INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

March 03, 2006

Third Party Communication: None
Date of Communication: Not Applicable

Index (UIL) No.: 1033.01-00
CASE-MIS No.: TAM-155942-05
Number: **200625032**
Release Date: 6/23/2006
Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Appellate Court

Modeler

Company A

Company B

Company C

Company D

Company E

Company F

Company G

Company H

Company I
Company J =

Count One =

Damages Report 1

Damages Report 2

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Date 7

Date 8

Date 9

Date 10

Date 11

Date 12

Date 13

Date 14

Date 15

Date 16

District Attorney

District Court

Dynamic Modeling

Employee

Engineering Profession

License

Partial Re-design

Products

Product 1

Product 2

Product 3

Product 4

Product 5

Product 6

Prototypes

Settlement Agreement and Release

State

State Code

Superior Court

Virtual Modeling

Year 1

Year 2

Year 3

Year 4

Year 5

Year 6

Year 7

Year 8

Year 9

Year 10

Year 11

$a

$b

$c

$d

$e

$f

$g
$h

$i

$j

$k

$l

$m

$n

$o

$p

$q

ISSUE(S): Whether either the amounts that Company A received from Company B as payments pursuant to the State Code or amounts received as proceeds of a settlement of claims for copyright infringement and misappropriation of trade secrets may be excluded from income pursuant to section 1033 of the Internal Revenue Code as proceeds of an involuntary conversion.

CONCLUSION(S): The amounts that Company A received from Company B either as payments pursuant to the State Code or as proceeds of a settlement of claims for copyright infringement and misappropriation of trade secrets may not be excluded from income pursuant to section 1033 as the proceeds of an involuntary conversion.

FACTS:

During the periods involved, Company A and Company B were competitors in the development of Products for the Engineering Profession. Company A was formed through the merger of several companies in Year 1. The predecessor of Company B was formed in Year 2 by a number of former senior employees of Company A.

During Year 4, a Company A employee discovered evidence that a Company B product incorporated portions of Company A's copyrighted Product 1. A subsequent search of Company B's headquarters
showed direct detailed copying of Company A's copyrighted Product 1 by a former Company A employee who left Company A to join Company B.

On Date 2, Company A filed a complaint against Company B in District Court alleging claims for relief based on copyright infringement, unfair competition, misappropriation of trade secrets, conspiracy, breach of contract, and false advertising. Company A sought injunctive relief, recovery of damages sustained as a result of Company B's alleged wrongful acts, and recovery of the gains, profits and advantages which Company B obtained as a result of its alleged wrongful acts. It also sought punitive, exemplary and treble damages. As of the filing date, Company A had been unable to determine the amount of the claimed damages. Company A asserted that specified Company B products incorporated wholesale portions of Company A's copyrighted Products. Company A also alleged that Company B paid employees of Company A to provide valuable information concerning Company A Products.

On Date 3, Company B filed counter claims on various grounds, including antitrust violations, false advertising, interference with prospective economic advantage, and intentional interference with contractual relations.

After Company A filed the civil action, Company B undertook the Partial Re-design. It incorporated the results of the Partial Redesign in new versions of certain Company B products.

The District Court initially denied Company A's request for an injunction barring Company B's sales of infringing products. The denial was the result of the District Court's erroneous consideration of the effect an injunction might have on Company B, the infringer. After the Appellate Court reversed and remanded the denial, the District Court prohibited Company B from using or licensing specified Company B products as well as any other product which infringed Company A's Product 1. It also issued a preliminary injunction which prohibited Company B from selling or distributing specified Company B products. The District Court found that Company A had established that Company B copied some of Company A's Product 1

On Date 5, the District Court stayed the civil action, except with respect to documentary discovery and discovery related to third parties, pending the outcome of the proceeding. On Date 6, the

District Court lifted the stay with respect to Company A's claims against Company B relating to Company A's Product 1 and the results of Company B's Partial Re-design. The District Court continued the stay as to the other issues.

