Internal Revenue Service

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Date:
March 28, 2008

In Re:

LEGEND:

Taxpayer	=	
Company A	=	
Company B	=	
Company C	=	
Company D	=	
Company E	=	
Company F	=	
Company G	=	
Company H	=	
Company J	=	
Company K	=	
Company L	=	
Company M	=	
Company N	=	
Country A	=	
Country B	=	
Country C	=	
State D	=	
State E	=	
Products	=	
Amount 1	=	
Amount 2	=	
Amount 3	=	
Amount 4	=	

Amount 5	=	
Amount 6	=	
Amount 7	=	
Amount 8	=	
Amount 9	=	
Amount 10	=	
Amount 11	=	
Amount 12	=	
Amount 13	=	
Amount 14	=	
Amount 15	=	
Amount 16	=	
Amount 17	=	
Amount 18	=	
Amount 19	=	
Amount 20	=	
Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	
Date 5	=	
Date 6	=	
aa	=	
bb	=	
cc	=	
dd	=	
ee	=	
ff	=	
gg	=	
hh	=	
jj	=	
kk	=	
mm	=	
nn	=	
pp	=	

Dear :

This letter responds to your letter dated February 27, 2007, and subsequent correspondence, requesting rulings concerning the federal tax treatment of a series of transactions entered into by Taxpayer, which are described below.

FACTS

General Background

Taxpayer, which is incorporated in State D, is the common parent of an affiliated group of corporations, including Company A, Company B, Company C, Company D, Company E, Company F, and Company G. Taxpayer files a Consolidated Federal Income Tax Return, uses an accrual method of accounting, and has a taxable year that ends on December 31. Taxpayer and its affiliates design, manufacture, and market Products.

Company A and Company B are the two affiliates that are primary parties to the transaction. Taxpayer is related to Company A and Company B as follows. Taxpayer owns aa% of Company C, which is organized in Country B. Taxpayer represents that Company C is treated as a disregarded entity for US federal tax purposes. Taxpayer also owns aa% of Company D, which is a disregarded entity. Company E is bb% owned by Company C and cc% owned by Company D. Company E is treated as a disregarded entity for federal tax purposes and is indirectly owned aa% by Taxpayer. Company E is a State E limited partnership. Company E owns aa% of the non-voting common shares of Company A, and Taxpayer owns aa% of the voting preferred shares of Company A. Thus, Taxpayer directly and indirectly owns all of the interests in Company A. Company A is a State D corporation. Taxpayer also owns aa% of Company B, a State D corporation.

Company F and Company G are State D corporations wholly owned by Taxpayer. Company H is a domestic partnership that is aa% owned by members of the Taxpayer's consolidated group: Taxpayer owns dd%, Company F owns ee%, and Company G owns ff%. Company J is a State D LLC that is wholly owned by Company H. Company J is a holding company that holds significant equity in some of Taxpayer's foreign operations.

Company K is incorporated in Country C and is wholly owned by Taxpayer. Company L is a wholly-owned subsidiary of Company K. Company L, which is incorporated in State E, is not part of Taxpayer's consolidated group. Company L is a financing company with experience in financing leased assets.

Global research and technology functions related to Taxpayer's Products business are centralized in Company A. Company A has control of, and is responsible for, Taxpayer's engineering budget and pays for engineering services performed on its behalf by both affiliated and unaffiliated contract engineering service providers. Taxpayer represents that Company A owns all of the intellectual property related to Products that Taxpayer and its affiliates either develop internally or acquire from third parties. Company A licenses the Products-related technology to Taxpayer, Taxpayer's affiliates, and third party users. The amount of royalties paid by a user is based upon the number of Products sold to third parties that incorporate technology owned by Company A.

Annually, Company A receives approximately Amount 1 in royalties from Taxpayer's US affiliates. Company A receives an additional Amount 2 annually from Taxpayer's foreign affiliates. Company A spends approximately Amount 3 per year on Taxpayer-developed and third party-developed technology and intellectual property.

Company A has licensed Products-related technology to Company M and Company N. Company M and Company N have agreed to pay Company A a royalty that is based upon the number of Products sold to third party buyers. Payments are due to Company A in the month after the end of a calendar quarter and are calculated using estimated sales numbers that are determined in the first month of the calendar quarter. An adjustment payment will be made in the second month after the calendar quarter to reflect the actual amounts of Product sold. The adjustment payment would flow from Company A to Company M or Company N if actual sales were less than estimated, and would flow to Company A from Company M or Company N if actual sales were greater than estimated.

