Internal Revenue Service

Number: **201002006**
Release Date: 1/15/2010

Index Number: 453.00-00, 453.09-00, 453.09-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-120656-09

Date:
September 29, 2009

Legend

Taxpayer =
Buyer =
State =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Month 1 =
Month 2 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
y% =
$b =
$c =
$d =
$e =
$f =
$g =
$h =

Dear :

This is in reply to Taxpayer's request for a ruling requesting permission to use an alternative method of basis recovery under § 15a.453-1(c)(7) of the Temporary Regulations under the Installment Sales Revision Act of 1981 to report payments from a contingent payment sale. In accordance with § 15a.453-1(c)(7)(ii), Taxpayer filed its

ruling request prior to the due date (including extensions) of its Year 3 Form 1065, *U.S. Return of Partnership Income*.

FACTS:

Taxpayer is a State limited liability company that is treated as a partnership for federal income tax purposes. It uses the cash receipts and disbursements method of accounting and files its returns on a calendar year basis. In Month 1, Taxpayer entered into an agreement to sell its business and certain assets (Acquired Assets) to Buyer. The closing of the transaction contemplated by the Purchase Agreement occurred on Date 2.

Pursuant to the Purchase Agreement, Buyer purchased the Acquired Assets. Under the terms of the Purchase Agreement (excluding a nominal consideration), Buyer agreed to (i) assume certain liabilities of Taxpayer at closing, and (ii) pay Taxpayer a contingent purchase price.

The contingent purchase price consists of three contingent earn-out payments that were to be made for the following earn-out periods: (i) from Date 2 until Date 3 (hereinafter, Year 2); (ii) Year 3; and (iii) Year 4. The earn-out payment for each earn-out period equals y% of the "Net Client Revenues" for that earn-out period. Net Client Revenues are defined generally as credited revenue during the relevant earn-out period minus direct expenses during that period. The earn-out payment for each earn-out period is the aggregate of the monthly Net Client Revenues (both positive and negative) for that period. If an earn-out payment is due, Buyer will make the payment in Month 2 of the year immediately following the applicable earn-out period. There was no ceiling on the earn-out payments.

Taxpayer reported $b as income in the year of sale as depreciation recapture under § 453(i). In addition, Taxpayer transferred certain assets with an aggregate basis of $c. Taxpayer aggregated the $b and $c to compute the ultimate gain or loss of the sale.

Taxpayer was an investment advisor and financial consultant, and its earnings were a function of assets under management (AUM). Taxpayer's business focused primarily on the servicing of large institutional clients, so that a loss of a client is of considerable consequence in determining the AUM, as is a decline in the securities market.

For the Year 2 earn-out period, Taxpayer was paid an earn-out payment of $d in Year 3. For the Year 3 earn-out period, Taxpayer's earn-out payment, which was paid in Year 4, was only $h. This was due to the decline in the securities market and loss of a significant number of customers (as well as significant customers) beginning in Year 2 and continuing through Year 4. To illustrate, as of Date 1, the AUM was $e. As of Date 4 however, the AUM had declined by over 70% to $f. This decline was due, in part, to the fact that there was a loss of about 50% of the customers. In addition, Taxpayer

supplied information indicating that in each month of the Year 4 earn-out period through Date 4, Net Client Revenues have been less than $0. Taxpayer has represented that there will be no earn-out payment payable in Year 5 due to the loss of customers and the financial crisis. Taxpayer's representation is based on actual revenue figures through Date 4 and estimates for the remainder of Year 4. Based on the foregoing, Taxpayer asserts that the normal basis recovery rule of § 15a.453-1(c)(3) would substantially and inappropriately defer recovery of its basis on the sale of the Acquired Assets.

RULING REQUESTED:

Taxpayer requests a ruling allowing it to use an alternative method of basis recovery, as provided under § 15a.453-1(c)(7)(ii). Under its alternative method of basis recovery, Taxpayer proposes to allocate $d of basis to Year 3, the remaining basis of $g to Year 4, and $0 of basis to Year 5.

