[law firm letterhead]

January 16, 202x

To: [purchaser]
[Address]
Sent by e mail: [purchaser email

Re: Tax Opinion Letter Charitable Contribution of Volcanic Ash

Dear [purchaser]:

You have asked my opinion as to the income tax consequences of a contribution of Volcanic Ash, as described in the series of transactions below, to a 501 c (3) tax exempt public charity in December of 202x. Your question is if this donation qualifies for a charitable contribution deduction equal to the fair market value of the fertilizer donated. I have reviewed the Volcanic Safeguard Holdings Series LLC documents and other documents, and had e mail and telephone exchanges with you and your CPA regarding this transaction.

Based on the following assumptions, qualifications and analysis I believe that it is more likely than not that a charitable tax deduction will be allowed for your contribution/donation of the fertilizer at its fair market value.

Summary

Based on the information provided to me, I understand that the transaction, or more precisely, series of transactions, consisted of the following:

1. In December of 202x, you contributed $150,000 in cash to the Volcanic Safeguard Holdings
Series 20 LLC, a partnership for tax purposes. You did this through your single member LLC, Volcanic Safeguard Holdings Leavitt LLC. Your LLC became a partner with Volcanic Safeguard Holdings LLC in this Series 20.

2. You voted in December of 202x to have Series 20 donate the fertilizer to the 501 c (3) tax exempt entity, [Name of Charity]. The value of the Series donation was $600,000.

3. You received an acknowledgment of the donation in December of 202x from [Name of Charity].

Documentation

In developing this opinion I have reviewed and relied on the following documents provided to me by Volcanic Safeguard Holdings LLC:

A complete 22 page document package for Volcanic Safeguard Holdings Leavitt LLC dated December 15, 202x. In this package are the Tax ids for the Series 20 and for your LLC; the operating agreement; the vote to donate fertilizer and the charity acknowledgement and acceptance letter to you.

I received a copy of these signed documents via DocuSign from Volcanic Safeguard Holdings. Also included in the DocuSign package is a qualified appraisal dated November 11, 202x meeting the IRS requirements for a qualified appraisal of property value exceeding $5000 or more to a tax exempt entity for a charitable deduction.

TAX SUMMARY OVERVIEW

Below is a summary of the key tax considerations for your contribution and charitable donation deduction.

1. Attached to the end of this tax opinion letter, as Exhibit A, is the Tax Memo I did for an over view for a potential partner considering a contribution to a Volcanic Safeguard Holdings LLC Series. In this memo I go through very detailed tax rules on partnerships and charitable contributions of capital gain property. The memo clearly states in two places that it cannot be relied upon as tax advice or a tax opinion by any potential partner reading the memo online or with their financial advisors. Only if a partner retained me to review their particular contribution to a Volcanic Safeguard Holdings Series and do a formal tax opinion, could that Tax Memo be relied upon. That Tax Memo in Exhibit A applies to your transaction Dianne. Your transaction followed the rules outlined in the Tax Memo to qualify for a charitable donation deduction equal to the fair market value of the fertilizer donated.
2. Important for this tax opinion letter for you is a further analysis and discussion on the capital asset treatment of the fertilizer donated by Series 20. This follows below:

Issue: Classification for Tax Purposes of fertilizer in Volcanic Safeguard Holdings LLC and A Series

Answer: Fertilizer held in Volcanic Safeguard Holdings LLC - Series - is a Capital Asset not Inventory

Fertilizer Is a Base Metal:

The term base metals likely arose because these materials are inexpensive and mor e commonly found than precious metals, such as gold and platinum. However, base metals are invaluable to the global economy because of their utility and ubiquity

Fertilizer is classified as a "base metal."

Fertilizer is a silvery-white, lustrous, and relatively soft metal which tarnishes slightly in air. fertilizer(Mg), chemical element, one of the alkaline-earth metals of Group 2 (IIa) of the periodic table, and the lightest structural metal. Its compounds are widely used in construction and medicine, and fertilizer is one of the elements essential to all cellular life

IRS classifies Metals as Capital Asset:

Reporting Capital Gains

FS-2007-19, May 2007

In order to educate taxpayers about their filing obligations, this fact sheet, the twelfth in a series, provides information with regard to capital gains reporting. Incorrect reporting of capital gains accounts for part of an estimated $345 billion per year in unpaid taxes, according to Internal Revenue Service estimates.

Almost everything you own and use for personal purposes, pleasure, business or investment is a **capital asset**, including:

- Your home
- Household furnishings
- Stocks or bonds
- Coin or stamp collections
- Gems and jewelry
- Gold, silver or any other **metal**, and
- Business property

Tax Court Cases:

Tax Court cases would classify investors/ partners in a Series in the Volcanic Safeguard Holdings as traders who are investors (capital assets) , not dealers (inventory). These Tax Court Cases Find Capital Asset not Inventory treatment: **King v. Commissioner | 89 T.C. 445 (1987); Douglas J. Michelson; T.C. Memo. 1990-27.**

KING v. COMMISSIONER | 89 T.C. 445 (1987) | aitc4451500 | Leagle.com

United States Tax Court.

Background

Petitioner is a registered member of the Chicago Mercantile Exchange (CME), a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission. Petitioner is also a member of the International Monetary Market (IMM), a division of the CME, and has been a member of the IMM since its establishment in 1972. From approximately 1954 through 1985, petitioner was also a member of the Chicago Board of Trade (CBOT).

Petitioner has spent his entire business career in various aspects of the commodity futures business. Following his graduation from New York University in 1948, petitioner worked in New York for 2 years for two firms dealing in butter and eggs, and cheese, respectively. Since 1950, when petitioner moved to Chicago and purchased a seat on the CME, his principal source of income has been the trading of regulated futures contracts on the CME, IMM, and CBOT. Petitioner engaged in such trading from 1950 to the present. In the 1950's, petitioner principally traded egg and onion futures. Petitioner began trading pork belly and live cattle futures in the early 1960's, and also traded futures for hogs and feeder cattle at various times. After the IMM was established, petitioner also began trading foreign currency, gold, and Treasury bill futures.

Until 1968, in addition to trading for his own account, petitioner also acted as a broker. In 1962, petitioner and his brother established King & King, Inc., which engaged in brokerage and in trading for speculation. King & King is a clearing member of the CME and IMM (i.e., a member of the CME Clearing House which the CME organization established to guarantee performance of and provide for settlement of all contracts traded on the CME) and clears petitioner's trades and the trades of a few other customers. In 1979 and 1980, petitioner was the president and sole shareholder of King & King. Since 1968, petitioner has traded primarily for his own account.

Petitioner's Daily Exchange Activities

Petitioner monitors the trading on the CME and IMM on a regular basis on most days that the exchanges are open for trading. Since 1975, petitioner has not conducted his trading activity on the trading floor. Rather, he monitors trading through television screens in his offices and Highland Park home, and telephones instructions to King & King for execution by floor brokers. During the years in issue, petitioner had an office in Palm Springs, California, and an office in King & King's offices in Riverside Plaza in Chicago.

Petitioner normally spends approximately 6 hours per day on trading and activities related to his trading. Petitioner normally arrives in his office 1 hour before the opening of the futures markets. He ordinarily calls a consultant to discuss information on the cash markets for the commodities he is trading. Petitioner also customarily consults with a clerk on the CME floor to obtain any statistics published by the CME. Petitioner also, if possible prior to the opening of the markets, calls to consult other traders around the country with whom petitioner is acquainted and who, like petitioner, trade on the basis of supply and demand.

Opinion

Our only issue for decision is whether the amounts of $231,499.84 and $124,591.92 paid by petitioner as interest in 1979 and 1980, respectively, are subject to the limitations of section 163(d).4

As relevant to this case, section 163(d) restricts the deduction of "investment interest" otherwise allowable as a deduction to the amount of $10,000 plus the amount of net investment income. Investment interest is defined as "interest paid or accrued on indebtedness incurred or continued to purchase or carry property *held for investment.*" Sec. 163(d)(3)(D) (emphasis added). Petitioner argues that he was engaged in the trade or business of commodities trading and that the gold transaction here in issue was a part of that trade or business. Petitioner concludes that because the gold was held as a part of his trade or business, it was not held for investment within the meaning of section 163(d).

Respondent has not contested that petitioner's *futures* trading activities qualify as a trade or business. On the other hand, respondent argues that petitioner was not in the trade or business of trading physical commodities and that such trading, or at least the gold transaction here in issue, was not a part of his trade or business of trading futures.

One who regularly buys and sells on an exchange may be either a dealer or a trader. In this regard, we have stated,

Those who sell "to customers" are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. * * * Such sellers are known as "dealers."

Contrasted to "dealers" are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell. That is, the securities are as easily accessible to one as the other and the seller performs no services that need be compensated for by a mark-up of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as "traders."

[*Kemon v. Commissioner,* 16 T.C. 1026, 1032-1033 (1951); citations omitted.]

As a result of Congress' amending the predecessor of section 1221 (sec. 117 of the Revenue Act of 1934), traders, as opposed to dealers, occupy an unusual position with respect to the tax laws. Traders may engage in a trade or business which produces capital gains and losses rather than ordinary income and losses. The history behind this anomaly was explained in *Wood v. Commissioner,* 16 T.C. 213, 219-220 (1951).

> Prior to 1934, a trader, as distinguished from a dealer, in securities was taxable on the gains derived from his trading activities in the same manner as the gains of dealers in securities, namely, as ordinary income. Such gains were excluded from the operation of the capital gains provisions of the statute because "capital assets" were defined as not including "property held by the taxpayer primarily for sale in the course of his trade or business." In 1934 Congress amended section 117 for the purpose of treating certain transactions in securities as transactions in capital assets in order that losses incurred in these transactions could not be deducted in full. * * * In the Revenue Act of 1934 Congress sought to accomplish this * * * result by amending the definition of "capital asset" in the new section 117 so as to exclude, not *all* property held primarily for sale in the course of business, but only such property as was held primarily for sale "to customers" in the "ordinary" course of business. Since the sale on a securities exchange is not usually considered to be a sale "to customers," it was asserted that this amendment made it "impossible to contend that a stock speculator trading on his own account is not subject to the provisions of Section 117" [H. Conf. Rept. 1385, 73d Cong., 2d Sess. 22 (1934)] — or, to state it in the positive, that a stock speculator trading on his own account would be subject to capital gain and loss treatment under section 117, as so amended. See *Francis Shelton Farr,* 44 B.T.A. 683 (1941). [Fn. refs. omitted; emphasis in original.]

As a result, a primary distinction for Federal tax purposes between a trader and a dealer in securities or commodities is that a dealer does not hold securities or commodities as capital assets if held in connection with his trade or business, where as a trader holds securities or commodities as capital assets whether or not such assets are held in connection with his trade or business.[5] A dealer falls within an exception to capital asset treatment because he deals in property held primarily for sale to customers in the ordinary course of his trade or business. A trader, on the other hand, does not have customers and is therefore not considered to fall within an exception to capital asset treatment.

The distinction between a "trader" and an "investor" also turns on the nature of the activity in which the taxpayer is involved. A trader seeks profit from short-term market swings and receives income principally from selling on an exchange rather than from dividends, interest, or long-term appreciation. *Groetzinger v. Commissioner,* 771 F.2d 269, 274-275 (7th Cir. 1985), affd. 480 U.S. ___ (1987); *Moller v. United States,* 721 F.2d 810, 813 (Fed. Cir. 1983). Further, a trader will be deemed to be engaged in a trade or business if his trading is frequent and substantial. *Groetzinger v. Commissioner, supra* at 275; *Fuld v. Commissioner,* 139 F.2d 465 (2d Cir. 1943), affg. 44 B.T.A. 1268 (1941). An investor, on the other hand, makes purchases for capital appreciation and income, usually without regard to short-term developments that would influence prices on the daily market. *Groetzinger v. Commissioner,* 82 T.C. 793, 801 (1984), affd. 771 F.2d 269 (7th Cir. 1985), affd. 480 U.S. ___ (1987); *Liang v. Commissioner,* 23 T.C. 1040, 1043 (1955). No matter how extensive his activities might be, an investor is never considered to be engaged in a trade or business with respect to his investment activities. *Higgins v. Commissioner,* 312 U.S. 212, 216, 218 (1941); *Groetzinger v. Commissioner,* 771 F.2d at 275.

Petitioner clearly was in the trade or business of trading commodity futures during the years in issue.[6] Petitioner's trading was frequent and substantial but he traded solely for his own account during the years in issue and neither had customers nor performed services analogous to those performed by a merchant.[7] The parties appear to agree that petitioner was in the trade or business of trading commodities futures.[8]

Based on the above, we are faced with the unusual situation of a taxpayer engaged in a trade or business which produces capital gains and losses. The application of section 163(d) to such a taxpayer has been presented by the parties as a novel issue.

Initially, respondent argues that petitioner's holding of the physical gold was subject to the provisions of section 163(d) whether or not such property was held in connection with petitioner's trade or business. Respondent argues that this conclusion necessarily follows from both the legislative history of section 163(d), as well as from this Court's opinion in *Miller v. Commissioner,* 70 T.C. 448 (1978).

The legislative history of section 163(d) describes the abuse which Congress intended to curb by the enactment of section 163(d):

The itemized deduction presently allowed individuals for interest, makes it possible for taxpayers to voluntarily incur substantial interest expenses on funds borrowed to acquire or carry investment assets. Where the interest expense exceeds the taxpayer's investment income, it, in effect, is used to insulate other income from taxation. For example, a taxpayer may borrow substantial amounts to purchase stocks which have growth potential but which return small dividends currently. Despite the fact that the receipt of the income from the investment may be postponed (and may be capital), the taxpayer will receive a current deduction for the interest expense even though it is substantially in excess of the income from the investment. [H. Rept. 91-413 (Part 1)(1969), 1969-3 C.B. 200, 245.]

The House report also adds, however, that "interest on funds borrowed in connection with a trade or business would not be affected by the limitation."

Respondent argues that a trader such as petitioner makes purchases and incurs debt in order to earn income which will be postponed and capital, and that the assets purchased by petitioner, unlike stock, produce no income of any type prior to disposition. Respondent concludes that petitioner's trading activities fall within the scope of the abuse described in the legislative history. As we previously stated, however, the primary characteristic which differentiates the activities of a trader from those of an investor is that a trader seeks short-swing gains while an investor seeks long-term appreciation. See *Liang v. Commissioner, supra* at 1043. As such, the general activities of a trader do not fit the description of the abuse described in the legislative history of section 163(d), i.e., investing for postponed income and current interest deductions. Further, the case law cited above distinguishes traders and investors. To the extent a trader is holding assets as part of his trading activities, he is not an investor and therefore does not hold property for investment. The statement in the legislative history that the limitations of section 163(d) are not to apply to "interest on funds borrowed in connection with a trade or business" is clear and unambiguous. From the above we conclude that section 163(d) does not apply to the extent a trader has incurred indebtedness in order to carry on ordinary trading activities as part of his trade or business.[9]

Nonetheless, respondent argues that this Court's holding in *Miller v. Commissioner, supra,* is controlling with respect to the application of section 163(d). In *Miller,* a partnership borrowed money to purchase a controlling interest in the stock of a bank. The taxpayer therein, a partner in the partnership and president of the bank, deducted his proportionate share of the interest incurred by the partnership on the loan used to purchase the bank's stock. Respondent determined that the interest should be treated as "interest paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment."[10] The partnership reported the gains on sale of the bank stock as capital gains. In holding that the partnership's interest payments were made on indebtedness incurred or continued to purchase or carry property held for investment, we stated that—

section 57, like section 163(d), attempts to deal with an abuse which is present whenever interest is incurred to obtain or maintain property held with sufficient investment intent for the gain on its disposition to constitute capital gain. Such property is investment property and the interest on funds borrowed to finance its purchase is investment interest. We, therefore, must look to the stock purchased by [the partnership] with the borrowed funds to determine whether the stock was held with sufficient investment intent to make it a capital asset. [70 T.C. at 455.]

Our *Miller* decision neither involved nor considered the unusual situation of a trader of securities or commodities. Rather, our opinion therein dealt with a factual pattern in which the taxpayer attempted to argue the applicability of the doctrine put forth in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46 (1955). In reaching our conclusion in *Miller,* we noted statements made by this Court in *W.W. Windle Co. v. Commissioner,* 65 T.C. 694, 714 n. 15 (1976), that "stock is normally a capital asset" held for investment, and that only where the "original purpose of [the] acquisition and the reason for continued retention are both devoid of substantial investment intent should the stock be treated otherwise." *Miller v. Commissioner, supra* at 455.

Under the factual scenario in *Miller,* whether the taxpayer therein could properly claim capital gains treatment was synonymous with whether the taxpayer held the property for investment. See *Corn Products Refining Co. v. Commissioner, supra; W.W. Windle Co. v. Commissioner, supra.* A trader, on the other hand, receives capital gains treatment whether or not the property is held for investment or held in connection with his trade or business. As discussed *supra,* to the extent a trader holds property as part of his trade or business of trading, he receives capital gains treatment even though such property is not held for investment. Our holding in *Miller* is limited to the factual situation involved therein, i.e., a taxpayer attempting to prove that stock is not held for investment due to the application of the doctrine set forth in *Corn Products Refining Co. v. Commissioner, supra.*[11]

Accordingly, we find that to the extent a trader has incurred debt in order to carry on ordinary trading activities as part of his trade or business of trading, the interest paid thereon is not subject to the limitations of section 163(d).

We next consider whether the holding of the gold by petitioner should nonetheless be treated as the holding of property for investment either because petitioner was not engaged in the business of trading physical commodities or because this particular transaction was not a part of petitioner's trade or business.

Petitioner acquired the 10,000 ounces of gold on December 4, 1978, by taking delivery of warehouse receipts representing ownership of gold under 100 long gold futures contracts, which called for delivery in December 1978. On May 5, 1980, petitioner disposed of the 10,000 ounces of gold by delivering the warehouse receipts to the CME Clearing House in satisfaction of his delivery obligation under 100 short gold futures contracts which called for May 1980 delivery. On the date petitioner took delivery of the gold, he executed a note to the King & King, Inc. Profit Sharing Plan and Trust. This note was due on December 4, 1979, one year after its execution. On December 4, 1979, petitioner executed a second note with a due date of December 4, 1980.

In addition to the delivery of gold here in issue, petitioner took delivery during the years 1979 and 1980 under 34 futures contracts and held these commodities for varying periods of time ranging from a few hours to 26 days. In some cases, petitioner affected disposition of these commodities by redelivering them in satisfaction of a short CME futures contract for the current delivery month, and, in other cases, disposition was affected by selling the commodity to a purchaser in a transaction off the exchange. Petitioner also made off-exchange purchases of various commodities during the year 1978 and held these physical commodities for periods as long as 8 months. Petitioner made no off-exchange purchases during 1979 or 1980. Other than the one gold acquisition at issue in this case, petitioner never took delivery of or purchased gold, silver, or any other precious metal.

Respondent directs our attention to statements of the Supreme Court in *Higgins v. Commissioner, supra,* in arguing that petitioner's dealings in physical commodities, or at least the gold transaction here in issue, can be separated out from petitioner's trade or business of trading in commodities futures. In *Higgins,* the taxpayer had extensive investment in real estate, bonds, and stocks, and devoted a considerable portion of his time to the oversight of his interests. He hired others to assist him with his investments, in offices rented for that purpose, and claimed that the salaries and expenses incident to looking after his properties were deductible under section 23(a) of the Revenue Act of 1932, the predecessor of section 162(a). The Supreme Court held that the taxpayer's expenses attributable to investment in securities were not deductible notwithstanding that the taxpayer was engaged in another trade or business, i.e., real estate. The taxpayer therein argued that—

his activities in managing his estate, both realty and personalty, were a unified business. Since it was admittedly a business in so far as the realty is concerned, he urges, there is no statutory authority to sever expenses allocable to the securities. * * * [312 U.S. at 218.]

The Court rejected this argument stating "we see no reason why expenses not attributable, as we have just held these are not, to carrying on business cannot be apportioned." 312 U.S. at 218.

As we have stated, petitioner herein was clearly in the trade or business of trading commodities futures. Petitioner acquired the gold in issue pursuant to delivery on long gold futures contracts which he acquired in the regular course of his business. Petitioner also disposed of the gold pursuant to short gold futures contracts. While petitioner had not regularly held physical commodities for extended periods of time, petitioner did periodically, in the course of his business, take delivery of physical commodities. Further, petitioner took no affirmative action to set apart or distinguish this transaction from other transactions which were entered into in the normal course of his business. These factors strongly suggest that petitioner's gold transaction was part of his trade or business of trading commodity futures.

This case is not factually similar to *Higgins* in that the transaction here in issue was integrally related to transactions which were indisputably part of petitioner's trade or business, i.e., the closing of the futures contracts by which the gold was acquired and disposed. In *Higgins,* the only relationship between the taxpayer's investment activities and real estate activities was that they were directed through the same office. *Higgins* does not lead us to the conclusion that the transaction here in issue should be separated out from petitioner's trade or business.

We are not aware of any case which has held that a taxpayer may hold property both as a trader of commodity futures and as an investor in commodities. Past cases have held that a taxpayer may be both a trader and a dealer with respect to securities, but these cases have not dealt with the issue of whether the taxpayer therein was a trader or investor. *Kemon v. Commissioner, supra* at 1033; *Carl Marks & Co. v. Commissioner,* 12 T.C. 1196 (1949).

In *Reinach v. Commissioner,* 373 F.2d 900 (2d Cir. 1967), affg. a Memorandum Opinion of this Court, a self-employed writer of put and call options sold such options through the services of a broker. In every case of an exercised put option, i.e., when the option holder exercised the option to sell stock to the taxpayer, the taxpayer disposed of the put stock immediately. In every case of an exercised call option, i.e., when the option holder exercised the option to buy stock from the taxpayer, the taxpayer never owned (nor was long) the stock. At the time a call option was exercised the taxpayer would, through the services of his broker, purchase the stock to deliver to the optionee. At issue were seven transactions in which a call option was exercised and the taxpayer's broker covered the call but the taxpayer did not immediately replace the stock that the broker delivered to the optionee. As to these seven transactions, the taxpayer maintained short positions for periods ranging from 1½ years to 3½ years.

There was no dispute in *Reinach* that the taxpayer therein was in the trade or business of writing options, and that the profits and losses resulting from his option writing business were ordinary in nature. The taxpayer argued that losses resulting from the seven short positions should also be treated as ordinary losses because his intent was not to "buy or sell stock except as required to fulfill options which he wrote." 373 F.2d at 904. The Court of Appeals concluded,

Whatever we might think about stock bought to honor a call or disposed of following a put within a few days after their exercise, we do not consider stock borrowed for one and one-half to three and one-half years thereafter to have been "held by the taxpayer primarily for sale to customers * * *."

* * * * * * *

When [the taxpayer] persisted in his decision to go short for such lengthy periods of time rather than covering immediately, it could not [sic] longer be said that the stock he sold short was held primarily for sale to any alleged customer. [The taxpayer] made his choice to keep the transaction open; that implied a parallel choice to transform this transaction from the ordinary exercise of an option into a short sale extending over a period of many months or even years.

[373 F.2d at 904; emphasis in original; fn. ref. omitted.]

The Court in *Reinach* did not consider whether the taxpayer therein was a trader or investor with respect to the seven short sales in issue.[12] Further, the opinion in *Reinach* does not furnish us with a basis for determining when a given commodities transaction can be separated out from the trade or business of a commodity futures trader. Even if we were to assume that the gold transaction here in issue could be examined on the same basis as the transaction in *Reinach,* we do not believe that it would lead to the conclusion advocated by respondent. The seven short positions there in issue were held for periods from 1½ to 3½ years. The very fact that the taxpayer therein entered into seven such transactions suggests that he intended to depart from his normal business practices, and the Court therein found that he "went short for a purpose entirely divorced from his put and call writing." 373 F.2d at 904. The gold here in issue was held for less than 1½ years and was not part of a series of transactions suggesting an intent on the part of petitioner to depart from his regular business practices.

Based on the above, we find that the gold here in issue was not property held for investment within the meaning of section 163(d) and that the investment interest limitations do not apply to petitioner's 1979 and 1980 interest payments made with respect to the holding of such property.

Decision will be entered under Rule 155.

Douglas J. Michelson; T.C. Memo. 1990-27

UNITED STATES TAX COURT

T.C. Memo. 1990-27.

January 16 1990 Douglas J.

Douglas J. Michelson v. Commissioner.

Docket Nos. 8130-82, 18686-84, 16775-85.
Michelson, pro se. Linda L. Wong and Val J. Albright, for the respondent.
Memorandum Findings of Fact and Opinion

PARKER, Judge: In these consolidated cases, respondent determined deficiencies in petitioner's Federal income tax as follows:

ULTIMATE FINDINGS OF FACT

1. Petitioner was not engaged in a trade or business as a dealer in metals in 1979 and 1980.

2. The losses petitioner sustained in 1979 and 1980 in certain commodity futures transactions were not hedging losses.

3. In his commodity futures transactions in 1979 and 1980, petitioner was acting as an investor or as a speculator trading on his own account and the losses he sustained were capital losses.

4. As to the portion of the 1980 loss attributable to Merrill Lynch's liquidation of his commodity account, petitioner has not established that that portion of the loss was "sustained" in 1980.

5. Petitioner has not established that he paid interest on his margin accounts with Merrill Lynch and E.F. Hutton in excess of the amounts allowed by respondent.

OPINION

The primary issue in this case is the proper characterization of the net losses on commodity futures, principally silver futures, as ordinary or capital. This depends on whether the commodity futures were "capital assets" within the meaning of section 1221. The term "capital asset" is defined in section 1221 as "property held by the taxpayer (whether or not connected with his trade or business)," with certain specific exceptions. The only exception on which petitioner can rely is section 1221(1), which excludes from the term "capital asset"

stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Petitioner contends he was a dealer in metals and that the commodity futures contracts were hedging transactions integral to his trade or business as a metals dealer. Respondent contends petitioner was a speculator trading on his own account or an investor, either of whom hold the commodity futures as capital assets. In various contexts the terms "dealer," "trader," and "investor" become significant for Federal tax purposes.

In different contexts where the tax issue turns on whether or not the person is engaged in a trade or business, a distinction is drawn between a trader (one dealing on his own account in securities or commodity futures) who is considered to be engaged in a trade or business and an investor who is not. Higgins v. Commissioner , 312 U.S. 212 (1941) (business expense deduction under predecessor of section 162); Moller v. Commissioner , 721 F.2d 810 (Fed. Cir. 1983) (office-in-the-home expense under section 280A); King v. Commissioner , 89 T.C. 445 (1987) (investment interest limitation under section 163(d)). [10] See also Groetzinger v. Commissioner , 82 T.C. 793, 800-801 (1984), affd. 771 F.2d 269 (7th Cir. 1985), affd. 480 U.S. 23 (1987). However, the characterization of property as a "capital asset" vel non does not turn on whether the taxpayer is engaged in a trade or business, whether he has a business motive for acquiring or holding the property, or whether the property is "connected with his trade or business." Sec. 1221; Arkansas Best Corp. v. Commissioner , 485 U.S. 212 (1988). Thus, the distinction between a trader and an investor has no bearing on the determination of whether securities or commodity futures are capital assets in the hands of the particular taxpayer since such securities or commodity futures would be capital assets in the hands of either a trader or an investor. King v. Commissioner, 89 T.C. at 458 and n.5.

In transactions involving securities or commodity futures, a distinction is also drawn between a trader and a dealer. Whether a particular taxpayer is a dealer or a trader is a question of fact. Kemon v. Commissioner , 16 T.C. 1026 (1951). In Kemon, 16 T.C. at 1032-1033, we explained the distinction between a dealer and a trader as follows:

In determining whether a seller of securities sells to "customers," the merchant analogy has been employed. * * * Those who sell "to customers" are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middle man bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. * * * Such sellers are known as "dealers."

Contrasted to "dealers" are those sellers of securities who perform no such merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell. That is, the securities are as easily accessible to one as the other and the seller performs no services that need be compensated for by a mark-up of the price of the securities he sells. The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are know as "traders." [Citations omitted.]

See also Adnee v. Commissioner , 41 T.C. 40(1963)[11]

Petitioner tries to bring himself within this "merchant analogy." Petitioner does not, however, claim to be either a dealer or a trader in commodity futures. In fact, he denies any dealing in commodity futures, insisting that he deals not with commodity futures but with the physical metals themselves. See n.4, supra. Petitioner says he is a dealer in metals, that he earns his living buying metals for his "inventory" and selling metals from his "inventory." He insists the commodity futures were merely hedging transactions in connection with his metals business, apparently invoking the presumed judicial exception of Corn Products Refining Co. v. Commissioner [55-2 USTC P. 9746], 350 U.S. 46 (1955) to section 1221. However, see and compare Arkansas Best Corp. v. Commissioner, supra. Unfortunately for petitioner, the record in this case simply does not establish that he had any trade or business separate and apart from his transactions on the commodity exchanges.

The Court reaches that conclusion despite the fact that petitioner over the years had acquired some copper and gold that he held by means of negotiable warehouse receipts. He had held that metal for rather long periods of time, two years or more, having acquired it in the period from

1974 through 1977. Thus, the metal itself has the characteristics of an asset held for investment purposes, a capital asset, and not an "inventory" item. Moreover, that metal too was acquired through transactions on commodity exchanges. There is no evidence in the record that petitioner ever acquired any metal directly from a refinery or any other off-exchange supplier. Also, while petitioner did own this copper and gold, he never owned any silver, and most of the losses in this case involved silver futures. See n.5, supra. Finally, the record reflects no frequent sales of metals by petitioners to customers, or related merchandising activity, such as advertising and sales calls, of sufficient frequency and scope to rise to the level of a "trade or business." Groetzinger v. Commissioner, supra.

Petitioner's expert, Dr. Teweles, testified that petitioner's commodity account with Merrill Lynch was a hedging account. However, it is evident from his testimony that Dr. Teweles believed that petitioner was engaged in some business separate and apart from the commodity futures transactions themselves. Dr. Teweles' contacts with petitioner in advance of the trial were quite minimal. The Court is satisfied that Dr. Teweles did not have the slightest inkling that petitioner's alleged metals business was nothing more than these commodity futures transactions themselves. Also, even as to his characterization of the commodity account as a hedging account, Dr. Teweles relied almost entirely upon his belief that Merrill Lynch had determined that the account was a hedging account. Dr. Teweles agreed that if Merrill Lynch had not determined it to be a hedging account, his conclusion would be different. Merrill Lynch regarded the account as a speculative account, at least by 1979 and 1980. See n.2, supra. While Dr. Teweles is a well qualified professor of finance and knowledgeable in the commodities field, his conclusions were based upon misconceptions of the underlying facts of this case. Accordingly, the Court disregards Dr. Teweles' conclusions as unsupported by the facts of record.

It is clear to the Court that petitioner is trying to concoct a trade or business out of his commodity futures transactions. Petitioner says he is in the physical metals business (which the record does not support), that these commodity transactions involved the same kind of physical metals in which he allegedly dealt (which is contrary to the record, particularly in regard to silver) and that that makes his losses ordinary rather than capital losses. So far as the record shows, the transactions in commodity futures in 1979 and 1980 did not differ from petitioner's earlier commodity futures transactions from 1974 through 1978 when he was admittedly an investor, reporting income from interest, dividends, and capital gains. It was only after he sustained the huge losses during the Hunt family silver debacle that petitioner for the first time filed Schedule C's and claimed to be a dealer in metals.

As the facts of this case establish, petitioner was an investor or a speculator trading on his own account in commodity futures. He performed no merchandising functions. He had no customers who regularly purchased either commodity futures or metals in the ordinary course of business. As we noted in Kemon v. Commissioner, 16 T.C. at 1033, petitioner's "source of supply" (the commodity exchanges) was not significantly different from that of those to whom he sold (those on the opposite side of his commodity futures contracts). All of petitioner's commodity transactions were handled through Merrill Lynch. He was not licensed to sell commodity futures nor was he a member of any commodity exchange. See Mirro-Dynamics Corp. v. United States , 374 F.2d 14 (9th Cir. 1967), cert. denied 389 U.S. 896 (1967). Nor was petitioner engaged in any separate business which utilized copper, gold, or silver. Thus, the commodity futures transactions were neither a hedge against raw materials used in a business nor purchases to insure a steady supply of raw material. Corn Products Refining Co. v. Commissioner, supra; Sicanoff Vegetable Oil Corp. v. Commissioner , 27 T.C. 1056 (1957), revd. on other grounds 251 F.2d 764 (7th Cir. 1958).

Petitioner's short positions in silver could not guarantee him a minimum sales price since he had no silver to sell; his.short positions could not provide him with any supply of or promise of supply of any silver such as long positions might have. Thus, petitioner's reliance on the example of a corn farmer engaging in futures transactions is completely inapt. The corn farmer with a corn crop growing in the field enters into a futures contract to deliver or sell corn at a certain price ("short" position) to guarantee a minimum price at which he can later sell his crop; the corn farmer may also enter into futures contracts to receive delivery of or buy corn at a certain price ("long" position) to guarantee a supply of corn at a certain price if his corn crop should fail or fall short of his expectations. Petitioner cannot come within this traditional type of hedging transaction, as he argues. Nor can petitioner bring himself within the judicial exception of the Corn Products doctrine, which at a bare minimum requires that the taxpayer have some separate trade or business apart from the commodity futures transactions themselves.[12]

Nevertheless, Dr. Teweles attempted to label petitioner's commodity futures transactions as an "anticipatory hedge," even if he did not own any silver at the time. Again Dr. Teweles was assuming, contrary to the facts, that petitioner was engaged in a metals business separate and apart from the commodity futures transactions themselves. Since petitioner did not have any other business and since he did not have and had never had any silver in his so-called "inventory," the logic of the situation is that petitioner was gambling that silver prices would fall and that he could obtain the silver at prices less than the prices in his short positions. There is an indication in the record that petitioner believed the Federal Government would step in and force down the price of silver. That did not happen. With the price of silver continuing to escalate dramatically during the Hunt family's foray into the silver market, petitioner, against the advice of his broker, continued to enter only short positions to deliver silver he did not have and silver which he could obtain (actually or by offset) only at ever increasing prices. The Court agrees with Merrill Lynch's warning to petitioner that this was tantamount to "financial suicide." Petitioner's transactions simply do not come within the merchant category, either actually or by analogy.