As an example, in Month 1, Company M projects that it will sell 100 units during Months 1 through 3. In Month 4, Company M makes a payment to Company A equal to 100 units times the royalty rate. In Month 5, it is determined that Company M actually sold 102 units, so it will pay Company A royalties on 2 additional units. If, on the other hand, it turns out that Company M only sold 98 units, in Month 5 Company A will repay to Company M the royalty on the 2 units that were expected to be sold but which were not actually sold.

<u>The Transactions</u>

The total amount of royalties received by Company A fluctuates from year to year. Taxpayer represents that Company A would like to stabilize the amount of future royalties so that it can develop more accurate and realistic budgets for technology development.

On Date 1, Company A and Company B entered into an agreement, where Company A agreed to pay to Company B "an amount equal to the royalty stream" receivable by Company A from Company M and Company N for a single year of Product sales, which was expected to be approximately Amount 4 (the "AB Transaction"). Payments would be made on Dates 2, 3, 4, and 5. In return, Company B agreed to pay Company A a total of Amounts 5 and 6, or approximately Amount 7. On each of Dates 2, 3, 4, and 5, Company B was scheduled to make periodic payments of Amounts 8 and 9 to Company A. In the event that an adjustment payment was received from Company M or Company N, Company A agreed to pay to Company B an amount equal to any adjustment payment received, and Company B agreed to pay to Company

A an amount equal to any adjustment payments that Company A had to make to Company M or Company N. The purpose of the payments from Company A to Company B or vice versa that are equal to any adjustment payments is to ensure that Company B, in the end, receives an amount equal to the variable royalties actually paid by Company M and Company N.

The AB Transaction was documented using an ISDA confirmation that referred to the transaction as a "Swap Transaction." Taxpayer represents that the AB Transaction was treated as a swap transaction for purposes of taxation by Country A. Taxpayer also referred to the AB Transaction as a "Swap Transaction" in the contracts used in the BJ and BL Transactions (described below). Further, Taxpayer represents that Company A has retained ownership of the intellectual property underlying the royalty stream and also has retained ownership of the royalty stream. Taxpayer also represents that in the event that Company A declares bankruptcy, the royalties due from Company M and Company N would be assets of the bankruptcy estate, and Company B would be treated as a creditor of Company A; Company B would not have a direct claim to any royalties. The Taxpayer also represents that the contract between Company A and Company B does not prevent Company A from entering into an identical contract relating to the same royalty stream that underlies the AB Transaction with any other party of its choosing.

Also on Date 1, Company B sold a portion of the variable stream of payments it acquired in the AB Transaction to Company J ("the BJ Transaction") and Company L ("the BL Transaction"). Company J purchased gg% of the payments based upon the royalties due from Company M and hh% of the payments based upon the royalties due from Company N. The purchase price was equal to Amount 10 plus Amount 11, or approximately Amount 12. Company J paid jj% of the total purchase price in cash on Date 1, and the remainder was paid with Promissory Notes 1 and 2. Promissory Note 1 called for kk% interest and payments of Amount 13 on each of Dates 2, 3, 4, and 5. Promissory Note 2 called for mm% interest and payments of Amount 14 on each of Dates 2, 3, 4, and 5, all of which occur during the two calendar years following Date 1. In the event that Company B received from Company A an amount equal to an adjustment payment, Company B agreed to pay to Company J gg% of any amount related to an adjustment payment from Company M and hh% of any amount related to an adjustment payment from Company N. In the event that Company B had to pay to Company A an amount equal to an adjustment payment, Company J agreed to pay to Company B gg% of any amount related to an adjustment payment to Company M and hh% of any amount related to an adjustment payment to Company N.

Company L purchased nn% of the payments based upon the royalties due from Company M and jj% of the payments based upon the royalties due from Company N. The purchase price was equal to Amount 15 plus Amount 16, or approximately Amount 17. Company L paid jj% of the total purchase price in cash on Date 1, and the remainder was paid with Promissory Notes 3 and 4. Promissory Note 3 called for kk%

interest and payments of Amount 18 on Dates 2, 3, 4, and 5. Promissory Note 4 called for mm% interest and payments of Amount 19 on Dates 2, 3, 4, and 5. The total received by Company B was approximately Amount 20. In the event that Company B received from Company A an amount equal to an adjustment payment, Company B agreed to pay to Company L gg% of any amount related to an adjustment payment from Company M and hh% of any amount related to an adjustment payment from Company N. In the event that Company B had to pay to Company A an amount equal to an adjustment payment, Company L agreed to pay to Company B gg% of any amount related to an adjustment payment to Company M and hh% of any amount related to an adjustment payment to Company N. The Taxpayer represents that there is no intention or arrangement that would cause the payment streams in the BJ and BL Transactions to return to the Taxpayer. The Taxpayer also represents that the income and expense related to these transactions will be reported on Taxpayer's Consolidated Federal Income Tax Returns with the exception of a small amount of income or expense resulting from the difference between the variable payments and the fixed payments that will be reported by Company J and Company L.

