

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:IT&A:5 PLR-106133-99

Date:

May 30, 2000

Re:

Legend:

\$a	=
W	=
X	=
Z	=
Date 1	=

Dear

This is in reply to your request for a ruling under section 453 of the Internal Revenue Code and section 15a.453-1(c)(7) of the Temporary Income Tax Regulations that W, a corporation which elected to be taxed as a small business corporation, be allowed to use an alternative method of basis recovery to report the contingent payment sale of one of its lines of business.

Prior to the sale which is the subject of this ruling, W operated two lines of business. One line of business involved the sale of products at wholesale. The second line of business, known as Z,

On Date 1, W sold Z to X for \$a plus contingent payments equal to the after-tax profits of Z in excess of a specified amount during the period beginning with the month of the sale. There was no limitation on the amount of payments that might be required under the earnout provision.

Section 453(a) provides that, except as otherwise provided, income from an installment sale shall be taken into account under the installment method.

Section 453(b)(1) defines "installment sale" to mean a disposition of property where at least one payment is to be received after the end of the taxable year in which the disposition occurs.

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Section 453(c) defines “installment method” as a method under which the income recognized for any taxable year from a disposition of property is that proportion of the payments received in that year which the gross profit (realized or to be realized when the payment is complete) bears to the total contract price.

Section 453(j)(2) directs Treasury to issue regulations to carry out the provisions of section 453 including regulations to provide for ratable basis recovery in transactions where the gross profit or the total contract price (or both) can not be readily ascertained.

Section 15a.453-1(c)(1) provides generally that contingent payments sales are to be reported on the installment method unless the taxpayer otherwise elects in the manner prescribed in §15a.453-1(d). The term “contingent payment sale” means a sale or other disposition of property in which the aggregate selling price cannot be determined by the close of the taxable year in which such sale or other disposition occurs.

Section 15a.453-1(c)(3)(i) provides generally that when a stated maximum selling price cannot be determined as of the close of the taxable year in which a sale or other disposition occurs, but the maximum period over which payments may be received under the contingent sale price agreement is fixed, the taxpayer’s basis (inclusive of selling expenses) shall be allocated to the taxable years in which payments may be received under the agreement in equal annual increments.

Section 15a.453-1(c)(7)(ii) generally provides that a taxpayer may use an alternative method of basis recovery if the taxpayer is able to demonstrate, prior to the due date of the return including extensions for the taxable year in which the first payment is received, that application of the normal basis recovery rules will substantially and inappropriately defer recovery of basis. The taxpayer must show:

(1) that the alternative method is a reasonable method of ratably recovering basis; and

(2) that, under that method, it is reasonable to conclude that over time the taxpayer likely will recover basis at a rate twice as fast as the rate at which basis would have been recovered under the otherwise applicable normal basis recovery rule.

Section 15a.453-1(c)(7)(ii) provides guidelines as to what type of data is acceptable in demonstrating that application of the normal basis recovery rule would substantially and inappropriately defer recovery of the taxpayer’s basis. The section provides that the taxpayer in appropriate circumstances may rely upon contemporaneous or immediate past relevant sales, profits, or other factual data that are subject to verification. The section further provides that the taxpayer ordinarily is not permitted to rely upon projections of future productivity, receipts, profits, or the like. However, in special circumstances a reasonable projection may be acceptable if the projection is based upon a specific event that already has occurred.

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Under W's proposed alternative method of basis recovery, the amount of basis allocated to an installment payment would bear the same ratio to W's total basis in the property sold that the installment payment bears to the estimated amount of the aggregate payments to be received by W during the term of the installment obligation. The estimate of the aggregate payments to be received during the term of the installment obligation was determined on the basis of historical data and earnings trends.

Based on the information provided and the representations made, it is reasonable to conclude that W's use of the proposed alternative method of basis recovery, over time, will result in basis recovery at a rate twice as fast as the rate at which basis would be recovered under the normal basis recovery rules. The proposed alternative method of basis recovery represents a reasonable method of basis recovery. Accordingly, W's use of the proposed alternative method of basis recovery is approved.

No opinion is expressed as to the tax treatment of any aspect of the subject transaction under the provisions of any other section of the Code and regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction which are not specifically covered by this ruling.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and the second authorized representative indicated on the power of attorney.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
Assistant Chief Counsel
(Income Tax & Accounting)

By Douglas A. Fahey
Acting Chief, Branch 5

cc: