Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200840036**
Release Date: 10/3/2008

CC:ITA:B07:RNasrallah
PLR-152446-07

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 197.00-00

date: May 20, 2008

to: Chief, Planning and Special Programs, SBSE (California)

from: Chief, Branch 7, Office of Associate Chief Counsel (Income Tax and Accounting) (CC:ITA:7)

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subject: No Rule of Private Letter Ruling Request under §§ 197 and 351

In accordance with section 7.07(2)(a) of Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 28, this Chief Counsel Advice advises you that we will not rule on a private letter ruling for a taxpayer within your operating division. This advice may not be used or cited as precedent.

LEGEND

B =

C =
D =
E =
F =
G =
H =
$I =
$J =
$K =
$L =
$M =
N =
O =

This memorandum advises that we will not rule on a private letter ruling request submitted on behalf of B. By letter dated C, B requested rulings on (i) whether B's acquisition of H qualifies under § 351 of the Internal Revenue Code, and (ii) whether the goodwill and going concern value that B acquired in that transaction is amortizable under § 197.

B, an S corporation, is in the business of manufacturing machine controllers, computer systems, cables, and machine parts. On D, B purchased the business and assets of H, a proprietorship. With respect to this transaction, B represents that the proprietor of H received stock of B and a note and, immediately after the sale, H owned N percent of B's stock. Further, B represents that the value of the note was $K, the value of the stock was $J, and the value of the tangible assets was $L. Moreover, B represents that there were no written documents associated with the transaction, the agreement was verbal between B and H, and no portion of the value of the note was attributable to interest. B also represents that B and H are unrelated parties.

With respect to the intangible assets acquired by B in this transaction with H, B represents that such intangible assets are goodwill and going concern value that were self-created by H. B further represents that its basis in these intangible assets is $I, the sum of $J and $K.

By letter dated E, the Office of Associate Chief Counsel (Corporate) advised B that pursuant to section 3.01(33) of Rev. Proc. 2007-3, 2007-1 I.R.B. 108, the Internal Revenue Service would not entertain B's ruling request on whether B's acquisition of H qualifies under § 351 because no significant issue exists.

By letter dated F, we advised B that we also would not entertain its ruling request under § 197 because B did not meet the procedural requirements in § 5.01 of Rev. Proc. 2007-1, 2007-1 I.R.B. 1, 7. Under § 5.01 of Rev. Proc. 2007-1, B had to file its ruling request before B filed its return for O, the year in which the transaction occurred.

In addition, B's ruling request under § 197 presents substantive problems with respect to the amount of basis that B proposes to amortize under § 197, which we discussed with B's representative at the conference of right held on G. B proposes to amortize the intangible assets at issue using a basis of $I, which B represents is the value of stock paid ($J) plus the value of the note paid ($K). However, we have determined that the amount of $I is incorrect because of the application of the "step into the shoes rules" of § 197(f)(2) and the apportionment rules under Rev. Rul. 68-55, 1968-1 C.B. 140, and § 1.167(a)-5 of the Income Tax Regulations.

Section 197(f)(2) provides that if a § 197 intangible is transferred in a § 351 transaction, the transferee is treated as the transferor for purposes of applying § 197 with respect to the amount of the adjusted basis of the intangible in the hands of the transferee that does not exceed the adjusted basis in the hands of the transferor. Because the intangibles at issue in this case were self-created by H, the intangibles were not an amortizable § 197 intangible in the hands of H and, therefore, to the extent B's adjusted

basis does not exceed H's adjusted basis in the intangibles, the intangibles cannot be amortized under § 197 by B. However, to the extent that gain is recognized in the transaction under § 351(b), B's adjusted basis in the tangible and intangible assets is increased and, as a result, B's adjusted basis exceeded H's adjusted basis in the tangible and intangible assets.

Rev. Rul. 68-55 provides that in determining the amount of gain recognized under § 351(b) where several assets are transferred to a corporation, each asset must be considered transferred separately in exchange for a portion of each category of consideration received and the fair market value of each category of consideration received is separately allocated to the transferred assets in proportion to the relative fair market values of the transferred assets. Similarly, § 1.167(a)-5 provides that in the case of the acquisition of a combination of depreciable and nondepreciable property for a lump sum, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time.

Under Rev. Rul. 68-55, $J and $K should be apportioned between the tangible and intangible assets. In a manner similar to that provided under § 1.167(a)-5, $J and $K should be allocated between the tangible and intangible assets for depreciation purposes.

However, the foregoing allocation should be adjusted because B did not impute any interest to the note. We believe that a certain portion of the note included interest, at least to the extent of the applicable federal rate amount. In that case, the imputed interest would have reduced $K and it is this reduced amount plus $J that should be apportioned between the tangible and intangible assets under Rev. Rul. 68-55 and § 1.167(a)-5. The amount of $M ($K less the imputed interest on the note) properly allocated to the intangible assets should be fully recognized under § 351(b). As a result, B's adjusted basis in the intangible assets would have exceeded H's adjusted basis in the intangible assets. Accordingly, the amount of B's adjusted basis that exceeded H's adjusted basis in the intangible assets is an amortizable § 197 intangible in the hands of B.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4930 if you have any further questions.

GEORGE BLAINE
Associate Chief Counsel
(Income Tax & Accounting)

By: _Kathleen Reed_____
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