DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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April 1, 1999

CC:DOM:FS:IT&A

UILC: 267.03-02

Number: **199925039**
Release Date: 6/25/1999

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER
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SUBJECT:

This Field Service Advice responds to your memorandum dated October 21, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer =
Year 1 =
Year 2 =
$x =

ISSUE:

Whether I.R.C. § 267(a)(1) prohibits Taxpayer corporation from recognizing a loss where Taxpayer purchased property from a major shareholder at fair market value in exchange for an annuity, then sold the property to an unrelated third party at fair market value, and finally deducted a loss on the property when it bought out the annuity.

CONCLUSION:

I.R.C. § 267(a)(1) does not prohibit the Taxpayer corporation from recognizing a loss under these circumstances.

FACTS:

During the taxable Year 1, Taxpayer purchased a $x property from a major shareholder at an arm's-length, fair-market-value price. The shareholder owned more than 50% of the value of the stock in the corporation. The purchase price was paid to the shareholder in the form of an annuity, using the annuity tables contained in the predecessor regulations to Treas. Reg. § 20.2031-7. Thereafter, Taxpayer sold the property to unrelated third parties at a price equivalent to the fair market value of the property. The major shareholder was still alive when the property was sold. Taxpayer recognized no gain or loss on the sale.

Annuity payments were made to the shareholder until Year 2, when Taxpayer decided to terminate the annuity by making a payment to the shareholder of the present value of the remaining annuity payments. The total payments made under the annuity contract, including the final payment, exceeded the sales price of the property to the unrelated third parties. In accordance with Rev. Rul. 55-119, 1955-1 C.B. 352, which applies to taxpayers not engaged in the business of writing annuities (which is the case here), Taxpayer took a capital loss deduction on its return for taxable Year 2.

LAW AND ANALYSIS

Section 267(a)(1) provides as follows:

> No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

Under section 267(b)(2), the "persons" referred to in subsection (a) include "[a]n individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual." Thus, Taxpayer and the shareholder are related parties under section 267 and section 267(a) would apply to prohibit a deduction for a loss realized on a transaction between them.

Case law provides that where property is exchanged for a private annuity, the entire amount of each annuity payment constitutes a payment for the purchase price of the assets received in exchange for a promise to pay the annuity. Dix v. Commissioner, 392 F.2d 313 (4th Cir. 1968); Bell v. Commissioner, 76 T.C. 232 (1981). Furthermore, Rev. Rul. 55-119 provides rules for recognizing gain or loss on the sale of property in exchange for a private annuity. It provides as follows:

> Where disposition of property acquired in exchange for a promise to make annuity payments has occurred prior to the death of the annuitant, the taxpayer may realize a gain or loss, for Federal income tax purposes, as a result of events occurring subsequent to such disposition...If the total of the annuity payments made under the contract (total of payments made before and after disposition of the property) exceeds the basis (unadjusted) of the property used in determining the gain or loss on the disposition, such excess is a loss in the year or years in which paid. In the case of a recognized loss, this will include all payments made after the date of disposition of the property. Where the selling price is such that neither gain nor loss is recognized upon disposition of the property, no loss is sustained until the total of the payments made under the annuity contract (total of payments made before and after disposition of the property) when decreased by depreciation allowable exceeds the selling price, at which time such excess is a loss in the year in which paid.

The ruling also states that where a taxpayer who is not engaged in the business of writing annuities receive property in exchange for his contract to make annuity payments, the resulting tax consequences are subject to the provisions of section 24(b) of the Internal Revenue Code of 1939, the predecessor to section 267.

Notwithstanding this provision, section 267 does not apply to the transaction or transactions described here. Although Taxpayer and the shareholder were related parties under section 267(b)(2), no loss was claimed on the transaction that was between them, the exchange of the properties for the annuity; thus, section 267(a) does not apply to the transaction. Although a loss was ultimately realized and recognized on the subsequent sales to third parties, Taxpayer was not related under section 267(b) to any of these third parties. Therefore, section 267(a) does not apply to prohibit a deduction for the loss in the year in which the annuity was terminated and the amount of the Taxpayer’s basis in the property was fixed.

Thus, we conclude that Section 267 does not apply to disallow the loss on the disposition of the property.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

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By:________________________
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