The 21st Century Tontine Lookalike: Tax Aspects of Stock Protection Funds

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Thomas Boczar and Mark Leeds explore certain federal income tax considerations applicable to stock protection funds.

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Tontine Trusts, initially devised in the 17th century by Lorenzo de Tonti to help governments fund war efforts, are making a 21st century resurgence.[1] A *tontine* is an investment plan based on the principles of risk pooling, designed to mitigate the risk of running out of income during one's lifetime. A new stock hedging technique recently invented by Brian Yolles,[2] called the *Stock Protection Fund or Stock Protection Trust*,[3] is now available in the market that provides a modern twist on the traditional tontine trusts. A Protection Fund creates a low-cost strategy for hedging concentrated equity exposure. This article explores certain federal income tax considerations applicable to Protection Funds. As described in detail below, Protection Fund transactions avoid a number of tax challenges that are posed by traditional hedging techniques.

Many individual investors own appreciated positions in publicly-traded stock. In many cases, these stock positions comprise a significant portion of the holder's net worth. Such investors face a challenging environment. The stock market is at an all-time high, interest rates are ratcheting up, and risks seem to be lurking everywhere around the globe. Investors also face considerable tax uncertainty. Since 2013, the tax cost of selling outright has skyrocketed, with the capital gains tax rate increasing almost 60%.[4] However, with President Trump in office and a Republican-controlled Congress, the possibility of significant tax reform is "in the air," which might include a reduction in the capital gains tax rate, the elimination of the estate tax, and the loss of the tax-free step-up in tax cost basis at death. Some investors holding highly appreciated stock would like to protect, and defer the capital gains tax on, their unrealized gains, and "wait it out" until this tax ambiguity is sorted out.[5]

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I. Overview of Stock Protection Funds

Protection Funds are a fairly recent development.[6] Protection Funds can help investors who wish to keep some or all of their stock position as a core, long-term holding, by allowing them to preserve their unrealized gains and keep all upside potential in a cost-effective manner.

The foundation of Protection Funds is rooted in the principles of modern portfolio theory (MPT) and risk-pooling/insurance. MPT reveals that as individual stocks are added to a portfolio, the average covariance of the portfolio will decline. While there is still some debate over the number of stocks necessary to achieve complete diversification (see, for example, Evans and Archer, 1968[7]; Tole, 1982[8]; Statman, 1987[9]; Campbell, Lettau, Malkiel and Xu, 2001[10]), most investors and researchers agree that 20 disparate and equal-sized stocks are necessary to maximize the benefits of diversification.[11]

Assuming a diversified, equally dollar-weighted portfolio of 20 stocks, over time substantial dispersion in individual stock performance will occur among the 20 stocks on a total return basis. Some will outperform (achieving large gains), many will perform in-line with the market, and some will underperform (losing substantial value). Specifically, after a period of years, it is highly probable that the distribution of total returns of the 20 stocks comprising the portfolio will resemble a normal or bell-shaped curve, with the big winners reflected on the right tail, the in-line performers in the middle of the curve, and the big losers on the left tail. *Protection Funds integrate this key element of MPT with the notion of risk-sharing (a self-insurance pool) to eliminate or truncate left-tail risk.*

II. Operation of a Stock Protection Fund

Each Protection Fund is a separate Series within a Delaware Statutory Trust. Each Series is separate and distinct from each other Series. Each Series can have a different value of a single interest within that Series. For instance, a Series might be formed to protect Certificate holders who each own a $5 million stock position, another to protect Certificate holders who each own a $10 million stock position and so on.

For purposes of this article, it is assumed that a Series has been formed to protect 20 Certificate holders who each own shares of a stock in a different industry worth at least $1 million.[12] Each Certificate in this Series of the Protection Fund costs $120,000 and provides up to $1 million of protection for a stock. After the payment of placement fees and expenses, $100,000 of the proceeds from the sale of each of the 20 Certificates ($2,000,000) is contributed to the Series. Therefore, a $2,000,000 cash pool has been raised to protect 20 investors who each wish to protect their $1 million stock position. Each of the 20 common stocks comprising the reference portfolio is referred to as the "Designated Security."

It is assumed that each investor who purchases a Certificate holds his Designated Security would recognize a substantial amount of long-term capital gain if he were to sell shares of the Designated Security in a taxable transaction. Each investor neither desires to dispose of his shares of the Designated Security nor to recognize such gain. Rather, the investor desires to continue to hold his Designated Security but to protect himself against the risk of a loss on his Designated Security in a cost-effective and tax-efficient manner. Should a Certificate holder choose to sell or otherwise dispose of his Designated Security prior to the termination of a Series, the tax considerations discussed in this article should not be affected.

The Protection Fund Series elects to be treated as a C corporation for federal income tax purposes.[13] Each Series Certificate is therefore treated as stock in a C corporation. Each of the 20 Certificate holders specifies a different publicly-traded stock, each in a different industry, as his Designated Security. Each Series uses 95% of the net offering proceeds from the sale of Certificates to purchase U.S. Treasury securities (USTs) with a maturity as close as possible to, but not exceeding, five years, which will be held until the end of the term of the Series. The remaining 5% is invested in a money market fund that invests exclusively in USTs. We have assumed that the annual interest income earned on these investments will be at least equal to the annual operating expenses of a Series. To the extent that a Series earns interest income in excess of such expenses, the Series will have taxable income subject to federal income tax.

At the end of the five-year term of a Series, the Series will either sell its USTs for cash or allow the USTs to be redeemed by the U.S. Treasury. At that time, the Certificate holders will be divided into two groups. The first group will be those Certificate holders whose Designated Securities have provided a total return (change in stock price plus any dividends/distributions) that was positive over the term of the Series. The second group will be those Certificate holders whose Designated Securities have produced a negative total return over the term of the Series. Certain Certificate holders whose Designated Securities have experienced a negative total return over the term of the Series will have a preferential claim on the cash pool of the Series as described below.

The cash pool is first used to reimburse the Certificate holder whose Designated Security incurred the largest loss

(largest negative total return) among the group of 20 Designated Securities to the level of the second-largest loss that was incurred among the other 19 Certificate holders who own Designated Securities. Next, the cash pool is used to reimburse these two Certificate holders to the level of the third-largest loss that was incurred among the remaining 18 Certificate holders who own Designated Securities, and so forth and so on. This "reverse waterfall" process continues until either all losses have been reimbursed or the cash pool has been depleted. The largest remaining loss at this point defines what is referred to as the "maximum stock loss" for all Certificate holders who have incurred losses (stated as a percentage of the notional amount of stock being protected on day one).

The maximum stock loss can be thought of as akin to the strike price of a long put protecting a stock position. For instance, if the maximum stock loss is 15% (similar to a put strike of 85%), an investor whose stock lost 80% of its value would be reimbursed from the cash pool reducing that loss from 80% to 15%, but an investor whose stock lost 10% of its value would not receive any reimbursement. If the maximum stock loss is 0% (similar to a put strike of 100%), both the investor's stock loss of 80% and the investor's stock loss of 10% would be fully reimbursed by the cash pool.

If any amounts remain in the cash pool after the reimbursement of all losses, the remainder is returned to the investors, such that any Certificate Holder whose designated security did not suffer a loss ("gainer") will be refunded an amount equal to the amount reimbursed to the Certificate Holder whose designated security had the smallest loss ("smallest loser") to the extent funds are available. Otherwise, the gainers will split the remaining Series Pool Assets on a *pro-rata* basis. If any Series Pool Assets remain once all gainers have received a distribution equal to the smallest loser's reimbursement, all gainers as well as the smallest loser will then each receive an additional share of the excess cash in an amount that will make the total distribution he/she has received equal to the amount reimbursed to the Certificate Holder whose designated security had the second-smallest loss ("second-smallest loser") to the extent funds are available. Otherwise, the gainers and the smallest loser will split the remaining Series Pool Assets on a *pro-rata* basis. This "waterfall" process continues until no Series Pool Assets remain.

Accordingly, if all of the Designated Securities experience a positive total return over the life of a Series, each Certificate holder will receive back the holder's proportionate share of the Protection Fund's assets, expected to be approximately $100,000, at the termination of the Series.

Extensive back-testing shows that there is approximately a 70% probability that all losses will be fully reimbursed from the cash pool[14]—which is economically equivalent to at-the-money put protection—and with excess cash returned to the investors. There is about a 30% chance that the aggregate losses will exceed the cash pool, with the largest losses substantially reduced[15]—which is economically equivalent to slightly out-of-the-money put protection.

The actual performance results of a "real money" Protection Fund that was operated throughout the financial crisis during the five-year period from June 1, 2006, to June 1, 2011, provides further clarity. The fund protected 20 investors with 20 stocks in different industries, each seeking to protect the same notional amount of stock. The required upfront cash investment was 10% (2% per annum for five years) of the notional value of the stocks being protected. Of the 20 stocks protected, eight incurred losses, some significant (37%, 32%, 24%, 18%, 13%, 8%, 5%, and 1%). For investors participating in the Fund, all of their stock losses were reimbursed (*i.e.*, the maximum stock loss was 0%) and the remaining cash was returned (in this case *pro rata*) to the investors. Therefore, each of the 20 investors received the equivalent of five-year "at-the-money" put protection on their stock, and the amortized cost of that protection was only 1.38% per annum pre-tax or about 1% after-tax. It should be noted that if each of these 20 investors had attempted during that same time period throughout the financial crisis to achieve the same level of protection by buying at-the-money put options, the cost would have been prohibitive.

As can readily be seen, Protection Funds add a new dimension to the portfolio construction process for investors with concentrated stock positions. As an example, senior public company executives and other investors with concentrated positions can often be convinced to diversify out of some portion of their stock position over time; however, for the reasons mentioned above, they usually retain a significant position in their stock as a core, long-term holding which is unhedged and remains a major risk exposure relative to their net worth. Due to its affordability, a Protection Fund can be "married" to the retained stock position, thereby mitigating what is likely the holder's biggest investment risk. Executives and other investors can continue to "chip away" at their position over time using the more traditional strategies (such as outright sales, exchange funds and equity derivatives) while using a Protection Fund to cost-effectively protect that portion of their stock position they wish to retain as a core holding.

For company insiders ("affiliates"), the use of a Protection Fund does *not* cause a reportable event, and company executives and employees can use a Protection Fund to protect *both* stock and stock-linked compensation such as RSU, SAR, NQO, ISO and ESPP.

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III. Tax Considerations

There are several key issues that potential investors and their advisors should consider when evaluating the tax efficiency of an investment in a Series Certificate of the Protection Fund:

1. Should the holding of a Designated Security and a Certificate result in a *common law or statutory constructive sale* of the Designated Security by the Certificate holder?
2. Should the holding of a Designated Security and a Certificate create a *tax straddle*?
3. Should a holder of a Designated Security and a Certificate have a *suspended holding period* for purposes of determining whether any dividend received on the Designated Security is qualified dividend income (QDI)?
4. Should a distribution to a Certificate holder from a Series of the Protection Fund be taxable as *long-term capital gain* if the distribution exceeds the Certificate holder's tax-cost-basis (the amount paid by the holder to acquire the Certificate) and *currently deductible long-term capital loss* if such distribution is less than the Certificate holder's tax-cost-basis?

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IV. Tax Analysis

1. Holding a Designated Security and Certificate Should Not Result in a Constructive Sale of the Designated Security

There are two sets of "constructive sale" rules that could potentially cause a Certificate holder to recognize all or a portion of the gain inherent in his shares of a Designated Security if he enters into a Protection Fund transaction. First, the courts and the IRS have developed a doctrine, referred to as the "common law constructive sale" rules, under which a transaction that is not structured as a sale is treated as a sale for federal income tax purposes. (One can think of this as an application of the substance-over-form rule.) Second, Code Sec. 1259 contains "statutory constructive sale" rules under which certain enumerated transactions are deemed to be sales for federal income tax purposes. As analyzed below, the holder of a Designated Security should not be considered to have entered into either a common law constructive sale or statutory constructive sale by purchasing a Certificate.

