Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

In Re: Request for Private Letter Ruling

Refer Reply To:
CC:PSI:B06 – PLR-138023-03
Date:
December 19, 2003

Legend

Parent	=
Purchaser	=
State X	=
Date 1	=
Seller	=
Business Segment 1	=
Business Segment 2	=
Product 1	=
Product 2	=
X	=
Trademark 1	=
Trademark 2	=
Y	=
Z	=
A	=
B	=
C	=
D	=
E	=
Patent 1	=
Patent 2	=

Dear :

This responds to your request dated June 20, 2003, for a ruling under section 197 of the Internal Revenue Code that certain patents, acquired by Purchaser in a proposed transaction described below, do not constitute "section 197 intangibles" in the hands of Purchaser because the acquisition of the patents is not a purchase of assets constituting a trade or business or substantial portion thereof. Additional information was submitted by letters dated November 25, 2003 and December 10, 2003.

FACTS

Taxpayer represents that the facts relating to its request are as follows:

Parent is a State X Corporation that files a consolidated return with Purchaser and its other subsidiaries (the "Parent Group"). The Parent Group computes its income using the accrual method of accounting and its taxable year is a 52/53 week year ending on the Saturday closest to Date 1.

The Parent Group's three main lines of business are Business Segment 1 and Business Segment 2. Business Segment 1 encompasses the development, manufacturing, marketing, distribution and sales of Product 1. Business Segment 2 includes the development, marketing and placement of Product 2.

Purchaser is a market leader in Business Segment 2. Several years ago, Purchaser operated X under the name "Trademark 1." Purchaser eventually acquired trademark protection for Trademark 1, which continued to be associated with the X. Purchaser developed a commercial relationship with Seller after receiving the trademark protection for Trademark 1. Purchaser entered into a license agreement with Seller for exclusive rights to produce Ys based on the technology developed and patented by Seller. Using trademarks and trade names it already owned, Purchaser named one of the Ys "Trademark 1." Following the success of Ys, Seller developed additional concepts and related processes and received several more patents for this technology. Thereafter, Seller licensed to Purchaser the patent rights to develop and make Ys using the Seller's technology.

Additionally, Purchaser and Seller sought and received trademark protection for the names for the Ys. Purchaser sold these trademarks to Seller for a total consideration of $A. Seller immediately licensed these trademarks back to Purchaser for no additional consideration other than the amount already being received under the patent license agreement. Purchaser currently has an exclusive license agreement with Seller for Patent 1 and Patent 2 (the "Patents") and associated trademarks. This license agreement, as amended, allows Purchaser to develop and market products based on the Patents in exchange for a royalty based on the placement of Zs.

For business reasons, Purchaser proposed to purchase the Patents from Seller (the "Transaction"), along with certain associated trademarks, including Trademark 1 and Trademark 2 (collectively, the "Trademarks"). The Trademarks have been used as an effective means of having customers quickly recognize a particular Z as using the Trademark 2 method.

Purchaser and Seller will have entered into a proposed agreement (the "Agreement") in connection with the Transaction. Under the terms of the Agreement, Purchaser will pay Seller the following amounts:

- A one-time, up-front fixed sum payment and annual fixed sum payments of the same amount, payable monthly, for a period of approximately Byears; and

- Contingent monthly payments over the life of the Patents based on the number of Zs in the hands of customers that use the Patents.

The overall consideration for the transfer of the Patents and Trademarks is expected to be approximately $C per month for a total of $D – $E over the entire term of the agreement.

Seller will continue as an ongoing trade or business and will continue to develop and license or sell other patents, ideas, trademarks, or any other item to other customers so long as the item does not infringe upon the Patents and associated trademarks to be acquired by Purchaser.

Purchaser has made the following additional representations in connection with the Transaction:

(a) Parent and Purchaser would have paid the same amount for the Patents regardless of whether or not the associated trademarks were transferred with the Patents in the Transaction.

(b) In the negotiations between Parent, Purchaser, and Seller, no price was separately negotiated for the Trademarks associated with the Patents.

RULING REQUESTED

Taxpayer requests a ruling that the purchase of the Patents and associated trademarks does not constitute the acquisition of assets constituting a trade or business or substantial portion thereof.

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. Section 197(b) provides that no other form of amortization or depreciation under the Code is allowable with respect to an amortizable section 197 intangible. According to section 197(c)(1), an amortizable section 197 intangible means any section 197 intangible which is acquired by the taxpayer after the date of enactment of section 197 (August 10, 1993) and which is held in connection with the conduct of a trade or business or an activity described in section 212. According to section 197(d)(1)(C)(iii), a section 197 intangible includes any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item.

