# Rethinking Property, Terminations, And Gain After *McKelvey*, Part 2

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In the second installment of their two-part article, Wood and Board argue that the IRS and the courts should abandon the assumption that section 1234A cannot apply to a transaction unless there is a sale or other disposition of property as described in section 1001.

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## Section 1001 and the IRS

The Tax Court hasn't been alone in struggling with the relationship between sections 1001 and 1234A; the IRS has recently engaged in an internal monologue regarding the meanings of gain and loss and the role of section 1001. To illustrate the difficulties the IRS has been facing, we will consider two field attorney advice memos from 2015 and 2016, as well as a chief counsel advice memo from 2022. After comparing today's situation with what might be described as the IRS's "traditional" view of gain and loss, we conclude that the IRS could simplify its analysis — and courts could reach more reliable results — if they abandon the assumption that section 1234A cannot apply to a transaction unless there is a sale or other disposition of property as described in section 1001.

## FAA 20154701F

The IRS took an expansive view of section 1001 in FAA 20154701F. The advice letter (the 2015 field attorney advice) is notable because it is the closest thing to guidance the IRS has provided regarding the tax treatment of litigation funders that bankroll claimants or their attorneys using variable prepaid forward contracts (VPFCs).

The 2015 field attorney advice is heavily redacted, so neither the facts nor the legal analysis is completely clear. Nevertheless, it appears that a litigation funder (in this case, an individual) contracted to purchase a portion of the settlement proceeds that his counterparty hoped to recover in litigation. That litigation generated a recovery for the counterparty (in the form of periodic payments), and the funder was paid his share under the terms of a VPFC.

The funder treated the VPFC as a derivative contract for the purchase of a capital asset. It appears that he also treated the counterparty's payments as amounts paid to terminate his rights under the contract. The funder reported the profit he realized upon settlement of the VPFC, which he had held for more than a year, as long-term capital gain under section 1234A.



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We can reconstruct the underlying analysis for the funder as follows[1]: (1) The counterparty's payment terminated the funder's rights and the counterparty's obligations under the VPFC, thereby closing the funding transaction; (2) the funder realized a profit from this closed transaction equal to the excess of the counterparty's termination payment over the previously unrecovered amount of the funder's advances; (3) the profit was a "gain" for purposes of section 1234A; (4) the funder's terminated rights were rights regarding a capital asset, so his termination gain was properly treated as gain from the sale of a capital asset under section 1234A; and (5) the funder was subject to tax on *long-term* capital gain because he had held the VPFC for more than one year.

The 2015 field attorney advice did not see things that way. It acknowledged that section 1234A says gain or loss attributable to the termination of specific *obligations* should be treated as capital gain or loss. However, it argued against capital gain treatment on the theory that, thanks to section 1001, the counterparty's payment to terminate the VPFC *had not triggered any gain*. So the funder had no gain for section 1234A to characterize as capital gain:

> Sections 1222 and 1234A address the character of a gain or loss under certain conditions. Both provisions are, by their terms, predicated on the existence of "gain" or "loss." However, a fundamental requirement of section 1001 is that in order to have a "gain or loss" there must be a sale or other disposition of property. With respect to Taxpayer's receipt of [the counterparty's termination payments], the facts indicate that there is no associated disposition of property.

Andrew McKelvey's estate could not have said it better. The counterparty had paid to terminate the funder's rights under the VPFC, but the funder had not sold or otherwise disposed of any "property" for purposes of section 1001. If we assume, as the 2015 field attorney advice seemingly did, that a taxpayer cannot realize gain outside section 1001, it follows that the funder had no gain that he could report as capital gain under section 1234A.

### Let's Add a 'Disposition'

Many sophisticated litigation funders responded to the 2015 field attorney advice by adding language to their VPFCs that they hoped would supply the supposedly necessary "sale or other disposition of property." These provisions typically provide that, "to the maximum extent provided by law," the funder is to be treated as receiving the counterparty's payments as part of a "disposition" of unspecified assets that may have been created or transferred to the funder by virtue of the VPFC.