As the Supreme Court's opinion in Arkansas Best Corp. v. Commissioner, supra, teaches us, section 1221 defines "capital asset" broadly, the statutory exceptions are the exclusive exceptions to that definition, the motive with which the taxpayer acquires or holds the property is irrelevant (i.e., that the taxpayer acquires or holds the property for a business purpose is irrelevant), and whether the property is "connected with his trade or business" is irrelevant. What is determinative, the Supreme Court teaches us, is whether the taxpayer can bring himself within one of the specific statutory exceptions to the definition of "capital asset." The Corn Products case itself involved the application of section 1221 's inventory exception, with the Supreme Court stating therein (350 U.S. at 50) that the company's futures transactions were "an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements." As our findings of fact and the discussion above amply demonstrate, petitioner had no metals business apart from the commodity futures transactions themselves. Petitioner was speculating on his own account. What we said in

Kemon v. Commissioner, supra, 16 T.C. at 1032, in regard to securities is equally applicable to commodity futures, namely,

Whether or not securities are held primarily for sale to customers in the ordinary course of business is a question of fact, Stern Brothers & Co. , 16 T.C. 295, in which the crucial phrase is "to customers." This phrase and the word "ordinary" were added to the definition of capital assets by Senate Amendment No. 66 in the Revenue Act of 1934 so that a speculator trading on his own account could not claim the securities he sold were other than capital assets. The theory of the amendment was that those who sell securities on an exchange have no "customers" and for that reason the property held by such taxpayers is not within the above quoted exclusionary clause. O. L. Burnett , 40 B.T.A. 605, 118 F.2d 659; Thomas E. Wood , 16 T.C. 213.

Those who merely buy or sell on a commodity exchange, as petitioner did, have no "customers" and are not engaged in a trade or business as a merchant, either actually or by analogy.

The Court concludes that petitioner was either an investor or a speculator trading on his own account as to these commodity futures. In either capacity, the commodity futures contracts were capital assets in his hands and his losses therefrom were capital losses.

In the notice of deficiency for 1980, respondent alternatively determined that petitioner had not established

that transactions which occurred on or about January 10, 1980 as a result of the liquidation of your brokerage account were closed transactions or that there was no reasonable prospect of recovery with respect to the losses [$1,034,930] claimed***.

The issue having been raised in the notice of deficiency, petitioner bears the burden of proof. Welch v. Helvering [3 USTC P. 1164], 290 U.S. 111, 115 (1933); Rule 142(a). Petitioner has failed to sustain that burden.

The record contains little information about the litigation between Merrill Lynch and petitioner. See n.7, supra. However, in that litigation petitioner counterclaimed against Merrill Lynch, contending the liquidation of his commodity account was improper. That litigation was still pending at the time of the trial of this case. We agree with respondent that petitioner has not established that in 1980 there was no reasonable prospect of recovery with respect to $1,034,930 of the loss claimed for that year. Accordingly, we cannot find that that portion of the 1980 loss was "sustained" in that year. Sec. 1.165-1(d)(2)(i), Income Tax Regs.

The final issue is the interest on petitioner's margin accounts with E.F. Hutton and Merrill Lynch. Section 163(a) allows as a deduction "all interest paid or accrued within the taxable year on indebtedness." The narrow issue is the amount of such margin account interest that petitioner, a cash-basis taxpayer, actually paid in each of the years 1978, 1979 and 1980. The E. F. Hutton and Merrill Lynch statements upon which petitioner relied merely show the amount of such interest that was charged by E. F. Hutton or Merrill Lynch each year. Those statements do not prove the amount that petitioner actually paid each year. Petitioner has not established that he actually paid any margin account interest in excess of the amounts allowed by respondent.

To reflect respondent's concessions and the above holdings,

Decisions will be entered under Rule 155.

SUMMARY AND CONCLUSION

It is my overall opinion that the federal tax treatment of the Series 20 contribution of fertilizer to a 501 c (3) organization qualifies you for a charitable deduction on your 1040 tax return, subject to the annual limitations on deductions and carry forwards of charitable gifts for capital gain assets. It is more likely than not that you, as a partner, will be entitled to deduct the contribution of fertilizer at its fair market value to the [Name of Charity]. It is more likely than not that the substance of this transaction is consistent with its form, namely a contribution of a long term capital gain asset donated to a 501 c (3) organization. It is more likely than not that no steps of this transaction will be disregarded or deemed unnecessary and meaningless such that you will be allowed a charitable deduction for 202x. All parties are unrelated and you are not donating to a private foundation. My opinion is limited to the United States federal income tax consequences of the matters described herein. Additional issues may exist that could affect the federal tax treatment of the transactions or matters addressed above and my opinion does not consider or provide a conclusion with respect to any such additional issues. Very Truly Yours,

EXHIBIT A

To: File

From: [lawyer]

Date: August 202x

Re: Volcanic Safeguard Holdings LLC Tax Benefits

SUMMARY

A purchase of an LLC interest in Volcanic Safeguard Holdings LLC, a partnership, presents a bulk buying opportunity with a group that has acquired minerals at a bulk price; with the plan to either contribute these minerals at FMV at year end to a 501 c 3 public charity or distribute out to the partners. A contribution at year end to a 501 c 3 public charity offers generous tax benefits for a capital asset contribution, with a deduction of 4 times the partners investment in the LLC and a carry forward of any unused charitable deduction in 202x. An outright distribution to a partner, if so elected by the partner, will result in a low tax basis asset and resulting ordinary income when the minerals are sold.

The foundation for the tax results are in the Internal Revenue Code of 1986, the Treasury Regulations, the Joint Committee on Taxation Report in 2018 for the 2017 Tax and Jobs Act, The IRS webpage and publications on partnerships and charitable contributions-deductions, revenue rulings, and Tax Court cases. Each of these is discussed below:

First, a discussion of Partnership Taxation in general; Second a summary of applicable charitable contribution- deduction rules ; Third the applicable 2017 Tax and Jobs Act changes to Partnerships and Charitable contributions-deductions; and finally, applicable Tax Court cases favoring the taxpayer.

This memo to the file for information purposes only. It cannot be relied upon as a tax opinion by any partner. [law firm name] Group and [lawyer name] have not been paid to prepare this memo.

PARTNERSHIPS

Like sole proprietorships, partnerships are "pass through" entities. A partnership is not subject to federal income tax. Rather, its owners are subject to Federal income tax on their share of the profit. Schedule K-1 is used to break down a partnership's income and deductions by category. Schedule K-1 is then used to show each partner's allocated share of the various types of income and deductions. Income and deductions from a partnership maintain their original classification when they are passed through to a partner.

IRS Publication 541 (02/2019), Partnerships, February 2019:

An organization formed after 1996 is classified as a **partnership** for federal tax purposes if it has two or more members and it is none of the following.

- An organization formed under a federal or state law that refers to it as incorporated or as a corporation, body corporate, or body politic.
- An organization formed under a state law that refers to it as a joint-stock company or joint-stock association.
- An insurance company.
- Certain banks.
- An organization wholly owned by a state, local, or foreign government.
- An organization specifically required to be taxed as a corporation by the Internal Revenue Code (for example, certain publicly traded partnerships).
- Certain foreign organizations identified in section 301.7701-2(b)(8) of the regulations.
- A tax-exempt organization.
- A real estate investment trust.
- An organization classified as a trust under section 301.7701-4 of the regulations or otherwise subject to special treatment under the Internal Revenue Code.
- Any other organization that elects to be classified as a corporation by filing Form 8832. A partnership **must file** an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it **does not pay** income tax. Instead, it "passes through" profits or losses to its partners. Each partner reports their share of the partnership's income or loss on their personal tax return. Partners are not employees and shouldn't be issued a Form W-2. The partnership must furnish copies of Schedule K-1 (Form 1065) to the partner.

LIMITED LIABILITY COMPANY (LLC).

An LLC is an entity formed under state law by filing articles of organization as an LLC. Unlike a partnership, none of the members of an LLC are personally liable for its debts. An LLC may be classified for federal income tax purposes as either a partnership, a corporation, or an entity disregarded as an entity separate from its owner by applying the rules in Regulations section

301.7701-3.A domestic LLC with at least two members that doesn't file Form 8832 is classified as a partnership for federal income tax purposes.

PARTNERSHIP AGREEMENT - LLC OPERATING AGREEMENT

The partnership agreement (**LLC Operating Agreement**) includes the original agreement and any modifications. The modifications must be agreed to by all partners or adopted in any other manner provided by the partnership agreement. The agreement or modifications can be oral or written.

Partners can modify the partnership agreement for a particular tax year after the close of the year but not later than the date for filing the partnership return for that year. This filing date doesn't include any extension of time. If the partnership agreement or any modification is silent on any matter, the provisions of local law are treated as part of the agreement.

PARTNERSHIP RETURN (FORM 1065)

Every partnership that engages in a trade or business or has gross income must file an

information return on Form 1065 showing its income, deductions, and other required information. The partnership return must show the names and addresses of each partner and each partner's distributive share of taxable income. The return must be signed by a partner. If an LLC is treated as a partnership, it must file Form 1065 and one of its members must sign the return.

CONTRIBUTION OF PROPERTY

Usually, neither the partner nor the partnership recognizes a gain or loss when property is contributed to the partnership in exchange for a partnership interest. This applies whether a partnership is being formed or is already operating. The partnership's holding period for the property includes the partner's holding period.

