

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

Number: **20121202F**
Release Date: 3/23/2012

CC:LB&I:RFPH:ATL:
POSTF-139443-11

UILC: 246.05-03

date: November 10, 2011

to:

(LB&I/FS)

from: Associate Area Counsel (Atlanta)
(Large Business & International)

subject: Holding Period Requirement for Dividends-Received Deduction
("Taxpayer")

In accordance with § 6110(k)(3), this advice should not be cited as precedent.¹ This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

LEGEND

A =
B =
C =
D =
E =
F =
Amount 1 =
Amount 2 =
Amount 3 =
Amount 4 =
Amount 5 =

¹ Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended.

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ISSUE

Whether, based on the facts described herein, Taxpayer diminished its risk of loss and therefore failed to satisfy the holding-period requirement in § 246(c) for a dividends-received deduction?²

CONCLUSION

² For purposes of rendering this advice, we have assumed that the interests at issue are equity rather than debt. We have made no legal conclusion that the interests are equity interests.

Yes. Through the transaction structure, Taxpayer diminished its risk of loss and, as a result, reduced its holding period to zero days. Accordingly, Taxpayer is not eligible for a dividends-received deduction under § 243.

FACTS

Parties to the Transaction

Taxpayer is a domestic corporation and the common parent of an affiliated group of corporations that files a consolidated Federal income tax return. Taxpayer conducts its business primarily through its operating entity,

is a subsidiary of is a subsidiary of is an affiliate of that is a domestic limited liability company organized under the laws of the state of Delaware. (“NewCo”) is a newly formed corporation that is wholly owned by

(“Issuer”) is a newly formed subsidiary of NewCo. Issuer is a limited liability company that has elected, for US income tax purposes, to be taxable as a corporation. (“Issuer Sub”) is a newly formed subsidiary of Issuer that has elected, for US income tax purposes, to be taxable as a corporation.

and NewCo made initial capital contributions to Issuer as follows:³

	Initial Contribution	Initial Shares
NewCo	\$	preferred ⁴
	\$	common
	\$	preferred
	\$	common

Issuer’s preferred shares rank senior to Issuer’s common shares in liquidation and in payment of dividends.⁵ Issuer cannot incur indebtedness for borrowed money in excess of \$ (except upon providing with 120-days’ notice) and Issuer’s annual expenses cannot exceed \$.⁶

Investments of Issuer and IssuerSub

³ Amended and Restated Limited Liability Company Agreement of [Issuer] (“LLC Agreement”)

§
⁴ During the initial years of this transaction, Issuer issued only one class of preferred shares (class A shares). During later years of the transaction, Issuer subsequently issued class B preferred shares. This advice deals only with the treatment of the initial preferred shares, which were later designated as class A shares).

⁵ Memorandum p. .

⁶ Memorandum p. .

Issuer subscribes for \$ (approximately % of Issuer’s assets) of all issued and outstanding preferred shares of IssuerSub.⁷ Issuer loaned (the remaining % of Issuer’s assets) to ⁸ and , which guaranteed, and to highly rated third parties.⁹ IssuerSub’s preferred shares (which are held by Issuer) are senior to the common shares in liquidation and payment of dividends.¹⁰ NewCo invested \$ in IssuerSub’s common shares. Therefore, if IssuerSub’s portfolio incurs a loss, NewCo bears the first loss, up to \$¹¹.

Of the \$ raised, IssuerSub lent approximately \$ to as fixed-rate loans, \$ to third parties, and the remaining \$ to as short-dated floating-rate assets.¹²

Dividend Payments

IssuerSub pays fixed-rate dividends to its preferred shareholders. Issuer pays quarterly dividends to its preferred shareholders.¹³

Exit Mechanisms

⁷ Issuer’s LLC Agreement restricts Issuer’s investments to permitted investments. “Permitted Investments” are:

Eligible Transactions that consist of investments denominated in U.S. dollars consisting of:

- (i) cash or Cash Equivalents;
- (ii) the Investment [in preferred shares of IssuerSub];
- (iii) demand deposits with or promissory notes issued by or any of its branches and commercial paper issued or unconditionally and irrevocably guaranteed by, and money market deposit accounts issued or offered by, , **provided** that (a) the aggregate outstanding principal amount of such investments may not at any time exceed \$, (b) the maturity thereof upon original issuance thereof shall not exceed 185 days and (c) any such guarantee shall be substantially in the form of the guarantee issued by with respect to commercial paper issued by dated ;
- (iv) an aggregate principal amount of not less than \$ and not more than \$ of senior debt obligations identified in Schedule II, **provided** that the maturity thereof upon original issuance thereof shall not exceed 185 days;
- (v) any other investment acquired by the LLC [Issuer] after , but only if such investment satisfies each of the applicable investment criteria specified in Schedule III as of the date of the acquisition of such investment

LLC Agreement p. .

⁸ Based on the facts you provided, it is unclear where fits into the counterparty’s corporate structure. Please clarify this fact.

⁹ (“Transaction Approval”) p. ;

Memorandum p. .

¹⁰ Memo. p. .

¹¹ Memo. p. .

¹² Transaction Approval p. .

¹³ Memorandum p. . Both Issuer and IssuerSub pay dividends on their common shares to the extent that additional funds are available and dividends on the preferred shares have been paid in full. Memorandum p. .

After 3 months, _____ can exit the transaction through the agreement (described below), through a Dutch auction, or through a redemption.¹⁴ _____ can also exit the transaction by dissolution of Issuer.

Agreement

_____ and _____ entered into an agreement, under which _____ has the right to require _____ to purchase all (but not part) of _____'s preferred shares of Issuer at the purchase price.¹⁵ The "purchase price" is the liquidation value multiplied by the number of class A preferred shares delivered, divided by the number of issued class A preferred shares outstanding.¹⁶ The "liquidation value" is "the lesser of (i) \$ _____ plus an amount equal to the then accumulated but unpaid dividends on the Preferred Shares without regard to any withholding or deduction for applicable taxes and (ii) the Total Value of the LLC [IssuerSub]."¹⁷

¹⁴ Transaction Approval p. _____; _____ Memorandum p. _____.

¹⁵ Preferred Shares Liquidity Agreement § _____.

¹⁶ Preferred Shares Liquidity Agreement p. _____.

¹⁷ Preferred Shares Liquidity Agreement § _____. The "Total Value of the LLC" is determined as follows:

Section 4. Determination of Liquidation Value.

(a) The Parties shall each make a good faith effort to agree, within two Business Days after _____ provides Notice to _____, on the Total Value of the LLC based upon their own respective due diligence and valuation of the assets and liabilities of the LLC.

(b) In the event that the Parties are unable to agree on the Total Value of the LLC within two Business Days after _____ provides Notice to _____, then shall calculate the Total Value of the LLC by aggregating each of the following:

- (i) the value of any cash held by the LLC; plus
- (ii) the value of the preferred stock (the **Corporation Preferred Shares**) of the Corporation [Issuer Sub], which shall be determined in accordance with Sections _____; plus
- (iii) the value of any assets held by the LLC not covered in clause (i) or (ii) above, which shall be determined in accordance with Section _____; minus
- (iv) the value of any liabilities of the LLC.

(c) _____ shall notify the Board of Directors of the Corporation (the **Board**) of _____'s intent to exercise its Liquidity Right. Upon receipt of such notice, the Board shall within two Business Days of the Corporation's receipt of such notice prepare a listing of the following: (i) all assets, including cash, held by the Corporation (including under any Swaption); and (ii) any liabilities of the Corporation currently outstanding (including under any Swaption).

