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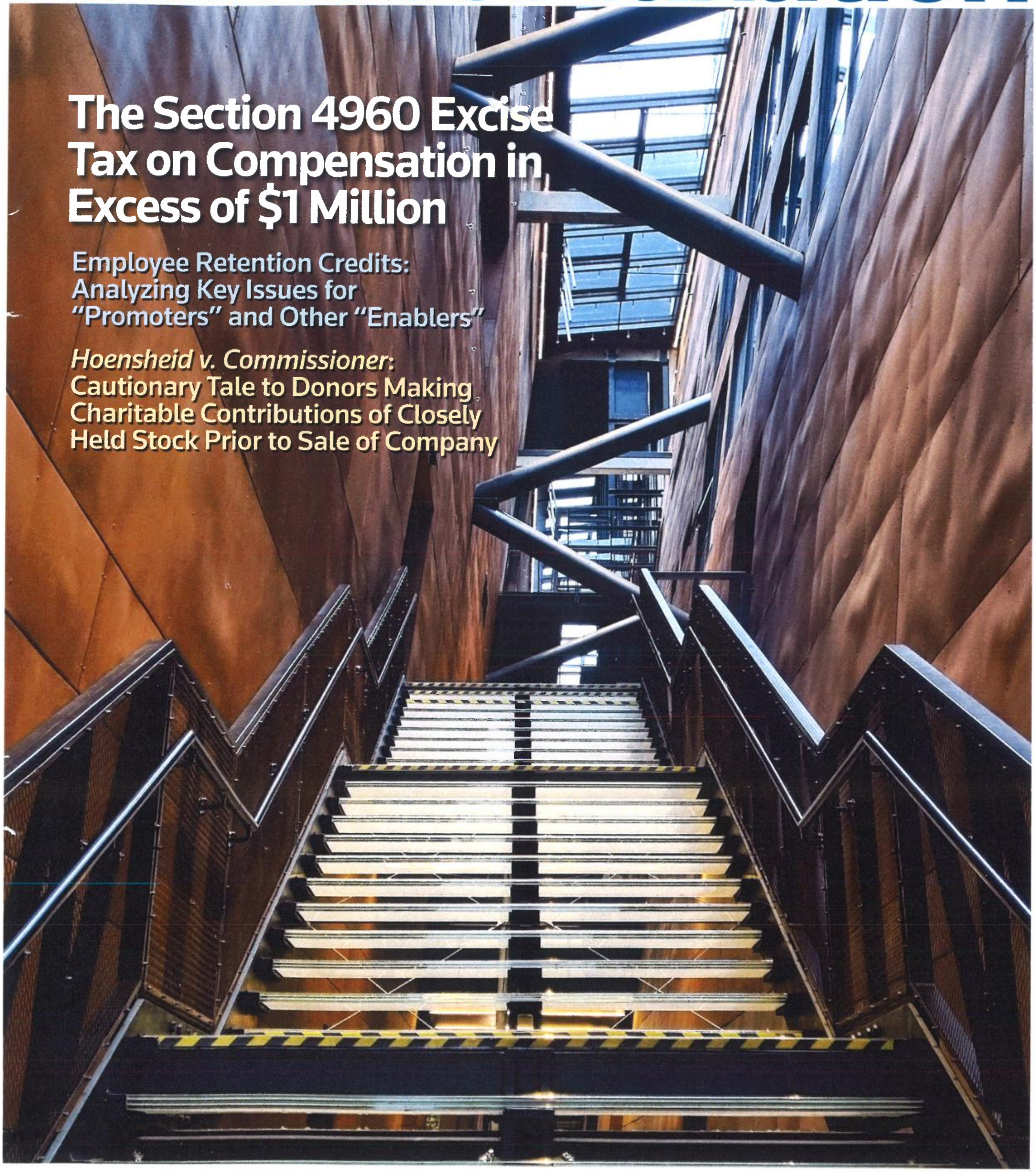

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SHOP TALK

The Taxpayer and Amicus Appellate Briefs in *Tribune Media* Throw Tough Pitches at the IRS

