United States Tax Court
Washington, DC 20217

GWA, LLC, George A. Weiss, Tax Matters Partner,	)	
Petitioner	)	Docket No. 6981-19.
v.	)	
Commissioner of Internal Revenue,	)	
Respondent	)	

O R D E R

This case is calendared for trial at a special session of the Court starting March 7, 2022, in Washington, D.C. On May 21, 2021, petitioner filed a Motion for Partial Summary Judgment. Finding material facts to be in dispute, we will deny the Motion.

Introduction

This case involves GWA, LLC (GWA), and its tax matters partner, petitioner George A. Weiss, a hedge fund manager. GWA conducts a securities trading business through its wholly-owned subsidiary, OGI Associates, LLC (OGI). OGI is a limited liability company (LLC) and is disregarded as a separate entity for Federal income tax purposes.

During the 2000s GWA or its affiliates entered into ten transactions with Deutsche Bank that were styled options (barrier transactions). GWA was the buyer and Deutsche Bank was the seller. Each barrier transaction referenced a basket of securities (basket securities). During 2009 and 2010 GWA treated these contracts as options contracts. See sec. 1234 and 1234A.[1]

[1]Unless otherwise indicated, all statutory references are to the Internal Revenue Code in effect during the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

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On December 3, 2018, the Internal Revenue Service (IRS or respondent) issued petitioner a Notice of Final Partnership Administrative Adjustment (FPAA). The FPAA determined (among other things) that, for Federal income tax purposes, the contracts were not "options" and that GWA was, in substance, the owner of the basket securities. This produced ordinary income adjustments in excess of $500 million for 2009-2010.

One issue raised by the FPAA is the scope of a "mark-to-market" election that was made on GWA's Form 1065, U.S. Return of Partnership Income, for 1998. See sec. 475(f). Petitioner contends that this election was made by OGI, that the election "applied only to securities directly held by OGI," and that the election is inapplicable to any securities held (or deemed to be held) by GWA. Petitioner seeks partial summary judgment in his favor on this question.

Respondent contends that GWA, not OGI, made the mark-to-market election. GWA properly made this election, in respondent's view, because GWA was "engaged in a trade or business as a trader in securities," sec. 475(f)(1)(A), by conducting the securities trading business in which OGI, a disregarded entity, engaged. Respondent concludes that GWA's mark-to-market election covered any securities held or deemed to be held by it--including the Deutsche Bank options and/or the basket securities--unless GWA establishes that such securities are exempt from mark-to-market treatment under the exception set forth in section 475(f)(1)(B). Respondent accordingly urges that summary judgment on this question should be denied.

Background

The following facts are derived from the joint stipulations of facts, the parties' motion papers, and the exhibits and declarations attached thereto. They are stated solely for purposes of deciding petitioner's motion and not as findings of fact in this case. See Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992), aff'd, 17 F.3d 965 (7th Cir. 1994). GWA had its principal place of business in Connecticut when the petition was filed. Absent stipulation to the contrary, appeal of this case would lie to the U.S. Court of Appeals for the Second Circuit. See sec. 7482(b)(1)(E).

Petitioner formed OGI in 1994 as a Connecticut LLC. Two years later he formed GWA to serve (in effect) as a holding company for various enterprises in which he was interested. GWA is treated as a partnership for Federal income tax purposes.

In 1998 GWA acquired 100% ownership of OGI. At no point thereafter did OGI elect to be regarded as an entity separate from its owner. Beginning in 1998, therefore, and continuing through all relevant tax years, OGI was disregarded as a separate entity for Federal income tax purposes. See sec. 301.7701-3(b)(1)(ii), Proced. & Admin. Regs.

For 1998 GWA filed a Form 1065 on which it reported (among other things) the results of OGI's operations. GWA included with this return an attachment that made a mark-to-market election. That attachment contains a header, in bold text at the top of the page, referencing "GWA, LLC," and providing GWA's mailing address and tax identification number. The attachment states that the mark-to-market election is being made "For OGI," which is identified as an LLC wholly-owned by GWA. The text of the attachment recites that OGI "is engaged in a trade or business as a trader in securities and elects to have * * * Section 475(f)(1) apply to such trade or business."

Around this time Deutsche Bank devised a financial product called "Managed Account Product Structure" (MAPS). Deutsche Bank sold ten of these products to GWA or its affiliates in the early 2000s. Each product referenced a basket of securities and was styled a call option. The buyer could trade the underlying basket securities as frequently as it wished. GWA traded them with gusto, creating large gains in the securities basket. But because these products were styled "options," those gains would supposedly be deferred until the option's expiration date (or termination if earlier).