Such language does no harm, but it is hard to see how it would help. If the termination of the funder's rights and obligations under the VPFC would not otherwise qualify as a sale or other disposition of property under section 1001, it seems unlikely that the parties could cure the defect simply by declaring that the transaction should be treated as if the funder had received the counterparty's payment in connection with a disposition of property. But litigation funders still include these provisions in their agreements to try to circumvent the 2015 field attorney advice.

Another point that should be noted about the 2015 field attorney advice is that it did not hold that the funder had to report ordinary gain. How could it? The IRS's theory was that the termination of the funder's rights did not qualify as a sale or other disposition of property as described in section 1001, which meant there was no gain.

When there is a sale or other disposition of property described in section 1001, the taxpayer's receipt is treated as an amount realized. An amount realized is not gross income, but rather is an element in the taxpayer's calculation of gain or loss under section 1001. It is only the taxpayer's gain (if any) that is included in gross income.[2]

Under the 2015 field attorney advice, however, the termination of the funder's obligations under the VPFC was not a sale or other disposition of property. Hence, what the

[1]For simplicity's sake, assume that the funder receives a lump sum.

[2]If the taxpayer has a zero basis in the property, the gain calculated under section 1001 will equal the amount realized (minus any selling expenses), but the two concepts remain distinct.



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funder received was not an amount realized, but rather a slug of gross income. Consistent with that analysis, the 2015 field attorney advice declared that "the payments should be taxed as ordinary income."

If the payments were simply ordinary income to the funder, what became of his advances to the counterparty? The IRS certainly did not expect the funder to deduct them in the years they were made. But if the advances were not taken into account as part of calculating gain realized by the funder, did the IRS expect that they would be deducted in the year of the termination on some other theory?

It is unclear whether the IRS addressed the fate of the funder's advances in the 2015 field attorney advice. If it did, the discussion was entirely removed as part of the redaction process. If that is what happened, it would suggest that the IRS may have had second thoughts about the implications of the "no gain" theory.

## FAA 20163701F

The IRS took a much different approach in FAA 20163701F (the 2016 field attorney advice). The taxpayer, AbbVie Inc., paid a $1.6 billion breakup fee to its counterparty (Shire PLC) when it pulled out of their planned corporate inversion. If the IRS had followed the 2015 field attorney advice, it would have concluded that AbbVie did not realize a loss under section 1001. Without a loss, AbbVie could not have been required to report a capital loss under section 1234A. AbbVie might then have deducted the full $1.6 billion against ordinary income under section 162 — the best possible outcome for the taxpayer.

But the 2016 field attorney advice did not conform to the 2015 field attorney advice. This time, the IRS treated the termination payment as triggering a loss, giving AbbVie something that could be treated as a capital loss under section 1234A.

To reach that conclusion, the 2016 field attorney advice pointed to the legislative history of the 1997 amendments to section 1234A. The amendments expanded the scope of section 1234A to include gains and losses attributable to the termination of rights or obligations regarding all forms of property.[3] According to the Senate report,[4] Congress adopted the amendment with the intention of overturning the result in *U.S. Freight*.[5]

In *U.S. Freight*, the Court of Federal Claims allowed the taxpayer to report an ordinary loss when it forfeited a down payment to purchase nonpublicly traded stock, which at the time was outside the scope of section 1234A. If Congress believed that it could require similarly situated taxpayers to report capital loss by simply expanding the reach of section 1234A, it must also have believed that forfeiting a down payment to purchase property could already generate a "loss" for purposes of section 1234A.

The legislative history was all that the 2016 field attorney advice needed to conclude that AbbVie should have reported a capital loss in connection with its payment of the breakup fee. Given Congress's intention to override *U.S. Freight*, that is a highly plausible result. Notably, however, the 2016 field attorney advice did not address what the 2015 field attorney advice had called the "fundamental requirement" of there being a sale or other disposition of property for a taxpayer to realize a gain or loss subject to section 1234A.

