

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:MSR:AOK:OKL:TL-N-8302-98
CGMcLoughlin

date: JUL 30 1999

to: Chief, Examination Division, Arkansas-Oklahoma District
Attn: Doug Craig

from: District Counsel, Arkansas-Oklahoma District, Oklahoma City

subject: Request for Assistance

Taxpayer: [REDACTED]

Taxable year: [REDACTED]

Related taxpayer: [REDACTED]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

DISCUSSION

We are responding to your December 9, 1998 memorandum requesting our assistance in developing an examination issue. The issue relates to a conduit financing arrangement among [REDACTED] and numerous other parties. The basic structure of the conduit financing arrangement uses a REIT in which [REDACTED] generally owns one class of stock and third parties own the other class of stock.

[REDACTED] borrowed \$[REDACTED] from the REIT. [REDACTED] also entered into a sale/leaseback transaction with the REIT covering approximately \$[REDACTED] of property. The transferred property consists of land where there are existing [REDACTED] facilities. The transferred property did not include any of the structures or other improvements on the land. [REDACTED] retained title to all structures or other improvements.

Except for [REDACTED] members of the [REDACTED], the only other REIT shareholder is a grantor trust established to finance the transaction. The grantor trust funded its contributions to the REIT through private placements of a note and an "equity certificate." The [REDACTED] partners contributed less than \$[REDACTED] each and are included as shareholders to meet the statutory REIT requirements. The [REDACTED] shareholders include [REDACTED] and [REDACTED]. [REDACTED] also acted as [REDACTED]'s counsel in the transaction.

[REDACTED] provided approximately [REDACTED] of the capital to the REIT. The remaining capital was provided by the other REIT shareholders. The REIT's corporate structure provides that the other shareholders will receive all dividends during the first [REDACTED] years of operation. For the next [REDACTED] years, [REDACTED] will receive all dividends.¹ Thereafter, dividends are divided pro rata among the shareholders. Using this structure, [REDACTED] will claim [REDACTED] of the deductions on the \$[REDACTED] debt and on the lease payments during the first [REDACTED] years. None of the interest and rental income received by the REIT will be reported by [REDACTED] during the same [REDACTED] year period.

¹ The [REDACTED] shareholders, in addition to Class A shares, also have minor amounts of the Class B shares held by [REDACTED]. Those shareholders would also receive dividends on the Class B shares during the next [REDACTED] years.

From an internal [REDACTED] memorandum, it appears that the other REIT shareholders will receive approximately \$ [REDACTED] from the projected dividend distributions during the first [REDACTED] years. [REDACTED] has an option to acquire the grantor trust's REIT shares at the end of [REDACTED] years. The grantor trust also has an option to put its REIT shares at the end of [REDACTED] years. [REDACTED] has a similar arrangement with the owner of the "equity certificate." The owner of the "equity certificate" is apparently exempt from U.S. income taxation.

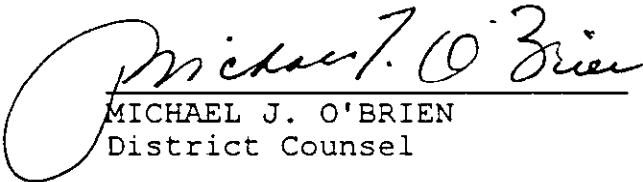
As you are aware, these types of fast pay stock arrangements are the subject of Notice 97-21, 1997-1 C.B. 407, and Prop. Treas. Reg. § 1.7701(l)-3. Both the notice and the proposed regulation seek to challenge these types of financing arrangements under the authority of I.R.C. § 7701(l). Notice 97-21 and the proposed regulation attempt to recharacterize the transactions and to eliminate the tax avoidance aspects of the transactions.

Unfortunately, both Notice 97-21 and the proposed regulation have effective dates which do not cover the years currently under examination. Thus, the government must look at some other more traditional doctrines (such as substance over form, sham, lack of economic substance, debt/equity or treating the REIT as a conduit) to attack [REDACTED]'s claimed deductions for the taxable year [REDACTED]. Portions of the transactions might also be attacked on more technical grounds (such as attacking the qualification of the REIT or the sale/leaseback).

In some informal consultation with National Office personnel, it was suggested that some additional factual development be done to determine if bases exist for asserting these alternative theories. Once that development is complete, the National Office personnel recommended that we seek their views, through a field service advice request, on the possibility of using these alternatives theories.

At the current time, insufficient facts are available to make any judgment as to the possible use of these alternative theories. The currently available documents generally include the instruments signed at the closing of the transaction. If some of the alternative theories mentioned above are going to be pursued, we will need to develop much more information on the parties' rationale for structuring the transaction and on the actual economic substance of the transaction. To help you develop the necessary facts, we have enclosed, as an attachment, a list of documents or other information you should consider including in an IDR.

Please contact Glenn McLoughlin at (405) 297-4803 or Brian Smith at (405) 297-4802 if you have any questions.


MICHAEL J. O'BRIEN
District Counsel

Attachment (1)

cc: ARC (TL), Midstates Region
ARC (LC), Midstates Region