The transactional documents used in both the BJ and BL Transactions were labeled "Swap Receivable Purchase Agreement" and provide that "Seller desires to sell to Buyer…and Buyer desires to purchase from Seller" the percentages of the AB contract that are described above. Further, each contract also provides that this sale is "free and clear of all Liens," that Company B will "execute and deliver to Buyer such instruments and documents as may be reasonably requested by Buyer in order to evidence the Buyer's ownership," and that "Buyer does not, by purchase of [the described percentages] acquire any assets or contracts of Seller under the SWAP Agreement except all rights, title and interest to [the described percentages]."

LAW and ANALYSIS

Issue One

You have asked us to determine whether the BJ and BL Transactions are accelerations of future income streams such that Company B recognizes ordinary income in an amount equal to the amounts paid to it by Company J and Company L.

Section 451(a) of the Internal Revenue Code of 1954 states that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides, in part, that under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

In Commissioner v. P.G. Lake, Inc., 356 U.S. 260 (1958), the Supreme Court held that the proceeds from the assignments of oil payment rights by the owners of royalty or larger depletable interests represented assignments of the transferors' rights to receive future income and were therefore taxable as ordinary income. In its decision the Court stated that the "... substance of what was assigned was the right to receive future income and the substance of what was received was the present value of income which the recipient would otherwise obtain in the future.... (H)ere, the taxpayer is converting future income into present income." Id. at 265-66. As a result of the Supreme Court's holding, the taxpayer realized ordinary income in the year of receipt.

In the case of Estate of Stranahan, 472 F.2d 867 (6th Cir. 1973), the taxpayer sought to accelerate future income to avoid losing the tax benefit of an interest deduction. The taxpayer attempted to assign the rights to future dividend payments of $122,820 to his son in exchange for an up-front lump sum payment of $115,000. The company paying the dividends was notified that it was to make all further dividend payments directly to the son until $122,820 had been paid, at which point the dividends would revert to the taxpayer. In holding that the taxpayer had accelerated income by selling the dividend stream to his son for $115,000, the court focused upon the fact that the documentation indicated an intent to sell the dividend stream and that the taxpayer transferred full and complete control over the dividend stream to his son until such time as $122,820 had been paid.

In the AB Transaction, the documentation indicates that the transaction was not intended to result in the sale of the underlying intellectual property. In addition to the documentation, other facts indicate that a sale of the underlying intellectual property did not occur. Further, Taxpayer represents that in the event that Company A were to declare bankruptcy, the royalties due from Company M and Company N would be assets of the bankruptcy estate, and Company B would be treated as a creditor of Company A; Company B would not have a direct claim to any cash flows under the licensing agreements.

Because the AB Transaction did not result in a sale of the underlying intellectual property, the AB Transaction represents a bilateral contract between Company A and Company B to exchange a series of fixed cash flows for a series of variable cash flows (the AB Contract).

The documents in the BJ and BL Transactions indicate an intent on the part of Company B to sell a portion of the AB Contract. Both the BJ and BL documents are labeled as “Purchase Agreements,“ and the language in each document clearly and explicitly describes the transaction as a sale of a percentage of the cash flows due under the AB Contract. Each Purchase Agreement explicitly states that the buyer is making an outright purchase of a portion of the underlying AB Contract, using language that the sale is “free and clear of all Liens,” that Company B will “execute and deliver to Buyer such instruments and documents as may be reasonably requested by Buyer in order to evidence the Buyer’s ownership,” and that “Buyer does not, by purchase of [the described percentages] acquire any assets or contracts of Seller under the SWAP Agreement except all rights, title and interest to [the described percentages].” The BJ and BL contracts also provide that additional payments or receipts due to adjustment payments will flow through to Company J and Company L according to the percentages purchased.

Based upon these facts, because the AB Contract does not result in a sale of intellectual property but is instead a bilateral contract to exchange cash flows, the interests purchased by Company J and Company L do not represent purchases of the underlying intellectual property. Further, the BJ and BL Transactions resulted in valid accelerations of portions of the future payments underlying AB Contract.