On Date 7, Company A submitted reports of two experts in connection with its claims for damages resulting from Company B's sales of products that infringed Company A's Product 1. Damages Report 1 determined Company A's damages on the basis of the profits it lost as the result of Company B's actions. It concluded that Company A was entitled to lost profits of at least $a as well as prejudgment interest and punitive damages of $b. Damages Report 2 determined Company A's damages by using different scenarios to determine the amount of Company B's unjust enrichment due to the alleged infringement of its copyrights and the misappropriation of Company A's trade secrets. Unjust enrichment was defined as the difference between the current actual value of Company B and its value if it had stopped selling infringing products and attempted a re-design. Damages Report 2 concluded that Company B's unjust enrichment was in the range of $c to $d. The expert who prepared Damages Report 2 also submitted percentages to calculate Company B's unjust enrichment attributable to follow-on sales, i.e., sales lost by Company A as a result of purchasers of Company B's infringing products subsequently purchasing non-infringing products from Company B.

On Date 12, Company C acquired Company B.

On Date 13, Companies A, B, and C and named individuals entered into a settlement and general release (the "Agreement") to resolve any and all pending actions and issues, including all claims the parties asserted or could have asserted in the lawsuit and with regard to conduct or events occurring before Date 12. Company A granted Companies B and C the License under the terms of the Agreement. It indicated that it did not perform a valuation of the License. The Agreement provides for Company B's payment of $e to Company A: $f on or before Date 15 and $g on or before Date 16.

Throughout the litigation, Company A treated the acts of the defendants as the cause of a single loss; it sought one amount of money as compensation for all of the defendants' wrongful acts. The "wrongful acts," which were the same for each claim, caused a fixed amount of damage even though each act could include a number of different torts. Such a position would be consistent with the view that it would be neither meaningful nor possible to determine what portion of the damage attributable to a single act was allocable to each of the different claims. Company A did not break out specific acts and the associated damages. No documents were prepared to calculate the exemplary and punitive damages sought in the fourth claim, the punitive damages sought in the second and third claims, or the treble damages sought in the seventh claim. No monetary amounts were sought in the fifth and sixth claims.

On its tax return for Year 9, Company A treated the $e it received pursuant to the Agreement as proceeds from the involuntary conversion of its property, and elected to exclude such proceeds from income in accordance with section 1.1033(a)-2(c)(1) of the Income tax Regulations.

. A Statement of Decision filed by the Superior Court on Date 11 indicated that it found: (a) that actual thefts of Product 1 and Product 2 (considered one trade secret) occurred during the period Year 2 through Year 6; (b) additional thefts of Products 3 thru 5 trade secrets and perhaps others occurred in Years 3 and 4; and that the theft of Product 6 (considered the fifth trade secret) occurred in Year 4.

The Superior Court found that Company A was entitled under the State Code to receive an amount sufficient to fully reimburse it for every economic loss, including lost profits (measured by "gross profits") incurred as a result of the defendants' conduct. It rejected Company A's calculation of lost gross profits and found that Company A was entitled to an award of $h under the State Code. The Superior Court divided the award into different components representing lost profits caused by the theft of Company A's different products. It used Company B's sales of products which incorporated Products 1 and 2 trade secrets to determine that Company A was entitled to lost profits of $i. Company A's actual loss was not reasonably ascertainable because Company A decided to pursue a different approach in lieu of continuing to market those products. For Product 6, the Superior Court awarded lost profits of $j, the amount of Company B's sales of a product that was a direct copy of Product 6. For Products 3 thru 5 that were stolen but not incorporated in any Company B products, the Superior Court awarded $k as the value of an extremely limited hypothetical license to examine those Products without having the right to use or copy any part of them. The Superior Court also found that Company A was entitled to: (i) pre-judgment interest of $l with respect to the award relating to Products 3 thru 5; attorneys' fees of $m and $n as reimbursement for the time spent by its employees in working on the cases.

On Company A's income tax return for Year 8, it treated $o, the portion of the award consisting of $i, $j, and $k received pursuant to the State Code as proceeds from an involuntary conversion of property and elected to exclude such amount from income pursuant to section 1.1033(a)-2(c)(1). It identified Company D stock it had purchased for $p in Year 6 as section 1033 replacement property. Company A indicated that It had reduced its cost basis of $p in that stock by $o, the amount of the award it excluded from income.

Company A's income tax return for Year 9 identified stock it purchased in Company E, in addition to the Company D stock, as section 1033 replacement property. According to Company A, it has a cost basis of $q in the Company E stock.

During Year 10, Company A acquired the stock of Companies F through J which it identified as section 1033 replacement property in its income tax return for Year 11.

Company A provided asset valuation reports for the acquired entities whose stock it treated as section 1033 replacement property. The reports were prepared to assist in the allocation of the purchase price of the respective entities for financial reporting purposes. The valuation reports, however, do not separately value the individual trade secrets or copyrights held by the respective entities.

Company A maintains that the stock of each of the corporations it purchased qualifies as "similar" property for purposes of section 1033 since the assets of each of the acquired companies were predominantly intangible property used in the Engineering Profession. It asserts that it acquired the companies to restore its competitive position in the Engineering Profession. However, the asset valuation reports and economic analyses for the acquired intangibles suggest that Company A acquired the companies to either establish a position or gain market share in other segments of the Engineering Profession rather than to restore its competitive position in the Products segment of the Engineering Profession in which Products 1 thru 6 were marketed.

In the period prior to Year 5, Companies A, B, and a third entity dominated the Products segment of the Engineering Profession. Company C dominated the Dynamic Modeling market segment of the market in which Companies A and B had insignificant positions. After Year 5, Company A's business changed significantly . In Year 5, Company A phased out a Dynamic Modeling product, , which had failed to break into the Dynamic Modeling market. . The acquisition of Company D in Year 6, signaled Company A's re-entry in Dynamic Modeling market and its objective of challenging Company C, the segment leader. Company A acquired Company G in Year 10 to gain additional market share in the Dynamic Modeling market segment.

In Year 10, Company A acquired Company F to compete with Company C in the Virtual Modeling segment of the market. Companies H, I, and J, which Company A acquired in Year 10, complemented its existing products. The Year 10 acquisition of Company E represented an expansion of Company A's business to serve all segments of the Engineering Profession related to Prototypes.

LAW AND ANALYSIS:

Section 61(a) indicates that, except as otherwise provided in the income tax provisions of the Code, gross income means all income from whatever source derived. It includes rents, royalties, and gains from dealings in property among the specifically listed items included in gross income

Section 1033(a)(2)(A) allows a taxpayer to make an election to limit current recognition of gain with respect to property that (as a result of destruction, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money to the excess of the amount realized upon such conversion over the cost of other property similar or related in service or use to the converted property, or the cost of purchasing stock in the acquisition of control of a corporation owning such other property, purchased by the taxpayer within a specified period for the purpose of replacing the converted property. The words "or threat or imminence thereof" in I.R.C. §1033(a) modify only the words "requisition or condemnation" and have no application to the words "destruction, theft, or seizure." Hitke v. Commissioner, 296 F. 2d 639, 644 (7th Cir. 1961).

The nonrecognition treatment provided by section 1033(a)(2)(A) is an exception to the general rule of section 61(a) that gross income includes all income from whatever source derived. However, such nonrecognition does not result in a permanent exclusion from income of the gain realized on involuntarily converted property. Section 1033(b)(2) provides that in the case of property purchased by a taxpayer in a transaction involving an involuntary conversion of property into money which resulted in the nonrecognition of any part of the gain realized as the result the involuntary conversion, the basis of the property (including stock purchased to acquire control of a corporation owning property similar or related in use to the converted property) shall be the cost of such property decreased by the amount of the gain not recognized, and if the property consists of more than 1 piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

Section 1033(b)(3) provides that if the basis of stock in a corporation is decreased under section 1033(b)(2), an amount equal to such decrease shall also be applied to reduce the basis of property held by the corporation at the time the taxpayer acquired control (defined in section 1033(a)(2)(E)(i) as ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation). Section 1033(b)(3)(C) provides rules for the allocation of basis reduction of a corporation's assets.