In 2010 the Internal Revenue Service (IRS or respondent) published a memorandum identifying MAPS transactions as abusive, and it subsequently selected GWA's 2009 and 2010 returns for examination. On December 3, 2018, the IRS issued petitioner an FPAA determining that, for Federal income tax purposes, the MAPS transactions were not "options" and that GWA was, in substance, the owner of the basket securities. The FPAA also determined that the mark-to-market election made on GWA's 1998 return "applied to both [GWA] and its disregarded entity, OGI." In May 2019 petitioner petitioned this Court for readjustment of the partnership items.

On May 21, 2021, petitioner filed a motion for partial summary judgment. Petitioner contends that the section 475(f) election "applied only to securities directly held by OGI" and "did not apply to any other securities," including securities held or deemed to be held by GWA. Further briefing ensued, and the Court on September 24, 2021, held oral argument via Zoomgov.

Discussion

A. Summary Judgment Standard

The purpose of summary judgment is to expedite litigation and avoid costly, unnecessary, and time-consuming trials. See FPL Grp., Inc. & Subs. v. Commissioner, 116 T.C. 73, 74 (2001). We may grant partial summary judgment when there is no genuine dispute of material fact and a decision may be rendered as a matter of law. Rule 121(b); Elec. Arts, Inc. v. Commissioner, 118 T.C. 226, 238 (2002). When determining whether to grant summary judgment, we must view factual materials and inferences drawn therefrom in the light most favorable to the nonmoving party (here respondent). See FPL Grp., Inc. & Subs. v. Commissioner, 115 T.C. 554, 559 (2000). "If, in this generous light, a material issue is found to exist, summary judgment is improper." Nationwide Life Ins. Co. v. Bankers Leasing Ass'n, Inc., 182 F.3d 157, 160 (2d Cir. 1999).

B. Statutory and Regulatory Background

1. Mark-to-Market Election

Gains from the sale of property are generally recognized in the year the property is sold. Sec. 1001(c). Section 475(f), captioned "Election of Mark to Market for Traders in Securities or Commodities," creates a statutory exception to this rule.

Section 475(f)(1)(A) provides that a "person who is engaged in a trade or business as a trader in securities and who elects to have this paragraph apply to such trade or business * * * shall recognize gain or loss on any security held in connection with such trade or business at the close of any taxable year as if such security were sold for its fair market value on the last business day of such taxable year." The election generally applies to all securities held by the person unless (i) it is "established to the satisfaction of the Secretary * * * [that a security has] no connection to the activities of such person as a trader," and (ii) the security "is clearly identified in such person's records" as having no such connection. Sec. 475(f)(1)(B)(i) and (ii). The mark-to-market election applies to the taxable year for which it is made "and all subsequent taxable years unless revoked with the consent of the Secretary." Sec. 475(f)(3).

Congress expressed its understanding that the mark-to-market election "will be made in the time and manner prescribed by the Secretary." H.R. Rept. No. 105-148, at 446 (1997), 1997 U.S.C.C.A.N. 678, 840. The Commissioner prescribed

the time and manner for making this election in Rev. Proc. 99-17, 1999-1 C.B. 503. "This revenue procedure provides the exclusive procedure for * * * traders in securities or commodities to make an election to use the mark-to-market method of accounting under section 475(e) or (f)." Id. sec. 1, 1999-1 C.B. at 504. To make a valid election a taxpayer "must follow the procedure set forth in Rev. Proc. 99-17." See Spicko v. Commissioner, T.C. Memo. 2016-41, 111 T.C.M. (CCH) 1173, 1174.

The revenue procedure states that the election to use the mark-to-market method "is a change in method of accounting to which the provisions of sections 446 and 481 * * * apply." Rev. Proc. 99-17, sec. 6.01, 1999-1 C.B. at 505. However, the Commissioner gave blanket consent "for a taxpayer to change its method of accounting" provided that "the taxpayer complies with the election requirements set forth in section 5 of this revenue procedure" and "complies with the applicable requirements of this section 6." Ibid.

For taxpayers in GWA's position, the procedures for making the mark-to-market election were spelled out in sections 5.02 and 6.02(2) of the revenue procedure. Section 5.02 provides:

> For a taxpayer to make a section 475(e) or (f) election that is effective for a taxable year which begins before January 1, 1999, and for which the original [F]ederal income tax return is filed on or after March 18, 1999, the taxpayer must make the election by attaching a statement that satisfies the requirements in section 5.04 * * * to an original [F]ederal income tax return for the election year." [1999-1 C.B. at 504.]

Section 5.04 states that the required statement must specify the election being made, the tax year for which it is made, and, "in the case of an election under section 475(f), the trade or business for which the election is made." Id. sec. 5.04, 1999-1 C.B. at 505. Section 6.02 provides that a taxpayer making an election under section 5.02 must complete Form 3115, Application for Change in Accounting Method, and must attach that Form "to the taxpayer's timely filed (including extensions) original [F]ederal income tax return for the year of change," with a copy to the IRS National Office. Id. sec. 6.02(2), 1999-1 C.B. at 505.

