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December 11, 2007

LEGEND

Taxpayer =
X =
Y =
Business1 =
Year1 =
Year2 =
Date1 =
Date2 =

Dear :

This letter responds to a letter dated May 18, 2007 and additional correspondences, submitted on behalf of Taxpayer, requesting rulings on the treatment of deferred research and experimental expenditures under § 59(e) of the Internal Revenue Code.

The facts and representations submitted are summarized as follows:

Taxpayer is a widely held publicly traded corporation and the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Taxpayer conducts Business1 and certain other businesses directly and indirectly through its subsidiaries. X is a wholly owned subsidiary of Taxpayer. Y is a recently formed, wholly owned subsidiary of X.

Pursuant to § 59(e), Taxpayer and its subsidiaries have elected to capitalize and amortize over 10 years certain research and experimental expenditures incurred from Year1 through Year2 taxable years. A portion of such capitalized expenses were incurred in connection with Business1. Currently, Taxpayer and its subsidiaries have unamortized research and experimental expenditures deferred under § 59(e).

Taxpayer plans to separate Business1 into an independent publicly traded company through the following transactions: X will contribute X's Business1 assets and liabilities to Y; X will distribute all the stock of Y to its sole shareholder, Taxpayer; Taxpayer will contribute Taxpayer's Business1 assets and liabilities to Y; and Taxpayer will distribute all of the stock of Y to the common stock shareholders of Taxpayer. Business1 assets include the assets that incurred research and experimental expenditures for which Taxpayer elected to defer and amortize under § 59(e).

On Date 1, Taxpayer submitted to the Internal Revenue Service, Associate Chief Counsel (Corporate), a separate request for private letter rulings with respect to the application of §§ 355 and 368(a)(1)(D) to the same facts as contained in this ruling requests. On Date 2, Taxpayer received rulings which stated, among others, that: (1) the transactions described therein would constitute a reorganization under § 368(a)(1)(D); (2) no gain or loss will be recognized to Taxpayer and its subsidiaries under §§ 355, 357(a), 361, and 1032(a); and (3) the basis of each asset received by Y will equal the basis of that asset in the hands of Taxpayer and X immediately before the transfer. Furthermore, the rulings stated that Corporate has not reviewed any information pertaining to, and has made no determination regarding the federal tax treatment of assets for which a § 59(e) election may be in effect and the unamortized remaining balance of expenses for which a § 59(e) election may be in effect.

Accordingly, Taxpayer requests the following rulings under § 59(e):

1. The unamortized amount of research and experimental expenditures for which § 59(e) election is in effect at both Taxpayer and X at the time of the transfer of the assets carries over to Y;

2. The unamortized amount of research and experimental expenditures for which § 59(e) election is in effect at both Taxpayer and X and which carries over to Y will continue to be amortized by Y in the same manner and over the remaining period that such amounts would have been amortized by Taxpayer and X; and

3. For the calendar year that the assets associated with Business1 (including the unamortized amount of research and experimental expenditures for which § 59(e) election is in effect) are transferred by Taxpayer and X to Y, the deduction associated with § 59(e) election relating to such business will be split ratably among Taxpayer, X, and Y. Taxpayer and X will claim a deduction based on that portion of the remaining unamortized § 59(e) expenditures as of January 1, 2007 that would have been claimed for 2007 by each such corporation absent a transfer multiplied by a fraction the numerator of which is the number of whole months in the 2007 calendar year prior to the month that the assets and related § 59(e) expenditures are transferred to Y

and the denominator is twelve. The balance of the unamortized § 59(e) expenditures as of January 1, 2007 that would have been claimed by Taxpayer and X for 2007 absent a transfer will be claimed by Y.

In general, § 174 provides two methods of accounting for research or experimental expenditures. Under § 174(a), taxpayers may deduct their research or experimental expenditures in the taxable year in which they are paid or incurred, or they may elect, under § 174(b), to amortize such expenditures over a period of not less than 60 months.

In addition to the methods of accounting for research and experimental expenditures under § 174, § 59(e) allows a taxpayer to elect, for regular tax purposes, to capitalize and amortize research and experimental expenditures and other expenditures that may give rise to a minimum tax preference over a 10-year period beginning in the taxable year in which the expenditures were paid or incurred.

