "[t]here is no requirement under Temp. Treas. Reg. § 1.367(d)-1T(e)(3) that the U.S. transferor remain a U.S. entity." Strictly speaking, that is true. Nothing in the section 367(d) regulations impinged on petitioner's freedom to participate in a reincorporation in which the surviving corporation was foreign. But exercising that choice left petitioner unable to comply with Temporary Treasury Regulation § 1.367(d)-1T(e)(3). As a result of the reincorporation, petitioner ceased to exist as a recognized taxable entity and, thereafter, had no income to report.

Petitioner posits that, were it to "report" the deemed annual payments described in section 367(d)(2)(A)(ii)(I), "Lee Bell would be taxed on the same amounts that it reported directly, but . . . under Subpart F instead." We are unconvinced by petitioner's speculations about the potential impact of subpart F. Section 951(a)(1)(A) requires each "United States shareholder" of a CFC to include in its gross income its pro rata share of the CFC's "subpart F income." After petitioner distributed to VF Enterprises the TBL GmbH stock that it constructively received in exchange for its intangible property, petitioner was not a CFC. *See* § 957(a) (defining "controlled foreign corporation" to mean specified foreign corporations).

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[25] Petitioner argues that "[t]he U.S. transferor's continuing to include the Annual § 367(d) Payments is a result [of the application of Temporary Treasury Regulation § 1.367(d)-1T(e)(3)], not a condition." Whatever label one applies, it remains the case that petitioner is unable to comply with the regulation.

Petitioner is no longer recognized for Federal tax purposes as any type of entity. It can no longer be required to "report" anything. Accepting that TBL GmbH is a CFC and that Lee Bell is a United States shareholder of TBL GmbH, Lee Bell would indeed be required under section 951(a)(1) to include in its income its pro rata share of TBL GmbH's subpart F income.[26] But Temporary Treasury Regulation § 1.367(d)-1T(e)(3) does not authorize treating TBL GmbH as the recipient of the deemed payments described in section 367(d)(2)(A)(ii)(I). TBL GmbH was not the U.S. transferor in the section 367(d) transfer at issue. It was, instead, the transferee foreign corporation. It was not the seller of the intangible property but the purchaser. Designating TBL GmbH as the recipient of the payments deemed to be made in exchange for the transferred property would treat it as paying itself.

C. *TBL GmbH as Successor to Petitioner*

Petitioner suggests that, under Temporary Treasury Regulation § 1.367(d)-1T(e)(3), TBL GmbH could be allowed or required to include in its income the deemed annual payments described in section 367(d)(2)(A)(ii)(I) because TBL GmbH is petitioner's "successor" and, "even more to the point, under the direction of section 368(a)(1)(F), is one in the same entity" as petitioner. Petitioner contends that it "did not go out of existence" but instead merely "changed form."

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[26] Petitioner cites no authority for the proposition that the deemed annual payments described in section 367(d)(2)(A)(ii)(I) would, if treated as received by a CFC, be included in the CFC's subpart F income. Section 954(c)(1)(A) includes "royalties" in foreign personal holding company income, which is an element of subpart F income. *See* § 952(a)(2) (providing that subpart F income includes "foreign base company income"), § 954(a)(1) (defining "foreign base company income" to include foreign personal holding company income). While amounts described in section 367(d)(2)(A)(ii)(I) may be akin to royalties, they are expressly treated as such only "[f]or purposes of applying section 904(d)" (dealing with the foreign tax credit). § 367(d)(2)(C). Moreover, the subpart F income of a CFC for a taxable year is limited to the corporation's earnings and profits. § 952(c)(1)(A). Therefore, if a CFC were treated as having received the payments described in section 367(d)(2)(A)(ii)(I), those amounts, even if included within the definition of foreign personal holding company income, would not be subpart F income for any year for which the CFC had sufficient expenses to offset them.

In some reincorporation transactions, the identity between the old and new corporations may be so strong as to allow treating the two as a single corporation. *See, e.g.*, *Weiss v. Stearn*, 265 U.S. 242 (1924) (holding that, in reincorporation in which both corporations were organized under the laws of the same State, participating shareholders realized gain only to the extent of the cash they received). In those situations, the shareholders' exchange of stock of the old corporation for that of the new corporation would not be a realization event. The shareholders would have no need for section 354(a)'s nonrecognition rule. And, in that circumstance, the corporate-level nonrecognition rules provided in section 361 might be unnecessary because no transfer of assets or stock distribution need be imputed.

The transaction in which TBL GmbH acquired petitioner, however, is not of the type in which the participating entities can be viewed, for all purposes, as one and the same. *See, e.g.*, *Marr*, 268 U.S. 536; *Phellis*, 257 U.S. 156. Because TBL GmbH was organized under the laws of Switzerland, it is "essentially different" from a limited liability company organized under the laws of Delaware that is treated as a corporation for Federal tax purposes by reason of the entity's election. *See Marr*, 268 U.S. at 541.[27]

[27] Petitioner's "same entity" argument may rest on section 368(a)(1)(F)'s reference to "one corporation." Congress added the phrase "of one corporation" to that section to deny F reorganization treatment to fusions of two commonly owned operating corporations. The amendment was part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, § 225(a), 96 Stat. 324, 490. The TEFRA conference report describes the amendment as "limit[ing] the F reorganization definition to a change in identity, form, or place of organization of a single operating corporation." H.R. Rep. No. 97-760, at 541 (1982) (Conf. Rep.). The conferees explained: "This limitation does not preclude the use of more than one entity to consummate the transaction provided only one operating company is involved. The reincorporation of an operating company in a different State, for example, is an F reorganization that requires that more than one corporation be involved." *Id.* Therefore, Congress' addition of the phrase "of one corporation" to section 368(a)(1)(F) should not be understood to mean that, when an F reorganization involves two corporate entities, the successor must be treated for all purposes as one and the same as its predecessor.

D. *Temporary Treasury Regulation § 1.367(d)-1T(d)(1)*

Petitioner also argues that "[t]he § 367(d) Regulations provide that a lump-sum inclusion under the Lump-Sum Exception results only where there is a subsequent transfer to an unrelated party." Petitioner apparently has in mind Temporary Treasury Regulation § 1.367(d)-1T(d)(1), which provides:

> If a U.S. person transfers intangible property that is subject to section 367(d) and the rules of this section to a foreign corporation in an exchange described in section 351 or 361, and within the useful life of the intangible property that U.S. transferor subsequently disposes of the stock of the transferee foreign corporation to a person that is not a related person (within the meaning of paragraph (h) of this section), then the U.S. transferor shall be treated as having simultaneously sold the intangible property to the person acquiring the stock of the transferee foreign corporation. The U.S. transferor shall be required to recognize gain (but not loss) from sources within the United States in an amount equal to the difference between the fair market value of the transferred intangible property on the date of the subsequent disposition and the U.S. transferor's former adjusted basis in that property (determined as of the original transfer).

Contrary to petitioner's description, Temporary Treasury Regulation § 1.367(d)-1T(d)(1) does not provide that a U.S. transferor recognizes gain upon a disposition of the stock of the transferee foreign corporation *only* if that disposition is to an unrelated party. Instead, it says that *when* the disposition is to an unrelated party, the U.S. transferor must recognize gain. Temporary Treasury Regulation § 1.367(d)-1T(d)(1) says nothing about the consequences of a U.S. transferor's disposition of the stock of the transferee foreign corporation to a related person. Those dispositions are addressed elsewhere in the regulations—in particular, Temporary Treasury Regulation § 1.367(d)-1T(e)(1) and (3). As explained above, subparagraph (1) does not apply to petitioner's case and petitioner cannot comply with the mandate of subparagraph (3).

E. *Notice 2012-39*

Petitioner suggests that "Respondent's position in this case" "is directly at odds" with a notice respondent issued in 2012. Notice 2012-39, § 1, 2012-31 I.R.B. 95, 95, announced plans for the issuance of regulations to address "significant policy concerns" about outbound reorganizations that involve transfers of intangible property.[28] According to the notice, the forthcoming regulations would "apply to transfers occurring on or after July 13, 2012." *Id.* The notice goes on to state: "No inference is intended as to the treatment of transactions described in this notice under current law, and the IRS may challenge such transactions under applicable Code provisions or judicial doctrines." *Id.* § 5, 2012-31 I.R.B. at 98.

The notice describes the transactions of concern as having the "inten[t] to repatriate earnings from foreign corporations without the appropriate recognition of income." *Id.* § 3, 2012-31 I.R.B. at 96. Among the examples given of those transactions are "cases in which a controlled foreign corporation uses deferred earnings [an apparent reference to earnings not previously subject to U.S. tax] to fund an acquisition of all or part of the stock of a domestic corporation from an unrelated party for cash, followed by an outbound asset reorganization of the domestic corporation to avoid an income inclusion under section 956."[29] *Id.*

Under one of the rules that would be added to the regulations, the U.S. transferor of intangible property would "take into account income under section 367(d)(2)(A)(ii)(II)" to the extent that the stock of the transferee foreign corporation that the U.S. transferor distributes in the reorganization is received by "non-qualified successors." *Id.* § 4.03. For that purpose, foreign corporations, individuals, and some domestic corporations subject to special tax treatment would be nonqualified successors. *Id.* § 4.07, 2012-31 I.R.B. at 97. Therefore, if a domestic target corporation, after being acquired by a CFC, transferred intangible property in a subsequent outbound reorganization, the target would recognize immediate gain under section 367(d)(2)(A)(ii)(II) because its shareholder, as a foreign corporation, would be a nonqualified successor.

If the rules announced in Notice 2012-39 had applied to the outbound F reorganization in which petitioner constructively transferred intangible property to TBL GmbH, petitioner would clearly have been required to recognize gain

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[28] A copy of Notice 2012-39 that petitioner sought to include with the parties' First Stipulation of Facts is also covered by respondent's Motion in Limine and Motion to Strike.

[29] Under section 956, investments in U.S. property by CFCs generally result in deemed repatriation of the CFC's earnings.

under section 367(d)(2)(A)(ii)(II) as a result of the transfer. Its shareholder, VF Enterprises, was a foreign corporation and, thus, a "non-qualified successor" within the meaning of the notice. Respondent asserts that the same result obtains under the law in effect during 2011. If that were so, petitioner reasons, respondent would have had no need to issue Notice 2012-39.[30]

As respondent observes, however, the notice's scope extends well beyond transactions such as petitioner's. For example, the notice addresses situations in which the outbound reorganization involves the payment of boot. Even the specific rule that would address transactions like petitioner's—applicable to U.S. transferors owned by nonqualified successors—would apply to circumstances beyond those of the present case. The nonqualified successor rule would require the recognition of gain not only by U.S. transferors, like petitioner, owned by foreign corporations but also those owned by individuals. (The notice reflects the view that the tax paid by individual shareholders deemed to receive annual payments described in section 367(d)(2)(A)(ii)(I) would not be an adequate substitute for the corporate-level tax that would, in the absence of a disposition, have been paid by the U.S. transferor.) Therefore, the pending amendments to the regulations announced in Notice 2012-39 would have been necessary, at least in part, even it if it had already been clear that a transfer of intangible property in an outbound reorganization by a U.S. transferor owned by a foreign corporation requires the recognition of gain under section 367(d)(2)(A)(ii)(II). The notice's inclusion of foreign corporations in the definition of "non-qualified successor" could have either restated existing law or addressed an issue on which existing law was uncertain.[31]

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[30] In effect, petitioner asks us to draw inferences about the state of the law before the IRS' issuance of Notice 2012-39, notwithstanding the customary "no inference" disclaimer included in the notice.

[31] For similar reasons, we decline to draw the inferences petitioner would have us draw from the Office of Tax Policy/IRS business plans that are among the documents covered by respondent's Motion in Limine and Motion to Strike. As explained *supra* part II.C, petitioner views those documents as relevant primarily to support an inference regarding the purposes behind the timing of the adoption of Treasury Regulation § 1.367(a)-1(f) in final form. In its opposition to respondent's Motion in Limine, however, petitioner suggests that the proffered business plans are also relevant

In short, petitioner's task, again, is to identify one or more provisions of the regulations that allow it to avoid gain recognition under section 367(d)(2)(A)(ii)(II) notwithstanding its disposition of TBL GmbH stock. Its invocation of Notice 2012-39 does not accomplish that task. The notice does not give us grounds to conclude that the law in effect before its issuance allowed petitioner to avoid gain recognition by means of reporting of deemed annual payments by Lee Bell, TBL GmbH, or any other person or entity recognized for Federal tax purposes.

F. *New York State Bar Association Tax Section Report*

Finally, petitioner suggests that a 2010 report on section 367(d) prepared by the New York State Bar Association Tax Section (NYSBA report) "supports [its] reporting position." *See* N.Y. State Bar Ass'n (NYSBA), *Report on Section 367(d)* (2010). As we read the NYSBA report, however, it does not support the specific reporting undertaken in respect of the transaction at issue in this case—that is, Lee Bell's inclusion in income of deemed annual payments under section 367(d)(2)(A)(ii)(I). The NYSBA report does take the position that immediate gain recognition should not be required in the case of an outbound reorganization involving a transfer of intangible property by a U.S. corporation owned by a CFC parent. As explained below, however, we find unpersuasive the analysis offered in the report in support of that conclusion.

Before turning to the merits of the report's recommendation, we first address the more general question of its status as authority. Petitioner sought to include a copy of the NYSBA report as part of the parties' First Stipulation of

because they include regulations under section 367(d) among the priority guidance projects. Petitioner presumes that "[r]egulations under consideration . . . would include regulations identified as necessary by Notice 2012-39." The announced plans for future guidance, petitioner reasons, "also support[] that § 367(d) Regulations are needed to achieve Respondent's litigating position in this case, and that Treas. Reg. § 1.367(a)-1(f) is insufficient to reach the result Respondent seeks." To the extent that the intended regulations would address petitioner's transaction and, in particular, would require the recognition of immediate gain upon the U.S. transferor's distribution of the stock of the transferee foreign corporation, those regulations could be understood as simply confirming—or at least resolving uncertainty in—current law.

Facts. Respondent dismisses the report as "not authoritative, binding, or otherwise dispositive" and, in his Motion in Limine, asks us to disregard the report. Petitioner responds that it "never claim[ed] the NYSBA Report is binding, but rather that it is a type of persuasive authority that courts may look to and that it warrants consideration by this Court."

In his Motion in Limine, respondent accepts that the NYSBA report "should be viewed as secondary legal authority." He seeks only to strike the report "as factual evidence." But petitioner's purpose in submitting the report was not to establish any fact relevant to the case. As petitioner explains in its Opposition to Respondent's Motion to Strike, it "attached the NYSBA Report to . . . [the parties' first stipulation of facts] for the Court's convenience." We will therefore consider the report as secondary authority to the extent that it may assist us in resolving the legal dispute before us.

The parties offer competing interpretations of the NYSBA report, with each claiming that the report supports its or his own position. It seems clear that the drafters of the report believed that a domestic target corporation acquired in an outbound reorganization should not be required to recognize immediate gain under section 367(d)(2)(A)(ii)(II) as a result of its distribution of stock of the transferee foreign corporation if the domestic target is owned by a CFC that, in turn, is owned entirely by United States shareholders who would be required to include in their income their ratable shares of the CFC's subpart F income. It is less clear, however, whether, in that respect, the report reflects the drafters' understanding of then-current law or, instead, their recommendation that new regulations be issued to achieve that result.

The drafters begin by acknowledging that "[t]he Temporary Section 367(d) Regulations do not specifically address what happens if the U.S. transferor goes out of existence, either in connection with the Section 367(d) transfer or after the transfer." NYSBA, *supra*, at 76. The drafters then consider an outbound reorganization in which a domestic target corporation is owned by a U.S. parent corporation. If the transferred assets include intangible property, the drafters reason, "it should be clear that the U.S. parent should be required to continue to include deemed Section 367(d) income as a result of the outbound transfer of Section 936 Intangibles over the life of such Intangibles." *Id.* at 77. That conclusion reflects a relatively straightforward application of Temporary Treasury Regulation § 1.367(d)-1T(e)(1). If the U.S. parent is viewed as a person "related" to the U.S. transferor, on the basis of the relationship that existed before the U.S. transferor's dissolution, the U.S. parent can step into the shoes of the U.S. transferor and report the deemed annual payments described in section 367(d)(2)(A)(ii)(I).

The NYSBA report then considers the consequences of an outbound reorganization of a domestic target owned by a foreign corporation:

> Somewhat more complicated is the situation where a U.S. target owned by a foreign corporation effects an outbound . . . reorganization of Section 936 Intangibles. In the easier case, assume U.S. Target is owned by a controlled foreign corporation ("CFC") subject to Subpart F. As a statutory construction matter, we would think that Section 367(d) displaces Section 367(a) only for U.S. Target's transfer of a Section 936 Intangible to the foreign transferee. U.S. Target's subsequent distribution to its parent of the transferee's stock in liquidation should be eligible for non-recognition under Section 361(c) and Section 367(a)(2).[32] Accordingly, a tax free distribution of the transferee's shares should be available to the U.S. target's CFC/parent. The CFC/parent as successor to U.S. Target's attributes under Section 381(c) would succeed to and recognize subsequent Section 367(d) inclusions over the useful life of the transferred Section 936 Intangibles or until it ceased to be a CFC. In the case of a CFC, this analysis preserves the widest ambit for Section 367(d) to operate and avoids allowing taxpayers to elect current recognition and elect out of Section 367(d) by such related person transfers.
>
> However, in the case of a foreign parent corporation that is not a CFC (or to the extent the foreign parent corporation's shareholders are not U.S. Shareholders within the meaning of Section 951(b)), continuation of the Section 367(d) regime would ensure that Section 367(d) income would be taxable. For example, existing Regulation § 1.367(d)-1T(e)(3) provides that, in the case of subsequent transfers of shares bearing a Section 367(d) obligation to a related CFC, only the continuing U.S. transferor continues absorbing the Section 367(d) inclusions. Accordingly, new regulations could provide, with respect to an outbound . . . reorganization in which the transferor of Section 936 Intangibles goes out of existence in connection with the transaction, that the transferor is taxed currently on its gain as in the case of a terminating disposition under Section 367(d)(2)(A)(ii) unless the distributee is domestic or, if foreign, is, e.g., a

[32] Section 367(a)(2) provides generally that the gain recognition rule of section 367(a)(1) "shall not apply to the transfer of stock or securities of a foreign corporation which is a party to the exchange or a party to the reorganization."

> CFC more than 80% of whose shares are held by U.S. shareholders, in which case the distributee would continue recognitionof Section 367(d) inclusions.

NYSBA, *supra*, at 78-79 (footnote omitted).

Petitioner, apparently referring to the first paragraph quoted above, observes that "the NYSBA Report . . . concluded that a transaction very similar to the one at issue does not require a lump-sum inclusion." More specifically, petitioner contends that the report "supports Lee Bell's inclusion of Annual § 367(d) Payments."

Focusing on the second of the above-quoted paragraphs, respondent interprets the NYSBA report as "saying that the regulations could—but presently do not—provide an exception to immediate reporting for a situation like Petitioner's." Thus, respondent concludes that "a close reading of the . . . report demonstrates that it actually confirms that Respondent's position is correct."

We are inclined to accept petitioner's interpretation of the NYSBA report. The first of the quoted paragraphs concludes, on the basis of statutory interpretation, that a target corporation's distribution of stock of the transferee foreign corporation to a CFC parent does not require the recognition of immediate gain under section 367(d)(2)(A)(ii)(II). The report's reference to possible new regulations in the second paragraph is unclear. Would those regulations be necessary to require the recognition of gain on a liquidating distribution of stock of the transferee foreign corporation or instead to provide that immediate gain recognition is not required when the distribution is to a CFC a sufficient portion of whose stock is owned by United States shareholders who would be required to include in income their respective shares of the CFC's subpart F income? Even if the hypothesized regulations would serve the latter purpose—providing an exemption from the recognition of immediate gain that would otherwise be required—the drafters may have envisioned those regulations as simply confirming their interpretation of the statutory provisions they viewed as governing.

Even so, the NYSBA report does not support the specific reporting undertaken to reflect the transaction in issue. The report posits that, when a U.S. target owned by a CFC transfers intangible property in an outbound reorganization, the target's

CFC parent should assume the obligation to report the deemed annual payments described in section 367(d)(2)(A)(ii)(I). In the present case, that would be VF Enterprises. By contrast, Lee Bell—a U.S. corporation other than petitioner's CFC parent—voluntarily reported deemed annual payments—apparently not as its share of subpart F income of VF Enterprises but as income of Lee Bell in its own right. In support of its motion for summary judgment, petitioner suggested the alternative possibility of TBL GmbH reporting deemed annual payments as petitioner's successor. But that approach would differ from the one recommended by the NYSBA report.

Leaving those details aside, we accept that the drafters of the NYSBA report concluded by means of statutory analysis that a U.S. target's distribution to a CFC parent of stock of the transferee foreign corporation as part of an outbound reorganization should not require immediate gain recognition under section 367(d)(2)(A)(ii)(II). To the extent that that analysis supports petitioner's position, however, we find it unpersuasive. The drafters' conclusion rests on the premise that, while section 367(d) can override section 361(a) (the nonrecognition rule applicable to transfers of assets), it should not be interpreted to override section 361(c) (the nonrecognition rule that applies to distributions of the stock received in exchange for transferred assets). While we agree with that premise, it does not support the drafters' conclusion. Treating the target's distribution of stock of the transferee foreign corporation as the trigger for the recognition of gain in the transferred intangible property would not affect the nonrecognition treatment afforded by section 361(c) on the distribution of stock. The stock distribution itself would remain eligible for nonrecognition treatment. The occurrence of that nonrecognition event would simply determine when the gain on the transferred intangible property must be recognized.

Moreover, the drafters of the NYSBA report erred in another respect in their reading of the statutes they relied on. They suggest that section 381(c) supports having the parent of the target corporation assume responsibility for the reporting of the deemed annual payments described in section 367(d)(2)(A)(ii)(I). Section 381 does provide for the carryover of the tax attributes of a target corporation acquired in specified types of reorganizations, including one described in section 368(a)(1)(F). But the entity that succeeds to those attributes is not the target's parent corporation (if any), but instead the acquiring corporation.[33] And, as explained *supra* part IV.B, it would make no sense to have the acquiring corporation in the reorganization (the transferee foreign corporation) assume responsibility for reporting the payments described in section 367(d)(2)(A)(ii)(I). Doing so would treat that corporation as making payments to itself, as simultaneously buyer and seller of the transferred intangible property.

In short, we do not agree that, "[a]s a statutory construction matter," a U.S. transferor of intangible property in an outbound reorganization is not required to recognize gain under section 367(d)(2)(A)(ii)(II) if that corporation was (before its dissolution) owned by a CFC and that, instead, the CFC parent should be required to include in income the deemed annual payments described in section 367(d)(2)(A)(ii)(I). On the contrary, for the reasons explained *supra* part III.A, the U.S. transferor's distribution of the stock of the transferee foreign corporation is a "disposition" within the meaning of section 367(d)(2)(A)(ii)(II). Therefore, the distribution will require the U.S. transferor to recognize any gain in intangible property transferred in pursuance of the plan of reorganization in the absence of a rule in the regulations providing contrary treatment. The NYSBA report identifies no provision in the regulations that would allow reporting of deemed annual payments notwithstanding the U.S. transferor's "disposition" of the stock of the transferee foreign corporation.

G. *Conclusion*

For the reasons explained *supra* part III, we have concluded that petitioner's constructive distribution to VF Enterprises of the TBL GmbH stock that petitioner constructively received in exchange for its intangible property was a "disposition" within

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[33] Sec. 381(a). General rule.—In the case of the acquisition of assets of a corporation by another corporation—

. . . .

(2) in a transfer to which section 361 . . . applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D), (F), or (G) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account . . . the items described in subsection (c) of the . . . transferor corporation . . . .

the meaning of section 367(d)(2)(A)(ii)(II). We also conclude, for the reasons explained in this part IV, that no provision of the regulations allows petitioner to avoid the recognition of gain under that statutory provision.

Petitioner suggests that respondent is to blame for the absence of a provision in the regulations that can be applied to petitioner's circumstances. The absence of an applicable regulatory provision, however, requires that we look to the statute alone to determine the tax consequences of petitioner's transaction. For the reasons explained *supra* part III, section 367(d)(2)(A)(ii)(II), interpreted in accordance with the legislative history, requires petitioner to recognize gain. The absence of a provision in the regulations providing otherwise is petitioner's problem—not respondent's.

Because respondent's position is grounded in an interpretation of the applicable statutory provisions and not on any regulations, we do not understand petitioner's argument that respondent's "litigating position" is "impermissible" under *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988). *Bowen* stands for the proposition that an agency's litigating position is not entitled to the same deference a court would give to a position adopted through notice and comment rulemaking. *See id.* at 212–13; *see also Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984). Respondent does not ask that we grant *Chevron* deference to the interpretation of the applicable statutes that he advances in this case.

In support of its efforts to cast disfavor on respondent's litigating position, petitioner asks us to consider facts concerning the examination of its return for the year in issue. In the Memorandum it submitted in support of its Motion for Summary Judgment, petitioner proposed a finding to the effect that the team initially assigned to the examination "did not make an adjustment for Petitioner to include immediate lump-sum gain under § 367(d)(2)(A)(ii)(II) or Temp. Treas. Reg. § 1.367(d)-1T." Respondent does not contest the accuracy of that proposed finding but nonetheless objects to it as "irrelevant, vague, [and] misleading." In addition, respondent has asked us to strike the declaration of a former VF employee that petitioner submitted in support of its proposed findings concerning the circumstances of the examination. Petitioner cites no authority for the proposition that views expressed during the course of the audit bind respondent for purposes of the present litigation.

Petitioner suggests that the disputed evidence demonstrates that the position respondent now advances "was not foreseeable." The extent to which a taxpayer might have been subjectively surprised by a position advanced by the Commissioner has no direct bearing, however, on the position's merits. Moreover, as the NYSBA report acknowledges, the regulations "do not specifically address" cases like petitioner's, in which a U.S. transferor of intangible property "goes out of existence" in the act of disposing of the stock of the transferee foreign corporation. Petitioner chose to carry out a transaction in regard to which the law was, at best, uncertain. In doing so, it necessarily assumed the risk of an outcome that, by its lights, would be unfavorable.[34]

We are left with one task remaining. Having determined that petitioner must recognize gain for the taxable year in issue by reason of the application of section 367(d)(2)(A)(ii)(II), we now determine the amount of that gain.

V. *Amount of Required Income Inclusion*

The parties agree on the amount of income inclusion required under section 367(d)(2)(A)(ii)(II) by reason of petitioner's transfer of foreign workforce and foreign customer relationships. They have stipulated that, "[i]f the Court decides that a lump-sum inclusion of income is required under I.R.C. § 367(d)(2)(A)(ii)(II), then Petitioner's increase in income for the transfer of the foreign workforce and the foreign customer relationships would be $23,400,000 and $174,400,000, respectively." The parties agree only in part, however, as to the income inclusion required by reason of petitioner's transfer of trademarks. As to that question, their Stipulation states:

> If the Court decides that a lump-sum inclusion of income is required under I.R.C. § 367(d)(2)(A)(ii)(II), then Petitioner's increase in income for the transfer of the trademarks is $1,274,100,000, unless the Court

[34] Petitioner repeatedly invokes our observation in *Xilinx Inc. & Consol. Subs. v. Commissioner*, 125 T.C. 37, 62 (2005), *aff'd*, 598 F.3d 1191 (9th Cir. 2010), that taxpayers "are merely required to be compliant, not prescient." We made that observation, however, in regard to a position advanced by the Commissioner that was contrary to governing regulations.

agrees to reduce the adjustment to income for the trademarks based on a 20-year useful life limitation, pursuant to Temp. Treas. Reg. § 1.367(d)-1T, in which case the increase in income for the transfer of the trademarks is $1,029,200,000, in each case less the reported trademark basis of $19,339,000.

Thus, the parties apparently agree that the income inclusion required by section 367(d)(2)(A)(ii)(II) is the excess of the fair market value of the transferred intangible property at the time of petitioner's disposition of the TBL GmbH stock over the basis of that property. *Cf.* Temp. Treas. Reg. § 1.367(d)-1T(d)(1). They also agree on the values of the foreign workforce and customer relationships that petitioner constructively transferred to TBL GmbH. And they agree as to petitioner's tax basis in the transferred property. And, finally, they agree on the resolution of the factual question of the trademarks' value under two alternative legal assumptions. Their point of disagreement is whether, as a matter of law, the fair market value of the trademarks must be determined by treating each as having a useful life of no more than 20 years. That legal question, which petitioner raised in an amendment to its Petition, arises by reason of Temporary Treasury Regulation § 1.367(d)-1T(c)(3), which, as in effect for 2011, provided: "For purposes of this section, the useful life of intangible property is the entire period during which the property has value. However, in no event shall the useful life of an item of intangible property be considered to exceed twenty years."

Petitioner argues: "If this Court determines that a subsequent transfer occurred resulting in a lump-sum inclusion amount under the Lump-Sum Exception, Temp. Treas. Reg. § 1.367(d)-1T(c)(3) requires that the inclusion be calculated with a 20-year useful life limitation." Respondent counters that section 367(d)(2)(A)(ii)(II) "makes no reference whatsoever to 'useful life' of the transferred property." Respondent characterizes Temporary Treasury Regulation § 1.367(d)-1T(c)(3) as a "regulatory grace applicable to the annual inclusion paradigm." According to respondent: "Petitioner cannot rely on an administrative limitation on the time period over which annual inclusions would be taken into account for purposes of reducing its disposition rule amount. The 20-year regulatory limitation on the annual inclusion period is not a substitute methodology overriding settled law concerning the definition of fair market value." In that regard, respondent points to

Temporary Treasury Regulation § 1.367(d)-1T(g)(5), which provides: "For purposes of determining the gain to be recognized immediately under paragraph (d), (f), or (g)(2) of this section, the fair market value of transferred property shall be the single payment arm's-length price that would be paid for the property by an unrelated purchaser determined in accordance with the principles of section 482 and regulations thereunder." Finally, respondent suggests that imposing an "artificial limitation" on the value of transferred intangible property would frustrate Congress' purpose in enacting section 367(d). "Because the limitation on useful life in Temp. Treas. Reg. § 1.367(d)-1T(c)(3) could only have the effect of reducing the amount that would be taxed pursuant to Congress's intentions under section 367(d)," respondent reasons, "the limitation should be read narrowly and applied only to the circumstances specified in the regulations, *i.e.*, annual inclusions and the time frame within which the intangible property must be transferred to trigger [section 367(d)(2)(A)(ii)(II)]."

In response to respondent's argument, petitioner observes that "Temp. Treas. Reg. § 1.367(d)-1T(c)(3) does not state that it only applies to Annual § 367(d) Payments." Instead, paragraph (c)(3) of Temporary Treasury Regulation § 1.367(d)-1T provided that it applied "[f]or purposes of this section." Petitioner notes that a property's useful life is a relevant factor in determining its fair market value and insists that "the regulations require a 20-year time frame for all useful life analyses."

Our conclusion that petitioner must recognize gain as a result of its constructive transfer of intangible property to TBL GmbH does not rest on any provision in Temporary Treasury Regulation § 1.367(d)-1T. The only rule in that section of the regulations that requires the recognition of gain upon a disposition of stock of the transferee foreign corporation applies when that disposition is to a person unrelated to the U.S. transferor. Temp. Treas. Reg. § 1.367(d)-1T(d)(1). We have accepted the parties' apparent view that VF Enterprises was related to petitioner within the meaning of Temporary Treasury Regulation § 1.367(d)-1T(h). Consequently, Temporary Treasury Regulation § 1.367(d)-1T(d)(1) is not the basis for our conclusion that petitioner must recognize gain in the transferred intangible property as a result of its constructive distribution to VF Enterprises of TBL GmbH stock. Instead, our conclusion rests on the statutory gain recognition rule provided in section 367(d)(2)(A)(ii)(II).

Accordingly, we might dismiss petitioner's argument on that ground that, regardless of the extent to which Temporary Treasury Regulation § 1.367(d)-1T(c)(3) applies in implementing other rules of that section of the regulations, it does not apply when gain recognition is required by the statute and the statute alone. Under that analysis, however, a U.S. transferor who disposes of stock of the transferee foreign corporation to a related person and, in so doing, goes out of existence might be required to recognize gain in a greater amount than if the disposition had been to an unrelated person. That distinction would be unsupported by any apparent policy grounds. Therefore, we will accept that, if the 20-year useful life limitation imposed by Temporary Treasury Regulation § 1.367(d)-1T(c)(3) can limit the amount of gain required to be taken into account under Temporary Treasury Regulation § 1.367(d)-1T(d)(1) upon a disposition of the stock of the transferee foreign corporation to a person unrelated to the U.S. transferor, it should also reduce the amount of gain petitioner is required to take into account under the statutory gain recognition rule of section 367(d)(2)(A)(ii)(II).

As petitioner emphasizes, paragraph (c)(3) applied, by its terms, "[f]or purposes of" Temporary Treasury Regulation § 1.367(d)-1T. We therefore ask: For what other provisions within Temporary Treasury Regulation § 1.367(d)-1T is the useful life of transferred intangible property relevant? "[U]seful life" appears seven times in provisions of that section, as in effect during 2011, other than paragraph (c)(3). Each of those instances has to do with the period during which (1) deemed annual payments must be taken into account and (2) a direct or indirect disposition of the transferred intangible property can require the recognition of gain.[35] The

[35] Temporary Treasury Regulation § 1.367(d)-1T(a), captioned "Purpose and scope," states the general rule that, as a result of a transfer of intangible property to which section 367(d) applies, "the U.S. transferor will be treated as receiving annual payments contingent on productivity or use of the transferred property, over the useful life of the property (regardless of whether such payments are in fact made by the transferee)." Temporary Treasury Regulation § 1.367(d)-1T(c)(1) in restating that general rule, again refers to the property's useful life. Temporary Treasury Regulation § 1.367(d)-1T(d)(1) requires the U.S. transferor to recognize gain upon

provisions that require or allow the recognition of gain refer to the fair market value of the intangible property but do not expressly make the property's useful life relevant in determining that value. If the 20-year useful life limitation applies for that purpose, it does so only implicitly.

Any implication that the useful life limitation imposed by Temporary Treasury Regulation § 1.367(d)-1T(c)(3) might apply in determining the amount of gain that must be recognized under paragraph (d)(1) would conflict with the definition of "fair market value" provided in paragraph (g)(5). As respondent observes, Temporary Treasury Regulation § 1.367(d)-1T(g)(5) provides that the fair market value of transferred property is the amount that an unrelated purchaser would pay for the property. Temporary Treasury Regulation § 1.367(d)-1T(g)(5) expressly applies "[f]or purposes of determining the gain . . . recognized immediately under paragraph (d), (f), or (g)(2)" of Temporary Treasury Regulation § 1.367(d)-1T.[36] In an arm's-length transaction, an unrelated purchaser of intangible property would consider the entire period during which the property would have value in determining the price it would pay for the property. The terms of paragraph (g)(5), which specifically and expressly govern the determination of the fair market value of intangible property for the purpose of determining gain that must be recognized under an immediate gain recognition rule must take precedence over possible implications of a more general provision

disposing of the stock of the transferee foreign corporation to an unrelated person if the disposition occurs "within the useful life of the intangible property." Temporary Treasury Regulation § 1.367(d)-1T(e)(1) applies if the disposition of the stock of the foreign transferee corporation "within the useful life of the transferred intangible property" is to a related U.S. person. In that event, the related U.S. person must include deemed annual payments in income "over the useful life of the property." Temp. Treas. Reg. § 1.367(d)-1T(e)(1)(ii). Temporary Treasury Regulation § 1.367(d)-1T(e)(3) applies when the disposition of transferee foreign corporation stock, "within the useful life of the transferred intangible property," is to a related foreign person. And Temporary Treasury Regulation § 1.367(d)-1T(f)(1) requires the recognition of gain if the transferee foreign corporation, "within the useful life of the intangible property," transfers that property to an unrelated person.

[36] Temporary Treasury Regulation § 1.367(d)-1T(g)(2) allows a U.S. transferor of intangible property to a foreign corporation, under specified circumstances, to elect immediate gain recognition.

regarding the property's useful life. As petitioner recognizes, "[s]pecific regulations govern over general regulations."

Petitioner admits that $1,029,200,000 is not "the full fair market value" of the trademarks it constructively transferred to TBL GmbH. Petitioner acknowledges that the values it reported on its Form 926, including the $1,274,100,000 value assigned to the trademarks, were "the fair market values of the Timberland Intangible Assets . . . without the application of the regulations' useful life limitation." Petitioner reported those amounts, it explained, because "Form 926 states that the full fair market value be stated on the form."

By contrast, petitioner offers us no explanation for why the drafters of Temporary Treasury Regulation § 1.367(d)-1T might have intended that the amount of gain a U.S. transferor is required to recognize upon a direct or indirect disposition of transferred intangible property should be computed on the basis of a value that is less than the property's "full fair market value." The useful life limitation provided in Temporary Treasury Regulation § 1.367(d)-1T(c)(3), when applicable, allowed a U.S. transferor to recognize less than the full amount of gain in intangible property transferred to a foreign corporation. As applied to the requirement to report deemed annual payments, the useful life limitation could have been understood as a rule of administrative convenience. And it follows that a U.S. transferor should not be required to recognize gain upon a direct or indirect disposition of the intangible property that occurs after all required annual deemed payments have been taken into account. Applying the 20-year useful life limitation to limit the amount of gain recognized upon a disposition before all deemed annual payments have been reported, however, cannot be understood as a rule of convenience. Allowing the U.S. transferor, in that circumstance, to avoid recognizing the full amount of gain in the transferred intangible property would have no apparent justification. If the drafters of Temporary Treasury Regulation § 1.367(d)-1T had intended that result, we would have expected them to have been more explicit.

Therefore, we decline to apply Temporary Treasury Regulation § 1.367(d)-1T(c)(3) beyond the purposes for which it was expressly relevant (that is, for purposes of applying other provisions of the regulations that explicitly refer to the intangible property's "useful life"). By reason of Temporary Treasury Regulation § 1.367(d)-1T(g)(5), the gain that a U.S. transferor must recognize under paragraph (d)(1) upon disposing of the stock of the transferee foreign corporation to an unrelated person should take into account the actual fair market value of the transferred intangible property on the date of the disposition. That fair market value should reflect the amount that an unrelated purchaser would pay for the property in an arm's-length transaction, taking into account the entire period during which the property may be expected to have value.

Because we do not "agree[] to reduce the adjustment to income for the trademarks based on a 20-year useful life limitation, pursuant to Temp. Treas. Reg. § 1.367(d)-1T," we determine, in accordance with the parties' Stipulation, that "[p]etitioner's increase in income for the transfer of the trademarks is $1,274,100,000." Adding that figure to the agreed value of the foreign workforce and customer relationships that petitioner transferred to TBL GmbH and reducing the sum by the agreed trademark basis, we conclude that petitioner's income for the taxable year in issue should be increased by $1,452,561,000 ($1,274,100,000 + $23,400,000 + $174,400,000 – $19,339,000), as determined in the notice of deficiency. Because petitioner did not assign error to the other two adjustments reflected in the notice of deficiency, it follows that respondent is entitled to judgment as a matter of law. Accordingly, we will grant respondent's Motion for Summary Judgment and deny petitioner's corresponding Motion. We will also deny as moot respondent's Motion in Limine and Motion to Strike.

An appropriate order will be issued, and decision will be entered for respondent.

ESTATE OF MARION LEVINE, DECEASED, ROBERT L. LARSON, PERSONAL REPRESENTATIVE, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 13370-13. Filed February 28, 2022.

D, the deceased, entered into split-dollar life-insurance arrangements which required her revocable trust to pay premiums for life-insurance policies taken out on the lives of her daughter and son-in-law. When the arrangements terminate, D's revocable trust has the right to be paid the greater of the premiums paid or the cash surrender value of the policies. An irrevocable life-insurance trust was the owner of these policies. D's children and grandchildren were the beneficiaries of the irrevocable trust, and F, a family friend who was substantially involved in the family's businesses, was the sole member of the investment committee that managed the irrevocable trust. F and two of D's children also acted as D's attorneys-in-fact and as the revocable trust's successor cotrustees. As the sole member of the irrevocable trust's investment committee, only F had the right to prematurely terminate the life-insurance policies: The arrangements gave D and the other two attorneys-in-fact no rights to terminate the policies or the arrangement itself.

1. *Held*: Treasury Regulation § 1.61-22 governs only the gift-tax consequences of this transaction.

2. *Held*, *further*, as of the date of her death, D possessed a receivable created by the arrangements, which was only the right to receive the greater of premiums paid or the cash surrender values of the policies when they are terminated.

3. *Held*, *further*, I.R.C. §§ 2036(a)(2) and 2038 do not require inclusion of the policies' cash-surrender values because D did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies because only the irrevocable trust had that right.

4. *Held*, *further*, I.R.C. § 2703 applies only to property interests that D held at the time of her death. There were no restrictions on the split-dollar receivable, so I.R.C. § 2703 is inapplicable.

G. Michelle Ferreira, *Brooke D. Anthony*, and *Joseph W. Anthony*, for petitioner.

Randall L. Eager, for respondent.

OPINION

HOLMES, *Judge*: Marion Levine entered into a complex transaction in which her revocable trust paid premiums on life-insurance policies taken out on her daughter and son-in-law that were held by a separate and irrevocable life-insurance trust. Levine's revocable trust had the right to be repaid for those premiums. Levine has since died, and the question is what has to be included in her taxable estate because of this transaction—is it the value of her revocable trust's right to be repaid in the future, or is it the cash-surrender values of those life-insurance policies right now?

We considered aspects of similar transactions both in *Estate of Morrissette v. Commissioner*[1] and in *Estate of Cahill v. Commissioner*,[2] but in this one we have novel questions of how to decide what the revocable trust transferred before Levine's death and what it held when she died.

Background

Levine was born in St. Paul, Minnesota in 1920. She lived there with her nine brothers and sisters through the Great Depression until she married George Levine. They were of the Greatest Generation, and Levine followed her new husband as best she could even after he was drafted into service. He served honorably, and when we had won, he and she made their way back to St. Paul. They enlisted together in the ensuing baby boom, and had two children—Nancy and Robert. Nancy married Larry Saliterman, and they themselves had three children: Scott, P.J., and Jonathan. Robert has two of his own: Charles and Michel. A family tree may be helpful here:

[1] 146 T.C. 171 (2016).
[2] 115 T.C.M. (CCH) 1463 (2018).

Marion Levine (d. 2009) -- George Levine (d. 2009)

Nancy | Robert

Scott | P.J. | Jonathan | Charles | Michel

George died in 1974, and Levine married Henry Orenstein sometime in the 1980s. This marriage lasted only a year before it ended in divorce. Levine then married Harold Frishberg around 1990, and they remained married until his death in 2005.

I. *Levine's Business Success*

A. *Humble Beginnings*

Levine graduated from high school and received some business-school training, but never earned a college degree. At a time when it was especially unusual, she nevertheless became a highly successful businesswoman. Her success began in 1950 when the Levines opened Penny's Supermarket. This small family business eventually grew to a 27-store, multimillion-dollar company. Levine did almost everything at Penny's—she collected timecards, oversaw payroll, paid bills, and tracked inventory. She became the sole boss after George died, until after more than three decades of minding the store, she sold the business for $5 million in 1981. The proceeds did not become a nest egg for a comfortable retirement; Levine used them instead as capital to hatch new businesses that increased her net worth to $25 million over the next twenty years.

B. *After Penny's*

None of these new businesses had anything to do with groceries. They were real-estate investments, a stock portfolio that she had begun in the early '60s and tended herself, interests in two Renaissance fairs and several mobile-home parks, and loans to real-estate partnerships and mobile-home park residents.

1. *Real Estate Investments*

Most of Levine's real-estate investment activity was as a lender. Levine, her close personal friend Bob Larson, Larry, and Robert created two companies named 5005 Properties and 5005 Finance to manage all the real-estate ventures.[3] Larson, Larry, and Robert managed the day-to-day business for these properties, while Levine mostly supplied the financing. One of Levine's biggest and most profitable assets in her real-estate portfolio was Penn Lake Shopping Center, LLC (Penn Lake). She and her late husband had built Penn Lake in 1959, and by 2007 the property was free of debt and produced approximately $200,000 in annual income.

2. *Mobile Home Parks*

Levine owned several mobile-home parks through 5005 Properties. This business began in 1979 when she bought a mobile-home park in Dayton, Minnesota. These investments settled into a simple pattern: 5005 Properties would buy the property and rent spaces to residents. At the height of this business, 5005 Properties owned 30 mobile-home parks, but its portfolios had shrunk. Banks had stopped financing mobile homes after enactment of reform legislation,[4] so 5005 Finance itself stepped in and got extra revenue from lending to prospective residents. Many of these tenants had low credit

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[3] 5005 was the address of the office building that used to house Penny's business.

[4] Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), manufactured-home loans were classified as "high cost." The Act also classified manufactured-home retailers as "mortgage originators." A widely reported, if unintended, consequence was that almost all lenders chose to stop making these loans. *See The Impact of Dodd-Frank's Home Mortgage Reforms: Consumer and Market Perspectives: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the Comm. on Fin. Servs.*, 112th Cong. 10–11 (2012) (statement of Tom Hodges, General Counsel, Clayton Homes, Inc., on behalf of the Manufactured Housing Institute). Congress later amended the Truth in Lending Act to solve this problem. *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

scores, but 5005 knew its tenants and with some care could lend them money to buy their homes at rates they could afford. Levine took pride in avoiding evictions and was pleased when the tenants' improved scores let them climb the ownership ladder up to "stick-built" homes.

3. *Renaissance Fairs*

Levine also began to invest at some point in Renaissance fairs. These are a bit like state fairs, if the state were a small principality in fifteenth-century Europe populated entirely by modern people who enjoy costumed role-playing and adding extra "e's" to words like "old" and "fair." There are 20 major Renaissance fairs around the country, and 5005 Properties owns and runs 2 of them—the Arizona and Carolina Renaissance Festivals (the latter in North Carolina). Levine entered the business in 1988 and her festivals were generally open 7–8 weekends a year. Each festival is a small business. 5005 Properties charges admission, sells food and drinks for all concessions, contracts with skilled craftsmen and entertainers, and buys advertising to make it all profitable.

II. *Family and Business Dynamics*

Levine's entrepreneurial success allowed her to support her children. Nancy graduated from the University of Minnesota in 1967 with a major in English literature and minors in humanities and art history. She worked mainly in different retail jobs after college (including at Penny's for a short time), but for the most part was not active in the family businesses.

Her brother Robert, on the other hand, became deeply involved early on and remains so today. He graduated from the Wharton School of Business with a degree in economics and a major in accounting and finance. He then went on to get his J.D. from the University of Colorado Law School in 1977. He is still a member of the Minnesota bar, although he has not practiced since the mid-1980s.

He also seems to have inherited his parents' business acumen. He acquired his first piece of real estate—the Time Square Shopping Center in Minnesota—in 1974 upon his father George's death. He got involved in the purchase of Levine's first mobile-home park in 1979 and even worked at Penny's for about two years until its sale in 1981. He now works at 5005 Properties, where he is an astute manager of the Levine family's investments.

As the turn of the millennium neared, Levine began to plan for her own old age. She gave both of her children a statutory power of attorney in 1996 to take care of her affairs if something happened. But Nancy and Robert have not always gotten along, so Levine thought it was necessary to have a third attorney-in-fact to play the referee. This role was played by Bob Larson.

Larson is a Vietnam-era Marine who earned an accounting degree in 1966. He was working two different accounting jobs when his career—and his life—changed after meeting Levine in 1969. Larson's wife was Levine's hair dresser, and the Larsons got invited to Nancy and Larry's wedding. After meeting Levine at the wedding, Larson ran into her again while she was getting her hair done at his wife's salon. They started chatting, and at one point he complained about the prospect of moving to a small town in Oklahoma for a job. Levine listened, and she had a better idea. She told Larson that she needed an in-house controller for Penny's and he should consider interviewing for the job. It all worked out very well. Larson won the position and began a 50-year professional and personal relationship.

Penny's had just moved its accounting in-house, and Larson became head of its accounting staff, took care of the financial statements, and did the bank reconciliations. After George died in 1974, Larson became more deeply involved with the family's business. When the family sold Penny's, he even stayed on for another year or two to help close the business out.

He also helped Levine as she began exploring other investments. According to Larson, Levine had her eye out for investments that would help the key people that she worked with, all of whom were family—except for Larson himself. Indeed, it was Larson who saw the potential in that first mobile-home park in Dayton, Minnesota. He brought the idea to Levine, she approved, and the family went off in that new direction.

Larson's role grew with the business, and he has stayed on with 5005 Properties and 5005 Finance, where he is president of both. He oversees the tax and accounting work for the companies, and he signs most of the companies' tax returns.

Levine's making him one of her attorneys-in-fact was especially sensible as he was close with every member of the Levine family.[5] Levine drafted these powers of attorney; if there are any disagreements among the three attorneys-in-fact, the decision of the majority takes the day.

Levine's decision to name attorneys-in-fact meant that she contemplated her mortality, but it didn't mean at first that she was any less active. She continued to manage her own legal affairs and stayed involved in the businesses. She was happy to delegate, but always stayed alert as the "watchdog." She would look over financials with Larson monthly and made sure she knew all that was going on with the businesses. Then, in 2003, she suffered a stroke while on vacation in Palm Springs.[6] In 2004 or 2005 Robert and Nancy became concerned about her driving skills. They arranged for her to take a driver's test, and her driver's license was taken away. This was an important event. Levine remained involved in the business, but she worked less and less. She hired someone to drive her to the office but came in only about twice a week. Her health did not improve. It took another step down in 2008, when signs of dementia began to appear, but even as she neared 90, Levine still wanted to know what was going on. Larson began to go to her home with financial statements to review, but more out of habit and to hear echoes of earlier times than to get her advice or seek her approval.

III. *Levine's Estate Planning*

Well before any of these health issues arose, Levine began to plan her estate. She first created a revocable trust—the Marion Levine Trust—in May 1988. Levine herself was the

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[5] Larson described Levine as "my second mom." Nancy claimed that Larson was "as close to [Levine] as any person could have been" and his role as an attorney-in-fact was to protect her. And Robert credibly stated that he and Larson "have been friends forever."

[6] There was sincere but conflicting testimony regarding when and exactly how much Levine's health began to decline. Robert identified the stroke in 2003 as the first sign that his mother was no longer as mentally sharp as she used to be. Larson also thought that her mental activity probably started to decline after the stroke, although at first he didn't notice anything different about her when she returned to work. And Nancy claimed not to notice any real changes until around 2006, after her mother's third husband died.

trustee; she named Larson, Robert, and Nancy as successor trustees; and Nancy, Robert, and their children as beneficiaries.[7] She first amended this trust agreement in May 1996 to add Larson, Robert, and Nancy as cotrustees. Then, in February 2005 she resigned as trustee and made Larson, Nancy, and Robert the sole cotrustees at about the same time as she signed the short-form power of attorney that we've already mentioned. *See* Minn. Stat. § 523.23 (2005).

Between 1996 and 2007 Levine used an attorney named Bill Brody to do her estate planning, and Brody had prepared all of Levine's estate-planning documents. But as Levine's health grew worse, her family and Larson pressed her to search for a new lawyer to advise them. Shane Swanson, an attorney at Parsinen Kaplan Rosberg & Gotlieb, P.A. (Parsinen), was referred to the Levine family by Levine's sister, who had been using Swanson and was extremely pleased with his work. The family and Swanson clicked, and in November 2007 they retained the Parsinen firm to review and revise Levine's estate plan. Although Howard Rubin, a senior estate-planning partner at Parsinen, negotiated the fee for services and signed the engagement letter on behalf of the firm, Swanson was the primary point of contact for Levine and her attorneys-in-fact, and he took the lead on the estate-planning work.

Swanson first worked with Levine to make sure all her business entities both were properly structured and meshed well with a comprehensive estate plan. Many of the entities that Levine had invested in—especially the partnerships—were governed by old documents, so Swanson worked to revise them. While he ran into difficulties when multiple other partners and parties were involved, Swanson was able to either update or restructure the partnerships that Levine controlled directly

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[7] Levine limited the interests of her grandchildren to a subtrust that would be funded by whatever was left of her generation-skipping-transfer-tax (GSTT) exemption. (The GSTT prevents taxpayers from avoiding the estate tax by passing their property to grandchildren instead of children. It includes an exemption that allows taxpayers to exclude a certain amount, and in 2009, this amount was $3.5 million. *See* § 2010.) The remaining unused amount of Levine's GSTT exemption that was accounted for in creating the grandchildren's subtrust was a little over $3 million. (All section references are to the Internal Revenue Code and regulations in effect at the relevant time, and all Rule references are to the Tax Court Rules of Practice and Procedure, unless we state otherwise.)

into more modern entities such as LLCs. Swanson also created different trusts to hold some of Levine's real-estate assets which allowed her to pass them to her children in ways that would produce estate-tax savings. He wasn't looking to do anything radical and started by using two tools well known to estate planners: the grantor retained annuity trust (GRAT) and the qualified personal residence trust (QPRT).

A GRAT is a "tax-saving device in which a grantor transfers assets into trust and retains an annuity payable for a specified term." *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278, 96 T.C.M. (CCH) 422, 425 n.2 (citing Bittker et al., *Federal Estate and Gift Taxation* 80–81 (9th ed. 2005)). When these GRATs are structured according to the Code, the transferor avoids incurring any gift-tax liability. *See Grieve v. Commissioner*, T.C. Memo. 2020-28, at *6 & n.4. If the grantor survives to the end of the specified term, any appreciation in the asset's value over the rate specified in section 7520 passes to the beneficiaries without any gift or estate tax. *Id.* If the grantor does not survive, however, the full value of the asset is included in her gross taxable estate. Treas. Reg. § 20.2036-1(c)(2)(i). This GRAT structure is specifically provided for in the regulations under special valuation rules. *See* Treas. Reg. § § 25.2701-1 to -8. Levine placed her Dayton Park project partnership—located in Dayton, Minnesota—into the GRAT with a two-year term, with any appreciation on the asset to pass to Nancy and Robert at the end of this term.

A QPRT allows an individual to transfer her home into a trust, which makes it exempt from estate and gift taxes so long as the transferor uses the home as her personal residence for the specified term. *See* § 2702; Treas. Reg. § 25.2702-5. Levine placed 50% of her Minneapolis condo into a QPRT with a two-year term, and the other 50% in a different QPRT with a three-year term. During these terms, she was able to live in her condo rent free, but after the terms expired, title would pass to Nancy and Robert. If Levine wanted to continue to live in the condo, she would at that point be required to pay fair market rent to them to do so. A QPRT can reduce the value of the property it holds by an amount equal to the value of the right to live in it for the trust's term, which would also reduce potential estate tax.[8] *See Estate of Riese v. Commissioner*, T.C. Memo. 2011-60, 101 T.C.M. (CCH) 1269.

Levine's specific estate-planning goals and her diverse assets presented challenges even to estate planners as skilled as the ones the family retained. From the beginning, Larson and Levine's children made it clear to Swanson that Levine wanted enough money to maintain her lifestyle until her death. This meant that any estate planning needed to be done with Levine's excess capital—i.e., assets that she would not likely need during her lifetime. This would be difficult in most circumstances, but especially because so much of Levine's wealth was in real estate or partnerships that owned real estate. She owned a number of properties that were unencumbered by any debt—her condo in Minneapolis, a home in Rancho Mirage, California, her interests in the mobile-home parks and the two Renaissance fairs, and the Penn Lake Shopping Center. Levine wanted these assets to stay in her estate so that her children would inherit them with stepped-up bases when they passed to her children.[9] But, like a halberd, stepped-up basis cuts both ways. Holding onto real estate might cut future capital-gains tax, but it also meant that its value would be part of Levine's gross taxable estate. In situations like this, Swanson typically suggested looking to insurance as a way to help clients prepare to pay the estate tax that would eventually be due on these relatively illiquid investments. Swanson knew that Levine earned more than $1 million annually and that this money would need to be redeployed into other investments. He also thoughtfully asked about the children's situation and learned that they themselves also had large real-estate holdings and completely lacked any estate plans. So he suggested to them and Larson that there just might be a way for Levine to invest her excess capital to provide her with a good return, while at the same time meshing with the Levine children's needs for estate plans of their own.

His idea: intergenerational split-dollar life insurance.

[8] Since Levine did not survive the full term of either the QPRTs or the GRAT, the gamble did not pay off, and the full values of both the Dayton Park partnership and the Minneapolis condo became includible in her gross estate.

[9] Section 1014 resets basis in property to its fair market value at the time of its owner's death. This results in a smaller taxable gain realized by the heir if he ever sells the property and the property's value has increased.

A. *Planning the Split-Dollar Life Insurance*

While Swanson had done a split-dollar insurance arrangement before, he had never done a transaction like the one he was proposing for Levine—loans from a parent to her children to buy life insurance for *them*. He explained that the circumstances that might make this type of transaction attractive are very rare, and require that the client:

- has enough cash to buy a substantial amount of life insurance, and to live on for the rest of her life;
- faces an estate-tax bill large enough to justify the costs of planning and execution;
- has children whose lives would be insured, and who themselves have a sufficient net worth to qualify for large life-insurance policies; and
- has children who are healthy enough to navigate the underwriting process successfully.

Swanson spent a good deal of time thinking through all the advantages and disadvantages, conditions and qualifiers. He put together a PowerPoint presentation for the family in late 2007 or early 2008. Then in January 2008 he sent a letter to Larson and the children in which he described the transaction and its legal and tax implications.

He told them that Levine could contribute money to a trust that would be for the benefit of Robert, Nancy, and her grandchildren. Its trustees would then use the money to buy life-insurance policies on Nancy's and Robert's lives. This would not be purely a gift—the trust would get Levine's money only in exchange for a promise by the trust to pay her the greater of the money she advanced, or the cash value of the policies upon the earlier of the insureds' deaths or the policies' surrender. The right to this repayment would be held by Levine as a "receivable",[10] or in other words an asset that the Estate had to report on its estate-tax return. His proposal assumed that Levine would lend the trust enough to pay $10 million in premiums, but he said that the technique could be used at any premium level depending on the insured's insurability—i.e., "proof of good health of the insured." *See Likly &*

[10] When we refer to the "split-dollar receivable" or "receivable," we are referring to this contract right.

Rockett Trunk Co. v. Provident Mut. Life Ins. Co., 85 F.2d 612, 613 (6th Cir. 1936). Swanson's proposal was complex, and we believe the testimony of Levine's children and Larson that, even though they each received a copy of this detailed proposal letter, they actually learned more about the transaction and finally understood it better through Swanson's discussions with them.

Levine, her children, and Larson spoke among themselves about the costs and benefits of the deal. Levine herself approved the transaction, but limited the amount that she was willing to lend to the trust for premiums to $6.5 million. Levine thought that she had done enough for her kids and wanted to make sure that she could take care of her grandchildren.

Swanson set to work.

1. *Establishing the Irrevocable Life-Insurance Trust*

First he created the trust that would own the split-dollar life-insurance policies—the Marion Levine 2008 Irrevocable Trust (Insurance Trust).[11] Irrevocable life-insurance trusts are typically used as a vehicle to own life-insurance policies to reduce gift and estate taxes. *See Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, 98 T.C.M. (CCH) 534, 535 n.3, *aff'd*, 653 F.3d 1012 (9th Cir. 2011). If done properly, a life-insurance trust can take a policy out of its settlor's estate and allow the proceeds to flow to beneficiaries tax free. *Id.* Levine's Insurance Trust was signed at the end of January 2008 by her children and Larson as attorneys-in-fact and the South Dakota Trust Company, LLC (South Dakota Trust) as an independent trustee. The Insurance Trust's beneficiaries were Robert, Nancy, and Levine's grandchildren—the grandchildren that Levine naturally wanted to take care of.

Swanson settled the Insurance Trust in South Dakota because its laws are favorable—it has no rule against perpetuities, but does have a taxpayer-friendly state income tax and a favorable premium tax. South Dakota is also one of the few states with a "directed" trustee statute, which allows

[11] While Swanson created the Insurance Trust to own the life-insurance policies taken out as part of the split-dollar transaction, we find him credible when he said that he also viewed the Insurance Trust as something Nancy and Robert could use in their own eventual estate planning.

the separation of management and administration of a trust's investments. *See* S.D. Codified Laws ch. 55-1B (1997). Levine's Insurance Trust named South Dakota Trust as its directed trustee. This put South Dakota Trust in charge of administration—opening up trust accounts and handling them according to the terms of the trust document. But South Dakota Trust was only the administrator—it had no authority to choose what the trust would invest in.[12] Swanson drafted the trust to have trustees whose job it would be to direct its investments. This was the "investment committee," and its membership consisted of one person—Larson.[13] Levine picked Larson for this role because he had long been very close to the Levine family yet was not a part of it. Levine knew the relationship between her children was fraught. She wanted someone she could trust to manage not just the trust but the relationship—and her children understood this. Larson has been the sole member of the investment committee since it began. South Dakota law defines this committee's fiduciary obligations to the Insurance Trust and its beneficiaries. *See* S.D. Codified Laws § 55-1B-4 (1997). And we specifically find that, as the committee's only member, Larson was under a fiduciary duty to exercise his power to direct the Insurance Trust's investments prudently, and he faced possible liability to its beneficiaries if he breached that duty.

Larson approved the split-dollar life-insurance arrangement on behalf of the Insurance Trust in his role as the investment committee.

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[12] South Dakota Trust could also be directed by the investment committee on how to deal with distributions for the trust, although it maintained discretion on how to do this.

[13] S.D. Codified Laws § 55-1B-9 (2017) states:

> A trust instrument governed by the laws of South Dakota may provide for a person to act as an investment trust advisor or a distribution trust advisor, respectively, with regard to investment decisions or discretionary distributions. Unless otherwise provided or restricted by the terms of the governing instrument, any person may simultaneously serve as a trust advisor and a trust protector.

This allows for an investment committee of just one person.

2. *Acquiring the Life Insurance Policies*

The next step was for the Insurance Trust to buy insurance. Levine, her children, and Larson first had to decide who would be the insured parties. Swanson initially suggested that the life-insurance policies should be taken out on the lives of both Nancy and Robert. But Robert had a preexisting medical condition that would have made him uninsurable at a reasonable price. So Levine, her children, and Larson decided instead that the Insurance Trust would buy policies on the lives of Nancy and her husband Larry. Swanson then worked with an insurance broker to find the right insurance companies. After mulling over Swanson's advice Levine, her children, and Larson settled on two last-to-die policies with John Hancock and Pacific Life. Once the applications for the life-insurance policies were submitted in April 2011, the process of pulling together the cash to fund the policies began.

This had to be given some thought. Even though Levine had a net worth in excess of $25 million in 2008, Swanson and Levine's children decided to borrow money to fund these life-insurance premiums.[14] This was an investment decision made by Levine and her children. They wanted to lock in the quoted premium rates for the policies, so they quickly took out short-term loans to do so. Several of these loans would be taken out by Levine's real-estate partnerships. And, with the exception of the Central Bank loan, they expected to quickly repay the loans and any of Levine's advances by refinancing the debt on the partnerships, as well through the sale of the Arizona Renaissance Festival.

Between June and August 2008, the children and Larson—as Levine's attorneys-in-fact—executed the paperwork to marshal the $6.5 million they needed, almost all through loans:

[14] Larson credibly testified that they could have paid all the premiums in cash if they had decided to take that route.

Source	*Amount*	*Annual interest rate*	*Term*
Central bank loan	$3,800,000 ($3,730,000 used for premiums)	6.35%	60 equal monthly payments
Private bank line of credit	$2,000,000	5.25%	1 year, single balloon payment
Business bank loan	$516,000 ($500,000 used for premiums)	6.9%	60 monthly payments, plus one lump-sum payment at end of 5 years
Penn Lake Shopping Center's savings account	$270,000	N/A	N/A

a. *Central Bank Loan*

The first loan was $3.8 million from Central Bank to Penn Lake. Levine owned 100% of Penn Lake and had paid off the mortgage on the property years before. This loan had an interest rate of 6.35%, and Penn Lake promised to make 60 equal monthly payments until July 1, 2013. Penn Lake pledged various properties that it owned as collateral.

Levine and her children felt no urgency to repay the principal of this loan. Their plan was instead to pay the interest, which they'd been advised would increase Levine's basis in the receivable that the Estate would be obtaining as part of this split-dollar transaction.[15] Levine's estate would eventually owe tax on what it got back from the Insurance Trust through the receivable the Estate held, and that tax would shrink if Levine's basis in the receivable increased.[16]

[15] While interest paid can be deducted from income under section 163, section 264 denies this deduction to the extent that the money is borrowed to fund a life-insurance policy, and in effect defers the deduction until the policy matures.

[16] The family thought that the tax that would eventually be owed by Levine's estate on this receivable would be determined by the difference between the receivable's value at the date of its repayment and its basis. The receivable's basis would be the receivable's reported value on the estate-tax return plus the total deferred interest payments from the Central Bank loan. If it all worked, the arrangement would produce a nice deferral of the tax owed until the Insurance Trust repaid the Estate its receivable.

b. *Private Bank Line of Credit*

The children and Larson, acting as her attorneys-in-fact, also opened a personal line of credit with Private Bank of Minnesota. This gave Levine access to $2 million for a term of one year at 5.25%. Any outstanding balance was due and payable in a single balloon payment in thirteen months. They secured this line of credit with various properties and assets that Levine Investments, 5005 Properties, and 5005 Finance owned.

c. *Business Bank Loan*

The last of the three loans was arranged by Nancy and Robert in their capacities as cotrustees of Levine's Revocable Trust. It was with Business Bank for $516,000 at an annual rate of 6.9%, with monthly payments of $4,000 over the course of 5 years, followed by a balloon payment of any unpaid principal and interest at the end of that term. They secured it with the Revocable Trust's interests in several installment-sales contracts and leases.

With the loan proceeds and some cash from Penn Lake's account, Levine's children and Larson—again acting as her attorneys-in-fact—wired $4 million from Penn Lake to the Pacific Life Insurance Company to pay the one-time premium for insurance on the lives of Nancy and Larry. It is a whole-life policy with a face value of $10,750,000 that will pay out after both of their deaths. It also had a cash-surrender value that was guaranteed to increase by at least 3% per year.

A few days later, Private Bank of Minnesota wired $2 million to the John Hancock Life Insurance Company. A month later, Business Bank wired another $500,000. This paid the one-time premium for another last-to-die whole-life policy, this one for $6,496,877. It had a cash-surrender value guaranteed to increase by at least 3% per year.

B. *Levine's Split-Dollar Arrangement*

Between June and July 2008, Nancy, Robert, and Larson—in their capacities as Levine's attorneys-in-fact and as trustees of her Revocable Trust—executed several documents to put the split-dollar arrangement into effect. We summarize the most important parts of the deal:

- The Insurance Trust agreed to buy insurance policies on the lives of Nancy and Larry;
- The Revocable Trust agreed to pay the premiums on these policies;
- The Insurance Trust agreed to assign the insurance policies to the Revocable Trust as collateral;
- The Insurance Trust agreed to pay the Revocable Trust the greater of (i) the total amount of the premiums paid for these policies—$6.5 million—and (ii) either (a) the current cash-surrender values of the policies upon the death of the last surviving insured or (b) the cash-surrender values of the policies on the date that they were terminated, if they were terminated before both insureds died.

It was very important, if this deal was to work, that the Insurance Trust and not the Revocable Trust own the policies. The recitals in the arrangements state that the parties do *not* intend to convey to Levine or the Revocable Trust any "right, power or duty that is an incident in ownership . . . as such is defined under Section[s] 2035 and 2042" in the life-insurance policies at the time of Levine's death. They also state that neither the Insurance Trust, nor its beneficiaries, nor the insureds—Nancy and Larry—would have access to any current or future interest in the cash value of the insurance policies.

We also specifically find that *only* the Insurance Trust—and that means Larson—had the right to terminate the arrangements. There were two split-dollar arrangements, one for each insurance company. Paragraph 6 from both arrangements controlled the right to terminate the arrangements:

> The Insurance Trust shall have the sole right to surrender or cancel the Policy during the lifetime of either insured. In addition the Insurance Trust may terminate this Agreement in a writing delivered to the other party, effective upon the date set forth in such writing.

If the Insurance Trust did terminate the Agreement, however, it would get nothing:

> The Revocable Trust shall have the unqualified right to receive the total amount payable upon such surrender or cancellation of this Policy, or upon termination by notice from the Insurance Trust, and the Insurance Trust shall not have access to, or any current or future interest in, the Cash Value. Upon such payment of said funds to, and receipt of said funds by, the Revocable Trust, this Agreement shall terminate.

With the split-dollar deal done, Swanson had finished hammering into place the paper armor he had designed to protect as many of Levine's assets from tax as he legally could. He was just in time; within months, Levine's physical and mental health began to deteriorate more rapidly. She became more forgetful and began to not recognize her family and friends. At the start of 2009, she became bedridden. On January 22 she died.

C. *Tax Reporting*

Everyone involved knew that Levine, through her Revocable Trust, had given away some of her property to the Insurance Trust and its beneficiaries—they knew, in other words, that the value of the money the Revocable Trust would get years later wasn't equal to the $6.5 million it had given to the Insurance Trust for it to buy the insurance policies on Nancy and her husband. They knew that this was a taxable gift. Swanson prepared gift-tax returns for 2008 and 2009. Larson and Nancy signed these returns in their capacities as Levine's attorneys-in-fact. Each Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, reported the value of the gift as the economic benefit transferred from the Revocable Trust to the Insurance Trust. Gifts of valuable property for which the donor receives less valuable property in return are called "bargain sales." *See Estate of Bullard v. Commissioner*, 87 T.C. 261, 265 (1986). And the value of gifts made in bargain sales is usually measured as the difference between the fair market value of what is given and what is received. *Id.* at 270–71. Not so here. The Secretary, for whatever reason, has issued regulations that provide a different measure of value when split-dollar life insurance is involved. *See* Treas. Reg. § 1.61-22(d)(2). The number Larson and Nancy came up with after applying the valuation rules in the regulations was $2,644. *See* Treas. Reg. § 25.2512-1.

Everyone involved also knew that the promise of the Insurance Trust to pay the Revocable Trust some amount sometime in the future was also valuable. It had to be reported on the Levine's estate-tax return. And on Levine's Schedule G, Transfers During Decedent's Life, of the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, the value of the split-dollar receivable, as owned by the

Revocable Trust on the alternate valuation date, was reported as an asset worth about $2 million.[17]

IV. *Audit and Trial*

This shift of money from the Revocable Trust for the purchase of the life-insurance policies that benefited the Insurance Trust caught the IRS's attention. The Commissioner issued his challenge, and the joust between the IRS and the Estate began. The Commissioner noticed two things in particular. The first was the small amount—only $2,644—that Levine reported as the gift that her Revocable Trust had made to the Insurance Trust. The second was that the Insurance Trust had promised to pay the Revocable Trust the *greater* of $6.5 million or the policies' cash surrender value at *either* the death of both Nancy and her husband *or* upon termination of the policies. At the time of Levine's death, this value was close to $6.2 million, and the Commissioner suspected there was no insurmountable hurdle to the Insurance Trust's terminating the policies well before Nancy and her husband both died. This would mean that the Insurance Trust and Levine's descendants, as beneficiaries of the Revocable Trust, had ready access to $6.2 million, not just the $2.1 million + $2,644 that was reported on the estate- and gift-tax returns.

The Commissioner assigned as his champion estate-and-gift-tax attorney Scott Ratke. Ratke conducted an extensive audit, and in the end the Commissioner issued a notice of deficiency to the Estate for slightly more than $3 million. This reflected several adjustments, but his adjustment to the value of Levine's rights under the split-dollar arrangement was by far the biggest. He also determined that the Estate was liable for a 40% gross-misvaluation penalty under section 6662(h) because the value that it had reported for the split-dollar receivable was way too low. Ratke prepared a penalty-approval form for this penalty, which was signed by his immediate supervisor at the time—Nicole Bard—before the notices of deficiency were sent.[18]

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[17] The parties later stipulated that the fair market value of the split-dollar receivable, if the Estate prevails, is a bit higher—$2,282,195.

[18] The Commissioner also issued a notice of deficiency for Levine's 2008 gift-tax return. Levine's estate challenged this as well, and we consolidated the cases. We then issued our opinion in *Estate of Morrissette v. Commis-*

Counsel for the parties worked together to narrow the issues so their combat could be confined to a small tilt and not become a general melee. Three stipulations settled most issues. Only two remain:

- Was the value of the split-dollar receivable in Levine's estate on the alternative valuation date $2,282,195, or the policies' cash-surrender value of $6,153,478; and
- Is any resulting underpayment subject to the 40% gross-misvaluation penalty under section 6662(h).[19]

The parties have also stipulated that this case is appealable to the Eighth Circuit. *See* § 7482(b)(2).

Discussion

I. *Split-Dollar Life Insurance*

Split-dollar life-insurance deals began as a form of employment compensation. Employers wanted to pay the premiums on life insurance for their employees, keep an interest in the insurance policy's cash value and death proceeds, and pass on to the employee—or the employee's designated beneficiary—any remaining death benefit. *See De Los Santos v. Commissioner*, T.C. Memo. 2018-155, 116 T.C.M. (CCH) 304, 306. (The "split" in "split-dollar" refers to this division of the insurance proceeds between the insured and the person or entity that paid the premium.) In 1964, the IRS issued Revenue Ruling 64-328, 1964-2 C.B. 11, *revoking* Rev. Rul. 55-713, 1955-2 C.B. 23, in which it announced that it would include the death-benefit portion of a life-insurance policy in a recipient's income because it was an economic benefit. Tax planners and professionals began to devise different variations of

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sioner (*Morrissette I*), 146 T.C. 171 (2016). Both the Estate and the Commissioner agreed that *Morrissette I* required us to enter judgment against the Commissioner in the gift-tax case. We then severed the cases. The decision in the gift-tax case—that there was no deficiency despite the remarkably low value of the gift—has long since become final and unappealable.

[19] There was one additional issue that the parties did not settle—whether the Estate was entitled to a $1 million charitable contribution to the George and Marion Levine Foundation. That contribution has not yet been made, but the parties stipulated that this deduction will be allowable once the Estate provides proof of payment. The Estate intends to make this charitable contribution once we enter a decision.

these sorts of plans, and split-dollar arrangements eventually moved beyond the employment field.

They became a tool for estate planners who aimed to remove death benefits from their clients' taxable estates—or at least defer payment of any tax owed. What makes this attractive are some unusual advantages that the Code gives to buyers of life insurance—especially on what is called "inside buildup." An insurance company can sell a policy with premiums much larger than one would pay for term insurance. This money can go to work for the policyholder or her beneficiaries and "build up" as long as the policy remains in effect. It can make for a much larger death benefit or a substantial cash surrender value. Details quickly become very complicated, but it suffices here to characterize these policies as a form of tax-advantaged savings. Unlike income earned on other savings accounts—such as bank CDs or mutual funds—inside buildup is not taxed under section 72(e) as it accrues. It *is* eventually taxed when it is distributed to the policy holders, *id.*, but that can be a long time into the future, and all other things being equal, tax tomorrow is better than tax today. And tax decades from now is better still.

Over the years, the IRS provided limited guidance on the taxation of split-dollar life-insurance arrangements, mostly in the form of notices and revenue rulings.[20] That all changed when the Treasury Department issued final regulations in 2003. These govern all split-dollar arrangements entered into or materially modified after September 17, 2003. Treas. Reg. § 1.61-22. The final regulations broadly define a split-dollar life-insurance arrangement between an owner and a non-owner of a life-insurance contract in which:

- either party to the arrangement pays, directly or indirectly, all or a portion of the premiums;
- the party making the premium payments is entitled to recover all or a portion of those premium payments, and repayment is to be made from or secured by the insurance proceeds; and

[20] William L. Raby & Burgess J.W. Raby, *The Split-Dollar Life Insurance Regimes*, 94 Tax Notes 353 (2002); Sherwin P. Simmons, *Economic Benefit Under A Split Dollar Arrangement*, 1 Tax Prac. & Controv. 550 (Mar. 21, 1994).

- the arrangement is not part of a group-term life insurance plan (other than one providing permanent benefits).

Id. para. (b)(1).

The split-dollar arrangement in this case meets these specific requirements. After defining what a split-dollar arrangement is, the final regulations create two different and mutually exclusive regulatory regimes—called the "economic benefit regime" and the "loan regime"—that govern the income- and gift-tax consequences of split-dollar arrangements. Which regime a particular arrangement falls under depends on who "owns" the life-insurance policy at issue. *Id.* subpara. (3)(i). The general rule is that the person named as the owner is the owner. *Id.* para. (c)(1). Nonowners are any person other than the owner who has a direct or indirect interest in the contract. *Id.* subpara. (2). Under this general rule, the Insurance Trust would be the owner of the policies here, and the loan-regime rules would apply.

But there is an exception to this general rule. If the only right or economic benefit provided to the donee under a split-dollar life-insurance arrangement is an interest in current life-insurance protection, then the regulations tell us to ignore the formal ownership designation and treat the donor as the owner of the contract. This is the economic-benefit regime. *Id.* subpara. (1)(ii)(A)(*2*). So there's at least a threshold question here about whether the Insurance Trust received any economic benefit in addition to current life-insurance protection.

On this we have precedent. In *Morrissette I*, we held that a split-dollar arrangement much like this one fell under the economic-benefit regime for gift-tax purposes. But we also noted in *Morrissette I*, 146 T.C. at 172 n.2, that "we [were] not deciding whether the estate's valuation of the receivables . . . in the gross estate [was] correct." And Treasury Regulation § 1.61-22(a)(1) seems not to cover the estate-tax consequences of split-dollar arrangements at all.[21] The final regulations do make one reference to estate tax in their pre-

[21] Treasury Regulation § 1.61-22(a)(1) states:

> This section provides rules for the taxation of a split-dollar life insurance arrangement for purposes of the *income* tax, the *gift* tax, the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act

amble, which states "[f]or estate tax purposes, regardless of who is treated as the owner of a life insurance contract under the final regulations, the inclusion of the policy proceeds in a decedent's gross estate will continue to be determined under section 2042." T.D. 9092, § 5, 2003-2 C.B. 1055, 1063. But the express terms of section 2042 limit its applicability to life-insurance policies on a decedent's own life, not split-dollar arrangements where policies are taken out on the lives of others. *See* § 2042(1); Treas. Reg. § 20.2042-1(a)(2) ("[S]ection 2042 has no application to the inclusion in the gross estate of the value of rights in an insurance policy on the life of a person other than the decedent"). From this we conclude that neither the regulation nor section 2042 governs our valuation of the split-dollar arrangement we have to analyze.

II. *Estate Tax Generally*

That leaves us to look to the default rules of the Code's estate-tax provisions to figure out how to account for the effect of *this* split-dollar arrangement on the gross value of *this* estate. The Code defines a taxable estate as the value of a decedent's gross estate minus applicable deductions. § 2051. A decedent's gross estate includes the value of any property that a decedent had an interest in at the time of her death. § 2033. Some taxpayers reduce their estate-tax liability by making *inter vivos* transfers several years before death[22] and pay a usually smaller tax on the transfer.[23] § 2501(a). Sections 2034 through 2045 tell us what other property to include in an estate.

Among these sections is section 2036, which generally includes in a decedent's taxable estate the value of property that she transfers if, after the transfer, she kept either possession or the right to income from the property; or even if she

(FUTA), the Railroad Retirement Tax Act (RRTA), and the Self-Employment Contributions Act of 1954 (SECA).

(Emphasis added.)

[22] To reduce her estate-tax liability, a decedent must give property away more than three years before her death. If she doesn't, any tax paid on the gift must be added to her estate. § 2035(b).

[23] Usually, but not always. Federal gift-and-estate-tax law allows a credit that reduces the tax on gifts made while the donor is alive; and if it's not used up, it can reduce the estate tax. § 2505(a).

kept a right—either alone or in conjunction with another—to designate who would receive possession of that property or its income. Section 2038 generally claws back into a decedent's estate the value of property that she transferred in which she retained an interest or right—either alone or in conjunction with another—to alter, amend, revoke, or terminate the transferee's enjoyment of the transferred property. Both sections 2036 and 2038 include an exception for transfers that are "a bona fide sale for an adequate and full consideration in money or money's worth." §§ 2036(a), 2038(a)(1).

Section 2703 also tells us how to value property for gift, estate, and generation-skipping-transfer-tax purposes. It states that under certain circumstances property must be valued without regard to any right or restriction relating to the property that would result in the property's being valued at less than its fair market value. *See* § 2703(a).

The Estate asserts that the only asset from the split-dollar arrangement that Levine's Revocable Trust owned at the time of her death was the split-dollar receivable. In its view, Levine did not own, or have any other interest in, the life-insurance policies because those policies were owned by the Insurance Trust. And, as the Estate also points out, the value of that receivable is a number that the parties have stipulated. *See supra* note 17.

In the Commissioner's view, this entire transaction was merely a scheme to reduce Levine's potential estate-tax liability and, if it was a sale, it was not *bona fide* because it lacked any legitimate business purpose. He argues that the Estate should have reported on its return the cash-surrender values of the life-insurance policies, not the value of the receivable. He reasons that:

- under section 2036 Levine retained the right to income—or the right to designate who would possess the income—from the split-dollar arrangement, and
- under section 2038 she maintained the power to alter, amend, revoke, or terminate the enjoyment of aspects of the split-dollar arrangement, and
- even if the full values of the life-insurance policies are not includible in Levine's estate under section 2036 or 2038, the restrictions in the split-dollar arrangement should be disregarded under the special valuation rules provided in

section 2703, which would force the Estate to include in its taxable value the full cash-surrender values of the policies.

III. *Sections 2036 and 2038: What Rights Were Transferred and Retained*

We look first at what rights the Estate, through the Revocable Trust, transferred and what rights it retained. We agree with the Commissioner that the two snippets of the Code that we have to decrypt here are sections 2036 and 2038.

Section 2036(a) is a catchall designed to prevent a taxpayer from avoiding estate tax simply by transferring assets before she dies. *Strangi v. Commissioner*, 417 F.3d 468, 476 (5th Cir. 2005), *aff'g Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, 85 T.C.M. (CCH) 1331; *Estate of Bigelow v. Commissioner*, 503 F.3d 955, 963 (9th Cir. 2007), *aff'g* T.C.M. (RIA) 2005-065; *Estate of Thompson v. Commissioner*, 382 F.3d 367, 375 (3d Cir. 2004), *aff'g* 84 T.C.M. (CCH) 374 (2002). It states:

> Sec. 2036(a). General rule.—The value of the gross estate shall include the value of all *property* to the extent of any interest therein of which the decedent has at any time *made a transfer* (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
>
> (1) the possession or enjoyment of, or the right to the income from, the *property*, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the *property or the income* therefrom.

(Emphasis added.) Section 2038 also speaks of transferred "property," and includes in the gross value of an estate all property

> [t]o the extent of any interest therein of which the decedent has at any time *made a transfer* (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any

> such power is relinquished during the 3 year period ending on the date of the decedent's death.

(Emphasis added.)

The Estate argues that:

- it made no transfer of its property that could trigger these sections,
- it retained no interest in the property that it did transfer, and in any event,
- the *bona fide* sale for adequate and full consideration exemption applies.

We will take these arguments in order.

A. *What Was "Transferred"?*

Cases tell us to define "transfer" broadly. *Estate of Bongard v. Commissioner*, 124 T.C. 95, 113 (2005); *Estate of Jorgensen v. Commissioner*, T.C. Memo. 2009-66, 97 T.C.M. (CCH) 1328, 1333, *aff'd,* 431 F. App'x 544 (9th Cir. 2011). "A section 2036(a) transfer includes any inter vivos voluntary act of transferring property." *Estate of Jorgensen*, 97 T.C.M. (CCH) at 1333 (citing *Estate of Bongard*, 124 T.C. at 113). Section 2038's scope likewise imposes "a broad scheme." *Estate of Morrissette v. Commissioner* (*Morrissette II*), T.C. Memo. 2021-60, at *66, 121 T.C.M. (CCH) 1447 (quoting *Guynn v. United States*, 437 F.2d 1148, 1150 (4th Cir. 1971)).

But what property? Here the parties disagree. Is the property we look at the policies themselves? Is it the rights under the split-dollar arrangement to receive the greater of $6.5 million or the cash-surrender values of those policies? Or is it simply the $6.5 million in cash wired to the Insurance Trust from Levine's assets before she died?

We find that the "property" at issue cannot be the life-insurance policies, as these policies have always been owned by the Insurance Trust. The split-dollar transaction was structured so that the $6.5 million was paid by the Revocable Trust in exchange for the split-dollar receivable. It was the Insurance Trust that bought the policies and held them. These policies were never owned by the Revocable Trust, and there was no "transfer" of these policies from the Revocable Trust to the Insurance Trust.

The "property" is also not the receivable itself. That property belonged to the Revocable Trust and now it belongs to the Estate. It wasn't "transferred"; it was retained.

That leaves the $6.5 million that Levine sent to the Insurance Trust from her assets that the Insurance Trust used to pay for the insurance policies. And we do find that through her attorneys-in-fact Levine made a voluntary *inter vivos* transfer within the meaning of sections 2036(a) and 2038 when she wired $6.5 million to the life-insurance companies.

From the Commissioner's perspective, this is much too abbreviated an analysis. Don't look at the money or the policies or the receivable, he argues. Look for that right to unlock the cash-surrender values of those policies. To be sure, those values may be defined by the terms of the life-insurance policies and thus defined by an arrangement between the Insurance Trust and the insurance companies in property that the Estate did not itself *transfer*; but does the right of the Revocable Trust (and now the Estate) under the split-dollar arrangement to receive those cash-surrender values not somehow make them includible in the Estate's gross value?

Perhaps it might make sense, were this our first pass at the target, to more simply analyze the problem. We might just ask whether an estate that holds a split-dollar receivable has a right to a policy's cash surrender value in its gross value directly—to ask first whether an estate has such a right and, if so, what its value is as of the date of death.[24] But our approach as it has evolved instead elides the questions of whether this right was retained when the property creating it was transferred and whether it might somehow be exercised by the estate.

B. *Were Rights Retained?*

Section 2036's regulations tell us that "[a]n interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred." Treas. Reg. § 20.2036-1(c)(1)(i). The use, possession, enjoyment, right to income, or other enjoyment of property is considered having

[24] Remember that an estate's gross value is "the value at the time of . . . death of all property, real or personal, tangible or intangible, wherever situated." § 2031(a).

been retained or reserved "to the extent that the use, possession, right to the income, or other enjoyment is to be applied towards the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit." *Id.* para. (b)(2).

If we are right that the only property that Levine transferred was cash, then our analysis under section 2036 would seem to be easy—she retained no "interest" in that *cash*. But she did get something in return—the split-dollar receivable created and defined by the split-dollar arrangements. The receivable gave her the right to the greater of $6.5 million or the cash-surrender values of the policies. Under the terms of the split-dollar arrangements, however, Levine did not have an immediate right to this cash-surrender value. She (or her estate) had to wait until the deaths of both Nancy and Larry, or the termination of the policies according to their terms. Here we find what could be a very important difference between the split-dollar arrangements here and those analyzed in *Estate of Cahill* and *Morrissette II*. In Levine's case, the split-dollar arrangements between the Revocable Trust and the Insurance Trust expressly stated that *only* the Insurance Trust had the right to terminate the arrangement.

The split-dollar arrangements we analyzed in *Morrissette II* and *Estate of Cahill* were different. Look at the language in those arrangements. In *Morrissette II*:

> The Donor and the Trust may *mutually* agree to terminate this agreement by providing written notice to the Insurer, but in no event shall either the Donor or the Trust possess the unilateral right to terminate this Agreement.

And in *Estate of Cahill*:

> This Agreement may be terminated during the Insured's lifetime *only* by written agreement of the Donor *and* the Donee acting unanimously. Such termination shall be effective as of the date set forth in such termination agreement.

This difference matters. Unlike what we saw in *Morrissette II* and *Estate of Cahill*, we see here a carefully drafted arrangement that expressly gives the power to terminate *only* to the Insurance Trust. It gave Levine herself no unilateral power to terminate the policies and no language like that in the arrangement at issue in *Estate of Cahill* or *Morrissette II* that gave her that right acting in conjunction with the Insurance Trust. *See supra* p. 74. By requiring *both* parties' approval, the arrangements that we analyzed in *Morrissette II* and *Estate of Cahill* necessarily *required* each decedent's approval to terminate the arrangement. The opposite is true here, where only the Insurance Trust could terminate the arrangement. Without any contractual right to terminate the policies, we can't say that Levine had any sort of possession or rights to their cash-surrender values. If the contest between the Estate and the Commissioner were confined to the tiltyard defined by the transactional documents, we would have to conclude that sections 2036(a) and 2038 do not tell us to include the polices' cash surrender values in the Estate's gross value.

The Commissioner, however, tries to unhorse the Estate's argument with the pointed assertion that we should look at the transaction as a whole to get a clear picture of where each party stands and its role in the transaction. And that is exactly what we will do. We'll do it in two ways. We will question whether our review of the rights that any decedent might keep in a split-dollar arrangement really should be defined by the documents alone. Then we will look carefully to the particular circumstances of this transaction to see whether, as a practical matter on the facts of this case, Levine kept a right to the cash-surrender values of the policies bought by the Insurance Trust.

First to the law—should it make a difference whether the transactional documents in a split-dollar arrangement put the unilateral right to unwind the transaction onto the donee rather than split it between the donor and donee? First-year law students almost all learn that a black-letter rule of contract law is that the parties to a contract are free to modify it. *See* Joseph M. Perillo, Contracts (7th ed. 2014). The Commissioner would surely have a strong argument that this implicit power of parties to a contract is a "right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." § 2036(a)(2).

The Commissioner's first pass at the Estate in this part of their joust would thus be something like this: The Estate is a party to the split-dollar arrangement with the Insurance Trust. The insurance policies belong to the Insurance Trust.

But the policies' cash-surrender values are a form of income from that property. The right to the cash-surrender values belongs to the Revocable Trust (and thus the Estate) if the split-dollar arrangements are terminated. The arrangement may say that only the Insurance Trust has the power to terminate the deal and hand over that income to the Estate, but general principles of contract law allow the Estate to modify any term of the arrangements in conjunction with the Insurance Trust.

The language of section 2036(a)(2) *is* broad—it uses the word "right" without a modifier like "contract" or "instrument creating the." So why shouldn't we construe that word to include background rights like the right to modify a contract? And, if so, wouldn't the cash-surrender values of the insurance policies be either a "right to the income" from that property, § 2036(a)(1), or a right that could be exercised in "conjunction with" another to the income from that property, §§ 2036(a)(2), 2038(a)(1)?

The problem for the Commissioner is *Helvering v. Helmholz*, 296 U.S. 93 (1935), a case about revocable transfers. Helmholz was a widower, whose wife had named him her sole heir. *Id.* at 96. While she was alive, she settled valuable stock in a privately held corporation into a trust. *Id.* at 94. Her brothers and sisters and her parents were the other shareholders, and the trust corpus was destined for later descendants or, if her family line died out, to charity. *Id.*

But her will left everything she owned at death to her husband. *Id.* at 96. The Commissioner argued that settlors of a trust may, with the consent of its beneficiaries, terminate the trust and restore the contributed property to the settlors. *Id.* at 97. Is this not, the Commissioner argued (and here the quote is from the slightly different language of the Code's equivalent of section 2038 back then) "a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke" a transfer of property? *Id.* at 96.

A persnickety textualist might quickly respond that it was. But the Supreme Court looked at the text of the trust agreement itself. That language had express provisions for the trust's termination—the death of the last surviving grandchild in the family, the written agreement of all the beneficiaries, a resolution by the directors of the family's corporation, or the corporation's liquidation. *Id.* at 97. The Court characterized these express provisions for the termination of the trust as typical of "every welldrawn instrument." *Id.* at 96. The Court acknowledged that it was true that "a writing might have been executed by Mrs. Helmholz and her cobeneficiaries while she was alive, with the effect of revesting in her the shares which she had delivered into the trust." *Id.* at 97. But it held that

> [t]his argument overlooks the essential difference between a power to revoke, alter or amend, and a *condition* which the law imposes. The general rule is that all parties in interest may terminate the trust. The clause in question added nothing to the rights which the law conferred. Congress cannot tax as a transfer intended to take effect in possession or enjoyment at the death of the settlor a trust created in a state whose law permits all the beneficiaries to terminate the trust.

Id. (emphasis added) (footnote omitted).

A more recent case that addresses the same problem is *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976). Tully owned half the stock in a private corporation. *Id.* at 1402. He and his partner reached an agreement long before his death that their company would pay a large death benefit to each of their widows. *Id.* Tully died, and the government argued that the death benefit owed his widow from the corporation had to be included in his estate. *Id.* There was nothing in the instrument that created the benefit that gave Tully himself any interest in it at the date of death, but the government noted that he continued to own half his company till the day he died. *Id.* at 1403. It reasoned that this meant that he had the power, acting with his partner, to do anything he wanted with corporate assets, and maybe he could have persuaded his partner to change the death benefit at any time. *Id.*

Nice try, held the Court of Claims. A power to "alter, amend, revoke or terminate" would trigger inclusion in an estate, but that kind of power "does not extend to *powers of persuasion*." *Id.* at 1404. To be included within the Code's sweep, a power has to be in the instrument itself, not a speculative possibility allowed by general principles of law. A broader reading—that a power to amend an instrument in conjunction with others includes all speculative possibilities—"would sweep all employee death benefit plans into the gross estates of employees." *Id.* at 1405.

We encountered a somewhat similar argument in conservation-easement cases. Congress enacted a Code section to allow a deduction for such easements if done properly. One requirement of a proper easement is that it preserve land in perpetuity. But remember that the parties to a contract can modify its terms, and easements are a kind of contract. We rejected the Commissioner's argument that a power to amend means that the parties *might* amend it so as to destroy perpetuity, which means that the easement wasn't perpetual. We disagreed: "Generally speaking, the parties to a contract are free to amend it, whether or not they explicitly reserve the right to do so. . . . Respondent's argument would apparently prevent the donor of any easement from qualifying for a charitable contribution deduction under section 170(h) if the easement permitted amendments." *Pine Mountain Pres. LLLP v. Commissioner*, 151 T.C. 247, 282 (2018), *rev'd in part, aff'd in part*, *vacated and remanded*, 978 F.3d 1200 (11th Cir. 2020).

We therefore agree with *Helmholz* and *Estate of Tully* that general default rules of contract—rules that might theoretically allow modification of just about any contract in ways that would benefit the IRS—are not what's meant in phrases like section 2036's "right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom," or section 2038's "power . . . by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power)." What's meant are rights or powers created by specific instruments. A more extensive reading, as the old Court of Claims noted in *Estate of Tully*, would swing a broadax to fell large swaths of estate and retirement planning that Congress meant to allow to stand.

We therefore conclude that the Commissioner doesn't win as a matter of law here.

But we do think he's correct that we also must avoid being so blinded by any formal gleam from the Estate's armor that we overlook some practical chinks that deals like this may have: Can the Commissioner dismount from purely legal or theoretical arguments and start wielding shorter, sharper weapons forged from the particular facts of particular cases?

The Commissioner thinks he can, and would have us focus on our holdings in *Estate of Strangi*, 85 T.C.M. (CCH) 1331, and *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), cases in which we concluded that section 2036(a)(2) clawed value back into a decedent's taxable estate despite the drafting skills of talented estate lawyers. In both *Estate of Strangi* and *Estate of Powell* we distinguished the Supreme Court's opinion in *United States v. Byrum*, 408 U.S. 125 (1972), in which an estate won, so we can begin by summarizing that case.

In *Byrum*, the Supreme Court held that a decedent's right to vote shares of stock in three corporations that he had transferred to a trust for the benefit of his children did not cause those shares to be included in his estate under section 2036(a)(2). The Court noted that any powers the decedent might have had were subject to a number of different "economic and legal constraints" that prevented those powers from being equivalent to the right to designate a person to enjoy trust income. *Id.* at 144. One of these constraints was that the decedent, as the controlling shareholder of each corporation whose stock was transferred into the trust, owed fiduciary duties to minority shareholders that limited his influence over the corporations' dividend policies. *Id.* at 142–43. The Supreme Court also noted that an independent corporate trustee alone had the right under the trust agreement to pay out or withhold income, *id.* at 137, so the decedent had no way of compelling the trustee to pay out or accumulate that income, *id.* at 144. That the decedent had fiduciary duties to these minority shareholders—duties that were legally enforceable—was important to the Supreme Court's analysis. *Id.* at 141–42.

We have been careful to distinguish *Byrum* in later cases when we see something behind a transaction's facade that suggests appearance doesn't match reality. *Estate of Strangi*, 85 T.C.M. (CCH) at 1333–34, featured a decedent who could act with others to dissolve a family limited partnership to which he had transferred property in exchange for a 99% limited-partner interest. The decedent in *Estate of Strangi*—through his son-in-law—also had the right to determine the amount and timing of partnership distributions. *Id.* at 1337.

This led us to distinguish *Byrum*, because in *Byrum* the son-in-law had fiduciary duties to other members of the family limited partnership; in *Estate of Strangi*, the son-in-law's potential fiduciary duties—as the decedent's attorney-in-fact and 99% owner of the family limited partnership—were duties he owed "essentially to himself." *Id.* at 1343.

We decided *Estate of Powell* on essentially the same grounds as *Estate of Strangi*. In *Estate of Powell*, 148 T.C. at 394–95, a fiduciary also owed duties to the decedent both as his attorney-in-fact and as partner in a family limited partnership. We found that there was nothing in the record of that case to suggest that as a fiduciary he "would have exercised his responsibility as a general partner of [the family limited partnership] in ways that would have prejudiced decedent's interests." *Id.* at 404. And we again determined that whatever duties were owed were duties that "he owed almost exclusively to decedent herself." *Id.*

Here's where the Commissioner makes his thrust. He contends that Levine—through her attorneys-in-fact—stood on both sides of these transactions and therefore could unwind the split-dollar transactions at will. This meant that she—again through the attorneys-in-fact—had the power to surrender the policies at any time for their cash-surrender values. (Remember that, under the terms of the split-dollar arrangements, if the Insurance Trust surrendered the policies before the deaths of both Nancy and her husband, it would immediately owe the Revocable Trust the full cash-surrender values of the policies.) The Commissioner argues that these powers constitute the right to possession and enjoyment of, or the right to income from, the split-dollar receivable under section 2036(a)(1). If he's right, we would have to value the receivable at the policies' cash-surrender values.

We agree that Robert, Nancy, and Larson—as Levine's attorneys-in-fact—stood in the shoes of Levine for this split-dollar arrangement. That is the point of giving someone a power of attorney. The Revocable Trust is the entity that paid the $6.5 million, and its cotrustees are Nancy, Larry, and Larson. The Insurance Trust, however, owns the life-insurance policies, and its trustee is South Dakota Trust. South Dakota Trust is directed by the investment committee, and the investment committee's only member is Larson. This, however, means that the only person that stood on both sides of the transaction is Larson—in his role as the investment committee and as one of Levine's attorneys-in-fact.

We therefore must look at each of Larson's roles in this transaction to consider how to apply sections 2036(a) and 2038. Under the 1996 power of attorney and Minnesota law, all actions taken by Larson as an attorney-in-fact are considered to be actions of Levine. *See* Minn. Stat. § 523.12 (2008).[25] The Insurance Trust's instrument, however, states that the Insurance Trust is irrevocable. We have no reason to doubt that this means what it says. And the consequence is that Levine irrevocably surrendered her interest in the Insurance Trust and had no right to change, modify, amend, or revoke its terms. Once it was created, Levine had no legal power over its assets. Levine did not have the power to surrender the policies by herself. Since Larson—in his role as an attorney-in-fact—could not take any action which Levine could not take herself, we find that he could not surrender the policies in his capacity as attorney-in-fact. This means that even if we treat the Insurance Trust, the policies, or *that* Trust's rights under the split-dollar deal as the "property transferred" (and thus the property whose value we look for) under section 2036, Levine did not retain any right to possession or enjoyment of the property transferred.

To get around these problems, the Commissioner has to argue that Larson has the right to designate who shall possess or enjoy the cash-surrender value of the policies, either by surrendering them or by terminating the entire arrangement. *See Estate of Cahill*, 115 T.C.M. (CCH) at 1467. For example, in *Estate of Cahill*, we found that section 2036(a)(2) applied when the decedent jointly held the right to terminate the split-dollar life-insurance policy with the irrevocable trust that held the policies. *Id.* We think that's the only way the Commissioner can include the combined cash-surrender values of the life-insurance policies in Levine's estate under section 2036(a)(2) or section 2038.

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[25] The Minnesota statute states: "Any action taken by the attorney-in-fact pursuant to the power-of-attorney binds the principal, the principal's heirs and assigns, and the representative of the estate of the principal *in the same manner as though the action was taken by the principal* . . . ." (Emphasis added.)

But we also think that this argument fails to consider the fiduciary obligations Larson owes to the beneficiaries of the Insurance Trust—obligations that would prevent him from surrendering the policies. The Commissioner first questions the validity and existence of these duties. He notes that "Larson was not compensated for his role as the sole member of the Investment Committee despite the fact that petitioner has taken the position that he assumed significant fiduciary responsibilities under this role." But we don't think that matters. There is no requirement under either South Dakota law[26] or general trust law[27] that a trustee or trust adviser be compensated to have fiduciary obligations. The terms of the Insurance Trust expressly state that Larson—in his role as the single-member investment committee—shall be considered to be acting in a fiduciary capacity. Therefore we do find that Larson was under fiduciary obligations in his role as the sole member of the investment committee.

Larson's duties in his role for the Insurance Trust required him, however, to look out for the interests of *that* Trust's beneficiaries. And here is where the Commissioner makes a different and subtler argument. He contends that, since Nancy and Robert are beneficiaries of the Insurance Trust, they stand to benefit under the split-dollar arrangement regardless of whether the life-insurance policies remain in place or are surrendered during their lifetime. This means, he says, that Larson would not violate his fiduciary duties to the beneficiaries of the Insurance Trust if he either surrendered, or didn't

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[26] S.D. Codified Laws § 55-1B-4 (2008) provides:

> If one or more trust advisors are given authority by terms of the governing instrument to direct, consent to, or disapprove a fiduciary's investment decisions, or proposed investment decisions, *such trust advisors shall be considered to be fiduciaries when exercising such authority unless the governing instrument provides otherwise.*"

(Emphasis added).

And S.D. Codified Laws § 55-2-1 (2008) provides that "[i]n all matters connected with his trust a trustee is bound to act in the highest good faith toward his beneficiary . . . ."

[27] Restatement (Third) of Trusts § 70, cmt. d(1) (Am. L. Inst. 2007) states that "[w]hether or not a person receives compensation for serving as trustee, the person is subject to a duty to administer the trust in accordance with its terms . . . with prudence . . . and in good faith and conformity with other fiduciary duties referred to in Clause (b)."

surrender, the policies because Nancy and Robert would benefit no matter what. If Larson immediately terminated the split-dollar arrangement, surrendered the policies, and sent the money out of the Insurance Trust to the Estate and then to Levine's children, he'd just be benefiting the children in a different capacity.

To this subtle thrust, the Estate has a blunt parry: Levine's children are not the only beneficiaries under the Insurance Trust. Her grandchildren are also beneficiaries, and Larson has fiduciary obligations to them as well. According to the terms of the Insurance Trust, Levine's grandchildren would receive nothing if the life-insurance policies were surrendered. Left unmentioned is the final step in this argument—that Larson has no right to violate his fiduciary obligations by looting the Insurance Trust for the benefit of only some of its beneficiaries.

The Commissioner counters by arguing that the Insurance Trust itself allows Nancy and Robert to extinguish their children's interests in it. This means, he says, that Nancy and Robert are the only real beneficiaries, and stand to benefit regardless of whether the life-insurance policies stay in effect.

This misinterprets the way that "extinguishment" works under the provisions of the Insurance Trust, however. The Trust plainly states that "the special testamentary power of appointment hereby granted to said Beneficiary shall not be exercisable in favor of or for the benefit of the Beneficiary"—i.e. they can't extinguish another beneficiary's interest in favor of themselves. The Insurance Trust also states that extinguishment of a beneficiary's interest can occur only by will and cannot take place until the death of the beneficiary doing the extinguishing (which in this case would be Nancy or Robert). So if Nancy and Larry hoped to extinguish the interests of their own children, they couldn't do so until they themselves directly named some other beneficiary to take their place. This means that during the lives of Nancy and Robert, their children will remain beneficiaries of the Insurance Trust, and a decision by Larson to surrender the policies would mean the grandchildren would receive nothing. This would breach his fiduciary duties to them.

Levine's case is thus distinguishable from *Estate of Strangi* and *Estate of Powell*. Many of the same "economic and legal constraints" that existed in *Byrum* exist here. First, the fiduciary obligations that Larson owed were not duties that he "essentially owed to himself." His fiduciary obligations are owed to all the beneficiaries of the Insurance Trust, which include not just Levine's children, but her grandchildren. As we've already discussed, if Larson surrendered the life-insurance policies, those grandchildren would receive nothing as beneficiaries. That makes these fiduciary obligations more analogous to the duties owed to the minority shareholders in *Byrum*, which like them are duties that do limit the powers of the person who holds them. They are also legally enforceable duties, established by South Dakota state law, *see, e.g.*, S.D. Codified Laws §§ 55-2-1, 55-1B-4 (2008), and if Larson breached these duties or was put in a position where he was forced to do so, he would be required under S.D. Codified Law § 55-2-6 (2008) to inform all of the beneficiaries of the Insurance Trust, and he could be removed. He could also be subject to liability under South Dakota law for breach of his duty. *See, e.g.*, *Matter of Heupel Fam. Revocable Tr.*, 914 N.W.2d 571 (S.D. 2018) (trustee breaching fiduciary duties removed and required to personally reimburse trust).

We stress that the fiduciary duties that Larson owed to the beneficiaries of the Insurance Trust do not conflict with the fiduciary duties that he owed Levine as one of her attorneys-in-fact. In both *Estate of Strangi* and *Estate of Powell* we held that the fiduciary's role as the attorney-in-fact would potentially require him to go against his duties as a trustee. *Estate of Strangi*, 85 T.C.M. (CCH) at 1343; *Estate of Powell*, 148 T.C. at 404. This is not the case here: Under Minnesota law, whenever Larson and the other attorneys-in-fact exercise their powers, they are to do so "in the same manner as an ordinarily prudent person of discretion and intelligence would exercise in the management of the person's own affairs and shall have the interests of the principal utmost in mind." Minn. Stat. § 523.21 (1992). And Larson, Nancy, and Robert all credibly testified that one of the reasons for this split-dollar arrangement was that Levine wished to provide for her grandchildren and keep this arrangement in effect until the insureds died. So not only did Larson's role as an attorney-in-fact not require him to go against his duties as a trustee, the two roles reinforced each other and pushed him to fulfill Levine's stated purpose in her estate planning. They made it more likely that he would not want to cancel the life-insurance policies.

We therefore find it more likely than not that the fiduciary duties that limit Larson's ability to cancel the life-insurance policies were not "illusory." It also persuades us that we cannot characterize his ability to unload the policies and realize their cash-surrender values as a right retained by Levine, either alone or in conjunction with Larson, to designate who shall possess or enjoy the property transferred or the income from it.

We conclude that this precludes the inclusion of the cash-surrender values of the life-insurance policies in Levine's estate under section 2036(a)(2).[28]

Section 2038 focuses on a decedent's power to "alter, amend, revoke, or terminate" the enjoyment of the property in question. The Commissioner's argument under section 2038 mirrors his argument under section 2036—that the attorneys-in-fact have controlled the entirety of Levine's affairs since 1996, and that this control includes the ability to "alter, amend, revoke or terminate" any aspect of the split-dollar arrangements. He argues again that the termination of the split-dollar arrangements would provide Levine—through her attorneys-in-fact—with complete control over the cash-surrender values of the policies, and the power to do this would fall within section 2038(a)(1). He argues that it applies to section 2038(a)(1) for the same reasons that he argues it applies to section 2036. We disagree for the same reasons and need not repeat them.

The cash-surrender values of the insurance policies are not includible under section 2038(a)(1) either.[29]

IV. *Section 2703*

The Commissioner argues as a third alternative that the special valuation rules under section 2703 apply to Levine's split-dollar arrangement. Section 2703(a) provides:

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[28] Section 2036(a) also excepts from its sweep transfers that are *bona fide* sales for adequate and full consideration. We need not determine whether this exception applies.

[29] Section 2038 also includes an exception for a "bona fide sale for an adequate and full consideration in money or money's worth." We need not decide whether this exception applies here.

> Sec. 2703(a). General rule.—For purposes of this subtitle, the value of any property shall be determined without regard to—
>
> (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
>
> (2) any restriction on the right to sell or use such property.

The Commissioner argues that when Levine—through her attorneys-in-fact—entered into the split-dollar arrangement, she placed a restriction on her right to control the $6.5 million in cash and the life-insurance policies. And the restriction on Levine's right to unilaterally access the funds transferred to the insurance companies for the benefit of the Insurance Trust is what should be disregarded when determining the value of the property under section 2703(a)(2).

The Estate argues that section 2703 applies only to property owned by Levine at the time of her death, not to property she'd disposed of before, or property like the insurance policies that she never owned at all. If the inability to surrender the life-insurance policies is considered a "restriction," it is not a restriction on any property rights held by Levine since she never owned the policies.

The Commissioner doesn't parry this other argument, but argues instead that if we focus on the "rights" held by Levine under the split-dollar arrangement—and not the $6.5 million in cash—the result would remain the same. He wants to imagine that despite the different language in the split-dollar arrangement here compared to those in *Morrissette II* and *Estate of Cahill*, it should still be read to mean that both parties may consent to any early termination of the insurance policies. He says that without this restriction, the value of Levine's rights would equal the cash-surrender values of the life-insurance policies.

We disagree. Section 2703 does refer to "any property." But the "any property" it refers to is property of an estate, not some other entity's property. Our caselaw confirms the plain meaning of the Code, and tells us to confine section 2703's valuation rule to property held by a decedent at the time of her death. *See, e.g.*, *Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000), *aff'd in part*, *rev'd in part*, 293 F.3d 279 (5th Cir. 2002). The district court in *Church v. United States*, 85 A.F.T.R.2d 2000-804 (W.D. Tex. 2000), *aff'd without published opinion*, 268 F.3d 1063 (5th Cir. 2001), rejected precisely this argument when it held that "property" in section 2703 consideration does not include assets that a decedent contributed to a partnership before her death, but only the partnership interest she got in exchange. *See also Estate of Strangi*, 115 T.C. at 488 ("Congress 'wanted to value property interests more accurately when they transferred, instead of including previously transferred property in the transferor's gross estate.'" (citing *Kerr v. Commissioner*, 113 T.C. 449 (1999), *aff'd*, 292 F.3d 490 (5th Cir. 2002))).

The property we have to value here is the property in Levine's estate, which is the split-dollar receivable she held at the time of her death. There were no restrictions on *that* property. She could do with the receivable what she wanted. She was free to sell it or transfer it as she wished. One needs to remember that what the Estate valued on its return was the receivable owned by Levine in her Revocable Trust. Section 2703 is not relevant to the valuation of the receivable because Levine had unrestricted control of it. Section 2703 therefore does not apply.

The only property left in the Estate after this arrangement was done was the split-dollar receivable. It is the value of *that* property that must be included in the gross estate, and the parties have agreed that its value is $2,282,195. The Estate having almost entirely prevailed, no accuracy-related penalties apply.

Conclusion

If there is a weakness in this transaction, it lies in the calculation of the value of the gift between Levine and the Insurance Trust—the difference between the value that her Revocable Trust gave to the Insurance Trust and what it got in return. But the gift-tax case is not this estate-tax case.

And the problem there is traceable to the valuation rule in the regulations. No one has suggested that this rule is compelled by the Code and, if it isn't, the solution lies with the regulation writers and not the courts. *See Carpenter Fam. Invs., LLC v. Commissioner*, 136 T.C. 373, 387 (2011).

Decision will be entered under Rule 155.