However, if one or more of the above-mentioned structuring factors are present, then the parties should consider whether:

1. there is any compensatory intent to the transition payments or
2. the transition payments represent one component of the intrinsic value of the acquired company stock or assets.

From an income tax perspective, some of the judicial and administrative guidance related to these transition period payment characterization questions includes the following:

- *Arrowsmith* (344 U.S. 6 (1952)). In the *Arrowsmith* judicial decision, two taxpayers liquidated a corporation that they had co-owned.

  The two taxpayers divided the corporate liquidation proceeds equally, reporting the profits from the distributions as capital gains. In a subsequent tax year, a judgment was rendered against the liquidated corporation.

  The two taxpayers paid the judgment, and they then reported the judgment payment as an ordinary business loss deduction.

  In this judicial decision, the court held that those judgment payments—and the resulting tax deduction—were capital in nature. The court reached this conclusion because the claim on which the judgment was rendered related to the original corporate liquidation.

  The court concluded that the basis of the taxation treatment related to the origin of the claim (i.e., the liquidation).

  Likewise, if the payment of a transition payment represents nothing more than the intrinsic value of the company stock (or assets) that the individual sellers owned before the transaction, then *Arrowsmith* suggests that the transition payments represent a payment for the acquired company shares (or assets).

- *Lane Processing Trust*, 25 F.3d 662 (8th Cir. 1994). In the *Lane Processing Trust* judicial decision, an employee-owned company sold all of its assets, Then, the company sale proceeds were distributed to the employee-owners.

  In this case, both the right to the distribution and the amount of the distribution were contingent upon the employee/shareholders being employed by the company at the time of the transaction, their job classification, their length of employment, and so forth.

  The court rejected the company's claim that the distribution payments were not employee compensation.

  Rather, the court held that the distribution payments were based on factors "traditionally used to determine employee compensation, specifically, the value of services performed by the employee, the length of the employee's employment, and the employee's prior wages."

  Therefore, the court concluded that the sale proceed payments were more closely aligned to employment services than to stock ownership.

- *R.J. Reynolds Tobacco Co.* (149 F.Supp. 889 (Ct. Cl. 1957)). In this case, an employer company claimed that payments made to certain owner-employees, under a profit distribution plan and proportionate to their shareholdings, were deductible compensation expense—rather than stock dividends.

  The court held that the payments were not compensation payments, but were instead on account of the employees' stock ownership.

  The court reached this conclusion for the following reasons:

  1. The payments were in proportion to each employee's stock ownership.
  2. The payments were in addition to each employee's existing reasonable compensation arrangements.
  3. In prior income tax, accounting, and litigation matters, the employer company had treated the payments as dividends rather than as compensation.

- Revenue Ruling 2007-49. In Revenue Ruling 2007-49, three sets of guidance were issued on the following situations:

  1. No "transfer" for Section 83 purposes had occurred when new services-based restrictions imposed on vested stock caused those same stock shares to become "unvested."