The contribution of partnership interests in one partnership for partnership interests in another partnership qualifies as a tax-free contribution of property to the second partnership if the transaction is made for business purposes.

Basis of Contributed Property

If a partner contributes property to a partnership, the partnership's basis for determining depreciation, depletion, gain, or loss for the property is the same as the partner's adjusted basis for the property when it was contributed, increased by any gain recognized by the partner at the

time of contribution.

Basis of A Partner's Interest

The basis of a partnership interest is the money plus the adjusted basis of any property the partner contributed. If the partner must recognize gain as a result of the contribution, this gain is included in the basis of his or her interest. Any increase in a partner's individual liabilities because of an assumption of partnership liabilities is considered a contribution of money to the partnership by the partner.

The function of basis is to make sure that, over the partnership's life, the partner does not

withdraw more or less than his or her investment without some tax impact.
Technically, the basis limitation that causes gain to be recognized on a distribution, or that limits the partner's ability to currently recognize loss, is the rule that a partner's basis cannot be reduced below zero (Secs. 705(a)(2) and 733). So long as a partner has basis, distributions to the partner merely result in a reduction of his or her basis by the amount of money distributed or the basis of the property distributed. Sec 732.

Adjusted Basis

There is a worksheet for adjusting the basis of a partner's interest in the partnership in the Partner's Instructions for Schedule K-1 (Form 1065).

The basis of an interest in a partnership is increased or decreased by certain items.

Increases

A partner's basis is increased by the following items:

- The partner's additional contributions to the partnership, including an increased share of, or assumption of, partnership liabilities.

- The partner's distributive share of taxable and nontaxable partnership income.

- The partner's distributive share of the excess of the deductions for depletion over the basis of the depletable property, unless the property is oil or gas wells whose basis has been allocated to partners.

Decreases

The partner's basis is decreased (but never below zero) by the following items:

- The money (including a decreased share of partnership liabilities or an assumption of the partner's individual liabilities by the partnership) and adjusted basis of property distributed to the partner by the partnership.

- The partner's distributive share of the partnership losses (including capital losses).

- The partner's distributive share of nondeductible partnership expenses that are not capital expenditures. This includes the partner's share of any section 179 expenses, even if the partner cannot deduct the entire amount on his or her individual income tax return.

- The partner's deduction for depletion for any partnership oil and gas wells, up to the proportionate share of the adjusted basis of the wells allocated to the partner.

- A partner’s distributive share of foreign taxes paid or accrued by the partnership for tax years beginning after 2017.

- **A partner’s distributive share of the adjusted basis of a partnership’s property donation to charity.**

The Book Value of Partner's Interest

The adjusted basis of a partner's interest is determined without considering any amount shown in the partnership books as a capital, equity, or similar account.

Example: Enzo contributes to his partnership property that has an adjusted basis of $400 and a fair market value of $1,000. His partner contributes $1,000 cash. While each partner has increased his capital account by $1,000, which will be reflected in the partnership’s books, theadjusted basis of Enzo's interest is only $400 and the adjusted basis of his partner's interest is $1,000.

When Determined

The adjusted basis of a partner's partnership interest is ordinarily determined at the end of the partnership's tax year. However, if there has been a sale or exchange of all or part of the partner's interest or a liquidation of his or her entire interest in a partnership, the adjusted basis is determined on the date of sale, exchange, or liquidation.

HOLDING PERIOD

A partner’s holding period for a partnership interest received in exchange for a contribution of property depends on the character of the contributed property. If the contributed property is a capital asset or property used in a trade or business (within the meaning of Sec. 1231) immediately prior to the contribution, the partner’s holding period for the partnership interest includes the holding period of the contributed property (Sec. 1223(1)).Sec. 1223(2) provides that the partnership’s holding period for contributed assets includes the holding period of the assets in the hands of the contributing partner. The partnership’s holding period for the contributed property includes the contributor’s holding period (Sec. 1223(2)).

PARTNERSHIP DISTRIBUTIONS

Partnership distributions include the following:

- A withdrawal by a partner in anticipation of the current year's earnings.
- A distribution of the current year's or prior years' earnings not needed for working capital.
- A complete or partial liquidation of a partner's interest.
- A distribution to all partners in a complete liquidation of the partnership.

A partnership distribution is not taken into account in determining the partner's distributive share of partnership income or loss. If any gain or loss from the distribution is recognized by the partner, it must be reported on his or her return for the tax year in which the distribution is received. Money or property withdrawn by a partner in anticipation of the current year's earnings is treated as a distribution received on the last day of the partnership's tax year.

Effect on a Partner's Basis.

A partner's adjusted basis in his or her partnership interest is decreased (but not below zero) by the money and adjusted basis of property distributed to the partner.

Effect on the Partnership.

A partnership generally doesn't recognize any gain or loss because of distributions it makes to partners. The partnership may be able to elect to adjust the basis of its undistributed property.

Certain Distributions Treated As a Sale or Exchange

When a partnership distributes the following items, the distribution may be treated as a sale or exchange of property rather than a distribution:

- Unrealized receivables or substantially appreciated inventory items distributed in exchange for any part of the partner's interest in other partnership property, including money.
- Other property (including money) distributed in exchange for any part of a partner's interest in unrealized receivables or substantially appreciated inventory items.
- This treatment doesn't apply to the following distributions.
- A distribution of property to the partner who contributed the property to the partnership.

- Payments made to a retiring partner or successor in interest of a deceased partner that are the partner's distributive share of partnership income or guaranteed payments.

Partner's Gain or Loss

A partner generally recognizes gain on a partnership distribution only to the extent any money (and marketable securities treated as money) included in the distribution exceeds the adjusted basis of the partner's interest in the partnership. Any gain recognized is generally treated as capital gain from the sale of the partnership interest on the date of the distribution. If partnership property (other than marketable securities treated as money) is distributed to a partner, he or she generally doesn't recognize any gain until the sale or other disposition of the property.

Example. The adjusted basis of Jo's partnership interest is $14,000. She receives a distribution of $8,000 cash and land that has an adjusted basis of $2,000 and a fair market value of $3,000. Because the cash received doesn't exceed the basis of her partnership interest, Jo doesn't recognize any gain on the distribution. Any gain on the land will be recognized when she sells or otherwise disposes of it. The distribution decreases the adjusted basis of Jo's partnership interest to $4,000 [$14,000 − ($8,000 + $2,000)].

Loss on Distribution

A partner doesn't recognize loss on a partnership distribution unless all the following requirements are met:

- The adjusted basis of the partner's interest in the partnership exceeds the distribution.
- The partner's entire interest in the partnership is liquidated.
- The distribution is in money, unrealized receivables, or inventory items.

Partner's Basis for Distributed Property

Unless there is a complete liquidation of a partner's interest, the basis of property (other than money) distributed to the partner by a partnership is its adjusted basis to the partnership immediately before the distribution. However, the basis of the property to the partner cannot be more than the adjusted basis of his or her interest in the partnership reduced by any money received in the same transaction.

Example 1. The adjusted basis of Emily's partnership interest is $30,000. She receives a distribution of property that has an adjusted basis of $20,000 to the partnership and $4,000 in cash. Her basis for the property is $20,000.

Example 2. The adjusted basis of Steve's partnership interest is $10,000. He receives a distribution of $4,000 cash and property that has an adjusted basis to the partnership of $8,000. His basis for the distributed property is limited to $6,000 ($10,000 − $4,000, the cash he receives).

Complete Liquidation of Partner's Interest.

The basis of property received in complete liquidation of a partner's interest is the adjusted basis of the partner's interest in the partnership reduced by any money distributed to the partner in the same transaction.

Partner's Holding Period

A partner's holding period for property distributed to the partner includes the period the property was held by the partnership. If the property was contributed to the partnership by a partner, then the period it was held by that partner is also included.

CHARITABLE CONTRIBUTIONS AND DEDUCTIONS

In most cases, the amount of charitable cash contributions taxpayers can deduct on Schedule A as an itemized deduction is limited to a percentage (usually 60 percent) of the taxpayer's adjusted gross income (AGI). Qualified contributions are not subject to this limitation. Individuals may deduct qualified contributions of up to 100 percent of their adjusted gross income. A corporation may deduct qualified contributions of up to 25 percent of its taxable income. Contributions that exceed that amount can carry over to the next tax year. To qualify, the contribution must be: a cash contribution; made to a qualifying organization;made during the calendar year 202x.

Qualified charitable organizations include public **charities**, philanthropic groups, certain religious and educational **organizations**, **nonprofit** veterans' **organizations**, fraternal lodge groups, cemetery and burial companies, and certain legal corporations.

The IRS Tax Exempt Organization Search tool can help you verify its tax-exempt status.

