

Sales Termination, Litigation Investment Income Need Attention


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To the Editor:

A recent issue of *Tax Notes* included professor David J. Roberts' excellent article on [section 1234A](#) ("Law Treating Certain Terminations as Sales Needs Clarification," *Tax Notes*, Jan. 18, 2016, p. 337 ). He is correct that we need clarity with regard to the scope and application of

the law. Roberts summarizes numerous IRS authorities that have essentially ignored (or at least failed to meaningfully discuss) section 1234A.

Roberts also points out that IRS guidance has even been in conflict with the legislative history surrounding the expansion of section 1234A in 1997. Overall, Roberts makes a compelling case for the need to revisit and clarify the scope of section 1234A. We wish to underscore his arguments that are now even more compelling.

A recently released field attorney advice (FAA)¹ underlines the need for clarification. The FAA addresses the tax consequences of an investor's income from a litigation finance investment. Notably, the IRS assumes that the investor holds a capital asset.

Nevertheless, the FAA concludes that the investor's gain is ordinary because there was no sale or other disposition of the underlying capital asset. The FAA further concludes that section 1234A does not apply to the transaction because there has been no disposition of contract rights. Although the FAA is heavily redacted, it raises more questions about the scope of section 1234A.

It seems to retreat quickly from the IRS's position in *Pilgrim's Pride Corp. v. Commissioner*.² In *Pilgrim's Pride*, the IRS view of section 1234A was expansive. Although the FAA is arguably consistent with the Fifth Circuit's decision in *Pilgrim's Pride*, the FAA is enigmatic. In fact, it does not mention the case (either favorably or unfavorably). This suggests that the IRS may still be refining its position on section 1234A.

Roberts is right that section 1234A deserves more attention. With the FAA, it deserves even more. And the FAA itself deserves a more thorough discussion, especially as it relates to other litigation finance investments. We are writing an article for an upcoming issue of *Tax Notes* on the FAA, section 1234A, and the sale or exchange requirement. We hope the IRS, too, is trying to harmonize this confusing area.

Sincerely,

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FOOTNOTES

¹ 20154701F , July 28, 2015, released to the public on November 20, 2015.

² 779 F.3d 311 (5th Cir. 2015) .