A. Holding a Designated Security and Certificate Should Not Result in a Common Law Constructive Sale of the Designated Security

It has long been recognized that, for federal income tax purposes, the promise to pay over gain (or bear loss) with respect to property held by another person does not make the promisee an owner or co-owner of the property. Conversely, the party paying over the gain (or receiving a payment in respect of loss) should not be treated as having sold the security. For example, in *E.L. Connelly*,[16] a person purchased non-traded bank stock in 1930. Sometime after the purchase, the owner entered into an oral agreement with the taxpayer (Connelly) pursuant to which Connelly agreed to be responsible for one-half of any losses sustained with respect to the stock and would receive one-half of any gains realized by the holder of the stock. The stock became worthless and was sold for a nominal amount in 1934. Connelly made his required loss compensation payment to the stockholder in 1936. The IRS asserted that the arrangement made Connelly a one-half owner of the stock and that he experienced a capital loss when the stock was sold (or earlier). The taxpayer asserted that he had an ordinary loss when he paid the amount agreed to in 1936. The court agreed with the taxpayer:

> Petitioner, however, had no investment in the stock, but was merely under an obligation to reimburse [the holder] for one-half of the loss which he should sustain.

Accordingly, the court recognized that merely having the right to receive income or loss from a reference property does not cause the person with such rights to become the owner of that property for federal income tax purposes.[17]

In *J.D. Patton v. Jonas*,[18] an individual (Patton) desired to purchase the stock of a privately-held company but had insufficient funds to do so. Patton then approached his family-owned corporation to purchase the stock. The family-owned corporation agreed to do so, provided that Patton promised that he would purchase the stock from it upon demand for the purchase price plus a guaranteed yield thereon. In other words, the purchaser acquired the stock subject to a put option to Patton. Several years after the family-owned corporation acquired the stock, it exercised the put option and forced Patton to acquire the

stock. Patton claimed that he was the owner of the stock acquired by the family-owned corporation, and the guaranteed yield promised should be treated as the payment of interest by him. The court agreed with Patton and held that the family-owned corporation "was merely a conduit in plaintiff's chain of title and, in essence, did nothing more than advance the necessary funds for the stock purchase."

The enactment of the *constructive ownership rules* (Code Sec. 1260) in 1999 supports the conclusion that a financial contract that passes substantially all of the economics of a partnership interest (and certain other investments) to a person does not cause the person with the contractual exposure to be treated as the owner of the referenced asset for federal income tax purposes. Under Code Sec. 1260, when a taxpayer acquires economic exposure to a partnership or certain other passthrough entities through a forward contract, and the contract passes through "substantially all" of the economics of ownership to the taxpayer, the taxpayer is limited in the amount of long-term capital gain that can be realized from the derivative exposure to the amount of capital gain that it would have recognized if he or she had directly held the asset.[19] If the mere passage of substantially all of the economics of the investment pursuant to a contract were sufficient to cause the person who acquired such contractual exposure to become the tax owner of the referenced property, Code Sec. 1260 would have been superfluous. Indeed, the legislative history specifically notes that notional principal contracts with respect to financial assets have "potentially different tax consequences (as to the character and timing of any gain)" than a direct investment in the referenced property.[20]

In *Miami National Bank*,[21] the issue was, who was the owner of shares held in a subordinated brokerage account—the broker or the nominal owner of the account? Under the terms of the subordinated brokerage arrangement, the shares in the account were subject to claims of the broker's creditors and, if the broker experienced financial difficulties, the shares could be sold by the broker. (The customer, in exchange for agreeing to hold his shares in a subordinated account, received a fee.) The shares were held in the name of the broker, but the customer retained the right to receive dividends, vote the shares, withdraw the shares and substitute other property and retained full upside and downside price exposure to the stock. On these facts, the court held that possession of the substantial rights by the customer required the conclusion that the customer, and not the broker, was the owner of the stock in the account.

For federal income tax purposes, even in a *short against the box* transaction, a short sale remains open until the short seller delivers identical property to the lender.[22] Gain or loss is not triggered with respect to the shares held "in-the-box" because the short seller has the option to cash settle the short sale or purchase shares in the open market to repay his securities loan, as well as use the shares in the box. In other words, since the shares in the box may never be delivered to repay the securities loan, gain or loss on the short sale cannot be fixed until the short sale is closed by delivering property or cash to replace the property borrowed to cover the short position. Thus, if a taxpayer does not close out a short position, recognition of any gain or loss is suspended indefinitely.[23] There is no taxable event because there is no sale or exchange of a capital asset on establishing, and keeping open, a short sale.

In Rev. Rul. 2003-7,[24] the IRS analyzed a prepaid variable forward contract ("PVF") with respect to stock owned by the taxpayer. In the PVF considered in the Ruling, a person holding appreciated shares of a publicly-traded company promised to deliver in three years to an investment bank ("IB") a variable number of shares. Specifically, if the value of the stock was less than $20 (the value of the stock when the contract was signed), the shareholder would deliver 100 shares. If the value of the stock was at least $20, but not more than $25, the shareholder would deliver stock with a value of $2000. If the value of the stock was greater than $25, the shareholder would be required to deliver 80 shares of stock. In exchange for the promise of these deliveries, IB paid an unspecified amount of cash to the shareholder at the execution of the PVF. The shareholder pledged 100 shares of stock to the IB. The shareholder could deliver the pledged shares, other shares or cash at the termination of the contract.

Some investors holding highly appreciated stock would like to protect, and defer the capital gains tax on, their unrealized gains, and "wait it out" until this tax ambiguity is sorted out.

After analyzing certain of the cases discussed above, the IRS concluded that no sale occurred for federal income tax purposes upon the execution of the PVF, notwithstanding that the obligations of IB were fully prepaid. In reaching its conclusion, the IRS noted the following facts. First, the PVF did not deprive the shareholder of the right to receive dividends on the stock or vote the shares. Second, the shareholder was not required to deliver the pledged shares and could cash settle the PVF. Third, the shareholder

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was not under an economic compulsion to deliver the pledged shares. Fourth, legal title to the pledged shares was not put in the name of the IB.

In contrast to the favorable result reached by the IRS on the PVF in Rev. Rul. 2003-7, in TAM 200604033,[25] A.M. 2007-004 and *Anschutz,*[26] the IRS and ultimately the Tenth Circuit Court of Appeals concluded that a PVF, coupled with a loan of the shares subject to the PVF to the investment bank counterparty, *did* result in a sale of such shares for federal income tax purposes. In *Anschutz*, the taxpayer held appreciated stock and entered into a master stock purchase agreement consisting of PVFs and share lending agreements. (The taxpayer entered into three PVFs but, except for the fact that the investment bank prepaid its obligations, the economic terms of such PVFs were not disclosed.) The third PVF transaction permitted cash settlement, although the first two did not. The taxpayer also pledged the shares of stock to secure its obligations under the PVFs. The taxpayer then loaned the shares to the counterparty in order to enable the counterparty to execute short sales to hedge the synthetic long exposure to the stock it acquired through the PVFs. Under the terms of the stock loans, the taxpayer relinquished voting rights and allowed the counterparty to freely dispose of the shares.