2. Disregarded Entities

Section 7701(a) defines a "person" to include several categories of business entities, such as associations, companies, and partnerships. "Although an LLC

might be considered a company or an association, its proper characterization is not clear from the terms of the Code itself." McNamee v. Dep't of Treasury, 488 F.3d 100, 108 (2d Cir. 2007). Because LLCs may have "some features of corporations and some features of partnerships," ibid., the Department of the Treasury promulgated regulations to provide guidance as to how LLCs (and similar entities) are to be classified for Federal tax purposes. See secs. 301.7701-1, -2, and -3, Proced. & Admin. Regs. Practitioners refer to these provisions as the "check-the-box" regulations.

The check-the-box regulations provide default classifications for certain entities that are not classified as corporations. A domestic entity with two or more members is treated as a partnership, while a domestic entity with a single owner is disregarded. In either case the entity may elect to be treated as a corporation. See sec. 301.7701-3(a) and (b)(1), Proced. & Admin. Regs. To make this election the entity must check the appropriate box on Form 8832, Entity Classification Election, and file it with the IRS.

If a domestic entity with a single owner chooses the default position--i.e., chooses to be "disregarded as an entity separate from its owner"--then "its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner." Sec. 301.7701-2(a), Proced. & Admin. Regs. The entity is thus treated for Federal tax purposes "as having no existence separate and distinct from" its owner. See Whirlpool Fin. Corp. & Consol. Subs. v. Commissioner, 154 T.C. 142, 146 (2020). In other words, any trade or business of a disregarded entity is generally deemed to be conducted by its owner. See id. at 156.

C. Analysis

Petitioner agrees (as he must) that OGI, as a disregarded entity, is not a taxpayer. But he emphasizes that section 475(f)(1)(A) authorizes a "person" to make a mark-to-market election. In petitioner's view, a single-member LLC is a "person" under section 7701(a). Because OGI was a "person" engaged in business "as a trader in securities" during 1998, petitioner contends that OGI properly made this election.

Petitioner observes that section 475(f) is fairly consistent in using the term "person" rather than "taxpayer" to refer to the entity making a mark-to-market election. But see sec. 475(f)(1)(C) (referring to securities acquired "in the normal course of the taxpayer's activities as a trader in securities"). Petitioner contends that Congress intentionally used this terminology because it wished to allow an entity like OGI to make an election limited to its own securities trading business.

Because GWA assertedly made no mark-to-market election for itself, petitioner concludes that section 475(f)(1) has no application to securities held or deemed to be held by it.

Respondent replies that petitioner is focusing on the wrong "person." Revenue Procedure 99-17 "provides the exclusive procedure for * * * traders in securities * * * to make an election to use the mark-to-market method." Sec. 1, 1999-1 C.B. at 504. That revenue procedure consistently states that the election is made by "the taxpayer" and that "the taxpayer must make the election." Id. sec. 5.02, 1999-1 C.B. at 504. That election must be made "by attaching a statement that satisfies the requirements in section 5.04 * * * to an original [F]ederal income tax return for the election year." Ibid.

Only taxpayers file Federal income tax returns. Respondent accordingly contends that GWA--the only relevant taxpayer--was the proper person to make the section 475(f)(1) election. Conversely, respondent contends that OGI could not possibly have made the election: Disregarded entities do not file tax returns, and they are not allowed to make elections for Federal tax purposes, other than the initial check-the-box election that determines their status. See sec. 301.7701-3(c)(1), Proced. & Admin. Regs.

Respondent emphasizes that the election to use the mark-to-market method "is a change in method of accounting." Rev. Proc. 99-17, sec. 6.01, 1999-1 C.B. at 505. Indeed, section 475 is captioned "Mark to Market Accounting Method for Dealers in Securities." With an exception irrelevant here, only a taxpayer can have a "method of accounting" for Federal income tax purposes.[2] Thus, GWA alone could have made the election to change its method of accounting for securities trades.

GWA actually did make the election, respondent says, by attaching the required statement to its Form 1065 for 1998. That statement refers, in a bold-text header at the top of the page, to "GWA, LLC," and provides GWA's mailing address and tax identification number. The statement said that the election was being made "[f]or OGI," suggesting that GWA was making the election (albeit on OGI's behalf). The statement specified that the election applied to OGI's "trade or busi-

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[2]Petitioner cites section 1.964-1(c)(6), Income Tax Regs., as an exception to this rule. That regulation, promulgated under subpart F, defines circumstances in which a controlled foreign corporation must adopt a method of accounting for purposes of computing its "earnings and profits," which determine the character of distributions made to its U.S. shareholders.

ness as a trader in securities." But Rev. Proc. 99-17 requires that the statement attached to the taxpayer's return must specify, "in the case of an election under section 475(f), the trade or business for which the election is made." Id. sec. 5.04, 1999-1 C.B. at 505. In order to make a proper election, GWA had to specify some trade or business. In identifying OGI's business as the relevant business, GWA arguably was simply doing what it needed to do to make a valid election.