Courts have held that section 1033 is intended to relieve a taxpayer of an unanticipated tax liability arising from an involuntary conversion of property if the taxpayer "re-establishes his prior commitment of capital" within the time period specified by the statute and have liberally construed the provision to serve that purpose. If the gain realized on an involuntary conversion of property were subject to current taxation, a taxpayer that received conversion proceeds equal to the value of the converted property would not have sufficient funds to replace the converted property after paying taxes on the realized gain even though the conversion of the property which resulted in the gain was involuntary. To address such circumstances, section 1033(a)(2)(A) allows a taxpayer who realizes a gain on an involuntary conversion of property to defer recognition of the gain if he "re-establishes his prior commitment of capital" within the time period specified in the statute. However, the courts have recognized that section 1033 is not intended "to confer a gratuitous benefit upon the taxpayer by permitting him to utilize the involuntary interruption in the continuity of his investment to alter the nature of that investment tax free. . ." Filippini v. United States, 318 F.2d 841, 844 (9th Cir. 1963, cert. denied, 375 U.S. 922 (1963); see also Willamette Industries, Inc. v. Commissioner, 118 T.C. 126, 131 (2002).

"The word 'theft' is not like 'larceny', a technical word of art with a narrowly defined meaning. On the contrary, it is a word of general and broad connotation, intended to cover and covering any criminal appropriation of another's property to the use of the taker, particularly including theft by swindling, false pretenses, and any other form of guile." Edwards v. Bromberg, 232 F.2d 107, 111 (5th Cir. 1956); Perry A. Nichols, 43 T.C. 842 (1965); Robert S. Gerstell, 46 T.C. 161 (1966).

Not all thefts qualify as involuntary conversions; only those circumstances which involve an "involuntary interruption in the continuity" of the taxpayer's investment, e.g., a permanent disposition or the partial or complete destruction of the property, qualify as an involuntary conversion. In order to claim an involuntary conversion, a taxpayer must prove that the property at issue "is no longer available for his intended business purpose for the property." Id. at 133. See also Willis, Inc. v. Commissioner, 41 T.C. 468, 476 (1964), aff'd, 342 F.3d 996 (3d Cir. 1965) in which the court stated that "[i]nvoluntary conversion, within the meaning of section 1033(a), means that the taxpayer's property, through some outside force or agency beyond his control, is no longer useful or available to him for his purposes."). An involuntary conversion requires an "involuntary interruption in the continuity" of the taxpayer's investment. Filippini, 318 F.2d at 844.

Circumstances involving copyright or patent infringement, or trade secret misappropriation are distinguishable from those involving the theft of tangible personal property. Absent recovery, a theft of tangible personal property results in the owner's permanent loss of use of the property and loss of the investment in the property. In contrast to those results, copyright infringement or trade secret misappropriation does not deny the owner of the copyright or trade secret the use of the protected property or directly affect the owner's investment in the copyright or trade secret. The impermissible use has the economic effect of denying the owner the profit on the infringer's sale(s) of an infringing product. For example, if an infringer made 20 photocopies of a copyrighted investment newsletter and sold them, the infringer's actions would not directly affect the value of the publisher's copyright but they would deny the publisher the profits on the infringing sales. The owner would be entitled to recover the infringer's profits from sales of the infringing newsletters and any other amounts obtained by the infringer that were attributable to sales of the infringing newsletters.

The Uniform Trade Secrets Act, which has been adopted by the State, provides for recovery of damages for misappropriation of trade secrets. The damages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing the actual loss. If neither damages nor unjust enrichment caused by misappropriation are provable, the court may order payment of a reasonable royalty.

Similarly, 17 U.S.C. 504(a) provides that a copyright owner is entitled to recover the actual damages suffered as a result of infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.

Some courts take the position that actual damages are measured by lost profits. X-It Prods, LLC v. Walter Kidde Portable Equip, Inc., 227 F. Supp 2d 494 (E.D. Va 2002). Others view actual damages as the extent to which the market value of a copyrighted work, at the time of the infringement, has been injured or destroyed. Baker v. Urban Outfitters, Inc., 254 F. Supp. 2d 346 (S.D. N.Y. 2003). In circumstances involving copyright infringement or misappropriation of trade secrets, it would appear that the amount of any decline in the value of the copyrighted work or a trade secret would be consistent with the amount of damages determined by reference to lost profits since the value of a copyright or trade secret represents the present value of the amounts to be obtained from the economic exploitation of the copyright or trade secret.

The damages reports prepared by Company A's experts did not assert that Company B's actions had an adverse effect on the value of Company A's copyrighted material or trade secrets. There is no indication that Company B used the infringed material to develop products superior to those of Company A which adversely affected the market for Company A's products subsequent to Company B's sales of its infringing products.