Section 197(e)(4)(C) provides an exception to the general rule of section 197(d)(1)(C)(iii), stating that if an interest in a patent or copyright is not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof, then the patent or copyright will not be included in the definition "section 197 intangible." As a result, if a patent is not a section 197 intangible, it cannot be an amortizable section 197 intangible. If a patent is not amortizable under section 197, then it is amortizable under the provisions of section 167(f) and the regulations thereunder. See Treas. Reg. § 1.167(a)-14(c)(4).

Treas. Reg. § 1.197-2(c)(7) provides that a patent or copyright not acquired as part of a trade or business will include any incidental and ancillary rights (such as trademarks or trade names) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. Further, such rights will not be included in the definition of trademarks or trade names under Treas. Reg. § 1.197-2(b)(10)(i).

Treas. Reg. § 1.197-2(e) provides guidance on the question of what constitutes the acquisition of assets constituting a trade or business or substantial portion thereof for purposes of section 197. Under Treas. Reg. § 1.197-2(e)(1), the purchase of an asset or group of assets would constitute the purchase of a trade or business or substantial portion thereof if their use would constitute a trade or business under section 1060.

Treas. Reg. § 1.1060-1(b)(2)(i) provides, in general, that a group of assets would constitute a trade or business if either the use of such assets would constitute an active trade or business under section 355, or its character is such that goodwill or going concern value could under any circumstances attach to such group.

Treas. Reg. § 1.1060-1(b)(2)(ii) states that goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage and may be due to the name or reputation of a trade or business, or any other factor. The regulation further states that going concern value is the additional value that attaches to property because of its existence as an integral part of an ongoing business activity. Examples of going concern value are the ability of the business to continue functioning without interruption after a change of ownership, or any value attributable to the immediate use of revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

Treas. Reg. § 1.1060-1(b)(2)(iii) states that factors to be considered in determining whether or not goodwill or going concern value is present within a group of assets are the presence of any intangible assets; the existence of an excess of the total consideration over the aggregate book value of the tangible and intangible assets; and any other related transactions in connection with the transfer.

Under Treas. Reg. § 1.197-2(e)(2)(i), the acquisition of a franchise, trademark, or trade name generally constitutes the acquisition of a trade or business or a substantial portion thereof for purposes of section 197. There are three exceptions to this general rule listed in the regulations.

One exception to the general rule of Treas. Reg. § 1.197-2(e)(2) is that a franchise, trademark, or trade name is disregarded if its value is nominal or the taxpayer irrevocably disposes of it immediately after its acquisition.

Another exception to the general rule states that the acquisition of a right or interest in a trademark or trade name is disregarded if the right or interest is not, under the principles of section 1253, a transfer of all substantial rights to such property or an undivided interest in all substantial rights to such property.

The final exception to the general rule is that a trademark or trade name is disregarded if it is included in computer software (Treas. Reg. § 1.197-2(c)(4)(iv)) or in an interest in a film, sound recording, video tape, book, or other such similar property (Treas. Reg. § 1.197-2(c)(5)). Under these rules, trademarks and trade names that are incidental and ancillary rights, and that are necessary to effect the acquisition of title to, the ownership of, or the right to use the aforementioned properties are included as part of the principal intangible asset and not as a separate trademark or trade name.

Under the facts presented, for purposes of section 197(e)(4)(C), the Patents will be treated as separately acquired by Purchaser (ignoring the associated trademarks and trade names). Purchaser is not purchasing any other assets, other than the Patents and the associated trademarks and trade names.

RULING:

Accordingly, based on the foregoing facts and representations, we rule as follows:

The purchase of the Patents and the Trademarks does not constitute the acquisition of assets constituting a trade or business or substantial portion thereof and, therefore, the Patents and the Trademarks do not constitute a section 197 intangibles. Section 197(e)(4) and Treas. Reg. § 1.197-2(e).

Except as specifically ruled upon above, no opinion is expressed or implied regarding the application of any other provision of the Code or regulations.

This ruling is directed only to the taxpayers that requested 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, we are sending a copy of this letter to the Taxpayer. We are also sending a copy of the letter ruling to the appropriate Industry Director, LMSB.

Sincerely,

Peter C. Friedman,
Senior Technician Reviewer, Br 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

cc: