Danielson Strikes Again—*Tseytin* Revisited

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Last month, we reviewed the unhappy story in *M. Tseytin* [110 TCM 617, Dec. 60,478(M), TC Memo. 2015-247, *aff'd*, CA-3 120 AFTR 2d 2017-5539 (2017)]. Our focus was planning opportunities and pitfalls in the allocation of basis and boot in acquisitive reorgs. [*See* Donald P. Board, *Code Sec. 356 and 358 Regulations Are Taxpayer Friendly—But Only if Target Shareholders Use Them*, THE M&A TAX REPORT (Nov. 2017).]

Good times. But *Tseytin* is also worth noting for its remorseless application of *C.L. Danielson* [CA-3, 67-1 USTC ¶9423, 378 F2d 771, SCt, *cert. denied*, SCt, 389 US 858, 88, 88 SCt 94]. The Tax Court and the Third Circuit both rejected the taxpayer's attempt to recast his $54 million M&A transaction in accordance with its (alleged) substance.

Danielson sometimes allows taxpayers to assert positions at odds with the forms of their transactions. But the divergence of form and substance must result from mutual mistake, undue influence, fraud, duress, or similar circumstances. *Danielson* does not permit taxpayers to invoke substance to correct *tax-planning errors*.

Mr. Tseytin owned 75 percent of Target, Inc.; the other 25 percent belonged to Archer Consulting (Archer). Acquiring Corporation wanted to acquire Target for $23 million in cash and $31 million in Acquiring stock. All of this stock, however, was supposed to go to Mr. Tseytin. Archer was supposed to be cashed out.

The merger agreement required Mr. Tseytin to own 100 percent of Target at the time of the closing. So, Mr. Tseytin entered into a separate agreement to purchase Archer's 25-percent block (the "Archer Shares") for $14 million. Archer agreed to defer payment for a couple of weeks. That would give Mr. Tseytin a chance to collect his $23 million in cash from Acquiring.

As we saw last month, the merger agreement *should* have allocated as much boot as possible to Mr. Tseytin's high-basis Archer Shares. But it was silent on that score, so the cash was allocated equally to all of Mr. Tseytin's shares.

This forced him to recognize an extra $7.7 million of gain under Code Sec. 356(a)(1).

In the Tax Court, Mr. Tseytin argued that he should not have been taxed on the sale of the Archer Shares. *In substance*, he had simply been Archer's *agent* in the deal. Archer signed over the shares, and Mr. Tseytin delivered them to Acquiring. When he was paid, he sent Archer its share ($14 million), just as any good agent would have done.

Looking only at the movement of cash and shares, Mr. Tseytin's argument *might* have gained some traction. However, neither the Tax Court nor the Third Circuit bought the agent-in-substance theory. That would have required them to ignore too many terms of the transaction documents.

Mr. Tseytin's agreement with Archer said he was purchasing the 25-percent block for his "own account" and never mentioned agency. Archer may have *expected* Mr. Tseytin to exchange the Archer Shares in the pending merger, but there was nothing *requiring* him to do so. If Mr. Tseytin had decided to keep the shares and pay the $14 million from other resources, Archer could not have complained.

Mr. Tseytin had also warranted to Acquiring that he was the record owner of 100 percent of Target "free and clear of any restrictions." He had even signed several corporate consents as the *sole shareholder* of Target. That was the end of Mr. Tseytin's agency argument.

Taxpayers need to take their deal structures seriously. The IRS has no obligation to overlook features of a transaction just because they do not affect the economics of the deal. In short, "substance over form" is a one-way street.

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