LAW AND ANALYSIS:

Section 453(a) of the Internal Revenue Code provides that, except as otherwise provided, income from an installment sale is taken into account under the installment method.

Section 453(b)(1) defines installment sale to mean a disposition of property where at least one payment is to be received after the end of the taxable year in which the disposition occurs.

Section 453(c) defines "installment method" as a method under which the income recognized for any taxable year from a disposition of property is that proportion of the payments received in that year which the gross profit (realized or to be realized when the payment is completed) bears to the total contract price.

Section 15a.453-1(c)(1) defines a "contingent payment sale" as a sale or other disposition of property in which the aggregate selling price cannot be determined by the close of the taxable year in which such sale or other disposition occurs. Unless a taxpayer makes an election under § 15a.453-1(d)(3), contingent payment sales are to be reported on the installment method.

Section 15a.453A-1(c)(3)(i) provides that when a stated maximum selling price cannot be determined as of the close of the taxable year in which a sale or other disposition occurs, but the maximum period over which payments may be received under the contingent sale price agreement is fixed, the taxpayer's basis (inclusive of selling expenses) shall be allocated to the taxable years in which payments may be received under the agreement in equal annual increments.

Section 15a.453-1(c)(7)(i) generally provides that the normal basis recovery rules set forth in § 15a.453-1(c)(3) may, with respect to a particular contingent payment sale, substantially and inappropriately defer recovery of the taxpayer's basis.

Section 15a.453-1(c)(7)(ii) provides that the taxpayer may use an alternative method of basis recovery if the taxpayer is able to demonstrate prior to the due date of the return including extensions for the taxable year in which the first payment is received, that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis. To demonstrate that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis, the taxpayer must show (A) that the alternative method is a reasonable method of ratably recovering basis and, (B) that, under that method, it is reasonable to conclude that over time the taxpayer likely will recover basis at a rate twice as fast as the rate at which basis would have been recovered under the otherwise applicable normal basis recovery rule. The taxpayer must receive a ruling from the Internal Revenue Service before using an alternative method of basis recovery.

Section 15a.453-1(c)(7)(ii) further provides that the taxpayer must file the request for a ruling prior to the due date for the return including extensions. In demonstrating that application of the normal basis recovery rule would substantially and inappropriately defer recovery of the taxpayer's basis, the taxpayer in appropriate circumstances may rely upon contemporaneous or immediate past relevant sales, profit, or other factual data that are subject to verification. The taxpayer ordinarily is not permitted to rely upon projections of future productivity, receipts, profits or the like. However, in special circumstances a reasonable projection may be acceptable based upon a specific event that has already occurred (*e.g.*, corporate stock has been sold for future payments contingent on profits and an inadequately insured major plant facility of the corporation has been destroyed).

Taxpayer has shown, based on the decline in the value of assets under management, loss of significant customers, and the financial crisis that it is reasonable to assume that it will not receive an earn-out payment in Year 5.

CONCLUSION:

Based on the information provided and each representation made, Taxpayer’s proposed alternative method of basis recovery (i) represents a reasonable method of basis recovery and (ii) will result in basis recovery at a rate twice as fast as the rate which basis would be recovered using the normal basis recovery rules. Accordingly, we conclude that Taxpayer may use its proposed alternative method of basis recovery for the sale of assets under the Purchase Agreement.

CAVEATS:

We do not express or imply an opinion on the federal tax consequences of any aspect of these transactions other than that expressed in CONCLUSION, above. For example, we do not express an opinion concerning Taxpayer's basis in the Acquired Assets (including the basis of Class I and Class V assets as reported on its Form 8594, *Asset Acquisition Statement Under Section 1060*). In addition, this ruling assumes that Buyer's assumption of Taxpayer's liabilities did not result in a payment under § 15a.453-1(b)(3).

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

The ruling contained in this letter is based upon information and representations that the taxpayer submitted under penalties of perjury 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.

The taxpayer must attach a copy of this letter to any federal tax return to which it is relevant, or if it files its returns electronically, a statement to its return providing the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to the taxpayer's authorized representative.

Sincerely,

Michael J. Montemurro
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: