

Internal Revenue Service

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Third Party Communication: None

Date of Communication: Not Applicable

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PLR-139794-04

Date:

September 15, 2005

A =
B =
C =
D =
E =
X =
SB/SE
Official

Dear :

This responds to your request dated June 21, 2004, and supplemental correspondence, for a letter ruling under § 197 of the Internal Revenue Code as to the proper treatment of goodwill when such goodwill is purchased from a related corporation in a transaction to which the anti-churning rules of § 197(f)(9) do not apply.

FACTS

Taxpayer, an S corporation, was incorporated under the laws of the state of in and is engaged in the business of selling store fixtures to retail stores located throughout the United States. Taxpayer began operations during 1994. None of the assets used in the formation of Taxpayer constituted a previous trade or business.

Taxpayer has two 50% shareholders, A and B. Taxpayer's general manager is C. C has no ownership interest in Taxpayer.

Taxpayer will form New Corp, which will be 90% owned by B and 10% by C. Once formed, New Corp will make an election to be treated as an S corporation and will operate in the same locations, industry, and manner that Taxpayer operated. Since B is

a 50% shareholder of Taxpayer and will be a 90% shareholder of New Corp, Taxpayer and New Corp are related parties for purposes of section 197(f)(9).

D, who indirectly owns 50% of Taxpayer through A, desires to retire and sever all ties with Taxpayer. E, who owns 50% of Taxpayer through B, desires to continue Taxpayer's business. C desires to obtain an ownership interest in Taxpayer's business. To effectuate these aims, E and C have decided to form New Corp to purchase the assets and assume the liabilities of Taxpayer. New Corp's purchase price will be equal to the fair market value of the Taxpayer's assets, or approximately \$x, at the time of sale.

New Corp will purchase the Taxpayer's assets by issuing Taxpayer two installment notes. Each installment note will represent 50% of the fair value of the total assets, less the amount of debt assumed. Each note will contain a stated interest rate of %. Both notes will require monthly interest payments over their respective lives. One of the installment notes ("Note 1") will require principal payments during the years , , , , and . The other installment note ("Note 2") will require principal payments during the years , , , , and . The portion of the gain on the asset sale that is attributable to the installment notes will be deferred pursuant to § 453, except to the extent of any principal paid during the year of sale and any section 1245 or section 1250 recapture. Any gain attributable to the assumption of liabilities by New Corp will be taxable in the year of sale. Taxpayer will be subject to a tax on built-in gains under § 1374.

Taxpayer will adopt a plan of liquidation prior to the asset sale. Subsequent to the asset sale (and within 12 months of the adoption of the plan of liquidation), Taxpayer will liquidate and distribute Note 1 to A and Note 2 to B. No gain or loss will be recognized by Taxpayer upon the distribution of the installment notes receivable, pursuant to § 453(h), because: (1) the installment obligations will be acquired from the sale of Taxpayer's assets during the 12-month period beginning on the date of adoption of a plan of complete liquidation; and (2) the qualifying installment obligations will then be distributed to Taxpayer's shareholders as part of the liquidation.

At the time of the sale, the total fair market value of the Taxpayer's assets, which mainly consist of cash, receivables, prepaid expenses, inventory, and fixed assets, will be significantly higher than the fair value of the assets recorded on Taxpayer's books. This difference will be recorded on the books of New Corp as goodwill (a Class VII asset).

The facts above and their tax consequence are representations by Taxpayer.

RULING REQUEST

New Corp intends to amortize the goodwill at issue over 15 years pursuant to § 197. Accordingly, Taxpayer requests a ruling that, pursuant to § 197, New Corp is entitled to amortize the cost of the goodwill that New Corp acquires as a result of its

purchase of Taxpayer's business using the straight-line method and a 15-year recovery period.

LAW AND ANALYSIS

Section 197(a) provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable section 197 intangible. The amount of such deduction shall be determined by amortizing the adjusted basis of such intangible ratably over the 15-year period beginning with the month in which the intangible was acquired. Section 197(c) provides that the term "amortizable section 197 intangible" means any section 197 intangible which is acquired by the taxpayer after August 10, 1993, and which is held in connection with the conduct of a trade or business or an activity described in § 212. Section 197(d)(1)(A) defines the term "section 197 intangible" to include goodwill.

Section 197(f)(9) provides, in part, that the term "amortizable section 197 intangible" shall not include goodwill acquired by a taxpayer if such intangible was held or used at any time on or after July 25, 1991, and on or before August 10, 1993, by the taxpayer or a related person. Section 197(f)(9)(C) defines a related person to include those bearing a relationship to such person described in § 267(b), with "20 percent" substituted for "50 percent." Thus, the anti-churning rules apply to goodwill transferred after August 10, 1993, only if the taxpayer or a related person held or used the goodwill at any time from July 25, 1991, to August 10, 1993.

Section 267(b)(11) defines related parties as an S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation.

Section 1060(a) provides that in the case of any applicable asset acquisition, the rules of § 1060 are to be utilized to determine both the transferee's basis in the assets transferred and the gain or loss of the transferor with respect to such acquisition.

Section 1060(c) provides that the term "applicable asset acquisition" means any transfer (whether directly or indirectly) of assets that constitute a trade or business, and with respect to which the transferee's basis in such assets is determined wholly by reference to the consideration paid for such assets.

Section 1.1060-1(c)(2) of the Income Tax Regulations provides that, to determine the seller's amount realized for each of the assets sold (and therefore to determine the buyer's basis for each of the assets acquired), the residual method under §§ 1.338-6 and 1.338-7 should be used. Under this method, the purchase price is first allocated to Class I assets (cash and cash equivalents). Then the remaining consideration is allocated to Class II assets in proportion to their fair market value, followed by Class III assets through Class VI assets, respectively, in proportion to their fair value. Finally,

any remaining, unallocated portion of the purchase price is then allocated to Class VII assets (goodwill and going concern value).

Taxpayer represents that, based on the consideration paid by New Corp for Taxpayer's assets and allocating the consideration paid pursuant to § 1060, New Corp will acquire significant goodwill in the transaction. The goodwill acquired is part of the purchase of assets constituting a trade or business. B is a 50% shareholder of Taxpayer and will be a 90% shareholder of New Corp. As a result, Taxpayer and New Corp are related parties for purposes of section 197(f)(9). However, Taxpayer represents that Taxpayer began operations during 1994. Furthermore, Taxpayer represents that none of the assets used in the formation of Taxpayer constituted a previous trade or business. Thus, Taxpayer's goodwill asset did not exist during the section 197(f)(9) transition period, and the anti-churning rules of section 197(f)(9) do not apply.

Finally, by letter dated _____, Taxpayer represents that, for purposes of §§ 1239 and 453(g), the ruling request at issue does not involve a sale between related persons.

RULING

Based solely on the Taxpayer's representations and the above stated analysis, New Corp is entitled to amortize the cost of the goodwill that New Corp acquires as a result of its purchase of Taxpayer's business using the straight-line method and a 15-year recovery period, pursuant to § 197. We express no opinion on whether the installment notes are characterized as debt.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter to the SB/SE Official.

Sincerely,

Charles B. Ramsey
Branch Chief, Branch 6
(Passthroughs & Special Industries)

Enclosures (1):
copy of this letter for section 6110 purposes