## ACTION ON DECISION

**Subject**: *GreenTeam Materials Recovery Facility PN, GreenWaste Recovery, Inc., Tax Matters Partner, et al. v. Commissioner*
T.C. Memo. 2017-122
T.C. Docket Nos. 21946-09, 22233-09, 423-11

**Issue**: Whether the transfer of a non-capital asset is treated as the sale or exchange of a capital asset under I.R.C. § 1253(a) if the transferor does not retain any significant power, right, or continuing interest in the asset.

**Discussion**: In 2003, the taxpayers sold the assets of their waste collection businesses to a third party. The assets included contracts to provide waste collection services to certain municipalities. The taxpayers reported amounts allocable to the contracts as capital gain. The Service determined that the contracts were not capital assets so that the gains from the sale of the contracts produced ordinary income.

Section 1253(a) provides that a "transfer of a franchise, trademark, or trade name shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the subject matter of the franchise, trademark, or trade name." Section 1253(d)(1) allows transferees to deduct certain contingent payments, and section 1253(d)(2) states that an amount to which section 1253(d)(1) does not apply "shall be treated as an amount chargeable to capital account." The taxpayers argued that section 1253(a) entitled them to capital gains treatment because the contracts were franchises, as defined in section 1253(b), and they transferred the contracts without retaining a significant, power, right, or continuing interest. The Service argued that because the contracts were not capital assets under section 1221(a), whether the contracts were franchises for purposes of section 1253 was irrelevant. The Tax Court agreed with the taxpayers for three reasons.

First, the court held that the taxpayers satisfied the requirements of section 1253(a) since they transferred franchises within the meaning of section 1253(b) and did not retain a significant interest in them. However, this reasoning is not supported by the plain language of section 1253(a), which only provides that transfers over which a taxpayer retains certain powers, rights, and interests are not eligible for capital gains treatment; it does not state under what circumstances gain from the transfer of a franchise is eligible for capital gains treatment. *See, e.g., Furrer v. Commissioner*, T.C. Memo. 1976-331, ***aff'd*** 566 F.2d 1115 (9th Cir. 1977) (rejecting the taxpayers' argument for applying section 1253 "by negative implication," and holding that "in those transactions covered by section 1253, the taxpayer is entitled to capital-gains treatment only if the prohibition of section 1253 does not apply and the requirements of section 1221 and 1222 are met"). Second, the court held that the requirement in section 1253(d)(2) that a transferee capitalize noncontingent payments implies that the transferor is entitled to capital gains treatment. This interpretation ignores the plain

meaning of this subsection, which addresses the tax treatment of a transferee's payments, rather than the tax treatment of a transferor's receipt of payments. Third, the court cited *Jackson v. Commissioner*, 86 T.C. 492, 520 (1986), ***aff'd***, 864 F.2d 1521 (10th Cir. 1989), and *McIngvale v. Commissioner*, 936 F.2d 833 (5th Cir. 1991), ***aff'g***, T.C. Memo. 1990-340, as support that section 1253(a) mandates capital gains under the facts of this case. Neither case supports this principle. In *Jackson*, the Tax Court addressed the issue only in dicta, and the court clearly stated in that dicta that a transferor who retains no significant right or continuing interest may treat the transfer as a sale or exchange of a capital asset only if it "is otherwise a capital asset in the transferor's hands" under section 1221. *Jackson*, 86 T.C. at 520, n. 19. In *McIngvale*, the Fifth Circuit concluded that section 1253(a) requires capital gains treatment when a transferor does not retain any significant rights, but only if the transaction is "otherwise taxable as a sale or exchange of a capital asset." *McIngvale*, 936 F.2d at 839.

Based on the plain language of section 1253 and on the case law, the sale or exchange of a franchise that is not otherwise a capital asset under section 1221 is not treated as the sale or exchange of a capital asset under section 1253(a) merely because the transferor does not retain any significant power, right, or continuing interest in the franchise. Accordingly, the Service will not follow the Tax Court's opinion in *GreenTeam Materials Recovery Facility PN* and will continue to litigate this issue.

**Recommendation:** Nonacquiescence.

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