

Internal Revenue Service**Department of the Treasury**

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Washington, DC 20224

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Refer Reply To:
CC:ITA:4 – PLR-149801-01
Date:
June 10, 2002

LEGEND:

Taxpayer =
Agreement =
B =
d =
e =
f =
g =
h =
v =
w =
x =
y =
z =

Dear

This is in reply to your request for a ruling to allow Taxpayer to use an alternative method of basis recovery under § 15a.453-1(c)(7) of the Temporary Income Tax Regulations to report contingent payments, because the normal basis recovery rule method will substantially and inappropriately defer recovery of basis.

Taxpayer is an S corporation with two individual shareholders. It uses an accrual method of accounting for federal income tax purposes and files its returns on a calendar year basis. In y, Taxpayer disposed of certain assets to B pursuant to the Agreement for a (i) fixed cash amount, (ii) certain shares of stock, and (iii) contingent payments not to exceed \$d. Under the Agreement, the contingent payments are due only if B's defined earnings exceed its defined earnings goals for each of the years y through y, and if B's defined cumulative earnings exceed its defined cumulative earnings goals. The contingent payments were due in years w through z.

Taxpayer reported the payments it received in w from the sale under the installment method as set forth in § 453 of the Internal Revenue Code. Pursuant to § 15a.453-

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1(c)(2), Taxpayer recovered basis of \$e for its y tax year and \$f for its w tax year. Basis of \$g is yet to be recovered. Taxpayer represents that for years v through x, B has fallen far short of its defined earnings goals and that due to loss of a key license agreement B is not expected to meet its earnings goal for year y. As a result, Taxpayer anticipates that it will not receive any contingent payments in the years x through z, and will incur a capital loss in the amount of \$g in z under the basis recovery rules of § 15a.453-1(c)(2). Therefore, Taxpayer requests under § 15a.453-1(c)(7) that it be allowed to recover the remaining \$g of basis in its w tax year

Although Taxpayer filed its w year tax return before filing this ruling request, it submitted the ruling request before the due date of its w year tax return including extensions. The Internal Revenue Service office with jurisdiction over Taxpayer's return is aware of, and does not object to, this office's consideration of the ruling request.

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

Section 453(b)(1) defines the term "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.

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

Section 15a.453-1(c)(1) defines a "contingent payment sale" as 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. Unless a taxpayer makes an election under § 15a.453-1(d)(3), contingent payment sales are to be reported on the installment method.

Section 15a.453-1(c)(2)(i)(A) provides that a contingent payment sale will be treated as having a stated maximum selling price if, under the terms of the agreement, the maximum amount of sale proceeds that may be received by the taxpayer can be determined as of the end of the taxable year in which the sale or other disposition occurs. Generally, the taxpayer's basis shall be allocated to payments received and to be received by treating the stated maximum selling price as the selling price for purposes of § 15a.453-1(b). If, however, application of the foregoing rules in a particular case would substantially and inappropriately accelerate or defer recovery of the taxpayer's basis, a special rule will apply.

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Section 15a.453-1(c)(7)(i) provides that the normal basis recovery rules set forth in § 15a.453-1(c)(2) may, with respect to a particular contingent payment sale, substantially and inappropriately defer recovery of the taxpayer's basis.

Section 15a.453-1(c)(7)(ii) provides that the 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 rule will substantially and inappropriately defer recovery of basis. To demonstrate that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis, the taxpayer must show (A) that the alternative method is a reasonable method of ratably recovering basis and, (B) 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. The taxpayer must receive a ruling from the Internal Revenue Service before using an alternative method of basis recovery.

Section 15a.453-1(c)(7)(ii) further provides that the taxpayer must file the request for a ruling prior to the due date for the return including extensions. In demonstrating that application of the normal basis recovery rule would substantially and inappropriately defer recovery of the taxpayer's basis, the taxpayer in appropriate circumstances may rely upon contemporaneous or immediate past relevant sales, profit, or other factual data that are subject to verification. 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 based upon a specific event that has already occurred.

Section 15a.453-1(c)(7)(iv) provides that a contingent payment sale may initially and properly have been reported under the normally applicable basis recovery rule and, during the term of the agreement, circumstances may show that continued reporting on the original method will substantially and inappropriately defer or accelerate recovery of the unrecovered balance of the taxpayer's basis. In this event, the special rule provided in this paragraph is applicable.

In this case, based on the information submitted and representations made, it appears that Taxpayer will not receive any contingent payments after w. Accordingly, based on that information and those representations, we conclude:

1. The basis recovery rules under § 15a.453-1(c)(2) will substantially and inappropriately defer recovery of Taxpayer's unrecovered balance of the basis in the assets sold pursuant to the Agreement.

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2. Taxpayer's proposal to recover the unrecovered basis in w is a reasonable method of ratably recovering basis under § 15a.453-1(c)(7)(ii) and § 15a.453-1(c)(7)(iv).
3. Under Taxpayer's proposal to recover the unrecovered basis in w, it is reasonable to conclude that over time Taxpayer will recover the unrecovered 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.

Accordingly, we conclude based on the information submitted and representations made that Taxpayer may recover the remaining \$g of unrecovered basis in w.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Michael J. Montemurro
Senior Technician Reviewer
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: