Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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CC:ITA:6 – PLR-152667-03

Date:
February 27, 2004

LEGEND:

A =

B =

X =

Date 1 =

Dear

This letter is in response to the letter submitted by A's authorized representatives in which a ruling was requested under § 1.381(c)(4)-1(d)(1)(i) of the Income Tax Regulations. Specifically, a ruling was requested for the Commissioner to determine the appropriate overall method of accounting for the surviving corporation of a merger as described below.

Prior to the date of the merger, A and B were both corporations engaged in the business of X. Prior to the merger, A used the overall cash receipts and disbursements method of accounting, and B used an overall accrual method of accounting.

On Date 1, A acquired B in a nontaxable merger under § 368(a)(1)(A) of the Internal Revenue Code to which § 361 applies. The combined business of the two was continued in the name of A after the merger. A, as the surviving corporation, will operate the formerly separate businesses of A and B as an integrated business.

The total adjusted bases of the assets of A exceeded the total adjusted bases of the assets of B immediately preceding Date 1. However, the gross receipts of B for the 12 month period preceding Date 1 exceeded those of A for the same period.

For each prior taxable year ending on or after December 31, 2000, the combined average annual gross receipts of A and B for the three taxable-year period ending with the applicable prior taxable year have not exceeded $10 million.

Section 381(a)(2) provides that in the case of the acquisition of assets of a corporation by another corporation in a transfer to which § 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D), (F) or (G) of § 368(a)(1), the acquiring corporation shall succeed to and take into account, as of the close of the day of transfer, the items described in subsection (c) of the transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

Section 381(c)(4) provides that the acquiring corporation shall use the method of accounting used by the transferor corporation on the date of transfer unless different methods were used by a transferor corporation and the acquiring corporation. If different methods were used, the acquiring corporation shall use the method or combination of methods of computing taxable income adopted pursuant to regulations prescribed by the Secretary.

Section 1.381(c)(4)-1(b)(3)(ii) provides that to the extent that different methods of accounting were employed on the date of transfer by the parties to a transaction described in § 381(a) with respect to any trades or businesses which are integrated or required to be integrated in accordance with § 446(d) and the regulations thereunder, the acquiring corporation shall adopt the principal method of accounting determined under paragraph (c) of this section, or the method of accounting determined in accordance with paragraph (d) of this section, whichever is applicable.

Section 1.381(c)(4)-1(c)(1) provides that the acquiring corporation shall use the principal method of accounting (as determined under subparagraph (2) of this paragraph), provided that such method of accounting clearly reflects the income of the acquiring corporation, and the use of such method is not inconsistent with the provisions of any closing agreement entered into under § 7121 and the regulations thereunder. If the principal method of accounting does not meet these requirements, or if there is no principal method of accounting, see subdivision (i) of paragraph (d)(1) of this section.

Section 1.381(c)(4)-1(c)(2) provides that the determination of the principal method of accounting shall be made with respect to each integrated trade or business operated by the acquiring corporation immediately after the date of transfer, except with respect to items for which only a single method of accounting may be used by any one taxpayer. The determination of the principal overall method of accounting shall be made by making a comparison of the total of the adjusted bases of the assets immediately preceding the date of transfer and the gross receipts for a representative period (ordinarily the most recent period of 12 consecutive calendar months ending on or prior to the date of transfer) of the component trades or businesses which are integrated or are required to be integrated. If this comparison shows that the one or more component trades or businesses, having the greatest total of the adjusted bases of assets, does not also have the greatest amount of gross receipts, then there is no principal overall method of accounting, and the acquiring corporation shall request the Commissioner to determine the appropriate overall method of accounting for such integrated trade or business in accordance with paragraph (d) of this section.

Section 1.381(c)(4)-1(d)(1)(i) provides that if the acquiring corporation may not continue to use, under paragraph (b), the method of accounting used by it or the transferor corporation on the date of transfer, and may not under paragraph (c) use the principal method of accounting, or, if there is no principal method of accounting, then the Commissioner shall determine the appropriate method or combination of methods of accounting to be used.

Section 1.381(c)(4)-1(d)(1)(iii) provides that the increase or decrease in tax resulting from the change from the method of accounting previously used by any of the corporations involved shall be taken into account by the acquiring corporation. The adjustments necessary to reflect such change and such increase or decrease in tax shall be determined and computed in the same manner as if, on the date of transfer, the corporation that was not using the method or combination of methods of accounting adopted pursuant to subdivision (i) of this subparagraph had initiated a change in accounting method.

Section 1.381(a)-1(b)(2) provides that generally, in a transaction to which § 381(a)(2) applies, the acquiring corporation is that corporation which, pursuant to the plan of reorganization, ultimately acquires, directly or indirectly, all of the assets transferred by the transferor corporation.

Section 1.381(b)-1(b)(1) provides that the date of transfer shall be that day on which are transferred all those properties of the transferor which are to be transferred pursuant to the reorganization described in § 1.381(a)(1)-(b)(1).

Under Rev. Proc. 2002-28, 2002-1 C.B. 815, qualifying small business taxpayers with average annual gross receipts of $10 million or less may use the overall cash method of accounting with respect to eligible trades or businesses. A qualifying small business taxpayer's principal business activity is considered an eligible trade or business if the taxpayer reasonably determines that it is not described in one of the ineligible North American Industry Classification System (NAICS) codes listed in section 4.01(1)(a) of Rev. Proc. 2002-28.

Because A will operate the former businesses of A and B as an integrated business after the merger, A is required to use a single overall method of accounting under § 1.381(c)(4)-1(b)(3)(ii). This method could be the principal method of accounting, if one exists. However, A determined that there was no principal method of accounting under § 1.381(c)(4)-1(c). Thus, the Commissioner must determine the appropriate method to be used under § 1.381(c)(4)-1(d). A has requested the Commissioner determine that it may use the overall cash method of accounting as described in Rev. Proc. 2002-28.

A has determined that its principal business activity, X, is not described in one of the ineligible NAICS codes listed in section 4.01(1)(a) of Rev. Proc. 2002-28. A also represents that, for each prior taxable year ending on or after December 31, 2000, the combined average annual gross receipts of A and B for the three taxable-year period ending with the applicable prior taxable year have not exceeded $10 million. Thus, A represents that it meets the requirements of Rev. Proc. 2002-28 to use the overall cash method of accounting as described in that revenue procedure. Permission is hereby granted to A to use the overall cash receipts and disbursements method of accounting as described in Rev. Proc. 2002-28.

In accordance with § 1.381(c)(4)-1(d)(1)(iii), if there is any increase or decrease in tax resulting from the adoption of the method granted in this ruling, A, the acquiring corporation, is required to take such increase or decrease in tax into account on its tax return for the tax year that includes the date of the merger. The adjustments necessary to reflect such change and such increase or decrease in tax must be determined and computed in the same manner as if, on the date of transfer, each corporation that was not using the method of accounting adopted pursuant to § 1.381(c)(4)-1(d)(1)(i) had initiated a change in accounting method. Consequently, B must determine the difference, if any, between its tax liability reflected on its actual return computed on its accrual method and the tax liability reflected on a hypothetical return using the overall cash method of accounting as described in Rev. Proc. 2002-28. In addition, A must determine the difference, if any, between its tax liability reflected on its actual return computed on its overall cash method and the tax liability reflected on a hypothetical return using the overall cash method of accounting as described in Rev. Proc. 2002-28. The combination of these two amounts will result in an increase or decrease in tax which A will reflect on its tax return for the tax year that includes the date of the merger.

The information submitted and the statements and representations made in the request for this ruling form a material basis upon which our ruling is issued. Facts upon which this ruling is based are subject to verification by the director.

No opinion is expressed as to the tax treatment of the transaction under the provisions of any other sections of the Code and regulations that may be applicable thereto or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically set forth by the above ruling. Specifically, no opinion is expressed that A qualifies to use the cash method of accounting pursuant to Rev. Proc. 2002-28.

A copy of this letter should be attached to the federal income tax return of A for the tax year in which the transaction covered by this ruling letter is consummated.

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to A’s designated representative.

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

Sincerely,

THOMAS A. LUXNER
Chief, Branch Six
Office of Associate Chief Counsel
(Income Tax & Accounting)