Issue Two

You have asked us to determine whether the AB, BJ, and BL Transactions are the same as, or substantially similar to, the listed transaction described in Notice 2003-55, 2003-2 C.B. 395.

Section 1.6011-4(a) of the Income Tax Regulations provides that, in general, every taxpayer that has participated in a reportable transaction and who is required to file a tax return must attach a disclosure statement to its return for the taxable year.

Section 1.6011-4(b)(1) provides that a reportable transaction is a transaction described in any of the paragraphs (b)(2) through (7) of § 1.6011-4. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan. One type of reportable transaction is a listed transaction.

Section 1.6011-4(b)(2) provides that a listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.

Section 1.6011-4(c)(4) provides that the term substantially similar includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure.

Notice 2003-55, which modifies and supersedes Notice 95-53, 1995-2 C.B. 334, concerns the federal tax treatment of lease strips. Lease strips are transactions in which one participant claims to realize rental or other income from property and another participant claims the deductions related to that income (for example, depreciation or rental expenses). Notice 2003-55 describes three forms of lease strip transactions, but states that lease strips may take a variety of forms and are not limited to the three forms set out in the examples. These examples include a lease strip effected through a transferred basis transaction, a lease strip effected through a transfer of an interest in a partnership (or other pass-through entity), and a lease strip effected by a single participant. In a lease strip effected by a single participant, a participant assigns its right to receive future payments under a lease of tangible property at a time when that participant is not subject to U.S. federal income tax or in a manner in which the realized amount is not includable in computing the participant's U.S. federal income tax and that same participant or a successor claims deductions related to that income for purposes of U.S. federal income tax. Notice 2003-55 also applies to lease strips involving licenses of intangible property, service contracts, leaseholds or other non-fee interests in property, and the prepayment, front-loading, or retention (rather than assignment) of rights to receive future payments. The IRS has concluded that lease strips improperly separate income from related deductions and generally do not produce the tax consequences desired by the participants. The IRS identified transactions that are the same as, or substantially similar to, the lease strips described in Notice 2003-55 as "listed transactions" for purposes of § 1.6011-4(b)(2) and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations.

In determining if the AB, BJ, and BL Transactions are substantially similar to the transaction described in Notice 2003-55, we consider whether those Transactions are expected to obtain the same or similar types of tax consequences and are either factually similar or based on the same or similar tax strategy as the Notice 2003-55 transaction. We construe the term substantially similar broadly in favor of disclosure.

We have determined that the tax consequences expected to be obtained in the AB, BJ, and BL Transactions are not the same or of a similar type as the tax consequences obtained in the listed transaction. In the Notice 2003-55 transaction, the participant claims deductions without taking into account the corresponding income. In the AB, BJ, and BL Transactions both the income and related deductions will be reported on Taxpayer's Consolidated Federal Income Tax Return, with a small amount of income or expense possibly being reported on Company J and Company L's returns. Therefore, the AB, BJ, and BL Transactions will not separate improperly income from the related deductions.

Based on the facts submitted, representations made, and considering all the facts and circumstances of these transactions, we conclude that, under § 1.6011-

4(c)(4), the AB, BJ, and BL Transactions are not the same as, or substantially similar to, the listed transaction described in Notice 2003-55.

CONCLUSIONS

Based upon all of the information and representations submitted, we hold as follows:

1. The BJ and BL Transactions are accelerations of future income streams such that Company B recognizes ordinary income in an amount equal to the amounts paid to it by Company J and Company L.

2. The AB, BJ, and BL Transactions are not the same as, or substantially similar to, the listed transaction described in Notice 2003-55.

3. The BJ and BL Transactions are not intercompany transactions under § 1.1502-13.

The above holdings are based solely upon the information and representations submitted to us for consideration. Upon examination, an examining agent may ascertain whether the representations on which this ruling was based reflect a complete and accurate statement of the material facts.

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. We express no opinion as to the ownership of the intellectual property or whether any of the transactions discussed above may be treated as swap contracts. Further, in particular, this ruling in no way addresses or suggests the determination of the source of payments made in these or any similar transactions to any person, whether U.S. or foreign. See section 7701(a).

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

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.

Sincerely,

Associate Chief Counsel
(Financial Institutions and Products)

By: ______________________________
Alice M. Bennett
Chief, Branch 3

enclosures: copy of this letter
section 6110 copy