The fact that Company B did not use or incorporate any part of Products 3 thru 5 in its products and marketed a direct copy of Product 6 argues against such a position.

There is no indication that the value of Company A's business, copyrights and/or trade secrets related to Product 1 or 2 were adversely affected to an extent greater than the lost profits attributable to Company B's sales of infringing products. Although Company A maintains that it acquired the stock of various entities in the Engineering Profession to restore its competitive position, no information has been presented to indicate that its competitive position was adversely affected by Company B's actions to an extent beyond the sales lost to Company B's infringing products prior to the grant of the injunction barring sales of infringing products. There is no assurance that all of the purchasers of Company B's infringing products would have made purchases from Company A if there had been no infringement. The injunction prohibiting sales of infringing products was in effect for a substantial portion of the period involved. Although the value of Company A's stock experienced a number of short-term fluctuations during the periods involved, there were numerous other plausible explanations for those fluctuations, e.g., dilution resulting from a secondary offering of Company A stock; dilution attributable to the issuance of a significant number of shares Company A stock in connection with a merger; restructuring costs associated with integration of acquired companies; costs of terminating employees and eliminating facilities made redundant as a result of the acquisition of other businesses, general business conditions, product life cycles, client product life cycles, competition from new firms (business has low barriers to entry); emergence of better financed more adept competitors as the result of acquisitions and mergers; additional costs (training and learning curve) associated with new employees; intensified competition, and Company A's decision to curtail or cease marketing Products 1 and 2 and pursue a different course of action. Any change in Company A's competitive position could have been attributable to one or more of the above factors.

In the subject circumstances, Company A retained possession of the copyrighted material and trade secrets at issue and was able to exercise its rights as owner. There was no disposition of any portion of Company A's interest in the copyrights or trade secrets. Section 1033 applies in circumstances involving an involuntary disposition or destruction of property. Absent a disposition or destruction of property, there is no basis for application of section 1033 in Company A's circumstances.

Assuming, for the sake of discussion, that Company A's circumstances involved an involuntary conversion of property and the amounts Company A received were the result of the involuntary conversion, there would be an issue whether each of Company A's stock purchases qualified as the purchase of stock in the acquisition of control of a corporation owning property similar or related in service or use to the property converted. Company A has not established that the assets of each of the acquired entities were similar or related in use to Products 1 though 6 (the assets which were subject to copyright infringement or misappropriation of trade secrets).

Rev. Rul. 64-237, 1964-2 C.B. 319 provides that a functional use test will be used to determine whether replacement property acquired by an owner-user is similar or related in service or use to converted property. Property is not considered similar or related in service or use to the converted property unless the physical characteristics and end use of the converted and replacement properties are closely similar.

Company A maintains that the entities it purchased qualify as section 1033 replacement property since substantially all of the assets of the entities are used in the Engineering Profession. It does not address the fact that some of the acquired entities operate in segments of the Engineering Profession other than the segment served by Products 1 thru 6. The assets of some of the acquired entities appear to have been functionally different from Products 1 thru 6. It appears that Company A used some of the acquisitions to establish or enhance its position in segments of the Engineering Profession other than the Products segment.

In Mathey v. Commissioner, 10 T.C. 140, aff'd 177 F.2d 259 (1st Cir. 1949), damages received from a patent infringement action were likened to ordinary income arising from a non-exclusive license granted by the patentee to the competitor. The competitor was required to reimburse the patent holder for the loss of income the patent holder suffered as a result of the competitor's unauthorized use of the patent. Capital gain treatment was denied because the patentee continued to own, possess and actually use the patent despite the unauthorized use of the patent by the competitor.

In Kurlan v. Commissioner, 343 F.2d 625 (2nd Cir. 1965), the Court reached a similar result with respect to amounts realized as a result of litigation alleging copyright infringement. In denying capital gain treatment, the Court held that the transfer of a nonexclusive right to copy was not a "sale or exchange" entitled to capital gain treatment. The Court also rejected the copyright holder's argument that his property had been compulsorily or involuntarily converted. The Court concluded that "[d]espite infringement, a copyright or patent remains with its true owner who may always seek injunctive relieve against further misuse." It rejected the position that the infringement at issue represented a partial involuntary conversion and asserted that damages for infringement are "as much ordinary income as the royalties they replace …." Id.

Even if Company A established that there had been an involuntary interruption of its investment in its copyrights and trade secrets that would constitute an involuntary conversion, it would be required to establish that the payments which it received under the Agreement and the decision in Superior Court proceeding were intended to cover the value of the converted property rather than as reimbursement for lost profits, license fees, royalties or other taxable amounts. See United States v. Safety Car Heating and Lighting Company, 297 U.S. 88 (1936)(profits owed patentee by infringer were taxable income); Raytheon Prod. Corp. v. Commissioner, 144 F.2d 110, 113 (1st Cir. 1944), cert denied, 323 U.S. 779 (1944) (recoveries representing reimbursement of lost profits are taxable income); see also W.W. Sly Mfg. Co. v. Commissioner, 24 B.T.A. 65 (1931); Mathey v. Commissioner, 10 T.C. 1099 (1948), aff'd 177 F.2d 259 (1st Cir. 1949) cert. denied, 339 U.S. 943 (1950). The portion of any payments which represents punitive or exemplary damages is taxable as ordinary income irrespective of the tax treatment of the balance of such payments. United States v. Glenshaw Glass Co., 348 U.S. 426 (1955).

The Superior Court specified that the amount awarded pursuant to the State Code represented payments for lost profits, Company B's sales revenue from sales of a product that was a direct copy of a Company A product, and license fees for a hypothetical license for certain trade secrets which were stolen but not used by Company B in its products. None of the amounts qualify as proceeds of an involuntary conversion.

A position that any payment received as a result of copyright infringement or the misappropriation of trade secrets is within the scope of section 1033(a)(2)(A) would provide the owner more favorable treatment than he would have received if there had been no infringement. In the case of infringement, the owner would be allowed to defer tax on the amounts, representing lost profits, received from the infringer by reinvesting the amounts in similar property. However, the owner who received profits from sales of the copyrighted item would be subject to current tax. There is no indication that Congress intended such favorable treatment for payments received as a result of copyright or patent infringement. Application of section 1033 in such circumstances would provide an incentive for a copyright or patent owner to delay exploitation of the copyright or patent in the hope that a "deep-pocketed" infringer with marketing expertise would infringe the owner's copyright, patent, or trade secret.

The tax consequences of payments made pursuant to settlement agreements are governed by the nature of the underlying claims. United States v. Burke, 504 U.S. 229 (1992)(settlement payments are treated for tax purposes as if the payment was awarded in the underlying lawsuit); Tribune Publishing Co. v. United States, 836 F.2d 1176, 1177 (9th Cir. 1988). Courts have characterized settlement payments for tax purposes by asking, "In lieu of what were the damages awarded?" Millenbach v. Commissioner , 318 F.3d 924, 932 (9th Cir. 2003). The language used in complaints and settlement agreements may provide some evidence of the nature of the claims involved, Getty v. Commissioner, 913 F.2d 1486 (9th Cir. 1990). The taxpayer bears the burden of establishing the nature of the proceeds of a settlement. Millenbach v. Commissioner, Id. at 933. Courts have a duty to discern the true nature of a payor's intent in settling a claim. Id. at 934; Francisco v. United States, 267 F.3d 303, 322 (3d Cir. 2003).

Company A's complaints were based on copyright infringement, unfair competition, misappropriation of trade secrets, conspiracy, breach of contract, and false advertising. It sought injunctive relief, recovery of damages, and recovery of the gains, profits and advantages which Company B obtained as a result of its impermissible use of Company A's copyrights and trade secrets. The Agreement does not allocate the proceeds to its individual claims. Company A did not value the License which it granted Companies B and C under the terms of the Agreement.

Based on the documents provided thus far, it appears that the payments provided under the Agreement were to compensate Company A for lost profits and Company B's unjust enrichment. Although the Agreement provides that "lost profits" were not taken into account but were nevertheless waived as part of the Agreement, Company A has not established that any portion of the settlement payment represents a recovery of an investment of capital with respect to involuntarily converted property that it could re-establish by purchasing replacement property.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.