Finally, respondent urges that his position is consistent with the transition rules Congress specified for taxpayers electing mark-to-market treatment. See Pub. L. No. 105-34, sec. 1001(d)(4), 111 Stat. at 908. Those rules provide for a four-year spread of adjustments for "a taxpayer who elects * * * to change its method of accounting" for the taxable year that includes the date of the enactment. Ibid. In respondent's view, this transition rule confirms Congress' understanding that the election must be made by "a taxpayer" and that a taxpayer alone can elect to change its method of accounting for this purpose.

The parties have focused much of their firepower on the statutory requirement that a person electing mark-to-market treatment must be "engaged in a trade or business as a trader in securities." Sec. 475(f)(1)(A). Respondent contends that GWA was so engaged because it is treated during 1998 as conducting the securities trading activities of OGI. OGI being a disregarded entity, "its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner." Sec. 301.7701-2(a), Proced. & Admin. Regs. Because OGI is treated "as having no existence separate and distinct from" its owner, Whirlpool Fin. Corp., 154 T.C. at 146, its securities trading business, for Federal tax purposes, was necessarily conducted by GWA. Cf. McNamee, 488 F.3d at 111 (holding that a single-member LLC that does not elect to be taxed as a corporation "is '[d]isregarded' * * * [and] cannot be regarded as the employer" for employment tax purposes).

In reply petitioner essentially reverts to its central argument--that Congress meant what it said when it used the term "person," rather than "taxpayer," in section 475(f). Petitioner contends that OGI, as an "association" or "company," is a "person" within the meaning of section 7701(a)(1). And that section says that its definitions apply for all Code sections unless "manifestly incompatible with the intent thereof." In petitioner's view, it is not manifestly incompatible with the intent of section 475(f)(1) to treat OGI as a "person" entitled to make a mark-to-market election.

Petitioner further contends that respondent is over-reading the "activities clause," i.e., the regulatory provision stating that the activities of a disregarded entity "are treated in the same manner as a sole proprietorship, branch, or division of the owner." Sec. 301.7701-2(a), Proced. & Admin. Regs. Petitioner asserts that

this attribution rule is not "limitless" because the activities clause is intended mainly "to classify entities for tax reporting purposes." Petitioner cites RERI Holdings I, LLC v. Commissioner, 143 T.C. 41 (2014), and Pierre v. Commissioner, 133 T.C. 24 (2009), as examples of cases that (in petitioner's view) define a limited scope for the activities clause.

From these premises petitioner concludes that the activities clause cannot be used--at least not for section 475(f) purposes--to treat GWA as conducting OGI's securities trading business. "Allowing the activities clause to delink the activity from the person engaged in the activity," petitioner says, "would be manifestly incompatible with Congressional intent, which is explicitly expressed in the text of section 475(f)." Because OGI's securities trading activities are not properly attributable to GWA, petitioner concludes that GWA cannot have made the mark-to-market election because it was not a person "engaged in a trade or business as a trader in securities" during 1998. See sec. 475(f)(1)(A).

We conclude that we need not decide--at least not at this stage of the litigation--whether OGI's securities trading is attributed to GWA under the activities clause. In contending that GWA made the election, respondent needs to rely on the activities clause only if GWA itself engaged in no securities trading of its own during 1998. But respondent contends that the Deutsche Bank barrier transactions, which generated trading activity by GWA in the early 2000s, were not GWA's first venture into this territory. Respondent alleges that GWA may itself have engaged in trading securities--including basket securities acquired from the Royal Bank of Canada--as early as 1998, before the mark-to-market election was made. Respondent urges that such facts, if established at trial, "would affect the Court's determination of whether, under section 475(f)(1)(A), GWA was 'a person * * * engaged in a trade or business as a trader in securities.'"

We agree with respondent on this latter point. Petitioner asserts that the scope of the activities clause, as applied in the section 475(f) context, raises complex legal questions under precedents of this Court and the U.S. Court of Appeals for the Second Circuit. We need not address those questions if the evidence at trial establishes that GWA during 1998 directly engaged in securities trading activity. Because genuine disputes of material fact currently exist on that point, we conclude that prudence dictates the denial of petitioner's Motion for Partial Summary Judgment. Accordingly, it is

ORDERED that petitioner's Motion for Partial Summary Judgment, filed May 21, 2021, is denied.

(Signed) Albert G. Lauber
Judge