

From the desk of Jeanne M. Kerkstra, Esq., CPA

Viewpoint

There Is No Equity In Guarantee

Two recent Appellate Court cases reaffirm how a guarantee does not transform itself into equity in an entity.

On the one hand, we have the GE case. At the lower level, GE had scored a victory. The court had found that the IRS could not impose \$62 million in additional taxes. However, the Appellate Court disagreed. To sum up the holding, the court found that the two Dutch banks, which were supposedly shareholders, were never at risk. They did not actually ever stand in the shoes of the owners. They could benefit from the upside but would never be at risk for the downside. Their return on investment was basically guaranteed. In other words, they were creditors, not equity owners. *TIFDIII-E Inc. v. United States*, 2d Cir., No. 05-0064-cv, 8/3/06.

A less convoluted case which illustrates the same point is *Maloof v. Commissioner*, 6th Cir., No. 05-1967, 8/4/06. The Appellate Court looked to the doctrine of economic outlay. Basically, it states that if you are not currently on the hook for the loan, then you are not able to consider that basis. This is in line with a recent Tax Court decision on a similar matter. See *Miller v. Commissioner* (T.C. Memo. 2006-125, 6/15/06).

Equity or basis equals current economic outlay. It does not equal guarantees. In short, equity is not a spectator sport. You have to be in the game to claim it.

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