This list shall include, as to each asset, (i) the name of the issuer of the asset, (ii) the par amount of the asset, (iii) the seniority ranking of the asset, (iv) the currency of the asset, (v) the current coupon on the asset, (vi) the maturity of the asset, (vii) the call/put provisions, if any, of the asset, (viii) the amount of any accrued and unpaid interest of the asset as of the proposed Settlement Date, (ix) the name of any guarantor or other credit support provider with respect to the asset and (x) any other details about the asset relevant to determining the value thereof unless, with respect to this clause (x), the disclosure thereof would breach any confidentiality agreement by or to which the Corporation is bound or subject. _____ shall also obtain from the Corporation any relevant documentation (indentures, _____, etc.) related to such assets unless the disclosure therefore would breach any confidentiality agreement by or to which the

Corporation is bound or subject.

Additionally, the Board shall be required to provide within five Business Days after the date on which _____ notifies the Corporation of _____ intent to exercise its Liquidity Right, the Preferred Participation Amount, if any, that it would be required to pay in the event of a redemption of the Corporation Preferred Shares. Such amount shall be calculated in accordance with Section _____ of the Certificate of Incorporation.

For the purposes of calculating the Asset FMV, the Parties shall rely upon the Reference Market-Makers to provide pricing information for the assets held by the Corporation. For the purposes of calculating the value of any debt instrument held by the Corporation, it shall be assumed that any right to extend the maturity of such debt by its terms shall not be effective.

_____ shall then provide each Reference Market-Maker with all the information obtained from the Corporation pursuant to this Section _____, including the Swaption confirmations and Master Agreement. If _____ is unable to obtain such information from the Corporation, _____ shall provide each Reference Market-Maker the most recent listing of all such assets provided to

(d) For each asset or Swaption held by the Corporation, _____ shall require each Reference Market-Maker within two Business Days of such request to provide both an indicative bid and offer, quoted as a percentage of par, in the case of assets, and accrued interest where relevant, at which such Reference Market-Maker would execute a transaction with respect to such asset or Swaption. The quotes from the Reference Market-Makers shall be confirmed in writing by telex, facsimile, electronic messaging service, email or other hard-copy confirmation.

_____ shall then determine the midpoint of each such bid-offer paid and calculate the arithmetic mean of such midpoints for each asset to determine the fair market price (the **Fair Market Price**) for each of the assets held by the Corporation. With regard to the Swaptions, if the Reference Market-Maker would require the receipt of consideration to enter into such Swaption, then the related quotation shall be negative for the purposes hereof. In the event _____ is not able to obtain quotations from each Reference Market-Maker, then only the quotation or quotations provided shall be used to determine the Fair Market Price, and, in the event that _____ is unable to obtain any such quotations, _____ shall determine the Fair Market Price in any manner which it deems fair and appropriate. For each asset held by the Corporation, the Fair Market Price of such asset shall be multiplied by the par amount of such asset to determine the fair market value (the **Fair Market Value**) of that asset. For each Swaption held by the Corporation, the Fair Market Price of such Swaption shall be multiplied by the notional amount of such swaption to determine the Fair Market Value of that Swaption. The aggregate of the Fair Market Values of all of the assets and Swaptions held by the Corporation shall equal the **Asset FMV**.

(e) The total fair market value (the **Total Fair Market Value**) of the Corporation shall equal the Asset FMV less liabilities of the Corporation.

(f) The value of the Corporation Preferred Shares shall equal the lesser of (i) \$ _____ plus an amount equal to the then accumulated but unpaid dividends on the Corporation Preferred Shares in accordance with the terms of the Certificate of Incorporation, without regard to any withholding or deduction for applicable taxes plus, the Preferred Participation Amount, if any, and (ii) the Total Fair Market Value.

(g) The value of any assets held by the LLC not covered in Sections 4(b)(i) and _____ above shall be determined pursuant to a process identical to the one described in Sections _____ and _____ above.

(h) If any Settlement Date is to occur other than on a Potential Auction Date, then within five Business Days after _____ provides a Notice to _____ (the **Short-Term Rate Adjustment Date**), the Parties shall agree on an adjustment (the **Short-Term Rate Adjustment**) to reflect the potential fluctuation in the fair market value of the Class A Preferred Shares on account of any variation in the fair market value of the Class A Preferred Shares on account of any variation in any relevant short-term rate (notwithstanding evidence, if any, that the value of customary auction rate preferred instruments do not materially fluctuate between auction dates). The Short-Term Rate Adjustment shall be (i) negative if any relevant short-term rate has

Auction Procedures

Each quarter, _____ or NewCo can call for a Dutch auction.¹⁸

If an auction is requested, holders of the preferred shares (_____ and NewCo) must place orders with an auction placement agent that state, for the next quarter:

(1) whether the holder wants to hold its preferred shares; (2) whether the holder wants to hold its preferred shares during the next quarter if the preferred dividend rate is not less than a specified rate (*i.e.*, hold, but only if the dividend rate is at least x); and (3) whether the holder wants to sell all of its preferred shares.¹⁹ The placement agent solicits bids of purchasers willing buy a portion (or all) of the preferred shares at the liquidation preference if the preferred dividend rate is not less than the rate specified by the potential holder (*i.e.*, buy at the liquidation preference price, but only if the preferred dividend rate is at least y).²⁰

Redemption

Issuer may redeem the preferred shares, with the consent of the holders of the majority of the preferred shares (*i.e.*, NewCo) in whole (but not in part) at a price equal to the liquidation preference per share.²¹ _____'s "liquidation preference" was \$ _____ per share (*i.e.*, the initial contribution price).²²

Dissolution of Issuer

If Issuer dissolves or winds up, the holders of the preferred shares are entitled to a "liquidation preference," plus all accumulated but unpaid dividends and any applicable gross-up payment.²³ Again, _____'s "liquidation preference" was \$ _____ per share (*i.e.*, the initial contribution price).²⁴

increased and (ii) positive if any relevant short-term rate has decreased. For purposes of making the calculation in either case, the following assumptions will be made with respect the period after the Settlement Date: (I) an Auction on the next Potential Auction Date after the Settlement Date would result in acceptance of a submitted sell Order with respect to the Class A Preferred Shares under Section _____ of the LLC Agreement, and (II) any dividend due on a Dividend Payment Date after the Settlement Date will be paid. If the Parties cannot mutually agree on the Short-Term Rate Adjustment by the Short-Term Rate Adjustment Date, the Parties on that date shall identify and request one Reference Market-Maker to determine the Short-Term Rate Adjustment within two Business Days. In making such determination, the Reference Market-Maker shall take into account the assumptions set forth above. The decision of the Reference Market-Maker shall be final, conclusive and binding on the Parties.

¹⁸ Transaction Approval p. _____.

¹⁹ LLC Agreement § _____. Any offer (in 3) to sell is irrevocable and any offer (in 2) to sell if the preferred dividend rate is greater than the winning bid rate (*i.e.*, the preferred dividend rate for the next quarter) is irrevocable.

²⁰ LLC Agreement § _____. Any offer to buy is irrevocable.

²¹ LLC Agreement § _____.

²² LLC Agreement p. _____.

²³ LLC Agreement § _____.

²⁴ LLC Agreement p. _____. On _____, Issuer will issue _____ class B preferred shares, _____ of which NewCo will acquire for \$ _____ and _____ of which _____ will acquire for \$ _____.

Guarantee in Favor of

guaranteed to the payment and performance of under the Preferred Shares Liquidity Agreement.²⁵

Memorandum

's Memorandum analyzes the credit risks of the transaction.

Risks and Mitigants

The Memorandum identifies as a key credit risk that the underlying assets of IssuerSub can incur losses. That risk is mitigated, as follows:

Our % investment in [Issuer] namely through preferred shares) translates to a % investment in preferred shares in [IssuerSub]. shall be capitalized with \$ of common equity from [NewCo] (owned by) which will rank junior to preferred shares. . will use it[s] capital of \$ to invest in assets (\$) and third party assets of A to AAA (\$ -\$). The first loss (\$) in the underlying portfolio will first be borne by ().^[26]

Another key credit risk identified is that, “[u]pon exercise of ’s liquidity agreements, the value determined should be lower than par.” The mitigants are:

- According to the liquidity agreements, will calculate the fair market value of the common and the preferred shares of [Issuer].
- To the extent that and cannot agree on a fair market value, three financial institutions shall be solicited to provide pricing on the underlying assets held at . The fair market value of the assets will then be determined by calculating the average of the remaining three prices. Upon such determination, , as the calculation agent shall calculate the fair market value of the preferred shares and common shares by taking into account the value of the assets, the cash at and ’s liabilities. (Note: The amount of accrued but unpaid dividends at both and is in addition to the notional repayment amount due under the liquidity agreement). For the purposes of calculating the Preferred Participation, shall be the calculation

LLC Agreement § . The class B preferred shares have a liquidation preference of \$ per share. LLC Agreement p. .

²⁵ Guarantee () in favor of .

²⁶ Memorandum p. .

agent.^[27]

Recommendation

In the _____ Memorandum, the transaction was recommended based on:²⁸

- Strong financial and industry standing of _____
- Structure of the transaction essentially looks at this investment as risk
- Credit mitigation – ability to sell the preferred and common shares of the LLC anytime after 3 months with 10 days notice, ability to call auction every quarter
- Our existing strong relationship will be further enhanced through execution of this transaction
- Strong profitability of the transaction

Safeguards

The _____ Memorandum outlines certain safeguards “relative to _____’s exposure, which mitigate the risk in this transaction.” Those safeguards are:²⁹

- Restrictive control over Permitted Assets & Liabilities of [Issuer] and [IssuerSub];
- _____ will have the right to sell the _____ preferred shares and common shares to _____, in exchange for fair market value at any time after the third month upon 10 business days notice OR earlier in the event of 1) failure by _____ to pay dividends on the preferred shares; 2) the receipt by _____ of a notice from _____ copied to _____, of any amendment or proposed amendment to its Certificate of Incorporation or Bylaws; 3) there being more than five holders of either all of the outstanding common shares or all of the outstanding preferred shares of _____; 4) an asset of _____ or _____ ceases to be a Permitted Investment; or 5) a change in the law.
- _____ preferred shares will rank senior to the _____ common shares held by _____. As a result, in the event of any loss in the underlying portfolio of assets of _____, _____ will bear this loss first to the extent of its \$ _____ investment;
- The underlying assets of _____ will be principally loans to _____ (\$ _____ - \$ _____) and to _____ (\$ _____ - \$ _____). _____ obligations will be supported by an _____ guarantee, and _____ has a long-term debt rating of “Aa2” by Moody’s. The issuers of the _____

27

Memorandum p. _____

28

Memorandum p. _____

29

Memorandum pp. _____

- Third Party Assets (\$ - \$) will have minimum short-term debt ratings of "A1/P1".
- The loans shall be unconditional and unsecured deposit obligation(s) of and , ranking pari passu with all other senior secured and unsecured obligations of and respectively;
 - The \$ Third Party Assets will be unconditional and unsecured debt obligation(s) of Third Parties.
 - The and loans shall be terminated upon the occurrence of any of the following events: 1) Failure to make interest payments; 2) Failure to comply with any obligation in accordance with the loan agreement (subject to a cure period of thirty days); 3) any representation or warranty is incorrect or misleading in any material respect when made; or 4) is dissolved, rendered insolvent or bankrupt.
 - cannot pay dividends to on the common shares unless it has paid all accrued but unpaid dividends on the preferred shares.
 - may request that an auction be held at the end of each quarter.

LAW

A corporation is entitled to a dividends-received deduction of a percentage of dividends received from a domestic corporation that is subject to income tax. § 243(a).

No deduction is allowable, however, if the taxpayer did not hold the underlying shares for a specified period of time. § 243(c). Specifically, if the dividends are attributable to preferred shares, no deduction is allowed if the taxpayer held the stock for 90 days or less during the 181-day period beginning on the date that is 90 days before the date on which such share becomes ex-dividend with respect to such dividend.³⁰ § 246(c)(1) and (2).

To determine the holding period, the day of disposition but not acquisition is taken into account. § 246(c)(3). Section 246(c)(4) elaborates that the holding period is reduced where the risk of loss is diminished:

The holding periods determined for purposes of this subsection shall be appropriately reduced (in the manner provided in regulations prescribed by the Secretary) for any period (during such periods) in which—

(A) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities,

³⁰ A share is ex-dividend on the date it is sold without the right to receive a previously declared dividend, usually the business day after the distribution of a dividend. Progressive Corp. v. US, 970 F.2d 188, n.5 (6th Cir. 1992).

(B) the taxpayer is the grantor of an option to buy substantially identical stock or securities, or

(C) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

A “diminished risk of loss” occurs when a taxpayer holds positions with respect to substantially similar or related property if changes in the fair market value of the stock and the positions are reasonably expected to vary inversely. Treas. Reg. § 1.246-5(b)((2). Regarding paragraph (C), the regulations elaborate:

The term substantially similar or related property is applied according to the facts and circumstances in each case. In general, property is substantially similar or related to stock when—

(i) The fair market value of the stock and the property primarily reflect the performance of—

(A) A single firm or enterprise;

(B) The same industry or industries; or

(C) The same economic factor or factors such as (but not limited to) interest rates, commodity prices, or foreign-currency exchange rates; and

(ii) Changes in the fair market value of the stock are reasonably expected to approximate, directly or inversely, changes in the fair market value of the property, a fraction of the fair market value of the property, or a multiple of the fair market value of the property.

Treas. Reg. § 1.246-5(b)(1). Further, a taxpayer has diminished its risk of loss by holding substantially similar or related property “if the taxpayer is the beneficiary of a guarantee, surety agreement, or similar arrangement and the guarantee, surety agreement, or similar arrangement provides for payments that will substantially offset decreases in the fair market value of the stock.” Treas. Reg. § 1.246-5(c)(4). These regulations were promulgated in T.D. 8590. The preamble to T.D. 8590 states:

The final regulations retain the rule in the proposed regulations that a guarantee, surety agreement, or similar arrangement is treated as substantially similar or related property if it substantially offsets decreases in the fair market value of the stock. The IRS and Treasury caution that these arrangements or similar rights (even if they do not substantially offset decreases in the fair market value of the stock) may also be treated as options (whether settled in cash or property) to sell the stock for purposes of section 246(c)(4)(A).

The reduced holding period is not limited to short positions;³¹ rather, a holding period is reduced for any period in which the taxpayer has a concurrent option to sell the same stock. For example, in Progressive Corp. v. US, the U.S. Court of Appeals for the 6th Circuit reduced a holding period to zero because the taxpayer held an option to sell. The court said that “the statute requires that the holding period in this case be reduced by the period of time during which Progressive held put options on the same stock it owned, and, because it held put options on the same stock it owned at all times during its ownership, the holding period was zero, and Progressive was not entitled to the dividends received deductions it took.” Progressive Corp. v. US, 970 F.2d 188, 191-193 (6th Cir. 1992).

ANALYSIS

Taxpayer receives dividends on the preferred shares of Issuer for which it claimed dividends-received deductions. Taxpayer receives an amount equal to its purchase price for the shares upon redemption and upon dissolution of Issuer.

Under the agreement, which takes effect 3 months into the deal, _____ can cause _____ to purchase _____’s preferred shares for the lesser of (1) \$ _____ multiplied by the percentage of preferred shares that _____ holds to total preferred shares issued, or (2) the value of IssuerSub multiplied by the percentage of preferred shares that _____ holds to total preferred shares. Although the agreement is titled a “liquidity agreement,” the form does not comport with its substance, with which tax administrators are concerned. Helvering v. F&R Lazarus & Co., 308 U.S. 252, 255 (1930). IssuerSub was capitalized with \$ _____, only \$ _____ of which came from Issuer. IssuerSub is restricted from investing in anything other than “permitted assets,” which are substantially senior, unsecured debt obligations of _____ that _____ guaranteed. Any loss up to \$ _____ is allocated to NewCo, as holder of the common shares. Therefore, as a practical matter, because IssuerSub was capitalized with \$ _____ more than the value of the preferred shares and because any losses up to that amount are first allocated to the counterparty, _____, in effect, has a put option for the purchase price of the stock.³² See Rev. Rul. 88-31, 1988-1 C.B. 302 (holding that a cash payment guarantee of stock value was a put option).

In Rev. Rul. 90-27, the Service held that a taxpayer did not have an option to sell when it held preferred shares subject to a Dutch auction mechanism in which the holder expected – but was not guaranteed – the ability to sell the shares. 1990-1 C.B. at 51-

³¹ “A ‘short position’ is created when an investor borrows a stock in order to sell it, figuring the price of the stock will decline. The investor is in a ‘short position’ until he purchases the stock to repay the lender.” Progressive Corp. v. US, 71A A.F.T.R.2d 93-4088 at n.6 (N.D. Ohio 1990) (quoting BLACK’S LAW DICTIONARY 1236 (5th ed. 1979)), *rev’d on another issue* 970 F.2d 188 (6th Cir. 1992).

³² A “put” is an option to sell specified property, including corporate stock, at a stipulated price (the strike price) on or before a specific future date. A put is distinguishable from a stock purchase right, such as a call or a warrant. The value of a stock purchase right increases as the value of the stock increases. In contrast, as the value of the underlying property decreases, the value of the put increases. Thus, there is an inverse relationship between the value of a put and the value of the underlying property. Rev. Rul. 88-31, 1988-1 C.B. 302.

52. Under the facts of the ruling, the holder had no right to receive a sum certain on demand and, upon liquidation or bankruptcy, the holder's rights were subordinate to issuer's creditors. See Rev. Rul. 94-28, 1994-1 C.B. at 87 (holding that § 246(c)(4) applies to reduce the holding period and distinguishes Rev. Rul. 90-27). Again, in the present transaction, after 3 months, _____ can initiate its exit from the transaction through the agreement for the lesser of \$ _____, plus accumulated but unpaid dividends or the value of IssuerSub, multiplied by the number of preferred shares delivered, divided by the total number of preferred shares. The \$ _____ amount assures _____ a return of its purchase price for the shares and the \$ _____ overcollateralization at IssuerSub, the _____ guarantee, and the restriction on investments and liabilities at IssuerSub assures _____ that the \$ _____ will be the "lesser of" amount. Upon dissolution or winding up of Issuer, _____ is entitled to a "liquidation preference" plus accumulated but unpaid dividends. The liquidation preference equals _____'s purchase price.

Therefore, _____'s ability to receive its purchase price under these scenarios equates to an option to sell within the intent of § 246(c)(4)(A) (reducing a holding period for periods during which a taxpayer has an option to sell substantially identical stock or securities), which reduces Taxpayer's holding period.

_____ 's ability to receive an amount equal to its purchase price was in effect when _____ acquired the preferred shares of Issuer. Because these features diminish _____'s risk of loss, _____'s holding period for the preferred shares should be reduced to zero. As a result, _____ is ineligible for a dividends received deduction for dividends attributable to the preferred shares of Issuer.

* * * * *

This advice has been coordinated with Financial Products Associate Industry Counsel and has been reviewed by the Financial Institutions and Products Division.

If you have any questions, please contact the undersigned.

CLINTON M. FRIED
Associate Area Counsel
(Large Business & International)