Section 59(e)(2) provides that a qualified expenditure includes any amount, but for an election under § 59(e), that would have been allowable as a deduction under § 174(a) for the taxable year in which it was paid or incurred. An election under § 59(e) may be made for any portion of any qualified expenditure. Further, no deduction shall be allowed under any other section for any qualified expenditure to which an election under § 59(e) applies. Section 59(e)(4)(B) provides that the election may be revoked only with the consent of the Secretary.

Section 1016(a) sets forth the general rules for determining the adjusted tax basis of property. Treas. Reg. § 1.59-1(b)(2) states that the amount elected under § 59(e) is properly chargeable to a capital account under § 1016(a)(20). Section 1016(a)(20) requires that proper adjustment to the tax basis of property be made for amounts allowed as a deduction under § 59(e).

Section 362 states that if property is acquired by a corporation in connection with a transaction to which § 351 or 368 apply, the tax basis to the transferee shall be the same as it would be in the hands of the transferor increased by the gain recognized to the transferor on such transfer.

The facts and issues in this ruling request are similar to those in Philadelphia and Reading Corporation and Southern Carbon Corporation v. The United States, 602 F.2d 338 (Ct. Cl. 1979), where the court allowed a transferee of a mineral property to treat deferred development expenditures in the same manner as if it were the transferor. The transfer of the mineral property was in connection with transactions described in § 351. The transferor corporation had incurred development expenditures related to the mineral property, and had elected to defer and amortize under § 616(b). Although no specific authority exists as to the treatment of the unamortized development

expenditures, the court permitted the transferee to continue to amortize the remaining balance of the deferred expenditures.

The court recognized that in transactions described under §§ 351 and 368, "the transferor has not made a new investment but merely changed the form of the old. Both sections 351 and 368 are the result of statutory recognition of the mere change in form of legal ownership without a substantial change in the substance of the transferor's investment." The court also noted that such transferees acquire the property at the transferors' adjusted basis, and therefore, they only have basis in those development expenses which the transferors have not previously expensed or amortized. Furthermore, "the amortization deductions can only be taken by the transferees over production of the minerals actually benefited by the development costs."

Similarly, in the current rulings request, no specific authority exists as to whether the research and experimental expenditures for which the election under § 59(e) is made could carry over to Y such that Y could continue to amortize the remaining balance of the expenditures deferred under § 59(e). Nevertheless, the current facts show that the transfer of the assets related to research and experimental expenditures was in connection with a change in the legal ownership of the property without a change in the substance of its investment.

Pursuant to Treas. Reg. § 1.59-1(b)(2) and § 1016(a)(20), Taxpayer's basis in the assets that generated the research and experimental expenditures reflects the expenditures deferred under § 59(e) and is reduced by the expenditures that were deducted in prior taxable years. Furthermore, Y's basis in the assets is determined by Taxpayer's basis immediately prior to the transfer.

Accordingly, given the facts and circumstances of this rulings request, we conclude the following:

1. The unamortized amount of expenditures for which § 59(e) election is in effect at both Taxpayer and X at the time of the transfer of the assets carries over to Y.

2. The unamortized amount of expenditures for which § 59(e) election is in effect at both Taxpayer and X and which carries over to Y will continue to be amortized by Y in the same manner and over the remaining period that such amounts would have been amortized by Taxpayer and X; and

3. For the calendar year that the assets associated with Business1 (including the unamortized amount of expenditures for which § 59(e) election is in effect) are transferred by Taxpayer and X to Y, the deduction associated with § 59(e) election relating to such business will be split ratably among Taxpayer, X, and Y. Taxpayer and X will claim a deduction based on that portion of the

remaining unamortized § 59(e) expenditures as of January 1, 2007 that would have been claimed for 2007 by each such corporation absent a transfer multiplied by a fraction the numerator of which is the number of whole months in the 2007 calendar year prior to the month that the assets and related § 59(e) expenditures are transferred to Y and the denominator is twelve. The balance of the unamortized § 59(e) expenditures as of January 1, 2007 that would have been claimed by Taxpayer and X for 2007 absent a transfer will be claimed by Y.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Further, no opinion is expressed or implied concerning whether amounts Taxpayer treated as research and experimental expenditures eligible for treatment under § 174 or 59(e) are research and experimental expenditures within the meaning of section 174.

This ruling is directed only to the taxpayer(s) 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.

A copy of this letter must be attached to any income tax return to which it is relevant.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Joseph H. Makurath
Senior Technician Reviewer
Office of Associate Chief Counsel
(Passthroughs and Special Industries)