Anschutz Will Cost Taxpayers More Than the Billionaire

By David Cay Johnston

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In this article, Johnston examines the costly implications of the Tax Court finding against Denver billionaire Philip Anschutz and his wife and calls for new rules to protect the fisc.

The July 22 Tax Court decision in the *Anschutz* case will be expensive for the Denver billionaire if it stands or survives an appeal, but the way the court reached its decision will also prove to be enormously costly for American taxpayers. That is, it will prove painfully costly unless Congress acts to stop these outrages.

Judge Joseph Robert Goeke ruled that the Anschutzes engaged in shams to avoid paying $143.6 million of capital gains taxes in 2000 and 2001. (For *Anschutz Co. et al. v. Commissioner*, 135 T.C. No. 5, Nos. 18942-07, 19083-07, see *Doc 2010-16342* or *2010 TNT 141-13*.)

The tax policy problem is that Judge Goeke's 59-page decision also lays down a clear path to engage in almost identical transactions that will let the very wealthy pocket cash now with no tax bill. While there is no official figure on how big the problem is, Lynnley Browning's unattributed estimate in *The New York Times* of $35 billion — about 250 times what the Anschutzes owe — is certainly reasonable given how far and wide prepaid variable forward contracts were sold to executives and entrepreneurs.

Philip and Nancy Anschutz argued that they engaged in a sophisticated kind of stock loan with a safe harbor in section 1058. Loans do not trigger recognition of gain, but sales do.

Judge Goeke cited wrinkles in their plan. He ruled that because of one particular wrinkle, they completed sales on more than 4 million shares of Anadarko Petroleum and Union Pacific Resources Group.

The flaw involved the shares used by DLJ, now Credit Suisse, to short its position, creating a hedge against a collapse in the price of Anadarko and Union Pacific stock. If Credit Suisse had gone into the market to get shares to short the deal, it would have worked just fine, according to the most likely reading of the court's opinion.

But investors and institutions that lend their shares out to be shorted expect to get paid. I estimate the fees for this would have been less than $1.8 million and perhaps less than $1 million.

But Anschutz, a man who made his billions by never leaving a dime on a table, decided to save himself this expense. And how did he do that? He let Credit Suisse use his own shares — the very shares he was pledging as collateral for the loan — to create its short position. (For prior coverage, see *Tax Notes*, July 26, 2010, p. 354, *Doc 2010-16327*, or *2010 TNT 141-1*. For prior analysis, see *Tax Notes*, May 10, 2010, p. 699, *Doc 2010-10007*, or *2010 TNT 89-33*.)

Judge Goeke's decision is brief and blunt on the effect of that decision by Anschutz: Once sold by Credit Suisse, ''those lent shares were gone and could not be recovered.''

The most critical part of the court's finding concerned an element of the deal that the IRS said was a sham. The Anschutz Co. (TAC) could get the shares back and therefore retained badges of ownership. This happened during litigation, but in his findings Judge Goeke took a highly critical view:

> Petitioners argue that the ability to recall the shares means that TAC only temporarily transferred the benefits and burdens of ownership but could recall the stock at any time. Thus, in petitioners' view, although TAC transferred legal title, possession, the right to vote, risk of loss, and most opportunity for gain, the transfer was only temporary and could be rescinded at any time upon notice. . . .
>
> Respondent argues that the recalls should be ignored because they were shams meant to influence the result of this case. In respondent's view, if we ignore the recalls, petitioner could not recall the benefits and burdens of ownership.
>
> Although we agree with petitioners that TAC could recall the shares, the recalls were accomplished only to influence the tax analysis. The recalls were not a foreseeable economically motivated event when the transactions at issue were structured. They were rather an after-the-fact effort to change the earlier tax effect, which was fixed in 2000 and 2001.

The language is polite, but the court's finding is unambiguous: Anschutz tried to pawn off falsehood as truth.

Viewing the master agreement as a whole, Judge Goeke ruled that the Anschutzes ''transferred the benefits and burdens of ownership, including: (1) legal title to the shares; (2) all risk of loss; (3) a major portion of the opportunity for gain; (4) the right to vote the stock; and (5) possession of the stock.''

Without saying so, Judge Goeke found that Anschutz ignored a classic bit of economic philosophy taught to American children: Never be penny-wise and pound-foolish. Anschutz's cheapskate approach was just plain dumb, and were I him I would fire every one of the lawyers and accountants who did not warn me about using the shares pledged as collateral for the contract to short Credit Suisse's position. If they did warn him and he went ahead anyway, then Anschutz was an arrogant fool with no one to blame but himself.

But it's the substance of the deal, not Anschutz's cheapness, that should have been shot down. Judge Goeke lost sight of the forest not for the trees, but for a few rotten leaves.

As I read Judge Goeke's reasoning, he could have held that the short issue and some other flaws he cites that were specific to the *Anschutz* case were fatal, but even if they were not, the whole concept of prepaid variable forward contracts is fatally flawed. There are standard stock loans, and the prepaids strike me as artifices that don't deserve respect from the court or the IRS. And I say that even in light of the 2007 guidance the IRS gave that stated that if they meet certain conditions, prepaids can work.

Instead Judge Goeke laid out a clear path for anyone with enough money to justify the costs to swap appreciated shares of stock for cash without triggering capital gains taxes. Two of the savviest tax avoidance experts, Robert Gordon and Robert Willens, were quoted on just that point in *The Wall Street Journal* and *The New York Times*. Amy S. Elliott of *Tax Notes* quoted other tax lawyers making the same point: Prepaids done slightly differently than the Anschutz transactions will survive.

But why should they? Why should we encourage, or even allow, deals that weaken the matching principle? Why should anyone get to enjoy cash from gains now without paying taxes? And in pondering that, keep in mind how much federal borrowing costs taxpayers. (For analysis, see *Tax Notes*, June 7, 2010, p. 1161, *Doc 2010-12075*, or *2010 TNT 108-11*.)

If we had a Congress that cared about ordinary Americans, it would be all over this. But the only real party in Washington, the party of money, lacks the intellectual integrity and the backbone to take on the elements of the political donor class who use these contracts to pocket cash without paying taxes.

On the other hand, Congress maintains several principles that ensure the vast majority of Americans pay their taxes, mostly before they get any cash. And when it comes to borrowing against assets to raise cash without triggering recognition of capital gains, taxpayers from Joe Lunchpail to Main Street Merchants face very limited options.

Consider the limits on borrowing against your home. Interest is deductible only on $100,000 of a home equity line of credit, and then only if you are not subject to the alternative minimum tax. AMT taxpayers can deduct that interest only if they borrowed to improve their homes.

Anschutz's deal involved on the order of a half-billion dollars of securities, most of it unrealized gain.

And what of stock loans? You can take your employer's stock to a credit union sponsored by your employer and borrow 75 percent with no margin call. But if you want to draw cash against your brokerage account from a diversified portfolio, the limit is 50 percent, and if the value of your portfolio dips slightly, then out goes the margin call.

The awful truth is that America has two income tax systems, separate and unequal. One system is for the superrich, like Anschutz and his wife, Nancy, who are allowed to delay and avoid taxes on investment gains, among other tax tricks. The other system is for the less than fabulously wealthy, who have most of their taxes taken out of their income before they receive it, have tight restrictions on what they can borrow, and have strict limits on how much they can save pretax.

Current law does not define most borrowing against assets as income. Should it?

More significantly, should tax law draw a distinction between borrowing against basis, which generally reflects assets bought with after-tax dollars, and borrowing against unrealized gains, which is what Anschutz did?

It strikes me that the current borrowing and realization rules, especially as interpreted by Judge Goeke, make it possible for people with assets far in excess of humanly possible consumption to live tax free permanently. Why ever recognize gain when you can just borrow and, when the loan comes due, borrow more? Is that fair? And is it fair in light of the limits on the hoi polloi on borrowing against their assets?

Do the realization rules need updating in view of changing circumstances?

To argue that the rules are fine just as they are is to say that tax policy should not evolve. If tax policy cannot evolve in line with changing circumstances, then when do we stop the evolution of tax policy on recognition of gain? How about freezing it back before the invention of computerized spreadsheets made prepaid deals practical? How about before the invention of puts and calls?

Conditions change. The law must change too if we are to protect the fisc. So the best question is this: Who will step forward to protect the fisc?

Your thoughts? Email me at *JohnstonsTake@tax.org*.