Protection Fund transactions offer a significant opportunity to cost-effectively diminish risk from the holding of concentrated equity positions.

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The IRS and the court held that the analysis employed in Rev. Rul. 2003-7 required a contrary result on the facts described above. Specifically, the fact that the shares were loaned to the counterparty deprived the taxpayer of the ability to substitute collateral and to vote the stock. The fact that the counterparty acquired "possession and unfettered use of the pledged shares" distinguished these facts from those evaluated by the IRS in Rev. Rul. 2003-7.

Collectively, the authorities discussed above support the conclusion that a holder of a Designated Security who acquires a Certificate should not be considered to have undertaken a common law constructive sale of his shares of the Designated Security by reason of the acquisition and holding of a Certificate. The holder does not part with any ability to continue to be exposed to price appreciation, receive dividends, vote the stock, and dispose of the stock at will. It is even possible that the holder of the Certificate will be entitled to receive back 100% of the price paid for the Certificate (excluding the placement fee). Under the principle set forth in *Connelly*, *supra*, the fact that the Series has agreed to reimburse the Certificate holder (and 19 other Certificate holders) in certain situations for losses sustained on its stock position is insufficient to cause the Series to be treated as the owner of the stock. A Certificate does not even pass sufficient economics of ownership to a Series to invoke application of the constructive ownership rules to a Series (even if a Designated Security were subject to such rules).

In contrast to the facts presented in *Patton*, *supra*, a Certificate holder is not acting as a conduit in the acquisition of the Designated Security by a Series. Each Certificate holder must represent that he already owns a Designated Security as of the date the Certificate is purchased and, provided that the Certificate holder does not exercise his right to sell the Designated Security, thereafter will continue to possess all of the incidents of ownership described above. In *Miami National Bank*, *supra*, the IRS unsuccessfully asserted that a subordinated contingent pledge of shares caused the pledgee to become the owner of such stock. A Protection Fund transaction does not even require such a pledge; the Certificate holder is entitled to payment even if he does not hold the Designated Security at the conclusion of the five-year term of the Series.

The right of a Certificate holder to receive payments upon a total return loss on his Designated Security resembles the acquisition of a cash-settled put option because the holder of a Certificate may be entitled to receive payments only upon a total return loss on the Designated Security. *Lucas v. North Texas Lumber* makes clear that an arrangement treated as an at-the-money put option does not transfer ownership unless and until the option is exercised.[27]

Rev. Rul. 2003-7 makes clear that a hedging transaction that limits a taxpayer's downside in exchange for a relinquishment of the right to share in future appreciation after a certain point does not result in a constructive sale. The Protection Fund potentially limits the loss that would be sustained by a Certificate holder in exchange for the cost of the Certificate (which may ultimately be returned to the Certificate holder, depending upon the losses sustained on all Designated Securities). As in Rev. Rul. 2003-7, the Protection Fund does not limit the Certificate holder's right to receive dividends or vote the shares. In no instance will the Certificate holder be required to deliver the Designated Security. The legal title to the shares of the Designated Securities will not be transferred to the Series. In addition, a Certificate holder is entitled to all of the future appreciation of his/her Designated Security (provided that the Certificate holder does not exercise his right to dispose of the Designated Security). The conclusion

that the principle of Rev. Rul. 2003-7 should apply to a Protection Fund transaction should not be affected by the negative conclusions in TAM 200604033, A.M. 2007-004 and *Anschutz*, *supra* because the Series will not obtain the use of the Designated Securities or have the right to rehypothecate such Designated Securities. The Certificate holder retains the absolute right to keep or dispose of the Designated Security at any time.

B. Holding a Designated Security and Certificate Should Not Result in a Statutory Constructive Sale of the Designated Security

By 1997, Congress had become concerned that certain transactions, including the use of the short against the box and its synthetic equivalents such as total return equity swaps and forward contracts to economically dispose of already-owned stock, "did not result in the recognition of gain by the taxpayer."[28] In response to a number of well-publicized transactions in which taxpayers made use of such hedging techniques to hedge and monetize equity positions without requiring current taxation, Congress added Section 1259 (commonly referred to as the "constructive sales rules") to the Code. In general, Code Sec. 1259 requires that a taxpayer recognize gain, but not loss, upon entering into a "constructive sale" of an "appreciated financial position" in an amount equal to the amount of gain that would have been recognized if the position had been sold, assigned, or otherwise terminated at its fair market value on the date of the constructive sale. An "appreciated financial position" is defined as any position with respect to stock, certain debt instruments, or partnership interests if there would be gain if the position were sold, assigned or otherwise terminated at its fair market value.[29, 30]

Code Sec. 1259(c) provides that a constructive sale of an appreciated financial position takes place, *inter alia*, if the taxpayer enters into a short sale of the same or substantially identical property, a futures or forward contract to deliver the same or substantially identical property, or an offsetting notional principal contract. For purposes of the constructive sales rules, a forward contract results in a constructive sale of an appreciated financial position only if the forward contract provides for delivery of a substantially fixed amount of property for a substantially fixed price.[31] Although the statute does not offer any guidance with respect to what constitutes a "substantially fixed amount of property," the Senate Finance Committee Report accompanying the constructive sale rules provides that a forward contract that provides for "significant" variation in the amount of property to be delivered does not result in a constructive sale.[32]

The four enumerated transactions that trigger a statutory constructive sale all have one characteristic in common. Specifically, each of the transactions deprives the holder of the appreciated financial position of any further opportunity to recognize any gain and any loss with respect to the original position. In contrast, a Protection Fund transaction may insulate a Certificate holder against all, a portion or none of the loss that he sustains on his Designated Security. In addition, a Protection Fund transaction does not deprive the holder of a Certificate the ability to benefit from all future appreciation of the Designated Security or the ability to dispose of the Designated Security. Even if the cost of a Certificate is taken into account in making this determination, at worst, a Protection Fund only deprives a Certificate holder against economically earning the first 12% of any future gain—the cost of the Certificate itself. Furthermore, a Certificate holder may receive back all (excluding the placement fee) or a portion of the cost of his Certificate. Accordingly, a Protection Fund should not be considered to insulate a Certificate holder against all losses nor deprive him of all future gains.

