Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:6:
PLR-111973-10
Date: May 13, 2010

LEGEND:

Taxpayer =

Business1 =
Business2 =

Year1 =
Year2 =
Year3 =
Year4 =

Date1 =
Date2 =

Dear

This letter is in response to a letter dated requesting rulings with respect to the treatment of deferred research and experimental expenditures under § 59(e) of the Internal Revenue Code (the Code).

The represented facts are 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 is engaged in Business1, Business2, and certain other businesses. X is a

wholly owned subsidiary of Taxpayer. In addition to X, Taxpayer will form Y, another wholly owned subsidiary to carryout the proposed reorganization

Taxpayer plans to separate Business1 and Business2 from its other businesses as an independent publicly traded company and plans to implement the following contribution and distribution transactions. First, Taxpayer will contribute various assets and liabilities to X, including (a) all of its Business1 assets and liabilities, (b) all of its Business2 assets and liabilities, and (c) the stock of subsidiaries engaged in the Business1 and the Business2 (the “Drop-Down”). Immediately thereafter, Taxpayer will contribute the stock of X to Y (the "Contribution"). Finally, Taxpayer will distribute all of the Y stock to the common stock shareholders of Taxpayer (the “Distribution”). Although the transactions are subject to final action by the Taxpayer’s Board of Directors, it is expected that the Drop-Down and the Contribution will occur on or about Date1 (the “Contribution Date”) and that the Distribution will occur on or about Date2 (the “Distribution Date”). Taxpayer will treat the Drop-Down as a transaction in which no gain or loss is recognized under § 351 of the Code, and Taxpayer will treat the Contribution and the Distribution as a Type D reorganization under §§ 368(a)(1)(D) and 355. Taxpayer does not presently intend to seek a ruling from the Internal Revenue Service regarding the tax treatment of the foregoing transactions.

As part of the Drop-Down, Taxpayer will transfer its Business1-related and Business2-related intellectual property to X. For Year1, Taxpayer elected under § 59(e) to capitalize and amortize over 10 years certain Business1 research and experimental expenditures. For Year2, Taxpayer elected under § 59(e) to capitalize and amortize over 10 years certain Business1 and Business2 research and experimental expenditures. In addition, Taxpayer intends to elect under § 59(e) to capitalize and amortize over 10 years certain Business1 and Business2 research and experimental expenditures incurred in Year3 and the first part of Year4 up to the Contribution Date. A portion of the costs deferred under Code § 59(e) for Year1, Year2, Year3, and Year4 (collectively, “§ 59(e) Amount”) will still be unamortized as of the Contribution Date.

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

1. The unamortized remaining account balance of the § 59(e) Amount carries over to X;

2. The unamortized remaining account balance of the § 59(e) Amount that carries over to X will continue to be amortized by X in the same manner and over the remaining period that such amounts would have been amortized by Taxpayer; and

3. For the calendar year that the assets associated with the Business1 and Business2 (including the unamortized remaining account balance of the § 59(e) Amount) are transferred by Taxpayer to X, the deduction associated with § 59(e)

election relating to such businesses will be split ratably between Taxpayer and X. Taxpayer will claim a deduction based on (a) the portion of the § 59(e) Amount incurred during the first part of the year of the Contribution up to the Contribution Date and (b) that portion of the remaining unamortized account balance as of the first day of the Year4 that would have been claimed for such year by Taxpayer absent a transfer of the businesses, each multiplied by a fraction the numerator of which is the number of whole months in such year prior to Date1 and the denominator of which is twelve. The balance of the portion of the § 59(e) Amount incurred during the first part of the year of the Contribution up to Date1 and the balance of the unamortized § 59(e) Amount as of the first day of Year4 that would have been claimed by Taxpayer for such year absent a transfer will be claimed by X.

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 of 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 in 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, "amortization deduction 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 X such that X 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(2), 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, X'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 remaining account balance of the § 59(e) Amount carries over to X;

2. The unamortized remaining account balance of the § 59(e) Amount that carries over to X will continue to be amortized by X in the same manner and over

the remaining period that such amounts would have been amortized by Taxpayer; and

3. For the calendar year that the assets associated with the Business1 and Business2 (including the unamortized remaining account balance of the § 59(e) Amount) are transferred by Taxpayer to X, the deduction associated with the § 59(e) election relating to such businesses will be split ratably between Taxpayer and X. Taxpayer will claim a deduction based on (a) the portion of the § 59(e) Amount incurred during the first part of the year of the Contribution up to the Contribution Date and (b) that portion of the remaining unamortized account balance as of the first day of the Year4 that would have been claimed for such year by Taxpayer absent a transfer of the businesses, each multiplied by a fraction the numerator of which is the number of whole months in such year prior to Date1 and the denominator of which is twelve. The balance of the portion of the § 59(e) Amount incurred during the first part of the year of the Contribution up to Date1 and the balance of the unamortized § 59(e) Amount as of the first day of Year4 that would have been claimed by Taxpayer for such year absent a transfer will be claimed by X.

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 §174.

No opinion is expressed whether the Drop-Down will qualify under § 351 or whether the Contribution and Distribution will qualify under §§ 368(a)(1)(D) or 355.

This ruling is directed only to the taxpayer(s) who requested 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 the letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are 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,

Jaime Park
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)