In this article, designated hitter Samuel Grilli of Baker & McKenzie touched base to help walk our Shop Talk fans through the highlights of the latest inning in the tax case involving the Chicago Cubs professional baseball team. Whether or not you are a fan of the Cubs (and half of your Shop Talk editors are not), the tax case involving the acquisition of the franchise by the Ricketts family from Tribune Media Co. is worthy of playoff level attention. The appeals and cross-appeals of the Tax Court's memorandum decision in *Tribune Media*[1] are playing out before the Seventh Circuit Court of Appeals. We are closely following the play-by-play. The latest development is the taxpayer's opening and response brief filed August 8.[2] By all signs the briefs are giving rise to the making of a seminal tax case[3] with implications on a full lineup of critical partnership-tax related issues: partnership debt allocation; disguised sales characterization of transactions between a partner and a partnership; debt versus equity treatment; the meaning, scope and (in)appropriate use of anti-abuse rules; and ultimately, the rule of law itself. Let's dive in!

The case involves a leveraged partnership transaction. Regular readers of The JOURNAL may recall your editors' ongoing interest in the taxpayers' use of (and governmental responses to) such structured partnership transactions,[4] which have been prevalent for decades (ever since the disguised sales regulations were issued under Section 707(a)(2) in the 1990s).

From our view in the nosebleed bleacher section, we offer a high-level summary of the case. Tribune Media Company, formerly known as Tribune Company & Affiliates (hereafter Tribune) and the Ricketts family pooled the franchise and the Cubs' ballpark (Wrigley Field), structured as a contribution of property to a new partnership (Chicago Baseball Holdings LLC) intended to qualify under Section 721. The partnership then borrowed through senior and subordinate debt and distributed cash to Tribune intended to fall within the debt-financed exception to disguised sales (see Reg. 1.707-5(b)(1)). Tribune provided a guarantee of the loans intended to subject it to the economic risk of loss on the debt so as to qualify for this exception from gain recognition.

The Tax Court found against the taxpayer in concluding that the subordinate debt should be treated as equity for tax purposes, and thus, rendering the receipt of those proceeds by Tribune ineligible for debt-financed treatment. However, the Tax Court ruled for the taxpayer on the debt-financed distribution attributable to the partnership's senior debt that was found to be properly allocable to Tribune under the partnership debt allocation rules. Essentially borrowing through the partnership, Tribune was not considered to be receiving taxable proceeds from its share of the debt. The Tax Court considered the specific partnership debt allocation anti-abuse rule (Reg. 1.752-2(j))[5] inapplicable because under the hypothetical constructive liquidation test, Tribune was the only partner to which the partnership's creditors could seek collection for the guaranteed loans. In the Court's opinion, the guarantee was a "real" one even if there was a low likelihood that the guarantee would ever be called. The general partnership anti-abuse rule (Reg. 1.701-2) was also determined to be inapplicable.

This column provides an informal exchange of ideas, questions, and comments arising in everyday tax practice. Readers are invited to write to the editors: Sheldon I. Banoff, Retired Partner, Katten Muchin Rosenman LLP, 525 West Monroe Street, Suite 1900, Chicago, Illinois 60661-3693, Sheldon.Banoff@outlook.com; Richard M. Lipton, Senior Counsel, Baker McKenzie, 1900 North Pearl Street, Suite 1500, Dallas, Texas 75201, Richard.Lipton@bakermckenzie.com; and Samuel P. Grilli, Partner, Baker & McKenzie LLP, 300 East Randolph Street, Suite 5000, Chicago, Illinois 60601, samuel.grilli@bakermckenzie.com.

The July Shop Talk article questioned the IRS's thinking in appealing the case as an "abusive" transaction. The IRS position relies on application of two anti-abuse rules. The crux of its argument seems to be that (A) it was highly unlikely Tribune would ever have to pay on its guarantee and (B) the specific partnership debt allocation anti-abuse rule in Reg. 1.752-2(j) applies independently of the rest of the Section 752 regulatory structure in that the anti-abuse rule should take into account actual facts and circumstances (and should not operate within the hypothetical liquidation construct, although such framework underpins the rules for the allocation of partnership recourse debt). The IRS contends that under the general partnership anti-abuse rule each "component" of a partnership transaction must independently possess substantial business purpose. Tribune's guarantee should be disregarded under both anti-abuse rules, says the IRS, as each rule independently bars using miniscule risk to gain outsized tax benefits and there was no business purpose for the guarantee.

After review of the IRS brief,[6] the July Shop Talk article concluded that it appears that the IRS is likely to have a worse result by appealing. The article explained that *Tribune Media* was a memorandum decision understood as applying settled law to the applicable facts and not considered binding precedent.[7] By appealing to the Seventh Circuit, the IRS is raising the stakes. That is, the appeal takes some disappointing umpire calls from a partial victory in a regular season game and elevates it to a playoff game, moreover, where both teams can question more than just those particular umpire calls that one team (the IRS) found in error. Is this play a risk calculation akin to an intentional walk: a bold strategy that might work, but could backfire (or, is there some other concern or strategy behind this appeal)?[8]

Thus, as evaluated in the July Shop Talk article, the IRS's appeal appears to be of limited potential upside but substantial downside risk of elevating a lower court's adverse factual determination into a significant appellate court precedent. In any event, a significant appellate court precedent does appear to be in the making as the taxpayer now puts into play a bunch of additional calls it wants to question.

The recent publication of the taxpayer's opening and response brief confirms, even more so, that it is a whole new ballgame. The taxpayer emphasizes that it used a well-established and thoroughly regulated type of partnership transaction and followed on-point tax regulations to the letter. Relying on settled rules of partnership taxation to structure the transaction, the taxpayer argues there is no support for the IRS's reading of the specific anti-abuse rule. If the IRS believes that its current litigating position is how the rule should work, then according to the taxpayer the IRS should revise the regulation to provide sufficient notice to taxpayers, rather than trying to rewrite the regulation on the fly (ball) in litigation.

In addition to the points that popped-up in the July Shop Talk article, the taxpayer puts forth what appears to be a compelling argument that both the subordinated debt should have been treated as debt (not equity) and that the general partnership anti-abuse rule (Reg. 1.701-2) is invalid. So, the outcome could be a curveball — even worse for the IRS than previously discussed because the part the IRS won in Tax Court could be overturned *and* the partnership anti-abuse rule put into play could be significantly limited or even invalidated (as circuit courts are wont to do).[9] Buy us some peanuts and crackerjack - this is really getting interesting! Your editors (both in prior Shop Talk columns[10] and writing individually[11]) and others in the practitioner[12] and academic[13] communities have long questioned whether certain anti-abuse regulations were legally authorized or rather so inconsistent with the statutory framework and intent of Congress as to be invalid.

The taxpayer reasons in *Tribune Media* that the IRS interpretation of the anti-abuse rule would make the constructive liquidation test superfluous. The taxpayer also protests the double-play hurdle of anti-abuse challenges (specific and general) as violating the elementary legal tenet that the specific controls the general. A judge may balk at such an interpretation and application of the law. Could a transaction be found to be abusive under the general anti-abuse rule of Subchapter K when it is not abusive under the specific anti-abuse rule of Reg. 1.752-2(j)?

If that is even possible, what then is the proper level of analysis under the general partnership anti-abuse rule given that it refers to a "series of related trans-

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1 *Tribune Media Co., et al., v. Commissioner*, TC Memo 2021-122, *on appeal to CA-7.*

2 Petitioners' Opening and Response Brief, *Tribune Media Co., et al., v. Commissioner,* U.S. Court of Appeals for the Seventh Circuit, Docket No. 23-1135 (filed August 8, 2023).

3 The appellate opinion(s) may make *Tribune Media* another one of the most interesting tax cases that we have come across in several decades. See Shop Talk, "Is *Deitch* the Tax Court's Most Interesting 21st Century Partnership Case?," 139 JTAX 52 (October 2023).

4 Most recently, see Shop Talk, "What Was the IRS Thinking in Appealing *Tribune Media*?," 139 JTAX 33 (July 2023) (hereafter the July Shop Talk article). Also see Lipton, "Tax Court Drains Canal Corporation's Leveraged Partnership Transaction," 113 JTAX 340 (December 2010), "Leveraged Partnerships Under Fire? IRS Attacks the Tribune's Transactions," 119 JTAX 73 (August 2013), and "*Tribune Media*: A Split Decision for the Chicago Cubs' Leveraged Partnership Transaction," 136 JTAX 6 (February 2022).

5 Under Reg. 1.752-2(j)(1), an obligation of a partner or related person to make a payment may be disregarded if facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation or create the appearance of the partner or related person bearing the economic risk of loss when, in fact, the substance of the arrangement is otherwise.

6 Govt. Brief, *Tribune Media Co., et al., v. Commissioner*, U.S. Court of Appeals for the Seventh Circuit, Docket No. 23-1135, published in Tax Notes, 2023 TNTG 94-19, 2023 TNTF 94-29 (May 12, 2023).

7 "Generally, a Memorandum Opinion is issued in a regular case that does not involve a novel legal issue. A Memorandum Opinion addresses cases where the law is settled or factually driven. A Memorandum Opinion can be cited as legal authority, and the decision can be appealed." U.S. Tax Court, "Guidance for Petitioners: Things That Occur After Trial," ustaxcourt.gov/petitioners_after.html (visited 9/20/23).

8 The prior Shop Talk article speculates that the IRS may have decided to appeal *Tribune Media* because of the fear that taxpayers would rely on the Tax Court's memorandum opinion to claim large benefits. See the July Shop Talk article at n. 7 and accompanying text.

9 E.g., *RLC Industries Co. v. Commissioner*, 58 F.3d 413 (CA-9, 1995). See Shop Talk, "Ninth Circuit Invalidates Anti-Abuse Rule: Is Reg. 1.701-2 Similarly Flawed?," 83 JTAX 380 (December 1995).

actions"? The taxpayer contends that the IRS's position about the scope of Reg. 1.701-2 makes no sense because the IRS could focus on any level of minutiae to invalidate a transaction that is otherwise allowed under the tax laws. When a taxpayer enters a series of interrelated transactions it would be nonsensical, the taxpayer's brief argues, to try to assess the purpose of each of its many components in isolation. Are the general Subchapter K anti-abuse rules enabling selective imposition of higher standards than in the technical partnership regulations? If so, is this appropriate or is this an arbitrary application of the tax rules?

The taxpayer also takes a swing at the validity of Reg. 1.701-2, the general partnership anti-abuse rule. The taxpayer questions the IRS's claimed ability to invalidate a transaction even if it follows the literal words of a statute or rule, based simply on its own views about the intent of Subchapter K. Nothing gives the IRS the authority to make its own independent determinations about Congress's intent, says the taxpayer. Instead, in Subchapter K, Congress provided a comprehensive, detailed, and largely mechanical set of rules for taxing partnerships. Congress should not be assumed to have given authority to the IRS to prohibit tax planning. According to the taxpayer, this situation is highly problematic, as it purports to give the IRS the power to nullify the application of federal statutes. Congress gets to decide the intent of Subchapter K, posits the taxpayer, not the IRS.

This appeal turns bright, stadium lights on the proliferation of vague, broad anti-abuse rules and the IRS's increasing practice of wielding those anti-abuse rules to (in the view of many) undermine or rewrite entire long-standing regulatory frameworks effectuating Congressional decision-making and judgment calls when the IRS doesn't like the results.

Is the proliferation of long and complex regulations sprinkled with startlingly broad anti-abuse rules a positive development for the tax system? A positive development for the IRS? What is the impact upon the business community? What is the impact of such a paradigm on respect for the rule of law?

The Chamber of Commerce of the United States has also stepped up to the plate in filing an amicus brief to add historical and legal nuance with a practical perspective.[14] In its analysis, the constructive-liquidation test governing debt-financed partnership distributions has promoted economic growth and economic freedom. The Chamber makes the point that discarding on-point regulations in litigation significantly damages the rule of law on which businesses depend to structure their provision of goods and services. A fundamental legal concern with these anti-abuse rules is often the lack of a clear baseline against which to measure the facts.

Indeed, the Chamber's brief raises the question whether we would have a more functional and just tax system if tomorrow every single anti-abuse rule was struck from the Code and Regulations? Taxpayers and the IRS could then focus on just having clearer and simpler regulations policed via proper application of the judicial doctrines. Line-drawing is inherently fundamental to a legal system. We see the IRS as the catcher kicking dirt on the white chalk lines of the batter's box, so that neither the batters (taxpayers) nor the umpire (courts) can see whether the batter is standing safely inside, or rather is automatically out for standing outside, the box. Would we do a better job at line-drawing those benchmarks if one side couldn't rely on broad and vague anti-abuse rules as a theoretical backstop?

Businesses rely on predictability and certainty in tax laws to plan their affairs. The IRS approach, as the Chamber sees it, seeks to destroy that predictability by destroying the ability of a business to comply with and rely on clear and targeted tax regulations. Such sudden change would precipitate profound uncertainty in an area of the law— taxes— that demands certainty. Interpreting anti-abuse rules as a freestanding mechanism to disregard tax treatment the IRS dislikes, says the Chamber in its brief, violates the rule of law and inhibits prosperity. This prompts one to wonder, is the IRS abusing the anti-abuse rules?

There is an established regulatory framework intended to fit Congressional policy of minimizing interference in the flow of partnership capital. Congress has for generations promoted partnerships, maintains the Chamber, by tailoring tax treatment to their independent character and has particularly sought to permit the tax-free transfer of property into or out of a partnership. The current regulations favor the free flow of partnership capital with rules that are fairer and more administrable, emphasizes the Chamber in its brief, unlike what the IRS now seeks to slide in and impose via nebulous anti-abuse rules.

Is expanding or contracting the strike zone, even in the name of preventing abuse, itself abusive? The tax law may be amended, the Chamber underscores, in an appropriate manner through legislation or agency rulemaking that applies, and provides advance notice, to all. However, the Chamber calls foul any made-for-litigation interpretations where the IRS seeks to achieve its desired result in a particular case. The Chamber draws

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10 E.g., Shop Talk, "IRS Settlement Guidelines on Subchapter K Anti-Abuse Rule," 93 JTAX 64 (July 2000); Shop Talk, "Partnership Anti-Abuse Rules: Postpone the Funeral," 95 JTAX 123 (August 2001); Shop Talk, "Misuse of the Partnership Anti-Abuse Rule: New ILM Lacks Reasoned Analysis," 104 JTAX 376 (June 2006); Shop Talk, "Partnership Anti-Abuse Rules: Agents Will Apply, Courts May Deny," 106 JTAX 314 (May 2007); Shop Talk, "IRS Attempts to Utilize Anti-Abuse Rules to Overcome Its Failure to Issue Regulations," 131 JTAX 43 (July 2019).

11 See, e.g., Banoff, "Anatomy of an Anti-Abuse Rule: What's *Really* Wrong with Reg. 1.701-2," 66 Tax Notes 1859, 95 TNT 56-84 (3/20/95); Lipton, "IRS Improves Partnership Anti-Abuse Rules, but Major Problems Remain," 82 JTAX 132 (March 1995); Banoff, "The Use and Misuse of Anti-Abuse Rules," 48 Tax Lawyer 827 (Spring 1995); Lipton, "The Partnership Anti-Abuse Rules Revisited: Is There Calm After the Storm?," 83 JTAX 68 (August 1995).

12 E.g., J. Sowell, "The Partnership Anti-Abuse Rules: Where Have We Been and Where Are We Going?," 89 Taxes 69 (March 2011).

13 E.g., Jellum, "Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation is Unconstitutional," 70 U. Miami L. Rev. 152 (2015).

14 U.S. Chamber of Commerce Motion for Leave to File Amicus Curiae Brief, *Tribune Media Co., et al., v. Commissioner*, U.S. Court of Appeals for the Seventh Circuit, Docket No. 23-1135, published at uschamber.com/assets/documents/U.S.-Chamber-Amicus-Brief-Tribune-Media-Co.-v.-Commissioner-Seventh-Circuit.pdf (8/15/23).

the court's attention to the fact that federal legislators have recently reviewed the law of partnership-partner transactions via Senator Ron Wyden's draft legislation, considered changing it, and decided not to do so. Congress (and the regulatory drafters) make judgment calls about simplicity and administrability in considering changes to the tax laws, and balance those values against misgivings about appropriate tax treatment in certain cases. Ad hoc enforcement is at odds, states the Chamber's brief, with the purposes of agency rulemaking and fundamentally in tension with the cherished notion that we are governed by laws, not the whim of a regulator reinterpreting the laws at any given moment.

We thank Sam Grilli for his added insight on the anti-abuse rule aspects of *Tribune Media.* We look forward to further developments in Tribune Media and as always, welcome our readers' comments.