The right of a Certificate holder to receive payments upon a total return loss on a Designated Security resembles the acquisition of a cash-settled put option because the holder of a Certificate can receive reimbursement of losses only upon a total return loss on the Designated Security. The legislative reports accompanying the enactment of the constructive sale rules state that because the standard requires the reduction of both risk of loss and the opportunity for gain, it is intended that transactions that reduce only risk of loss *or* opportunity for gain will not be covered by the constructive sale rules. The reports go on to state in virtually identical language that it is not intended that a taxpayer who holds an appreciated financial position in stock will be treated as having made a constructive sale when the taxpayer enters into a put option with an exercise price equal to the current market price (an "at the money" option).[33]

For these reasons, the purchase of a Certificate by the holder of a Designated Security should not result in a statutory constructive sale of the Designated Security.

2. Holding a Designated Security and Certificate Should Not Create a Straddle

Although a Protection Fund transaction has the potential to compensate a Certificate holder for losses sustained on his Designated Security, each Series references 20 unrelated stocks. Under tax rules promulgated in a related area that generally are accepted to apply in determining whether a straddle exists, baskets of 20 or more stocks (or referenced stocks) do not create "offsetting positions"—a necessary precondition for the finding of a straddle—unless there is a "substantial overlap" between an investor's holdings and

the basket. Provided that a Certificate holder does not own an amount of the other Designated Securities referenced in the Series in which he holds a Certificate that meets the substantial overlap test (described below), the Certificate and the Designated Security should not constitute a straddle. As a result, if a Certificate holder borrows against his Designated Security in order to fund the purchase of a Certificate, the interest expense incurred in connection with such borrowing should be currently deductible against investment income. Also, if a Certificate holder purchases a Certificate before he owns his Designated Security for one year, the Certificate holder's holding period in his Designated Security should not be reset for the purpose of determining whether gain or loss on the Designated Security will qualify for long-term capital gain treatment.

A. Overview of Straddle Rules

In general, if a straddle exists, losses on one position are suspended to the extent that there are unrecognized gains on offsetting positions. In addition, if the long-term capital gain holding period of a position in a straddle is not satisfied before the straddle is entered into, the holding period for such position is reset to zero and will begin only after a straddle no longer exists. Interest and carrying charges incurred in connection with holding a straddle must be capitalized to the extent that they exceed qualified income offsets from the straddle positions, such as dividends.

A straddle exists in the case of offsetting positions with respect to personal property. Offsetting positions are considered to exist if there is a "substantial diminution of the taxpayer's risk of loss from holding any position with respect to personal property by reason of his holding one or more other positions with respect to personal property (whether or not of the same kind)."[34] A presumption arises that positions are offsetting if, *inter alia*, the positions are in the same personal property, the positions are sold or marketed as offsetting positions or the aggregate margin positions for the positions are lower than the sum of the margin requirements for each position if held separately.[35] In testing whether these conditions are met, two or more positions are treated as described in the presumptions if the value of one or more of such positions varies inversely with the value of one or more of the other positions.[36]

Code Sec. 1092 contains a series of rules that override the normal tax accounting rules for positions that comprise a straddle. Specifically, the straddle rules defer the recognition of any loss to the extent that the amount of such loss exceeds the unrecognized gain in an "offsetting position." The deferred loss is carried forward indefinitely and tested again for deductibility against the amount of unrecognized gain in each succeeding year.[37] To the extent that the amount of the unrecognized gain in a succeeding taxable year is less than the amount of the deferred loss, the deferred loss may be claimed in such succeeding taxable year.[38]

If a taxpayer has straddle positions, interest and carrying charges properly allocable to the straddle positions may not be deducted.[39] Instead, such amounts are capitalized and added to the basis of the property comprising the straddle.[40] Interest and carrying charges are defined as the excess of interest expense and carrying charges over interest income, certain other ordinary income items recognized on the straddle positions, and amounts received on security loans that are includible in gross income.[41]

If a straddle exists, "the holding period of any position that is part of a straddle shall not begin earlier than the date the taxpayer no longer holds directly or indirectly an offsetting position with respect to that position."[42] This rule does not apply if the long-term capital gain holding period was met prior to the initiation of the straddle.[43] A loss on the disposition of a leg of a straddle is treated as a long-term capital loss (regardless of the actual holding period of the position) if when the taxpayer entered into the loss position, it already satisfied the long-term capital gain holding period for one or more of the offsetting positions.[44]

B. Straddles and Basket Transactions

Positions are considered to be offsetting "if there is a substantial diminution of the taxpayer's risk of loss from holding any position … by reason of his holding one or more other positions."[45] Generally, positions are considered offsetting "if the value of one position decreases when the value of the other position increases."[46] The straddle rules only apply to actively traded personal property, such as listed debt instruments and stock.[47] Property is considered actively traded if an established financial market exists for such property.[48] An established financial market includes a national securities exchange registered under section 6 of the Securities Exchange Act of 1934.[49]

The dividend received deduction (the "DRD") is a tax benefit enjoyed by certain corporate holders of stock.[50] A corporate taxpayer is entitled to claim a DRD, however, only if it satisfies certain specified holding period rules for the stock paying the dividend.[51] The holding period of stock for a corporate taxpayer is reduced for any period in which the taxpayer "has diminished his risk of loss by holding one or more other positions with respect to substantially similar or related property," as determined under IRS regulations.[52] Applicable regulations provide that a diminished risk of loss exists when "changes in the fair market values of the stock and the positions are reasonably expected to vary inversely."[53] Reasonable expectations include representations made with respect to the marketing of the position.[54]

The definition of a straddle (set forth above) and the rules for tolling the holding period of stock that pays a dividend that could be eligible for a DRD utilize a substantially identical standard. Specifically, a straddle exists when the value of one position decreases when the value of another position increases. A corporate taxpayer's holding period is tolled when the market values of the stock and positions are reasonably expected to vary inversely. These tests are virtually identical in their formulation of when positions are considered to be offsetting under the straddle rules. In addition, both tests take into account whether the positions were marketed as being offsetting positions.[55] Indeed, existing and proposed regulations under the straddle rules specifically incorporate the DRD standard in determining whether a taxpayer has entered into a straddle with respect to stock.[56] This substantial similarity in standards makes tests under the DRD tolling rules extremely relevant to the determination of whether a straddle exists and *vice versa*.

