Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SF:TL-N-1993-00
BAKranzthor

VIA FACSIMILE ONLY

date: July 10, 2001

to: LMSB – San Francisco SF:6107
Attn: Revenue Agent Jimmy Chan

from: BRYCE A. KRANZTHOR
Attorney (LMSB)

---

subject: [redacted] – Substantial economic effect issue
Taxable Years [redacted]

We recommend dropping the substantial economic effect issue. The Field Service Advice dated March 9, 2001, pointed out two weaknesses with the substantial economic effect issue. First, although the after-tax economic consequences to the U.S. partner were clearly enhanced in the early years of the arrangement, the deficit restoration obligation under the partnership agreement could require substantial repayments by the U.S. partner if the partnership's future profits fall short of projections. Second, the Service had not shown that the special allocation of disproportionate income to the foreign partner in the early years has no adverse U.S. tax consequences to the foreign partner.

We have reviewed your further efforts to improve the Service's evidence on these points. No further evidence was discovered on the first point, such as a collateral stop-loss agreement or understanding. On the second point, the additional tax returns located for the foreign partner show that after [redacted] the foreign partner paid substantial U.S. tax, so this does not establish that the special allocation has no adverse U.S. tax consequences to the foreign partner.

Under these circumstances, we are unable to recommend pursuing the substantial economic effect issue in this cycle.

BRYCE A. KRANZTHOR
Attorney (LMSB)

10463