

## **Ordinary Losses: Plain Language Prevails In A Dispute Over Characterization.**

The Fifth Circuit issued an interesting decision earlier this week in a dispute over the proper characterization of losses from abandonment of securities, reversing a Tax Court ruling that had sustained a deficiency assessment of roughly \$30,000,000. *Pilgrim's Pride Corp. v. Comm'r*, 2015 U.S. App. LEXIS 2831 (5th Cir. Feb. 25, 2015).

Pilgrim's Pride, the taxpayer, was the successor to Gold Kist, Inc., which has sold its agriservices business to Southern States Cooperative, Inc. in 1998. The agreement for the sale of that business permitted Southern States to require Gold Kist to purchase certain securities issued by Southern States, and that requirement was imposed on Gold Kist, which purchased \$98.6 million in securities issued by Southern States. *Pilgrim's Pride Corp. v. Comm'r*, 2015 U.S. App. LEXIS 2831, slip op. at \*1-\*2 (5th Cir. Feb. 25, 2015).

In 2004, Gold Kist and Southern States discussed a potential redemption of the securities; Gold Kist sought \$31.5 million, but Southern States offered only \$20 million. *Id.*, slip op. at \*2. Gold Kist elected to abandon the securities because the resulting ordinary tax loss of \$98.6 million would produce tax savings that would exceed the \$20 million offered by Southern States. *Id.* Gold Kist then filed its tax return claiming an ordinary loss of \$98.6 million. *Id.*

Subsequently, the IRS issued a notice of deficiency relating to Gold Kist's 2004 tax year, treating the loss associated with the abandoned securities as a capital loss instead of an ordinary loss and assessing an additional \$29,682,682 in taxes. *Id.*, slip op. at \*3. The Tax Court sustained the assessment, applying Section 1234A(1) of the Code to support capital loss treatment.

On appeal, the Fifth Circuit started its analysis by noting that a capital loss typically arises from a sale or exchange of an asset under Section 165(f) of the Code and that the abandonment of an asset for no consideration is not a sale or exchange. *Id.*, slip op. at \*5-\*6. The court then noted that a variety of provisions of the Code required that certain transactions be treated as a sale or exchange, including Section 1234A(1). *Id.*, slip op. at \*6.

This provision, which was enacted to address tax straddles, provides for capital treatment of gains or losses that stem from "the cancellation, lapse, expiration, or other termination of— a right or obligation (other than a securities futures contract, as defined in section 1234B) with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer." I.R.C. § 1234A(1).

In the Fifth Circuit's view, the plain language of Section 1234A(1) only applied "to the termination of rights or obligations with respect to capital assets (e.g. derivative or contractual rights to buy or sell capital assets)," not to capital assets themselves. *Id.*, slip op. at \*8.

The government argued that Section 1234A(1) applied because the abandonment of the securities meant that certain rights and obligations inherent in the securities were terminated. While this was a clever argument, the court was not impressed: "We disagree. Congress does not legislate in logic puzzles, and we do not 'tag Congress with an extravagant preference for the opaque when the use of a clear adjective or noun would have worked nicely.'" *Id.*, slip op. at \*9 (quoting *Gutierrez v. Ada*, 528 U.S. 250, 256 (2000)).

The Fifth Circuit also noted that the government's position would render the balance of Section 1234A superfluous, since it dealt specifically with a defined set of situations where what was abandoned was a specific type of capital asset. *Id.*, slip op. at \*11-\*12.

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