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Is there a ruling by the Internal Revenue Service which approves tax deferral for a seller in a Monetized Installment Sale ("M453") transaction?

Not precisely, but substantively there is, in the form of the Internal Revenue Service Office of Chief Counsel Memorandum No. 20123401F, released August 24, 2012. In that Memorandum, the IRS approved tax deferral for an installment sale under Section 453, when the installment sale was coupled with a monetization loan.

Particularly on the step-transaction doctrine, that was a much harder case than M453 is, because that case involved a convoluted and extended series of complex steps through which the taxpayer went, to achieve the objective of deferring the tax and having cash in hand. For the benefit of tax lawyers, certified public accountants and other tax advisors, that Memorandum is reproduced on the following pages, together with delineated comments, comparisons and contrasts between the situation in that Memorandum, on the one hand, and M453 on the other hand.

S.Crow Collateral Corp. is sometimes asked whether it is willing to seek and obtain a specific private letter ruling from the Internal Revenue Service pertaining to M453. The answer is no, because we're not allowed to seek a private letter ruling about how a seller to us would be treated for tax purposes. Under Treasury Regulations Section 26 CFR 601.201, a ruling is issued "to a taxpayer" and must be signed by the taxpayer or his or her representative (such as the taxpayer's attorney or CPA). S.Crow Collateral Corp. is an opposite party to an M453 seller; S.Crow Collateral Corp. is the *buyer* from the M453 seller and must not function as a seller's advisor or agent in pursuit of a private letter ruling by the Internal Revenue Service or in any other way.

Of course, any prospective M453 seller is at liberty to seek a ruling from the IRS.

Each M453 seller must rely on that seller's tax advisor, for whom this document is prepared and compiled. Nothing in this document may be taken or understood as legal or tax advice to anyone.

Office of Chief Counsel
Internal Revenue Service

Memorandum

Number: **20123401F**
Release Date: 8/24/2012

Comment,
Comparisons and Contrasts:
M453 and Separate Loan

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

←Note.

ISSUES

I. Whether the Service should assert the substance over form doctrine to disregard the form of Taxpayer's Transaction and disallow the taxpayer's deferral of gain recognition on its sale of Asset.

II. Whether, in the alternative, the Service should assert the step transaction doctrine to disregard certain steps of Taxpayer's Transaction and disallow the taxpayer's deferral of gain recognition on its sale of Asset.[1]

CONCLUSIONS

I. The Service should not assert the substance over form doctrine. The substance of Taxpayer's Transaction does not vary from its form.

II. The Service should not assert the step transaction doctrine. Each step of the Transaction has independent economic significance.

FACTS

A "Transaction" is an orchestrated series of transactions between several parties pursuant to a promoted transaction. Taken as a whole, the Transaction enables the seller to (1) defer reporting sale proceeds and recognizing gain from the sale of Asset under the installment sales method of I.R.C. § 453, but (2) obtain cash roughly equal to the sales proceeds from a loan secured by the installment sale notes.

This is true of M453 and the separate loan.

[1] This advice does not implicate the Service' recently issued guidance (see e.g., LB&I Directive dated July 15, 2011 and Chief Counsel Notice CC-2012-08), regarding assertion of the "Substance Doctrine." Exam is considering assertion of substance over form and step transaction judicial doctrines and not the economic substance doctrine.

In Year 1, Taxpayer held approximately J Amount of Asset in various locations around the United States. That year, Taxpayer was put in a position that required the generation of a large amount of cash. In an effort to accomplish Purpose, Taxpayer's Board of Directors approved a plan (the Plan) that required Event GG, the retirement of corporate debt, and Event HH. In order to fund the Plan, Taxpayer needed to sell approximately K Amount of its Asset. The remaining L Amount of Asset would be retained by Entity T.

Similarly, the M453 seller's purpose is to sell an asset to generate cash, for seller's business or investment purposes, or to pay business debt.

Taxpayer retained the Advisors as advisors in selling its Asset. The sale was accomplished through a four stage bid selection process through which interested parties were invited to bid on the Asset. The preferred structure of the sale was through the use of installment notes and standby letters of credit, and such preferred structure was outlined as part of the bid package provided by the Advisors.

The M453 seller's preferred structure is an installment sale, but without standby letters of credit.

Taxpayer signed a sales contract with the winning bidder, Buyer, a subsidiary of Buyer Parent, on M Date of Year 1. The sales price was approximately $A. Buyer paid U% of this amount in cash and the remaining W% as installment notes (the "Purchase Notes"). The Purchase Notes are R-year, interest-only notes, are in registered form, and are supported by irrevocable standby letters of credit (the "Letters of Credit") issued by four separate banks (the "LOC Banks") which at the time were all Z banks: AA Bank, BB Bank, CC Bank, and DD Bank. The Letters of Credit are non-negotiable, nontransferable, and can be drawn upon only in the event of default. Interest on the Purchase Notes is paid quarterly and is tied to I Rate.

S.Crow Collateral Corp.'s installment debt to an M453 seller is interest-only, is not in registered form, and is not supported by standby letters of credit.

S.Crow Collateral Corp.'s installment contract is non-negotiable and non-transferable and can be accelerated only in the event of default. Interest is paid monthly.

The Letters of Credit are backed by cash time deposits (the "Deposits") made by Buyer in an amount equal to the Purchase Notes. The Deposits serve as collateral for the LOC Banks in the event that Buyer defaults on the Purchase Notes. If any of the LOC Banks do not maintain a required credit rating of at least "A+" by Standard & Poor's and at least "A1" by Moody's the LOC Bank in question must be replaced (via "substitution") with another bank within 30 days of the reduced credit rating. [Footnote omitted.] The Deposits provide for variable interest payments to Buyer in nearly identical terms to those of the Purchase Notes. Buyer also entered into an interest rate protection agreement ("Swap Agreement") with Hedge Bank to hedge against any difference in interest paid on the Deposits and due under the Purchase Notes.

S.Crow Collateral Corp. does not deposit any cash to support its obligation as installment buyer. S.Crow Collateral Corp. invests the proceeds of its resale of the asset, in pursuit of sufficient investment income to fund its payments to the M453 seller pursuant to the installment contract.

It is not said whether the buyer went into title or whether the buyer retained the property for any period of time.

Payments from the Deposits and the Swap Agreement are assigned to fund the interest due on the Purchase Notes each quarter. Paying Agent Bank acts as paying

In contrast, the installment interest payments by S.Crow Collateral Corp. provide the funds to the M453 seller to pay the loan interest.

agent on these amounts and allocates funds received and payable under the various agreements. In addition to the Deposits, Buyer paid an additional U% for fees to the LOC Banks and an additional W% for fees paid to the Paying Agent.

After signing the Asset sales contract, Taxpayer created two wholly-owned, bankruptcy-remote limited liability companies (LLCs) (the "Special Purpose Entities," or "SPEs"), which are disregarded entities for tax purposes. Taxpayer then conveyed the Purchase Notes to the SPEs. Taxpayer treated X% of the conveyance as a sale of the Purchase Notes to the SPEs in exchange for intercompany notes totaling an amount equal to X% of the face value of the Purchase Notes. Taxpayer treated the remaining Y% of the Purchase Notes as a contribution of capital.

An M453 installment sale and the separate loan require no additional entities.

The SPEs took out loans ("Monetization Loans") from Lender, for $B, approximately X% of the face value of the Purchase Notes. The SPEs pledged the Purchase Notes and Letters of Credit as security for the Monetization Loans. The loan agreements were signed and the proceeds from the Monetization Loans were distributed to the SPEs on Q Date of Year 1, S days after the Asset sale. The SPEs then distributed the entire amount of the loan proceeds to Taxpayer to repay the intercompany loans.

The loan agreement between the lender and an M453 seller may be signed before or after the sale of the asset occurs. Typically the loan proceeds are distributed to the M453 seller some days after the sale of the asset occurs.

To fund the loans to the SPEs, Lender initially used its own conduit lenders to issue participations in the Monetization Loans to various investors. The interest rates on the Monetization Loans are variable and are tied to the funding costs incurred by Lender or its conduit lenders, plus additional basis points for fees, commissions, and profit margins. [Footnote states in part, "Taxpayer did not expect to see much of a difference in interest received on the Purchase Notes and paid on the Monetization Loans."]

The lender to an M453 seller typically charges a fixed interest rate at market, plus a loan fee.

Similarly, there is typically little difference between the interest paid on the M453 installment contract and that on the loan.

The $A sale of the Asset provided the funds necessary to complete Event GG, reduce existing debt of Taxpayer, and complete Event HH in order to accomplish Purpose. While Taxpayer recognized a substantial gain on the Asset sale for financial reporting purposes, it used the installment sale method under I.R.C. §§ 453 and 453A to defer the $C tax gain for R years.

It's the same for an M453 seller.

LAW

Section 453

Section 453(a) [footnote omitted] provides, in general, that income from an installment sale is accounted for,

for tax purposes, under the installment method. Section 453(b) defines an "installment sale" as a disposition of property if at least one payment is received after the close of the taxable year of the sale. Section 453(c) defines the term "installment method" as a method under which the income recognized for any taxable year is the proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

Section 453(b)(2)(A) excludes dealer dispositions from the installment method of reporting income for tax years beginning after December 31, 1987. Section 453(l)(1)(B) defines a dealer disposition of real property as any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's business. Section 453(l)(2)(A) specifically excludes farm property dispositions from the definition of dealer property. Farm property is defined as any property used in the trade or business of farming within the meaning of I.R.C. §§ 2032A(e)(4) or (5).

The M453 seller holds the asset for investment and is not a dealer as to that asset, so the sale by the M453 seller is similarly not a "dealer disposition".

Section 2032A(e)(4) states the term "farm" includes stock, dairy, poultry, fruit, furbearing animals, and truck farms, plantations, ranches, nurseries, ranges, greenhouses, orchards, and woodlands. Section 2032A(e)(5) states that the term "farming purposes" means – cultivating the soil or raising or harvesting any agricultural or horticultural commodity on a farm; handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its un-manufactured state; and the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

Section 453A(d) provides that if an installment obligation is pledged to secure a loan or other indebtedness, the receipt of the proceeds from the indebtedness is treated as a payment on the installment obligation. Section 453A(b)(3)(B) provides an exception to the pledge prohibition for farm property, within the meaning of I.R.C. § 2032A(e)(4) or (5).

The M453 installment contract is not pledged to secure the loan from the lender to the M453 seller, so the loan proceeds cannot be treated as a payment on the installment obligation.

Section 453(f)(3) provides that an evidence of indebtedness of the person acquiring the property will not be considered a payment "whether or not payment of such indebtedness is guaranteed by another person." The legislative history indicates that Congress enacted I.R.C. § 453(f)(3) in 1980 in response to the conflicting court opinions as to whether a standby letter of credit securing an installment note should be treated as a payment for purposes of the installment sale provisions. In Griffith v. Commissioner, 73 T.C. 933 (1980), the Tax Court held that the taxpayer received full payment

The M453 installment contract is not guaranteed by anyone, although an M453 seller *who is not otherwise in default* cannot be compelled to pay more on the loan than the seller receives from S.Crow Collateral Corp. on the installment contract. In the event of such a failure to pay by S.Crow Collateral Corp., the M453 seller may undertake collection proceedings against S.Crow Collateral Corp.

in the year of sale because a standby letter of credit secured future payment for the sale of a cotton crop. In Griffith, the taxpayer used certificates of deposit as collateral for the letter of credit. In contrast, Sprague v. United States, 627 F.2d 1044 (10th Cir. 1980), held that a letter of credit used to secure payment for the sale of stock did not constitute payment for purposes of the installment sale provisions. In explaining I.R.C. § 453(f)(3), the Senate Finance Committee clearly expressed that a third party guarantee (including a standby letter of credit) used as security for a deferred payment sale should not be treated as a payment received on an installment obligation. S. Rep. No. 1000, 96th Cong., 2nd Sess. 18 (1980).

Consistent with the Code and the legislative history, Temp. Treas. Reg. § 15a.453-1(b)(3)(i) provides that the term "payment" does not include the receipt of evidences of indebtedness of the person acquiring the property ("installment obligation") whether or not payment of such indebtedness is guaranteed by a third party. The regulations provide that payments include amounts actually or constructively received in the taxable year under an installment obligation. An evidence of indebtedness which is secured directly or indirectly by cash or a cash equivalent, such as a bank certificate of deposit or Treasury note, will be treated as the receipt of payment.

Section 15a.453-1(b)(3) provides that a standby letter of credit is treated as a third party guarantee. Section 15a.453-1(b)(3)(iii) defines the term "standby letter of credit" as a non-negotiable, non-transferable (except together with the evidence of indebtedness which it secures) letter of credit, issued by a bank or other financial institution, which serves to guarantee payment of the installment indebtedness. A letter of credit is not a standby letter of credit if it may be drawn upon in the absence of default in payment of the underlying indebtedness. The crucial distinction between an ordinary letter of credit and a standby letter of credit is that a seller may draw upon (or access funds pursuant to) an ordinary letter of credit in the absence of a default on the installment note(s). That access constitutes constructive receipt to the seller, and the seller must recognize gain on all the sales proceeds despite the existence of the installment sale contract. Because a seller may not draw upon a standby letter of credit in the absence of a default, the seller is not deemed to have constructively received the sales proceeds.

Examples (7) and (8) of Temp. Treas. Reg. § 15a.453-1(b)(5) illustrate the effect of a standby letter of credit that secures an installment obligation. In Example (7), A sells the stock of X corporation to B for a $1

The only evidence of indebtedness which an M453 seller receives is Buyer's signature on the M453 installment contract.

The M453 installment contract is not secured by anything, let alone cash or a cash equivalent. The indebtedness of S.Crow Collateral Corp. under the M453 installment contract is a general obligation of S.Crow Collateral Corp. for which all of its assets may be subject to attachment and execution.

An M453 seller has nothing upon which the seller may draw funds in the absence of a default by S.Crow Collateral Corp. on the installment contract.

million installment obligation payable in equal annual installments over 10 years with adequate stated interest. The installment obligation is secured by a standby letter of credit issued by M bank. Under the agreement between B and M bank, B is required (1) to maintain a compensating balance in an account B maintains with M bank and (2) to post additional collateral, which may include cash or a cash equivalent, with M bank. Under neither the standby letter of credit nor any other agreement or arrangement is A granted a direct lien upon or other security interest in the cash or cash equivalent collateral. The example concludes that receipt of B's installment obligation secured by the standby letter of credit will not be treated as receipt of payment by A.

In Example (8), the facts are the same as in Example (7), except that the standby letter of credit is in the drawable sum of $600,000. To secure fully its $1 million note issued to A, B deposits in escrow $400,000 in cash and Treasury bills. Under the escrow agreement, upon default in payment of the note, A may look directly to the escrowed collateral. The example concludes that receipt of B's installment obligation will be treated as the receipt of payment by A in the sum of $400,000.

Substance Over Form Doctrine

In Gregory v. Helvering, 293 U.S. 465 (1935), the court held that where a transaction has no substantial business purpose other than the avoidance or reduction of Federal tax, the tax law will not respect the transaction. The doctrine of substance over form is essentially that, for Federal tax purposes, a taxpayer is bound by the economic substance of a transaction where the economic substance varies from its legal form.

The concept of the substance over form doctrine is that the tax results of an arrangement are better determined based on the underlying substance rather than an evaluation of the mere formal steps by which the arrangement was undertaken. Joint Committee on Taxation, Background and Present Law Relating to Tax Shelters (JCX-19-02), March 19, 2002. Under this doctrine, two transactions that achieve the same underlying result should not be taxed differently simply because they are achieved through different legal steps. As stated by the Supreme Court, a "given result at the end of a straight path is not made a different result because reached by following a devious path." Minnesota Tea Co. v. Helvering, 302 U.S. 609, 613 (1938).

Similarly, the M453 seller is not granted a lien on anything and is not secured by anything, let alone cash or a cash equivalent.

The application of the substance over form doctrine is highly factual. In Newman v. Commissioner, the Second Circuit (citing Frank Lyon v. U.S., 435 U.S. 561 (1978)), indicated that relevant criteria in applying the substance over form doctrine included: (1) the existence of a legitimate non-tax business purpose, (2) whether the transaction has changed the economic interests of the parties, (3) whether the parties dealt with each other at arm's length, and (4) whether the parties disregarded their own form. 902 F.2d 159, 163-164 (2d Cir. 1990).

If the doctrine applies, it allows the Service to recast the transaction in question according to the underlying substance of the transaction rather than being bound by the taxpayer's form. However, taxpayers are typically bound by their chosen legal form. Commissioner v. Danielson, 378 F.2d 771 (3d Cir. 1967), cert. denied, 389 U.S. 858 (1967); In the matter of: Insilco Corporation v. United States, 53 F.3d 95 (5th Cir. 1995).

Step Transaction Doctrine

The step transaction doctrine is considered an extension of the substance over form doctrine. Under the step transaction doctrine, a particular step in a transaction can be disregarded for tax purposes if the taxpayer could have achieved its objective more directly, but instead included the step for no purpose other than to avoid tax. See Del Commercial Properties, Inc. v. Commissioner, 251 F.3d 210-213, 214 (D.C. Cir. 2001), cert. denied, 534 U.S. 1104 (2002). The step transaction doctrine applies in cases where a taxpayer seeks to go from point A to point D and does so by stopping at intermediary points B and C. The purpose of the unnecessary stops is to achieve tax consequences differing from those which a direct path from A to D would have produced. In such a situation, courts may disregard the taxpayer' path and the unnecessary steps. See Gregory v. Helvering, 293 U.S. 465 (1935).

The step transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result." Penrod v. Commissioner, 88 T.C. 1415, 1428 (1987). The courts have developed three methods of testing whether to invoke the step transaction doctrine: (1) the end result test, (2) the interdependence test, and (3) the binding commitment test.

The end result test is the broadest of the three methods. The end result test evaluates whether it is evident that each of a series of steps is undertaken for the purpose of

In an M453 transaction or in the separate loan, no step is included only to avoid tax. The installment sale is for the purpose of selling an asset, and the separate loan is for the purpose of monetization, to meet the seller's need for funds for investment, business acquisition or operations, or to pay business debt.

achieving the ultimate result. King Enterprises, Inc. v. United States, 418 F.2d 511, 516 (Ct. Cl. 1969). The interdependence test requires showing that each step was so interdependent that the completion of an individual step would have been meaningless without the completion of the remaining steps. Stated differently, under the interdependence test, the step transaction doctrine applies if "the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series." Redding v. Commissioner, 630 F.2d at 1177. The binding commitment test is the narrowest of the three step transaction methods and looks to whether, at the time the first step is entered into, there is a legally binding commitment to complete the remaining steps. Commissioner v. Gordon, 391 U.S. 83, 96 (1968).

In determining whether to invoke the step transaction doctrine, the courts have looked to two factors: (1) the intent of the taxpayer, and (2) the temporal proximity of the separate steps. Excluding cases involving a legally binding agreement, if each of a series of steps has independent economic significance, the transactions should not be stepped together. Reef Corporation v. Commissioner, 368 F.2d 125 (5th Cir. 1966); Rev. Rul. 79-250,1979-2 C.B. 156, modified by Rev. Rul. 96-29, 1996-1 C.B. 50. In addition, the courts have refused to apply the step transaction doctrine where its application would create steps that never actually occurred. Esmark, Inc. v. Commissioner, 90 T.C. 171 (1988), aff'd without published opinion, 886 F.2d 1318 (7th Cir. 1989); Walt Disney, Inc. v. Commissioner, 97 T.C. 221 (1991); Grove v. Commissioner, 490 F.2d 241 (2d Cir. 1973). If the doctrine does apply, then the unnecessary steps are disregarded and the transaction is recast.

ANALYSIS

The Transaction meets the statutory and regulatory requirements of I.R.C. § 453. Because Asset meets the definition of farm property under I.R.C. § 2032A(e)(4), Taxpayer can pledge the Purchase Notes and obtain cash through a separate loan under I.R.C. § 453A(b)(3)(B) without the proceeds being treated as a payment for installment sale purposes. The Code and the regulations also specifically allow a standby letter of credit to secure an installment sale obligation. The Letters of Credit issued in the Transaction meet the definition of a standby letter of credit under Temp. Treas. Reg. § 15a.453-1(b)(3)(iii) because they are non-negotiable, non-transferable, and can be drawn upon only in the event of default. Example (7) of the regulations clearly provides that a standby letter of credit can be secured by cash collateral. As in Example

In regard to an M453 transaction and the separate loan, neither instrument requires the seller to execute the other, so there is no binding agreement to complete both of the steps. Further, each of the two transactions (the installment contract and the loan) has independent economic significance; each is legally binding, and each can be enforced by its respective parties.

An M453 transaction may, but need not, involve farm property, but either way with M453 there is no pledge of the installment contract.

Receiving loan proceeds from a loan that is not secured by the installment contract is not the same as receiving installment-contract proceeds.

(7), the Deposits secure the Letters of Credit, not the Purchase Notes. The Taxpayer cannot look directly to the Deposits for payment; only the LOC Banks and Buyer have a direct interest in the Deposits. At the time of the sale, Taxpayer received the proceeds of the Monetization Loans secured by the Purchase Notes and Letters of Credit; Taxpayer did not receive funds from the Deposits securing the Purchase Notes.

In M453, too, a seller may receive loan proceeds shortly after the asset is sold.

Application of the Substance Over Form Doctrine

In form, Taxpayer's Transaction comprised: (1) an installment sale, pursuant to which Taxpayer received the Purchase Notes backed by the Letters of Credit, and (2) a loan monetizing the Purchase Notes. The question presented is whether the substance of the Transaction was essentially a cash sale—shortly after the Asset sale Taxpayer obtained U% of the sales price in cash and an additional X% of the face value of the Purchase Notes through loan proceeds, all while deferring most of the gain recognition and tax on the transaction for R years.

With M453 as well, each step (of which there are only two) has a specific business purpose: for the first, selling the asset, and for the second, monetizing the amount owed to obtain funds for business or investment purposes. Further, the loan is with a financial institution that is separate from and unrelated to both S.Crow Collateral Corp. and the seller.

We conclude that the substance over form doctrine does not apply in this case. Using the Newman v. Commissioner criteria discussed above, the substance of the Transaction is consistent with its form. First, each step in the transaction had a specific business purpose. The sale of the Asset was a real transaction carried out to raise cash for Taxpayer. The Letters of Credit, by definition, provided economic security for Taxpayer in the event of Buyer' default. The Deposits served as the collateral. Taxpayer negotiated the Monetization Loans with a financial institution separate from the financial institutions that issued the Letters of Credit and held the Deposits.

In M453, the economic interests of the parties change, as well; the seller no longer owns the asset, the lender parts with the loan funds, and S.Crow Collateral Corp., the buyer, is indebted to Seller for the full amount of the purchase price.

Second, the economic interests of the parties did in fact change. After the Transaction, Taxpayer no longer owned the K Amount of Asset, Taxpayer held the Purchase Notes backed by the Letters of Credit, and Taxpayer's SPEs were obligors under the Monetization Loans with Lender in the total amount of $B. The economic interests of Buyer and Lender changed as well. Buyer deposited $D with the LOC Banks to secure the standby letters of credit and pay associated fees and became the new owner of the Asset. Lender parted with $B in exchange for the Monetization Loans, secured by the Purchase Notes and Letters of Credit.

In M453, all dealings are completely at arm's length; the parties are unrelated to one another, and each is pursuing only its own ends. The installment debt and the loan bear regular commercial interest at market rates, and the parties treat the installment sale and the loan separately.

Third, there is no indication that the terms of the Transaction are not arm's length. The terms of the Purchase Notes appear to be regular, commercial terms, with market-based interest rates. While the interest rate to be paid on the Monetization Loans is unusual, the loan agreement shows it to be structured as a

commercial loan. Fourth, all parties involved have treated the steps of the Transaction as a separate installment sale and monetization loan.

The Taxpayer reduced its risk exposure on the Monetization Loans by carrying out the monetization of the Purchase Notes through its two bankruptcy-remote LLCs and by making the Monetization Loans nonrecourse. Nevertheless, the taxpayer is still at risk. The Taxpayer only received X% of the face value of the Purchase Notes in loan proceeds and is therefore still at risk on the remaining Y% should one or more LOC banks fail. Taxpayer tried to limit this risk by spreading the LOCs among several banks and requiring LOC replacement if a bank's credit rating went below a certain level. This limited the risk, but did not eliminate it, given the high concentration of Z banks acting as counterparties. In addition, to recast the transaction as a cash sale would be to assume Taxpayer had already forfeited that remaining Y%, which it clearly has not done.

Application of the Step Transaction Doctrine

Because the step transaction doctrine is an extension of the substance over form doctrine, the step transaction doctrine also does not apply to this case. As noted above, the step transaction doctrine applies in cases where a taxpayer seeks to go from point A to point D and does so by stopping at intermediary points B and C, steps which give the taxpayer a tax benefit. The question is whether the interrelated steps between Taxpayer signing the sales contract and Lender wiring the Monetization Loan proceeds directly into Taxpayer's accounts should be collapsed.

"Step A" is the transfer of the Asset to Buyer while "Step D" is the transfer of the Monetization Loan proceeds from Lender to Taxpayer (through Taxpayer's SPEs). Collapsing the Transaction and going straight from Step A to Step D does not make sense. Taxpayer is selling the Asset to Buyer, while the loan proceeds are coming from Lender, which is unrelated to both Taxpayer and Buyer. In fact, to go from Step A to Step D and to treat the Transaction as a cash sale would require additional steps, which the Internal Revenue Service is prohibited from creating. See Grove v. Commissioner, 490 F.2d at 247.

Furthermore, the steps that did occur between "Step A" and "Step D" were not unnecessary or meaningless steps. The Deposits made by Buyer were necessary to back the Letters of Credit. The Letters of Credit were necessary to secure the Purchase Notes in the event of Buyer's default. The transfer of the Purchase Notes to

The loan to an M453 seller is limited-recourse, not non-recourse.

In M453, too, the seller typically receives loan proceeds that are less than the initial face amount of the installment contract. The seller remains at risk as to the difference.

Similarly, to recast an M453 transaction with the separate loan as a cash sale would be to assume that the M453 seller had forfeited the remaining balance on the installment contract over and above the loan balance, which clearly the seller has not done.

With M453, too, the asset is sold to the buyer (S.Crow Collateral Corp.), while the loan proceeds come from a lender which is unrelated to the seller and to S.Crow Collateral Corp.

With M453, there *are* no intervening steps.

the SPEs was necessary to protect Taxpayer in the event of Buyer's default. The pledging of the Purchase Notes and Letters of Credit was necessary in order for Taxpayer to receive the amount of loan proceeds it needed to carry out its Plan, pay off its existing corporate debt, and complete Event HH in order to accomplish Purpose.

Each of the steps has independent economic significance; therefore, the step transaction does not apply under either the end result test or the interdependence test. The binding commitment test would not be applicable in this case because there is no contractual obligation to complete all of the Transaction steps.

In summary, the judicial doctrines of substance over form and step transaction do not apply in this case. The steps in the Transaction accomplished legitimate business purposes and had independent economic significance. Taxpayer needed to sell its Asset and structured the sale in a way that minimized its taxes. Taxpayer did not create transactions with no substance merely to obtain tax benefits. Substantively, the steps of the Transaction matched their form: an installment sale coupled with a monetization loan. The Transaction allowed Taxpayer to take advantage of tax deferral on the Asset sale, which is a permitted result under I.R.C. §§ 453 and 453A.

In M453, too, each of the (two) steps has independent economic significance, and neither constitutes a binding commitment to complete the other.

In M453, too, the seller needs to sell the asset and structures the sale to minimize taxes. The seller does not create a transaction with no substance merely to obtain tax benefits. Further, with M453 the steps match their form: an installment sale coupled with a monetization loan.