While no standards have been promulgated under the straddle rules for determining when positions with respect to more than one stock create a straddle with actual stock positions, such standards have been promulgated under the DRD rules for determining when a corporate taxpayer's holding period is tolled for stock because the taxpayer holds positions that are reasonably expected to vary inversely to the stock (and the straddle rules specifically reference the DRD standard). Special rules have been promulgated for positions that reference any group of stock of 20 or more unrelated issuers.[57]

Under the special rules for positions that reference 20 or more unrelated issuers, a position will be considered to be offsetting if there is a "substantial overlap" between the taxpayer's long stock positions and the offsetting position. An investor's Designated Security and Certificate will be considered to substantially overlap if the quotient obtained by dividing the fair market value of the Designated Security held by the investor by the fair market value of all of the Designated Securities referenced by the Series is equal to or greater than 70%.[58] This determination is re-tested by reducing the size of the position until the positions overlap. If a Designated Security is the only security in the Series that is held by a Certificate holder, however, the reduction in the fair market value of the basket of securities held by the Series will not affect the fact that there would only ever be a 5% overlap.

In addition, the test must be rerun when a Series Certificate holder purchases or sells any Designated Security referenced by that Series, any day on which the taxpayer changes the position, or any day on which the composition of the position changes.[59] This retesting could result in a substantial overlap if a Certificate holder later buys stocks that are the Designated Securities for his Series (other than his originally Designated Security).

In TAM 200033004,[60] a taxpayer owned stocks that comprised a portion of the Standard & Poor's 500 Stock Index (the "Index"), a widely available stock index. The taxpayer purchased listed put options on the Index. An IRS auditing agent contended that the stocks and the put options constituted a straddle notwithstanding that the put options and long stock positions did not meet the substantial overlap standard. The TAM addressed certain effective date issues applicable to transactions undertaken in 1995. It is clear from the TAM, however, that for periods after March 17, 1995, it was the view of the IRS that the straddle regulations determine whether there are offsetting positions with reference to the tests contained in DRD basket rules, including the substantial overlap test for positions that include 20 or more stocks.

Even if a position that references 20 or more unrelated issuers does not "substantially overlap" with one or more stocks held by a taxpayer, the position can still be considered to diminish the risk of loss of holding the stock position. Specifically, under a so-called anti-abuse rule, the position will toll the holding period of the stock if two conditions are satisfied:

1. Changes in the value of the position or the stocks reflected in the position are reasonably expected to virtually track (directly or inversely) changes in the value of the taxpayer's stock holdings, or any portion of the taxpayer's stock holdings and other positions of the taxpayer; and
2. The position is acquired or held as part of a plan a principal purpose of which is to obtain tax savings (including by deferring tax) the value of which is significantly in excess of the expected pre-tax economic profits from the plan.[61]

TAM 200033004, *supra*, offers additional guidance on the application of this anti-abuse rule. In cases in which the short position offers a diminution in general market risk, but not the specific portfolio of stocks held by the taxpayer, the IRS stated that such a position would not constitute a straddle with a portfolio of stocks "but only in those cases where it is most clearly appropriate to do so." The IRS went on to state that if the position reducing market risk is in any way tailored to the portfolio, it would not grant an exception from the straddle rules on the ground that the position only coincidently reduced portfolio risk.

C. A Designated Security and Certificate Should Not Be Considered Offsetting Positions

The issue as to whether a Certificate and a Designated Security should be considered to be offsetting should be determined by whether there is a substantial overlap

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between the Certificate holder's Designated Security and the Designated Securities referenced in the Series. If there are 20 equally weighted Designated Securities referenced by a Series and a Certificate holder does not hold any of such Designated Securities other than his Designated Security, then the overlap between the basket of Designated Securities referenced in the Series and the Certificate holder's Designated Security would be 5%. Since 5% is below the 70% threshold specified for substantial overlap by the DRD basket rules, the basket of Designated Securities referenced by the Series and the Certificate holder's Designated Security should not be considered to substantially overlap. Accordingly, the Certificate holder's Designated Security and the Certificate should not be considered as offsetting positions for the purpose of determining whether a straddle exists.

There is one feature with respect to the operation of a Protection Fund transaction that differs from the operation of products more frequently found in the market providing exposure to baskets of stocks. In many of such products, such as a total return swap referencing a basket of stocks, a payment is due to the short counterparty only if the net aggregate exposure has resulted in a total return loss. In contrast, the Protection Fund program can result in a payment if a Certificate holder's Designated Security alone has experienced a total return loss. On the other hand, a basket total return swap always mandates a payment to the short counterparty if there is a total return loss on the basket. In the case of a Protection Fund transaction, a Certificate holder is not guaranteed to receive a payment if his Designated Security incurs a total return loss. For example, if other Designated Securities incur a greater total return loss than the total return loss experienced by a particular Certificate holder, that Certificate holder may not receive any payment. Furthermore, even if a Certificate holder receives a payment in respect of a total return loss, that payment may not be equal to the loss sustained. Thus, since the payment with respect to any particular Certificate holder is dependent upon the performance of the other referenced Designated Securities, the substantial overlap rule of the DRD basket rules should apply even though the payment to a Certificate holder is dependent, in part, upon a loss being sustained on his Designated Security and not the net exposure of the aggregate Designated Securities.

Even if there is not a substantial overlap between a Designated Security and a Series, a straddle can exist if certain other tests are met. Based upon our understanding of the operation and marketing of the Protection Fund, such other tests should not be considered to have been met in the case of the Certificates. First, the Certificates are not marketed as offsetting to equity positions. The Certificates are marketed as operating exactly as described herein.

Second, it has been represented to us that the broker-dealer ("B/D") community would not ascribe any "collateral value" to a Certificate, that is, an investor cannot borrow 50% of the purchase price of a Certificate from a B/D and buy it with 50% cash equity. In other words, B/Ds cannot lend against the Certificate itself. For long stock positions alone, the margin requirement generally is 50%, meaning investors can buy unhedged long stocks with a 50% margin loan. An investor who is long a Designated Security and a Certificate cannot borrow any more than the same 50% that an unhedged long stock holder could borrow. Therefore, the aggregate (stock and certificate) margin position is not lower than the margin for each sold separately. Accordingly, the second set of tests that determines whether a straddle exists supports the conclusion that a Certificate and a Designated Security should not be considered parts of a straddle.

The anti-abuse rule contained in the DRD basket rules should not apply to a Protection Fund transaction. The first prong of this test requires that it must be reasonable to expect that changes in the value of the Designated Security will be inversely correlated with changes in the value of a Certificate. Given the fact that the value of a Certificate will vary with changes in the values of 19 other positions as well as the value of the Designated Security, this should not be considered to be a reasonable expectation. Second, the expected tax savings are not anticipated to be significantly in excess of the pre-tax benefits of a Protection Fund transaction. The client could lose up to his entire contribution and could receive up to 8.3 times such investment, of which the overwhelming majority of which would be taxable. This taxable gain, by definition, could only possibly exceed any embedded gain inherent in a Designated Security by the cost of a Certificate.

3. A Certificate Holder's Holding Period in His Designated Security Should Not Be Tolled for the Purpose of Determining Whether Dividends Constitute QDI

QDI is taxed at the lower tax rates applicable to long-term capital gains. In order for dividends to constitute QDI, a holder must satisfy a holding period test. The fact that a Certificate holder has entered into a Protection Fund transaction should not prevent a Certificate holder from satisfying the holding period test with respect to his Designated Security.

Code Sec. 1(h)(11)(B)(iii) provides that a dividend will not constitute QDI unless the holding period requirements for common stock provided in the DRD rules are met by substituting 60 days for 45 days and substituting 121 days for 91 days, in each place that such number appears. The

DRD holding period rules, as modified by the QDI rules, require that a shareholder hold a share of stock paying a dividend more than 60 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date in order for a dividend to be treated as QDI. The DRD holding period rules provide that the holding period is tolled for each day during which the "taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property." As analyzed in depth in the discussion of the straddle rules, if the offsetting position references 20 or more stocks, the diminution in risk test is undertaken by determining whether the substantial overlap test of the DRD basket rules is met.

In the case of the Protection Fund, the substantial overlap test would not result in more than a 5% overlap (assuming that a Certificate holder does not hold any of the referenced Designated Securities of a Series other than the Designated Security he owns). The substantial overlap test requires a 70% or greater overlap. As a result, the substantial overlap test should not be met. Therefore, the holding period for purposes of determining whether any dividends paid on a Designated Security constitute QDI should not be tolled by reason of a Certificate holder holding a Certificate.

4. Distributions in Excess of Basis Should Be Long-Term Capital Gain and Distributions Less than Basis Should Result in Currently Deductible Long-Term Capital Loss

The Certificates should constitute capital assets in the hands of investors. As amounts paid to Certificate holders will be paid only upon a liquidation of a Series, the amounts paid should be treated as payment in full in exchange for their Certificates. Accordingly, if a Certificate holder receives more than its cost in exchange for a Certificate, the amount received should be treated as a long-term capital gain. If a Certificate holder receives back less than the cost of a Certificate, the Certificate holder should have a long-term capital loss.

Code Sec. 331 provides that a shareholder who surrenders stock in complete liquidation of a corporation is treated as receiving the proceeds in "exchange for the stock."[62] Gain or loss is long-term capital gain or loss if the stock has been held for more than one year.[63] As described above, the holding period of a position (including stock) can be tolled if the taxpayer enters into a straddle over such property before the long-term capital gain holding period has been met.

As analyzed above, the holding of a Certificate and a Designated Security should not constitute a straddle. As a result, the holding period of a Certificate should not be tolled for a Certificate holder by reason of his holding of a Designated Security. Based upon the assumption that each Certificate holder will have held his Certificate for the five-year life of the Series, each Certificate holder should meet the long-term capital gain or loss holding period. Thus, if a Certificate holder receives an amount in exchange for his Certificate that exceeds the amount that he paid for the Certificate, the Certificate holder should recognize a long-term capital gain. Conversely, if a Certificate holder receives less than the amount that he paid for his Certificate, the Certificate holder should recognize a long-term capital loss.

5. Stock-Based Compensation

Employees and former employees of public companies often receive compensation designed to incentivize their job performance (including incentive stock options, non-qualified stock options, restricted stock, restricted stock units, stock appreciation rights and employee stock purchase plan shares), the value of which is derived from, or linked to, the price of the company's publicly-traded common stock ("Stock-Based Compensation"). If an employee holds stock acquired pursuant to the exercise of incentive stock options ("ISOs"), a disposition of such stock before the expiration of statutory holding periods can result in adverse tax consequences. Applicable regulations define a disqualifying disposition as "a sale, exchange, gift or any transfer of legal title."[64]

The same rules that are discussed above should apply to Stock-Based Compensation that is a Designated Security. Given that a Protection Fund transaction should not be treated as a statutory or common law constructive sale, the entry into such a transaction should not be treated as a disqualifying disposition of a Designated Security that has been acquired pursuant to an ISO. Since a Protection Fund transaction should not result in a constructive sale or a tax straddle, the holding of a Certificate and a Designated Security that is Stock-Based Compensation should not result in adverse tax consequences to the holder of the Stock-Based Compensation or result in a loss of holding period for the purpose of determining whether a dividend constitutes QDI.

V. Summary

Protection Fund transactions offer a significant opportunity to cost-effectively diminish risk from the holding of concentrated equity positions. In addition, Protection Fund transactions avoid many of the tax

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challenges posed by traditional hedging techniques. Specifically, Protection Fund transactions should result in common law or statutory constructive sales. Protection Fund transactions should not result in tax straddles, with their various tax problems, including loss disallowance, holding period restarting and potential conversion of long-term capital gain on the stock to short-term capital gain on the hedge. Protection Fund transactions should not result in a loss of QDI from a loss of holding period.

ENDNOTES

[*] Thomas Boczar's Intelligent Edge Advisors is a financial advisory firm specializing in addressing investment and hedging for private investors and family offices. He can be reached at *tboczar@intelligent-edge.com*. Mark Leeds' practice includes advising both users and purveyors of financial derivatives, family offices and individual investors. He can be reached at *mleeds@mayerbrown.com*.

[1] *See* Tom Verde, *When Others Die, Tontine Investors Win*, NEW YORK TIMES, March 24, 2017, available online at *www.nytimes.com/2017/03/24/business/retirement/tontines-retirement-annuity.html?_r=1*.

[2] *See* U.S. patents: Nos. 7,720,736; 7,739,177; 7,987,133; 8,229,827; and 8,306,897.

[3] In text, we will just call the transaction, a "Protection Fund."