Contributions of non-cash property do not qualify for this relief. **Taxpayers may still claim non-cash contributions as a deduction, subject to the normal limits.** The limit on donating appreciated assets to qualified charities is 30% of AGI

Contributions must actually be paid in cash or other property before the close of the tax year to be deductible, for both a cash or accrual method taxpayer. A donation of property other than cash to a qualified organization, qualifies for a deduction equal to **the fair market value of the property.**

Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. Ordinarily, the date of a contribution is the date that the transfer of the property takes place. IRS Pub 561

Property is **capital gain** property if the taxpayer would have recognized long-term capital gain on a sale at fair market value on the date of the contribution. Capital gain property includes capital assets held more than 1 year. Capital assets include most items of property you own and use for personal purposes or investment.

When figuring a **deduction for a contribution of capital gain property, it is the fair market value of the property. This rule applies to the Volcanic Safeguard Holdings LLC intended charitable contribution to a 501 c 3 public charity of a long term capital gain asset in the minerals.**

There are certain situations when the deduction is reduced from the fair market value to the property's cost or other basis. None of the following exceptions apply to the Volcanic Safeguard Holdings LLC intended donation of a long term capital gain asset with the minerals.

This reduction is required if: The property (other than qualified appreciated stock) is contributed to certain private nonoperating foundations; The contributed property is intellectual property; The contributed property is certain taxidermy property; or The contributed property is tangible personal property that is put to an unrelated use by the charity, or has a claimed value of more than $5,000 and is sold, traded, or otherwise disposed of by the qualified organization during the year in which you made the contribution, and the qualified organization hasn't made the required certification of exempt use (such as on Form 8282, Donee Information Return, Part IV). Tangible personal property is any property, other than land or buildings that can be seen or touched.

A deduction for a contribution of tangible personal property can be limited by the IRS if all the following statements are true (these will not all be true with the intended contribution by Volcanic Safeguard Holdings LLC to a qualified 501 c 3 public charity- Form 8282 will be filed) :

The taxpayer donates tangible personal property with a claimed value of more than $5,000, and the deduction is more than the taxpayer's basis in the property; The organization sells, trades, or otherwise disposes of the property after the year it was contributed but within 3 years of the contribution; The organization doesn't provide a written statement (such as on Form 8282, Part IV), signed by an officer of the organization under penalty of perjury, that either: Certifies its use of the property was substantial and related to the organization's purpose, or Certifies its intended use of the property became impossible.

Substantiation Requirements

A donor who claims a deduction for a charitable contribution must maintain reliable written records regarding the contribution, regardless of the value or amount of such contribution. Sec. 170(f)(17). Generally, if the claimed deduction for an item or group of similar items of donated property is more than $5,000, you must get a qualified appraisal signed and dated by a qualified appraiser.

You must also complete Form 8283, Section B, and attach it to your tax return.

A qualified appraisal is an appraisal document that: Is made, signed, and dated by a qualified appraiser (defined later) in accordance with generally accepted appraisal standards; Meets the relevant requirements of Regulations section 1.170A-17(a); Is dated no earlier than 60 days before the date of the contribution and no later than the date of the contribution. For an appraisal report dated on or after the date of the contribution, the valuation effective date must be the date of the contribution made not earlier than 60 days before the date of contribution of the appraised property, and does not involve a prohibited appraisal fee.

Form 8283, Section B, must be attached to your tax return. Generally, you do not need to attach the qualified appraisal itself, but you should keep a copy as long as it may be relevant under the tax law. There are exceptions. One is if you claim a deduction of more than $500,000 for a donation of property, you must attach the appraisal. IRS Pub 561.

PARTNERSHIP TAXATION AND CHARITABLE DEDUCTIONS 202x

Section 703(a)(2)(C) of the Internal Revenue Code (IRC) provides that the taxable income of a partnership is computed in the same manner as in the case of an individual with certain exceptions. The exceptions provide, in part, that the deductions for foreign taxes and charitable contributions are not allowed to the partnership under Sec. 703(a)(2)(B) and (C). In addition, section 703(a)(2) provides that other deductions are not allowed to the partnership, notwithstanding that the partnership's taxable income is computed in the same manner as an individual's taxable income, specifically: personal exemptions, net operating loss deductions, certain itemized deductions for individuals, or depletion.

Instead, a partner takes into account its distributive share of the foreign taxes paid by the partnership and the **charitable contributions** made by the partnership for the

taxable year under Sec 702. Under Section 702(a)- (4), each partner takes into account separately the partner's distributive share of the partnership's charitable contributions.

Section 1.170A-1(h)(7) of the Treasury Regulations provides that **a partner's distributive share of charitable contributions actually paid by a partnership during its taxable year may be allowed as a deduction in the partner's separate return for the partner's taxable year** with or within which the taxable year of the partnership ends, to the extent that the aggregate of the partner's share of the partnership contributions and the partner's own contributions does not exceed the limitations in Section 170(b). In the case of a charitable contribution, a partner's basis is reduced by the partner's distributive share of the adjusted basis of the contributed property.

Rev. Rul. 96-11 1996-1 C. B. 140 explains Section 1.170A-1(c)(1) of the Income Tax

Regulations and provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the **fair market value of the property** at the time of the contribution reduced as provided by § 170(e)(1) and paragraph (a) of § 1.170A-4, or § 170(e)(3) and paragraph (c) of § 1.170A-4A.

However, prior to the Tax Cut and Jobs Act of 2017, in applying any basis limitation on partner losses, Treasury regulations did not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued. The regulation provided that ''[i]f the partner's distributive share of the aggregate of items of loss specified in section 702(a)(1), (2), (3), (8) [now (7)], and (9) [now (8)] exceeds the basis of the partner's interest computed under the preceding sentence, the limitation on losses under section 704(d) must be allocated to his distributive share of each such loss.'' The regulation did not refer to section 702(a)(4) (charitable contributions) and (6) (foreign taxes paid or accrued). Treas. Reg. sec. 1.704-1(d)(2). The IRS took the position in a private letter ruling that the basis limitation on partner losses did not apply to limit the partner's deduction for its share of the partnership's charitable contributions. Priv. Ltr. Rul. 8405084.

Even the well respected tax text book on partnership taxation by William S. McKee, William F. Nelson and Robert L. Whitmire, *Federal Taxation of Partnerships and Partners*, WG&L, 4th Edition (2011), paragraph 11.05[1][b], p. 11-214 (noting that the ''failure to include charitable contributions in the section 704(d) limitation is an apparent technical flaw in the statute. Because of it, a zero-basis partner may reap the benefits of a partnership charitable contribution without an offsetting decrease in the basis of his

interest, whereas a fellow partner who happens to have a positive basis may do so only at the cost of a basis decrease'').

THE JOINT COMMITTEE ON TAXATION, in consultation with the staffs of the House Committee on Ways and Means, the Senate Committee on Finance, and the Treasury Department's Office of Tax Policy, provided in December 2018 an explanation of Public Law No. 115-97 passed December 2017 (referred to as the ''Act'' throughout). This document may be cited as follows: **Joint Committee on Taxation**

***General Explanation of Public Law No. 115-97* (JCS-1-18), December 2018. Pub.**

L. No. 115-97, 31 Stat. 205, ''TAX CUTS AND JOBS ACT,''

The **Act** clarified and modified certain provisions of partnership taxation and charitable contribution deductions:

PART VI—PROVISIONS RELATED TO SPECIFIC ENTITIES AND INDUSTRIES SUBPART A—**PARTNERSHIPS** PROVISIONS

C. Charitable Contributions and Foreign Taxes Taken into Account in Determining

Limitation on Allowance of Partner's Share of Loss (sec. 13503 of the Act and sec. 704 of the Code)

The Act provides that contributions of appreciated capital gain property to public charities and other organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base (after taking into account contributions other than contributions of capital gain property).

Charitable Contributions And Foreign Taxes Taken Into Account In determining Limitation On Allowance Of Partner's Share Of Loss Sec. 13503 of the **Act** and sec. 704 of the Code:

The provision modifies the basis limitation on partner losses to provide that the limitation takes into account a partner's distributive share of partnership charitable contributions (as defined in Section 170(c)) and taxes (described in Section 901) paid or accrued to foreign countries and to possessions of the United States. Thus, the amount of the basislimitation on partner losses is decreased to reflect these items. In the case of a charitable contribution by the partnership, the amount of the basis limitation on partner losses is decreased by the partner's distributive share of the adjusted basis of the contributed property. In the case of a charitable contribution by the partnership of property whose fair market value exceeds its adjusted basis, a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner's distributive share of the excess.

Effective Date

The provision applies to partnership taxable years beginning **after December 31, 2017**.

NEW LIMITS ON PARTNERS' SHARES OF PARTNERSHIP LOSSES FREQUENTLY ASKED QUESTIONS | INTERNAL REVENUE SERVICE, IRS.GOV PAGE LAST REVIEWED OR UPDATED: 05-JUN-202x

1. To what extent is a partner allowed to take into account its distributive share of partnership losses?

Section 704(d) of the Code provides, in general, that a partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis of such partner's interest in the partnership (outside basis) at the end of the partnership year in which such loss occurred. If, in a given taxable year, a partner's share of partnership losses exceeds its outside basis, then the losses are allowed to the extent of basis and any excess amount is carried over for use in the next taxable year in which the partner has outside basis available. Except for deductions relating to charitable contributions and foreign taxes, current law and prior law are the same.

