

**Internal Revenue Service**

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

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Refer Reply To:

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PLR-145902-05

Date:

January 10, 2006

Re: Request for a Private Letter Ruling

Taxpayer =

A =

Date1 =

Date3 =

Date4 =

Date5 =

Product1 =

Location1 =

Location2 =

Location3 =

Location4 =

SB/SE Official =

Dear :

This letter responds to a letter dated July 14, 2005, and supplemental correspondence, requesting a ruling under section 197 of the Internal Revenue Code.

**FACTS**

Taxpayer represents that the facts are as follows:

Taxpayer, a subchapter C-corporation, has a fiscal year which ends on the Friday closest in time to Date1 of each year and is engaged in the Product1 business. Its business operations are located in Location1 and Location2. Taxpayer is an accrual basis taxpayer.

A, located in Location3, is also engaged in the Product1 business. Sometime in early Year1, Taxpayer entered into an agreement with A to purchase all of the

inventory, hard assets, and customer accounts of A. A retained its accounts receivable, name and leasehold, but otherwise sold all of its assets to Taxpayer. Under the agreement, Taxpayer was obligated to pay A a cash payment (the Initial Payment) which would be applied towards making partial payment to A's creditors. Taxpayer would also make deferred payments to A based upon the profits generated from the transferred customer accounts. In mid-Year1, Taxpayer paid A cash for A to distribute to its suppliers and creditors, and Taxpayer began using the customer accounts acquired from A to generate more business. Taxpayer and A, however, had some disagreements about other aspects of their agreement so A filed a lawsuit to enforce the agreement as it perceived it. During the litigation, the parties resolved their differences informally and this resulted in the execution of the finalized purchase agreement (the Purchase Agreement) on Date3, and the dismissal of the lawsuit.

Pursuant to the Purchase Agreement, Taxpayer paid A additional cash (the Additional Payment) to be applied towards making payments to A's creditors. Also, pursuant to the Purchase Agreement, Taxpayer is required to pay A two-thirds of the net profits (the Net Profits Payment) after taxes earned during the period from Date4 through Date5 (the Measuring Period) attributable to the customer accounts acquired by Taxpayer from A and any new accounts generated for Taxpayer after Date4 by one of A's principals who has been employed by Taxpayer since Taxpayer took over A's customer accounts. This individual generated no new accounts for Taxpayer so all payments made from Taxpayer to A have been or will be attributable to the pre-existing customer accounts purchased by Taxpayer. The Purchase Agreement also provided for Taxpayer to make a payment (the Tax Benefit Payment) to A of a portion of the income tax benefits that Taxpayer would receive from amortization of the costs of certain amortizable assets attributable to the payment to A of one-third of Taxpayer's net profits earned during the Measuring Period. Under the Purchase Agreement, A entered a covenant not to compete with Taxpayer.

Taxpayer and A are not affiliated with one another. Neither A nor any of its current or former shareholders or principals have any equity interest in Taxpayer.

## RULING REQUESTED

Taxpayer requests a ruling that the payments made to A attributable to the acquisition of A's customer accounts qualify for amortization under section 197 of the Internal Revenue Code.

## LAW AND ANALYSIS

Section 197(a) provides that a taxpayer is entitled to an amortization deduction with respect to any amortizable section 197 intangible. The amount of the deduction is determined by amortizing the adjusted basis (for purposes of determining gain) of the intangible ratably over the 15-year period beginning with the month in which the intangible was acquired.

Section 197(c)(1) provides that the term “amortizable section 197 intangible” generally means any section 197 intangible that is acquired by the taxpayer after August 10, 1993, and that is held in connection with the conduct of a trade or business or an activity described in section 212.

Section 197(d)(1) provides that the term “section 197 intangibles” includes any customer-based intangible and any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof.

For purposes of section 197(d)(1)(C)(iv), section 197(d)(2)(A) defines the term “customer-based intangible” to mean (i) composition of market, (ii) market share, and (iii) any other value resulting from future provision of goods and services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.

Section 1.197-2(b)(6) of the Income Tax Regulations provides, in part, that a customer-based intangible is any composition of market, market share, or other value resulting from the future provision of goods or services pursuant to contractual or other relationships in the ordinary course of business with customers. Thus, the amount paid or incurred for customer-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a customer base, a circulation base, an undeveloped market or market growth, insurance in force, the existence of a qualification to supply goods or services to a particular customer, a mortgage servicing contract (as defined in section 1.197-2(c)(11)), an investment management contract, or other relationship with customers involving the future provision of goods or services. However, any portion of the purchase price of an acquired trade or business attributable to accounts receivable or other similar rights to income for goods or services provided to customers prior to the acquisition of a trade or business is not an amount paid or incurred for a customer-based intangible.

Section 1.197-2(f)(2)(i) provides that, for treatment of contingent amounts, any amount that is properly included in the basis of an amortizable section 197 intangible after the first month of the 15-year period described in section 1.197-2(f)(1)(i) is amortized ratably over the remainder of the period beginning on the first day of the month in which the basis increases.

Under the Purchase Agreement, Taxpayer acquired A’s fresh and frozen inventory, certain tangible assets, A’s customer accounts, and a covenant not to compete. Taxpayer’s payments for these assets include, the Initial Payment, the Additional Payment, the Net Profits Payment, and the Tax Benefit Payment. The payments attributable to A’s customer accounts and to A’s covenant not to compete are attributable to the acquisition of amortizable section 197 intangibles. To the extent

these costs are attributable to contingent amounts, these costs become amortizable when added to the basis of the amortizable section 197 intangibles (section 1.197-2(f)(2)(i)).

## CONCLUSIONS

Based solely on the facts and representations submitted, we conclude that Taxpayer is entitled to an amortization deduction under section 197 with respect to the amounts paid for the acquisition of A's customer accounts.

Except as specifically set forth above, we express no opinion concerning the federal income tax consequences of the facts described above under any other provisions of the Code. Specifically, no opinion is expressed or implied regarding the amount of basis allocable to any asset acquired by Taxpayer from A or when any amount allocable to the basis of any amortizable section 197 intangible becomes amortizable.

In accordance with the power of attorney, we are sending copies of this letter ruling to Taxpayer's authorized representative. We are also sending a copy of the letter ruling to the appropriate SB/SE Official.

Sincerely,

CHARLES B. RAMSEY

Charles B. Ramsey  
Chief, Branch 6  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

## Enclosures:

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