## CCA 202224010

The IRS returned to the problem of expenses incurred in abandoned mergers and acquisitions in chief counsel advice CCA 202224010. Once again, the taxpayer was a corporation that had paid breakup fees when it terminated a pending acquisition. Hoping to avoid being stuck with a capital loss under section 1234A, the taxpayer tried to deduct its payments as business expenses under section 162.

Like the 2016 field attorney advice, the chief counsel advice started from the premise that Congress believed such payments would generate capital losses under section 1234A. If so,

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[3]Before its amendment in 1997, section 1234A applied only when the property in question was real property or nonpublicly traded personal property. Today's section 1234A(1) excludes only securities futures contracts, which are governed by section 1234B.

[4]S. Rep. No. 105-33, 1997-4 C.B. 1215.

[5]*U.S. Freight Co. v. United States*, 422 F.2d 887 (Ct. Cl. 1970).



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Congress must have assumed that the payment of a breakup fee would trigger a "loss" to which section 1234A could apply. A good portion of the chief counsel advice is devoted to trying to find a statutory justification for Congress's assumption.

If we take the expansive view that section 1001 defines gain and loss for general code purposes, section 1234A can apply to the termination of a right or obligation only if there has been a "sale or other disposition of property." That seems problematic, however, because it is unclear that terminating a right or obligation regarding property must always involve a sale or other disposition of property as described in section 1001.

### In Pursuit of 'Property'

The chief counsel advice contended that a satisfactory resolution could be found in the "plain language" of section 1234A. According to the chief counsel advice, section 1234A states that (1) there must be a "gain or loss attributable to an extinguishing event — (i.e., cancellation, lapse, expiration, or other termination)," and (2) the event must be one that "extinguishes a contractual right or obligation." Because the IRS's attempt to reconcile section 1234A with section 1001 depends on the second claim, we should examine it more closely.

Nothing in the language of section 1234A, plain or otherwise, limits the nature of the rights and obligations to which it applies, except for the proviso that they must be rights or obligations "with respect to property." The most important gloss on this gnomic but critical phrase is the Fifth Circuit's interpretation in *Pilgrim's Pride*.[6] The court distinguished between (1) "inherent" rights, which are part of the ownership of property per se; and (2) what we might call "extrinsic" rights and obligations, which concern such inherent rights "from the outside," so to speak.

A call option on stock, for example, is an extrinsic right that gives the option holder the power to cause the inherent rights that constitute ownership of the stock to be transferred from the current holder to the person exercising rights under the option. In *Pilgrim's Pride*, the Fifth Circuit held that section 1234A deals with the termination of extrinsic rights "with respect to" an item of property, not the inherent rights themselves. In doing so, the court referred to "derivative or contractual rights."

However, we should note that the court presented derivative or contractual rights as *examples* of what we have called extrinsic rights — not as an exhaustive list:

> By its plain terms, section 1234A(1) applies to the termination of rights or obligations with respect to capital assets (e.g. derivative or contractual rights to buy or sell capital assets). It does not apply to the termination of ownership of the capital asset itself. Applied to the facts of this case, Pilgrim's Pride abandoned the Securities, not a "right or obligation . . . with respect to" the Securities.

Like many subsequent commentators, the Fifth Circuit used a shorthand description of its holding, summarizing it with the statement that section 1234A "only applies to the termination of contractual or derivative rights, and not to the abandonment of capital assets." Although it appears that "only" was used here simply to emphasize the contrast between extrinsic rights and the property to which they relate, it can create the impression that section 1234A applies only to those two examples of extrinsic rights.

That seems harmless in the case of "derivative" rights because that term is almost as generic as "extrinsic" and conveys the same basic idea that there are legal rights that are essentially concerned with (or about) other legal rights. The term "contractual" is a different matter. Under its most natural interpretation, calling a right "contractual" indicates that the right was *created* by contract.

The chief counsel advice does not cite *Pilgrim's Pride*, yet it seems safe to assume that the IRS takes the case seriously. The chief counsel advice's claim that the "plain language" of section 1234A requires an event that "extinguishes a contractual right or obligation" seems to derive directly from the shorthand language in the Fifth Circuit's opinion. What matters for our purposes, however, is how the chief counsel advice tries to

[6] *Pilgrim's Pride Corp. v. Commissioner*, 779 F.3d 311 (5th Cir. 2015), *rev'g* 141 T.C. 533 (2013).



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use the concept of a "contractual" right or obligation to reconcile section 1234A with the supposed requirements of section 1001.

### Is Terminate Equivalent to Dispose?

Under the expansive view of section 1001, a taxpayer cannot realize a gain or loss in the absence of a sale or other disposition of property. If so, section 1234A cannot apply to the termination of a right or obligation "with respect to" property unless the termination itself can be treated as a sale or other disposition of property. If the right or obligation is created by contract, the termination of the right or obligation will be accompanied by the cancellation, lapse, expiration, or other termination of the contract.

That is useful to the chief counsel advice's analysis because a private contract should generally qualify — despite the Tax Court's position in *Estate of McKelvey*[7] — as "property" within the meaning of section 1001.[8] That allowed the chief counsel advice to argue that the termination of the taxpayer's obligations *did* involve a termination of "property," viz., the cancellation of the acquisition contract itself.

That, in turn, made it at least possible to argue that the termination of the planned acquisition was a sale or other disposition of property described in section 1001. In that case, there *would* be a "gain" or "loss" to which section 1234A would apply. The chief counsel advice proceeded along those lines, concluding that the termination of the taxpayer's contractual obligations "were dispositions of property for purposes of section 1001 that gave rise to gain or loss."

The analysis got the IRS where it needed to go in the case before it. Congress intended that section 1234A would require taxpayers that pay to terminate obligations regarding stock in M&A transactions to calculate and report capital loss. However, that analysis is problematic as a general interpretation of section 1234A because it addresses only the case of contractual obligations.

Suppose that a *statute* requires the taxpayer to purchase shares from some counterparty for some mandated price. Further suppose that the statutory sale price is $30, but the shares are now worth only $22. That raises a new version of the problem that led Congress to enact section 1234A.

If the taxpayer satisfies his statutory obligation by purchasing shares, he will acquire stock with a built-in capital loss of $8 per share. If the taxpayer instead pays the counterparty $8 per share to release him from his statutory obligation, can he claim some sort of ordinary deduction for his payment?

The taxpayer in this example has a statutory obligation to purchase shares, so the parties' agreement to settle in cash would not extinguish a *contractual* obligation. According to the chief counsel advice, however, the plain language of section 1234A requires an event that "extinguishes a contractual right or obligation." After all, if there is no contract, how can the termination of the obligation be treated as a sale or other disposition of "property" described in section 1001?

Under the chief counsel advice's analysis, the termination of the taxpayer's merely statutory obligation does not appear to trigger gain or loss under section 1001. Under the expansive view of section 1001, that would prevent application of section 1234A to require the taxpayer to report a capital loss.

Congress would not be pleased. It does not seem plausible that section 1234A should apply only when the obligation in question is created by contract. That reinforces the case for rejecting the chief counsel advice's already dubious claim that the "plain language" of section 1234A requires an event that "extinguishes a contractual right or obligation."

### Defining Disposition

The expansive view of section 1001 requires the chief counsel advice to deal with a second hurdle: To have a gain or loss as described in section 1001, it is not enough to identify some form of property on which we can somehow hang the termination; the transaction itself must be a "sale or other disposition" of property.

There appears to be no official tax definition of the term disposition. All we know for sure is that not every transaction or event that is a "disposition" qualifies as a "sale or exchange"

[7] *Estate of McKelvey v. Commissioner*, 148 T.C. 312 (2017).

[8] The Second Circuit apparently agreed with the Tax Court in *McKelvey II*, but that appears to have been dictum because the court of appeals decided the case without discussing section 1001.



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within the meaning of section 1222. Under the extinguishment doctrine, the IRS and the courts hold that some transactions involving capital assets cannot be considered "sales or exchanges" because they do not transfer the taxpayer's rights more or less intact to a third party.

The simple termination of a right does not involve a sale or exchange because the right is extinguished rather than transferred. But does it at least qualify as a disposition for purposes of section 1001? No one would dispute that transferring a right to a different holder counts as a disposition, even if it is not a sale or exchange, as in the case of a gift.

However, the question is whether some transactions should be treated as "dispositions" of property even if they do not involve the transfer of a right or obligation. We will return to that question, but the chief counsel advice held that they should, based largely on the legislative history of section 1234A:

> Congress enacted section 1234A to deem certain non-sale or exchange dispositions to be sales or exchanges to ensure that gain or loss from such dispositions had the same character as a gain or loss from selling the contract. Congress did not have to provide that a "gain or loss" arose from such dispositions in order to achieve uniform character because such dispositions already resulted in gain or loss prior to enactment of section 1234A.

The chief counsel advice is correct that Congress believed it was possible for a taxpayer to realize gain or loss from the termination of a right or obligation "with respect to" property. After all, section 1234A works by identifying gain or loss from the termination of a right or obligation and then treating it as a capital gain or loss.

However, it is another thing to conclude that Congress had a specific view regarding the technical question whether the termination of a right or obligation "with respect to" property must necessarily qualify as a "disposition" of property within the meaning of section 1001. The legislative history and the chief counsel advice appear to have reasoned backwards. Congress expected that the termination of some rights and obligations would generate gain or loss that could be treated as capital gain or loss under section 1234A.

So, the theory seems to be that Congress must have believed that all such terminations involve dispositions of property as supposedly required by section 1001. Whatever the logic, that line of reasoning might be appealing if Congress had actually used section 1001 to define the terms "gain" and "loss" with reference to sales or other dispositions of property. However, we can relieve the pressure to treat every termination as somehow constituting a "sale or other disposition of property" by dropping the assumption that taxpayers cannot realize gain or loss outside of section 1001.

To apply section 1234A, we still need to determine whether a termination triggered gain or loss. If gain or loss was triggered, we also need to find a way to measure it. However, we can do that without trying to recast the termination as a sale or other disposition of property described in section 1001.

The best way to do that is to adopt the "transactional" analysis the Second Circuit used in *McKelvey II*.[9] McKelvey entered into some stock transactions using VPFCs, providing him millions of dollars in upfront cash. Despite that receipt, the transactions remained "open" for tax purposes until McKelvey extended the settlement date of the contracts in July 2008.

As the Tax Court determined in *McKelvey III*,[10] changing the settlement date was a fundamental change in McKelvey's deal with the banks. Thus, the court found that McKelvey's original obligations under the VPFCs had been terminated for purposes of section 1234A. That closed McKelvey's initial transaction, making it an appropriate time to take account of any gain or loss from that transaction.

Nothing in this process of determining gain or loss realized from a closed transaction requires us to invent a "sale or other disposition of property" to bring the transaction within the scope of section 1001. As we previously observed, the Second Circuit reversed the Tax Court simply for failing to apply section 1234A. It did so without making

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[9] *Estate of McKelvey v. Commissioner*, 906 F.3d 26 (2d Cir. 2018).

[10] *Estate of McKelvey v. Commissioner*, 161 T.C. No. 9 (2023).



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any claim that (1) the termination of the original VPFCs was a "disposition" of those contracts; or (2) the contracts were "property" in McKelvey's hands when they were terminated.