Example 1
Facts

Jen and Dave are equal partners in JD Partnership. At the end of the partnership taxable year, but prior to taking into account the partnership's income and loss items, Jen and Dave each have a $50 basis in the JD partnership. For the taxable year the JD partnership has $20 of non-separately stated taxable income and a $150 long-term capital loss.

Analysis

To determine each partner's basis limitation under §704(d), Jen and Dave increase their outside bases from $50 to $60 under § 705(a)(1) for their $10 distributive shares of the partnership's non-separately stated income. Their $75 shares of long-term capital loss are limited by §704(d) and, as a result, Jen and Dave can each take $60 of the loss into account in the current taxable year. The remaining $15 of long-term capital loss is carried forward. This result is the same under current and prior law.

2. Under prior law, was a partner's share of charitable contributions made by, or foreign taxes paid by, the partnership subject to § 704(d) basis limitation?

No, under prior law a partner's share of a partnership's charitable contributions and foreign tax payments were not subject to the § 704(d) basis limitation. <u>This meant that partners could take into account their entire distributive shares of charitable contributions or foreign tax payments even if they were in excess of outside basis. Although a portion of certain charitable contributions and the entire amount attributable to foreign tax payments were (and still are) subject to basis reduction under § 705(a)(2), prior law did not limit a partner's deductions for payments in excess of basis. BEFORE: DOESN'T APPLY TO Volcanic Safeguard Holdings LLC.</u>

Example 2
Facts

Assume the same facts as in Example 1, except that, at the end of the partnership taxable year (and before partnership allocations), Jen's outside basis is $50 and Dave's is $30. For the taxable year, the partnership makes a contribution to a § 501(c)(3) charity of property that has a fair market value of $300 and a basis of $100, but has no other items of income, gain, loss, or deduction.

Analysis

Under prior law, Jen and Dave each would have been able to take into account (on their personal returns) their $150 shares of the charitable contribution. Jen would have been required to decrease her outside basis by $50 (her share of the partnership's basis in the property) to zero ($50-$50=0). However, because Dave only has $30 of outside basis, any basis reduction would have been limited to $30 because outside basis cannot be decreased below zero. Therefore, under prior law, Jen would have had to decrease her outside basis by $50 to receive the benefit the entire $150 contribution deduction whereas Dave only would have had to decrease his outside basis by $30 to receive the same $150 benefit.

3. How did the TCJA change the rules for determining losses subject to the basis limitation?

The TCJA adds new § 704(d)(3)(A). That section provides that charitable contributions and foreign taxes are taken into account under the basis limitation rules, thereby putting those items on par with other losses and, as a result, limiting the benefit of such items by a partner's outside basis. However, new § 704(d)(3)(B) provides that, in the case of a charitable contribution of built-in gain property (i.e., property whose fair market value exceeds its adjusted basis), the excess amount is not limited by outside basis. These changes apply to partnership taxable years beginning after December 31, 2017. This new rule means that, for charitable contributions of appreciated property, the amount allocable to the partners will effectively be split into two parts, one equaling the property's built-in-gain amount (FMV), the other the property's basis (MINERAL BASIS FOR Volcanic Safeguard Holdings LLC) . The deduction for the built-in gain portion neither reduces the partner's bases nor is subject to limitation under section 704(d) (as under prior law). However, the part reflecting the property's basis is limited by section 704(d).

Example 3
Facts

Assume the same facts as in Example 2, except that the partnership makes the contribution of appreciated property to charity in a taxable year of the partnership beginning after December 31, 2017.

Analysis

Under the new law, the portion of the contribution that is equal to the property's basis ($100) both reduces the partner's outside bases and is subject to section 704(d). The excess portion neither reduces outside basis nor is subject to section 704(d). Jen, whose outside basis is $50, would reduce her outside basis by $50 (her share of the basis of the contributed property) and receive a charitable contribution allocation of $150. For Dave, whose outside basis is $30, the basis reduction and charitable contribution with respect to the basis portion of the contribution would be limited to $30. The $20 excess would carry over to the following year. Dave's total charitable contribution would be $130.

RELEVANT TAX COURT CASES FAVORING CHARITABLE COBNTRI BUTIONS

The courts specifically allow the acquisition of assets even if done *for no other reason than to donate them to charity*

Three key cases :

In Skripak v, Comm'r, 84 T.C. 285, the taxpayers participated in a program to purchase books at a steep discount. The IRS sought to have the taxpayer's charitable deduction disallowed based on the economic substance of the donation. Holding against the IRS, the court held that "doctrines such as business purpose and an objective of economic profit are of little, if any, significance in determining whether [a taxpayer] made charitable gifts." Id. at 315.

Further, in RERI Holdings I, LLC v. Comm'r, T.C. Memo. 2014-99, the court noted

that Skripak, Weitz, and Hunterti presented the court with "taxpayers who participated in tax avoidance programs that, in a nutshell, involved buying tangible personal property at distress prices for the sole purpose of contributing the property to a qualified charitable recipient." Id. at 6. The court acknowledged that in such a situation "the lack of any non-tax purpose for entering into the transaction (i.e., the transactions' lack of 'economic substance') was not a deterrent to the taxpayer's entitlement to a charitable contribution deduction." Id. The court reasoned that the Skripak holding, in particular, was based on the principle that: "The deduction for charitable contributions provided by [I.R.C.] section 170 is a legislative subsidy for purely personal (as opposed to business) expenses of a taxpayer." Implicitly, as charitable contribution deductions do not arise from business activities, and are inherently unprofitable, business purpose and objective profit motive are not particularly revealing analytical tools.
In sum, RERI stands for the proposition that the courts have "said sufficiently that gifts to charity need have no economic substance beyond the mere fact of the gift".

Most recently , in Roderick M. Campbell and C. Sandra Campbell v.Commissioner of Internal Revenue, April 7, 202x, T.C. Memo. 202x-41, the taxpayers participated in an eyewear charitable contribution program. They took a charitable contribution deduction at the appraised fair market value at the time of donation. The Court said: A taxpayer is allowed as a deduction any charitable contribution made during the taxable year. Sec. 170(a)(1). A charitable contribution is defined as "a contribution or gift to or for the use of" a charitable organization.

Sec. 170(c). Sec. 170(a); see sec. 170A-13, Income Tax Regs. As relevant here, for any noncash charitable contribution exceeding $5,000, the regulations

require the donor to (1) obtain a "qualified appraisal" for the property contributed, (2) attach a fully completed "appraisal summary" to the income tax return for the year the deduction is claimed, and (3) maintain records containing certain information (as required by section 1.170A-13(b)(2)(ii), Income Tax Regs.). Sec. 1.170A-13(c)(2), Income Tax Regs.; see also sec. 170(f)(11)(C); Alli v. Commissioner, T.C. Memo. 2014-15, at *19 n.13.

CONCLUSION

Volcanic Safeguard Holdings LLC will acquire an interest in a pre-existing LLC. As a multi-member LLC, the LLC is classified as a partnership for federal tax purposes. This pre-existing LLC holds minerals that were contributed to the LLC as long term capital assets. The holding period and character for the LLC assets, of which Volcanic Safeguard Holdings will join as a partner, applies at the partnership level. A contribution by the LLC partnership at year end 202x, to a 501 c 3 public charity, qualifies for a charitable deduction equal to the fair market value FMV of the minerals at year end. The pro-rata share of such charitable contribution at FMV for each member in Volcanic Safeguard Holdings LLC will be documented on a K-1 at year end for such member.

In the alternative, by a members vote before year end, the member may receive a distribution of their pro-rata share of the minerals instead of a pro-rate share of the charitable contribution and deduction at FMV. Such member taking a distribution of the minerals will receive the lower of the basis in the minerals or their basis in the partnership, and a later disposition of the minerals will be taxable as ordinary income to such member.

THIS MEMO MAY NOT BE RELIED UPON BY ANY PERSON OR ENTITY FOR A MEMBERSHIP INTEREST IN VOLCANIC SAFEGUARD HOLDINGS LLC THAT THERE WAS A "REASONABLE CAUSE EXCEPTION" TO AVOID PENALTIES UNDER THE CODE ON THE BASIS THAT THE TAXPAYER ACTED IN GOOD FAITH.

Any member in Volcanic Safeguard Holdings LLC who wishes to have tax opinion letter for reliance purposes in the event of an IRS audit should contact xxxxxxxxx.

The transaction proposed herein for a bulk buying opportunity with Volcanic Safeguard Holdings LLC is not a listed transaction or on the IRS dirty dozen lists.