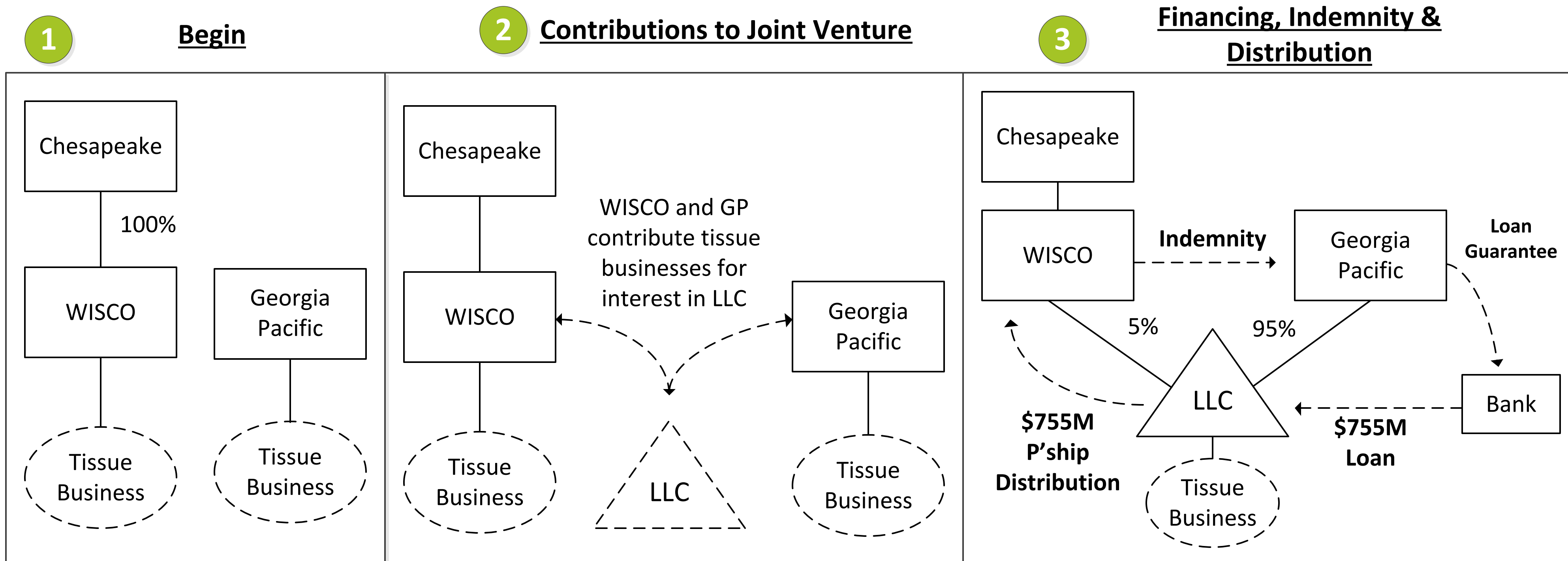
Canal Corp. & Subs. v. Comm'r,
135 T.C. 199 (2010)

Disguised Sale Under Section 707(a)(2)(B)

LINCOLN



Georgia Pacific ("GP") and WISCO formed Georgia-Pacific Tissue LLC ("LLC") as the vehicle for a joint venture. GP and WISCO treated the LLC as a partnership for tax purposes. Both partners contributed assets of their respective tissue businesses to the LLC. GP transferred its tissue business assets to the LLC, with an agreed value of $376.4M, in exchange for a 95% interest in the LLC. WISCO contributed to the LLC all of the assets of its tissue business with an agreed value of $775M in exchange for a 5% interest in the LLC. The LLC borrowed $755M from Bank of America ("BOA") on the same day it received the contributions from GP and WISCO. The LLC immediately distributed the loan proceeds to WISCO (note – the cash was actually transferred directly to Chesapeake as it maintained bank accounts for its subsidiaries). GP guaranteed payment of the BOA loan, and WISCO agreed to indemnify GP for any principal payments GP might have to make under its guaranty.

Chesapeake contended that the $755M distribution was not part of a disguised sale but instead was a debt-financed transfer of consideration, an exception to the disguised sale rules. See Treas. Reg. §1.707-5(b).

The court held that WISCO's transfer of assets to the LLC and the $755M distribution was a disguised sale. This was primarily because the indemnification was disregarded under Treas. Reg. §1.752-2(j)'s anti-abuse rule as it lacked economic substance and created no more than a possibility that WISCO would actually be liable for payment under the indemnification.

Further, the court held that Chesapeake could not rely on a should opinion from its advisors (PWC) to avoid penalties. Reliance on the opinion was found not to be reasonable or in good faith since the opinion was riddled with errors and based on unreasonable assumptions. The court also determined that PWC's advice was more like a quid pro quo arrangement and as a result was tainted by a conflict of interest.