### Historical Perspectives on Gain and Loss

The IRS has been trying to get a handle on the relationship between section 1001 and section 1234A for the better part of two decades. The main source of difficulty has been the expansive view of section 1001, which treats it as defining gain and loss for general code purposes — or at least subchapter O. Ironically, the expansive view of section 1001 appears to be an innovation. For most of the history of the income tax, neither the code nor the IRS has subscribed to the view that *every* gain or loss must derive from a sale or other disposition of property.

An example is section 165, which authorizes taxpayers to deduct the "losses" they sustain during the tax year. Of course, the paradigmatic "loss" is the loss realized when a taxpayer *sells* property for less than its basis in his hands. When there is a sale to point to, the statutory pieces mesh smoothly: There is a loss, and section 1001 provides a rule for calculating its *amount*.

Section 165, however, applies to more than losses from sales. Section 165(e), for example, allows a deduction for a "loss arising from theft." A theft of property is not a sale, but is it at least a disposition of property? If a "disposition" of property requires some kind of *transfer* of the owner's inherent rights, it would appear not.

A thief does not succeed to his victim's rights. But even if the victim of theft is not divested of his rights as the owner of the stolen property, his rights may not count for much in practical terms if he has no way to exercise or otherwise benefit from them. If we expect this unhappy situation to be permanent, the theft of the property seems like an appropriate occasion (from a transactional perspective) to assess the tax consequences of the victim's investment in the property. Allowing the victim to deduct his basis in the property as a "loss" makes sense, even if we believe that his legal rights in the property are completely unaffected by the theft.

However, there are also situations in which a taxpayer may abandon property and claim a loss under section 165, even when no thief or other third party has interfered with his practical enjoyment of his rights. There is, for example, no requirement that the taxpayer relinquish title to property to establish an abandonment loss.[11] All the taxpayer needs to do is show that the (practical) loss is reasonably certain in fact and ascertainable in amount.

This is consistent with section 165 and its regulations, which permit a deduction for losses "sustained" during the tax year, with no suggestion that a loss must involve a sale or other disposition of property described in section 1001. The regulations say only that losses "must be evidenced by closed and completed *transactions*" (emphasis added).[12] From this perspective, sales and other dispositions of property described in section 1001 are simply one type of closed and completed transaction; there is no reason to assume that they are the *only* one.

The regulations under section 165 are also notable for their explicit statement that a taxpayer can sustain a "loss" from the "sudden termination of the usefulness" of non-depreciable property in a business or transaction entered into for profit.[13] This can happen if the business or transaction is discontinued, or if the property is "permanently discarded from use" in the business or transaction.[14]

A change in business conditions that causes a taxpayer to discontinue a transaction or business because of the termination of the usefulness of property is not a property transfer, and it need not involve any third party. We could try to convince ourselves that when property loses its "usefulness" in a specific business or transaction, this is also a "disposition" of the property, but it is unclear what purpose this would serve.[15] After all, section 165 and its regulations do not treat section 1001 as defining loss, so why should we tie

[11] *See, e.g.*, *Echols v. Commissioner*, 935 F.2d 703 (5th Cir. 1991); and *Middleton v. Commissioner*, 77 T.C. 310 (1981) *aff'd per curiam*, 693 F.2d 124 (11th Cir. 1982).

[12] Reg. section 1.165-1(b).

[13] Reg. section 1.165-2(a).

[14] *Id.*

[15] *Cf.* Boris I. Bittker and Lawrence Lokken, *Federal Taxation of Income, Estates, and Gifts*, para. 40.2 (2023) ("It strains the language to say that there has been a disposition of property when the proceeds of insurance are collected for property destroyed by fire or when property becomes worthless and is retained rather than discarded. Yet, these events can produce taxable gain or deductible loss.").



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ourselves in knots trying to show that every transaction that produces a loss somehow involves a "sale or other disposition" of property?

### Regulations Under Section 1001

It is notable that the regulations under section 1001 recognize that gain can be realized "with respect to" property "even though property is not sold or otherwise disposed of."[16] If a taxpayer receives an amount that, under section 1016 or some other provision, must be applied against his basis in property, the regulations say he realizes gain to the extent that the amount received exceeds his basis.

The regulations follow that with the observation that a loss "with respect to" property is not "ordinarily" sustained before the sale or other disposition of that property.[17] Notably, however, the regulations do not claim that this treatment is mandated because section 1001 defines loss as requiring a sale or other disposition of property.

Instead, the regulations approach the matter pragmatically. They focus on section 165's familiar requirement that there be a closed and completed transaction:

> Until such sale or other disposition occurs there remains the possibility that the taxpayer may recover or recoup the adjusted basis of the property. Until some identifiable event fixes the actual sustaining of a loss and the amount thereof, it is not taken into account.

When the loss relates to a decline in the value of property, a sale or other disposition provides an "identifiable event" that "fixes the actual sustaining of a loss and the amount thereof." That can be taken as a restatement of the more general idea that a taxpayer should not report a loss in connection with a transaction (here, his investment in a piece of property) until that transaction can reasonably be viewed as having reached its conclusion.

[16] Reg. section 1.1001-1(c)(1).

[17] *Id.*

### Conclusion

We began this article with a review of *Estate of McKelvey* and the distortions that result from assuming that section 1001 defines the terms "gain" and "loss" for purposes of section 1234A. In *McKelvey I*, that expansive interpretation led the Tax Court to conclude that section 1234A did not apply to the huge profit the taxpayer realized when he terminated his obligations under two prepaid forward contracts. The Tax Court's reasoning was mechanical, and its rationale (that the contracts had ceased to be "property" as soon as the taxpayer pocketed a $194 million advance) seems irrelevant to section 1234A absent the assumption that it applies only to gains and losses described in section 1001.

The Second Circuit overturned that result in *McKelvey II*, but it failed to address the underlying rationale. Thus, in *McKelvey III*, the Tax Court was ready to conclude, on essentially the same theory, that McKelvey's gain could not be calculated under the code. The Tax Court refused to accept this perverse result on policy grounds, but it expressed no doubts about the expansive interpretation of section 1001 from which it was logically derived.

Despite its close call in *Estate of McKelvey*, the IRS appears not to have questioned the Tax Court's assumption that section 1001 and section 1234A are joined at the hip. Instead of questioning the premise, the IRS has been searching for arguments showing that just about every termination of a right or obligation somehow involves a disposition of property described in section 1001.

Those arguments are well intentioned, but we believe they are misdirected. Nothing in the text of section 1001 says that a taxpayer can realize gain or loss *only* through a sale or other disposition of property. The expansive reading of section 1001 is also hard to reconcile with (1) the long-standing acceptance of property-related losses that do not involve any actual disposition of property, and (2) the regulations under section 1001, which state unequivocally that a taxpayer can realize property-related gain even *without* a sale or other disposition of property.

The alternative, of course, is to drop the assumption that section 1001 plays a critical role in the application of section 1234A. Taxpayers



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realize gain or loss upon the conclusion of a transaction. Sometimes the event that closes a transaction is a sale or other disposition of property, but that is not the only way gain or loss can be realized.

If a taxpayer realizes a gain that does not involve a sale or other disposition of property, that just means that the amount of his gain or loss is not calculated using the rules in section 1001. However, the same general tax principles apply, and an analysis outside section 1001 is likely to primarily differ in terminology. For example, a funder's advance to a taxpayer under a VPFC will surely be taken into account when the contract is settled, even if that involves nothing more than the termination of the parties' respective rights and obligations under the contract. The fact that we cannot describe it as an amount realized from a sale or other disposition of property does not seem to matter.

Clarifying the relationship between section 1001 and section 1234A seems unlikely to transform the application of either provision. However, we need clarification if we want to avoid the sort of confusion that marked *Estate of McKelvey*. Besides, the IRS has enough to do without devoting time and energy to unnecessary debates about section 1234A and what counts as "property" or a "disposition" for purposes of section 1001. ■



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