[4] The American Taxpayer Relief Act of 2012, enacted January 2, 2013, increased the top tax rate on long-term capital gains to 20% for high-income earners. In addition, beginning in 2013, long-term capital gains became subject to an additional 3.8% surtax, enacted as part of the Health Care and Education Reconciliation Act of 2010. Although President Trump and the Congress have attempted to repeal this latter tax, such efforts have not been successful.

[5] Of course, many investors wish to maintain ownership of some or all of their concentrated stock positions for reasons other than tax planning, such as an emotional attachment to the stock, a belief in the further upside potential of the stock, a dividend yield that compares favorably to current fixed income yields, and restrictions on selling shares imposed by securities regulations or contract law (*i.e.,* employment, IPO lock-up or merger agreement).

[6] *See* U.S. patents: Nos. 7,720,736; 7,739,177; 7,987,133; 8,229,827; and 8,306,897.

[7] John L. Evans & Stephen H. Archer, *Diversification and the Reduction of Dispersion: An Empirical Analysis*, 23 JOURNAL OF FINANCE 761–767 (Dec. 1968).

[8] Thomas M. Tole, *You Can't Diversify Without Diversifying,* 8 JOURNAL OF PORTFOLIO MANAGEMENT 5–11 (winter 1982).

[9] Meir Statman, *How Many Stocks Make a Diversified Portfolio?* 22 JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS 353–363 (Sept. 1987).

[10] John Y. Campbell, Martin Lettau, Burton G. Malkiel & Yexiao Xu, *Have Individual Stocks Become More Volatile? An Empirical Exploration of Idiosyncratic Risk,* 56 JOURNAL OF FINANCE 1–43 (Feb. 2001).

[11] Frank K. Reilly & Keith C. Brown, at 213–214 (10th ed. 2012) summarizes the relevant research studies and findings.

[12] In order to purchase a Certificate, a potential investor must first represent that he owns at least the same amount of the single publicly-traded common stock that he is protecting through the purchase of a Certificate.

[13] A C corporation is a corporation that is subject to federal income tax on its taxable income.

[14] StockShield, LLC.

[15] *Id*.

[16] *E.L. Connelly*, 46 BTA 222, Dec. 12,255 (1942).

[17] *See also* Rev. Rul. 72-25, 1972-1 CB 127 (employee is not the owner of an annuity contract held by an employer for employee's benefit where the annuity contract could be reached by employer's creditors); Rev. Rul. 82-54, 1982-1 CB 11 (insurance company, not policy holder, is treated as the owner of non-publicly available investment held in connection with a life insurance policy issued to policy holder).

[18] *J.D. Patton v. Jonas*, CA-7, 57-2 USTC ¶10,002, 249 F2d 375.

[19] Code Sec. 1260(a)(1).

[20] H.R. Rept. No. 106-289 (Part 3), 106th Cong., 1st Sess., at 402 (1999).

[21] *Miami National Bank*, 67 TC 793, Dec. 34,251 (1977).

[22] Code Sec. 1233(a); Reg. §1.1233-1(a)(1).

[23] It is worth noting that Code Sec. 1259 can override the general non-recognition rule applicable to open short against the box transactions.

[24] Rev. Rul. 2003-7, 2003-1 CB 363.

[25] TAM 200604033 (Oct. 20, 2005).

[26] *Anschutz*, CA-10, 108 AFTR2d 2011-7590.

[27] *Lucas v. North Texas Lumber,* SCt, 281 US 11, 50 SCt 184, 74 LEd 668 (1930).

[28] *See* Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997, at 173 (Dec. 17, 1997). We note that the legislative reports accompanying the 1997 tax law changes support the analysis described in IV.1.A. above. Specifically, such reports recognize that under the federal income tax rules in effect prior to the passage of Code Sec. 1259, the entry into a forward contract to sell stock of a type that the taxpayer already owns does not result in a current sale of such stock.

[29] A "position" is defined as an interest in property, including a futures or forward contract, short sales, or option. Code Sec. 1259(b)(3).

[30] Code Sec. 1259(b)(1).

[31] Code Sec. 1259(d)(1).

[32] S. Fin. Rep. No. 105-33, 105th Cong., 1st Sess. 125–126 (1997).

[33] S. Fin. Rep. No. 105-33, 105th Cong., 1st Sess. 126–127 (1997), House Ways and Means Committee Report No. 105-220, 105th Cong., 192–194 (1997).

[34] Code Sec. 1092(c)(2)(A).

[35] Code Sec. 1092(c)(2)(A).

[36] *Id*.

[37] Code Sec. 1092(a)(1)(B).

[38] *Id.; see also* Reg. §1.1092-1T(b).

[39] Code Sec. 263(g)(1); Proposed Reg. §1.263(g)-1(a).

[40] *Id*.

[41] Code Sec. 263(g)(2).

[42] Reg. §1.1092(b)-2T(a)(1).

[43] Reg. §1.1092(b)-2T(a)(2).

[44] Reg. §1.1092(b)-2T(b)(1).

[45] Code Sec. 1092(c)(2)(A).

[46] S. Rep. No. 97-144, 97th Cong., 1st Sess. 150 (1981).

[47] *See* Code Sec. 1092(d)(1); Reg. §1.1092(d)-1(a).

[48] Reg. §1.1092(d)-1(a).

[49] Reg. §1.1092(d)-1(b)(1)(i).

[50] *See* Code Sec. 243(a) (specifying the various levels of the DRD).

[51] *See* Code Sec. 246(c)(1), (2).

[52] Code Sec. 246(c)(4)(C).

[53] Reg. §1.246-5(b)(2).

[54] Reg. §1.246-5(b)(4).

[55] *See* Code Sec. 1092(c)(3)(A)(iv); Reg. §1.246-5(b)(4).

[56] Reg. §1.1092(d)-2(a); Proposed Reg. §1.1092(d)-2(b).

[57] Reg. §1.246-5(c)(1).

[58] Reg. §1.246-5(c)(1)(iii)(B).

[59] Reg. §1.246-5(c)(1)(iv).

[60] TAM 200033004 (Aug. 18, 2000).

[61] Reg. §1.246-5(c)(1)(iv).

[62] *See also* Reg. §1.331-1(a) (amounts received by a shareholder in a complete liquidation "shall be treated as full payment in exchange for the stock").

[63] Code Secs. 1222(3), 1222(4).

[64] Reg. §1.422-1(c).

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