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**Wall Street Journal article–dated July 31, 2010 –<u>When a Popular Tax Shelter Springs a Leak</u>:**

This article focuses on Philip Anschutz who, on July 22nd, lost a Tax Court case and now owes approximately $150 million in taxes on stock positions which he hedged through forward sale transactions. Mr. Anschutz appears to have loaned his own shares to the counterparty ("client borrow") who executed the transactions in question. As the article points out, "The IRS didn't challenge the substance of the deal. Instead, it faulted an important detail: the fact that Mr. Anschutz lent his own shares to his broker, Donaldson, Lufkin and Jenrette (now part of Credit Suisse)." and "The judge rules that when Mr. Anschutz lent his shares to DLJ, he no longer controlled them – so his $375 million payment came from a taxable sale."

**Discussion:**
The 2007 IRS Technical Advice Memorandum ("TAM") (2007-004) discussed certain aspects of a pre-paid variable forward sale and reiterated the IRS' conclusions from a February, 2006 TAM (2006-04033).

In particular, the 2006 TAM notes that "client borrow" in a forward sale transaction may be deemed a constructive sale (IRS §1259) in which investors would be required to pay tax immediately, rather than at the scheduled maturity of the transaction. The 2007 TAM adds that the executing counterparty (the institution such as a bank or broker-dealer) need <u>not</u> borrow the client's shares outright to trigger a constructive sale. Merely having the shares held as collateral in an account where the counterparty has <u>the right to borrow</u> in the future may be sufficient to have the transaction deemed a constructive sale.

A February 9, 2006 article in the Wall Street Journal outlined the 2006 TAM. The specific transaction reviewed by the IRS in the 2006 TAM identified that the client's transaction, in addition to lending the counterparty shares, also included restrictions on the client's ability to receive dividends, the client's requirement to physically settle the transaction, and the institutional counterparty's ability to trigger the delivery of shares. In short, the client in this case "checked all of the boxes" that the IRS wanted to highlight.

"Client borrow" occurs when an investor lends his/her own shares, which are pledged as collateral for the hedging transaction, to the executing counterparty. To hedge its' own trading book, the counterparty will sell short a certain number of the underlying shares. In order to complete this short sale, the counterparty must borrow the shares from institutional shares lenders such as pension funds or institutional investors ("market borrow"), or directly from the client. While "client borrow" may afford an investor marginally more attractive forward sale pricing (since there is no borrow cost imbedded in the forward sale), it can put the client at risk for a constructive sale. *Historically, all Moors & Cabot clients' transactions utilize "market borrow" for this specific reason.*

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**MOORS & CABOT** INVESTMENTS

Given the recent TAMs, Moors & Cabot suggests that clients who have loaned their own shares to execute transactions contact their tax professional to discuss their specific situation. We also suggest that clients do not lend their own shares at execution or during the life of a transaction.

**Conclusion**:
Neither the 2006 nor the 2007 TAM appears to affect clients who have previously executed "market borrow" transactions, or would like to in the future.

**Client Considerations:**
*Clients should be sure to consult their personal tax advisor for their interpretation of whether these types of transactions are appropriate. Moors and Cabot does not provide tax advice.*

*No strategy is without risk, and both advisors and investors must be aware of these risks prior to entering into the transaction. In the case of "zero-premium collar," an investor's risk includes the complete loss of premium paid for the put, the complete forfeiture of any gains above the call strike price, counterparty risk, downside price protection less than 100% of the initial stock price, and the possible requirement to physically deliver the stock. For a "pre-paid variable forward sale," an investor's risk includes the complete loss of any costs associated with the structure, the complete forfeiture of any gains above the upper strike price, and the requirement to physically deliver 100% of their shares.*

*Clients should understand they may not be entitled to increases in cash dividends on their underlying stock, or to any extraordinary dividends or other payments. They should consult their own legal and tax advisors regarding their responsibility for taxes on such dividends, regardless of whether they are entitled to retain those dividends under their transaction documents. They should also understand their dividends may not constitute qualified dividend income for income tax purposes.*



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