The basis of the hot stock held by the Class B shareholders immediately after the distribution equals the fair market value of the hot stock.

Saying "hot stock" may be fun, but paying tax on it is not. Hot stock may not disqualify a spin-off, but corporations and shareholders should be prepared to pay tax on it.

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**Book Review: The CIRCULAR 230 DESKBOOK, by Blatmachr, Gans and Rios**

Reviewed by Larry Bercovich • Wood & Porter • San Francisco

These days, Circular 230 permeates many aspects of a tax advisor’s daily life. After all, it sets forth standards of conduct with which practitioners must comport in providing federal tax advice, or be faced with disciplinary action. While Circular 230 has been around for nearly 90 years, recent amendments have touched all federal tax practitioners, and arguably lots of other people too.

In fact, we are reminded of this every time we see the pervasive Circular 230 language in emails or other written communications. In today’s world of enhanced tax practitioner responsibilities and overlapping standards of care imposed by Circular 230, Treasury regulations and professional regulatory bodies (e.g., the ABA), the standards applicable to the provision of tax advice are anything but clear-cut. For this and other reasons, the CIRCULAR 230 DESKBOOK by Blatmachr, Gans and Rios is a practical book that belongs on (or nearby) nearly every tax practitioner’s desk.

The DESKBOOK will act as a map to help navigate through critical issues such as the following:

- Which taxpayer-practitioner communications rise to the level of advice?
- What are the different standards of conduct required between oral and written advice; and, preliminary and final advice?

The DESKBOOK will also help a practitioner assess the consequences when a taxpayer files a return based on arguments that do not have a realistic possibility of success, but are not frivolous; or, the significance of a taxpayer having a tax position based on substantial authority, but a position that is not likely to prevail. While a comprehensive answer is beyond the scope of this review, the key issues involve penalties, and the possibility of avoiding such penalties by adequate disclosure.

The authors state that the DESKBOOK is designed primarily as a reference book, and, indeed, I have found it to be a rich reference. The book is divided into four chapters. The first chapter addresses the deference courts provide to government interpretations of the law. This should be relevant to practitioners in determining what weight to give to certain Treasury pronouncements.

The second chapter contains an overview of selected penalties imposed under the Internal Revenue Code. There is a very concise discussion regarding when penalties apply, and the standards that must be met to avoid them. This is a discussion many practitioners will likely find helpful. The third chapter addresses disclosure of Reportable Transactions and list maintenance requirements imposed by the Code. The fourth chapter, the main focus of the book, is an in-depth analysis of the requirements under Circular 230, including the heightened duties imposed on practitioners when providing written federal tax advice (e.g., a practitioner may not make unreasonable factual or legal assumptions; nor may a practitioner unreasonably rely on representations or statements from third parties).

**A Picture Is Worth a Thousand Words**

Given that I am a sucker for flowcharts and diagrams, I enjoyed the various flowcharts and diagrams included in the DESKBOOK. For instance, Appendix D is a Circular 230 Decision Tree which will assist in determining which parts of Circular 230 apply to a practitioner’s communications.

For written advice, there is a checklist to assist in identifying applicable standards. And, for “Covered Opinions,” there is a chart to assist in identifying applicable requirements and exceptions. Last, but certainly not least, there is a chart summarizing the criteria
Stock Sales and Share Lending

By Richard C. Morris • Wood & Porter • San Francisco

Ben Franklin is generally credited with the now universal maxim, “In this world nothing can be said to be certain, except death and taxes.” If Ben were alive today, he might include a third certainty: a perpetual increase in the complexity of the Internal Revenue Code. Mr. Franklin also wanted our national bird to be the turkey.

Even though there has been much lip service paid to simplifying the Code, each year without fail Congress enacts countless new statutes, and amends countless existing ones. This has led to the current state of affairs, where tax planning has become almost mandatory, even for simple transactions. Yet, tax planning is no guarantee that a transaction will be respected by the IRS.

Indeed, on February 2, 2007, the IRS released a Generic Legal Advice, disagreeing with a taxpayer’s reporting of a complex plan to sell stock, coupled with a share lending agreement. [See AM 2007-004.] (Note that a Generic Legal Advice is a relatively new form of advice issued by the Associate Chief Counsel from various field offices.) The taxpayer had undertaken a transaction similar to the transaction described in, and respected by, Rev. Rul. 2003-7, 2003-1 CB 363. In both the Generic Legal Advice and the ruling, the issue was whether a variable price contract for the sale of stock and a share lending agreement, both involving the same parties and pertaining to the same shares, when viewed together, resulted in a current sale of stock.

The Transaction

An individual (“Seller”) held common stock in publicly traded XYZ corporation. When XYZ’s stock had a fair market value of $20 (“the Execution Date”), Seller entered into an arm’s-length sales contract with an unrelated third party (“Purchaser”), in which Seller received $1,600 upon execution. In return, Seller promised to deliver to Purchaser three years later (“the Valuation Date”) a number of XYZ shares to be determined by a formula.

Under the formula, if the market price of XYZ stock was less than $20 on the Valuation Date, Purchaser would receive 100 shares. If the market price were at least $20, but under $25, Purchaser would receive a number of shares having a total market value equal to $2,000. If the market price exceeded $25, Purchaser would receive 80 shares of common stock. Notwithstanding the formula, Seller could deliver cash in lieu of shares.

In order to secure Seller’s obligations, Seller pledged 100 shares of XYZ stock to Purchaser, the maximum number of shares Seller could be required to deliver. Seller effected the pledge by transferring the shares to an unrelated third-party trustee. Under the pledge agreement, Seller retained the right to vote the pledged shares and to receive dividends. However, the pledge agreement allowed the trustee to loan the pledged shares to Purchaser (or another person at Purchaser’s direction). After the Execution Date, Purchaser executed the share lending agreement, borrowing all 100 shares from the pledge account, and then selling them to a third party. The shares were unrestricted, having both dividend and voting rights.

Benefits and Burdens

The taxpayers did not report the transaction, believing it to be a share loan. The IRS saw things differently, arguing that the transaction was a sale. The IRS found support for its position in many places. Its analysis begins in Code Sec. 1001, which provides that an amount is realized when there is a sale or other disposition of property. Although Code Sec. 1001 refers to a “sale or other disposition,” that phrase is not defined in the Code.