Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
June 08, 2012

TY:

Legend

Taxpayer =
Subsidiary =
State A =
Business X =
Business Y =
Date 1 =

Dear :

This letter is in response to a ruling request dated December 12, 2011 submitted on behalf of Taxpayer by its authorized representative, requesting a ruling under § 1.381(c)(4)-1(d)(1)(ii)[1] of the Income Tax Regulations that the Commissioner determine the appropriate method of accounting for accrual of liabilities for services provided to Taxpayer by third parties (service liabilities).

FACTS

Taxpayer is a corporation organized under the laws of State A, and is the common parent of a group of corporations. Taxpayer is engaged in Business X and employs an overall accrual method of accounting. In the course of Taxpayer's business, Taxpayer incurs liabilities for . Prior to the transaction, Subsidiary was engaged in Business Y. In the course of Subsidiary's business, Subsidiary incurred liabilities for .

[1] All references to § 1.381(c)(4)-1 of the Income Tax Regulations refer to the regulations prior to amendment by T.D. 9534, effective for transactions occurring on or after August 31, 2011.

On Date 1, Taxpayer acquired all of the assets of Subsidiary in a transaction to which section § 381(a) applies. After the transfer, Taxpayer did not operate Subsidiary's trades or businesses as separate and distinct from its own.

Immediately prior to the transfer, Taxpayer and Subsidiary did not use the same method of accounting for service liabilities. Under Taxpayer's method of accounting prior to the transfer, Taxpayer deducts service liabilities to the extent that the liability is recorded for book purpose and to the extent that the liability has been paid or is estimated to be paid, pursuant to a predetermined formula, within 8 ½ months of the end of the year in which the services are provided to Taxpayer.

Under its method of accounting prior to the transfer, Subsidiary deducts service liabilities in the taxable year in which all events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Specifically, Subsidiary deducts service liabilities in the taxable year in which the services are provided to Subsidiary.

After the transfer, Taxpayer represents that the principal method of accounting for service liabilities, determined under § 1.381(c)(4)-1(c) of the Income Tax Regulations, was Taxpayer's method of accounting. Taxpayer represents that its method of accounting does not clearly reflect income under § 446(b) because it is an impermissible method. Therefore, because Taxpayer may not use its method of accounting after the Date 1 transfer, Taxpayer has requested that the Commissioner determine the appropriate method of accounting under § 1.381(c)(4)-1(d)(1)(i). Taxpayer requests that the Commissioner determine that Taxpayer may deduct service liabilities in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. Specifically, Taxpayer requests to deduct service liabilities in the taxable year in which the services are provided to Taxpayer.

LAW AND ANALYSIS

Section 381(a)(1) of the Internal Revenue Code provides that in the case of the acquisition of assets of a corporation by another corporation in a distribution to such other corporation to which § 332 (relating to liquidations of subsidiaries) applies, the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in § 381(c) of the distributor or transferor corporation, subject to the conditions and limitations specified in §§ 381(b) and (c).

Section 381(c)(4) of the Code provides that the acquiring corporation shall use the method of accounting used by the transferor corporation on the date of transfer unless

different methods were used by several transferor corporations or by a transferor corporation and the acquiring corporation. If different methods were used, the acquiring corporation shall use the method or combination of methods of computing taxable income adopted pursuant to regulations prescribed by the Secretary.

Section 1.381(c)(4)-1(b)(3)(ii) of the Income Tax Regulations provides that to the extent that different methods of accounting were employed on the date of transfer by the parties to a transaction described in § 381(a) with respect to any trades or businesses which are integrated or required to be integrated in accordance with § 446(d) and the regulations thereunder, the acquiring corporation shall adopt the principal method of accounting determined under § 1.381(c)(4)-1(c) or the method of accounting determined in accordance with § 1.381(c)(4)-1(d), whichever is applicable.

Section 1.381(c)(4)-1(c)(1) provides that the acquiring corporation shall use the principal method of accounting (as determined under § 1.381(c)(4)-1(c)(2)), provided that such method of accounting clearly reflects the income of the acquiring corporation.

Section 1.381(c)(4)-1(c)(2)(ii) provides that the determination of the principal method of accounting shall be made by making a comparison of the total of the adjusted bases of the assets immediately preceding the date of distribution or transfer and the gross receipts for a representative period (ordinarily the most recent period of 12 consecutive calendar months ending on or prior to the date of distribution or transfer) of the component trades or businesses which are integrated or are required to be integrated. If this comparison shows that one or more component trades or businesses, having the greatest total of the adjusted bases of assets, also has the greatest amount of gross receipts, then the method of accounting of such one or more component trades or businesses shall be the principal method of accounting.

Section 1.381(c)(4)-1(d)(1)(i) provides that if the acquiring corporation may not continue to use under § 1.381(c)(4)-1(b), the method of accounting used by it or the transferor corporation or corporations on the date of transfer, and may not under § 1.381(c)(4)-1(c) use the principal method of accounting, or, if there is no principal method of accounting, then the Commissioner shall determine the appropriate method or combination of methods of accounting to be used.

Section 1.381(c)(4)-1(d)(1)(iii) provides that the increase or decrease in tax resulting from the change from the method of accounting previously used by any of the corporations involved shall he taken into account by the acquiring corporation. The adjustments necessary to reflect such change and such increase or decrease in tax shall be determined and computed in the same manner as if, on the date of transfer, each of the several corporations that were not using the method or combination of methods of accounting adopted pursuant to §§ 1.381(c)(4)-1(d)(1)(i) or (ii) had initiated a change in accounting method.

Section 461(a) of the Code provides that the amount of any deduction must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2)(i) of the Income Tax Regulations provides that under an accrual method of accounting, a liability is incurred and generally is taken into account for federal income tax purposes in the taxable year in which (1) all events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect to the liability.

Section 461(h)(1) provides that, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 461(h)(2)(A)(i) and § 1.461-4(d)(2)(i) provide that, if the liability of a taxpayer arises out of the providing of services or property by another person to the taxpayer, economic performance occurs as the services or property is provided.

CONCLUSION

Taxpayer may not continue to use the principal method of accounting for service liabilities because it is an impermissible method, pursuant to § 1.381(c)(4)-1(d)(1)(i). Permission is hereby granted to Taxpayer to change its method of accounting for service liabilities. Taxpayer must deduct service liabilities in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability, in accordance with § 1.461-1(a)(2)(i) of the Income Tax Regulations. Specifically, Taxpayer must deduct service liabilities in the taxable year in which the services are provided to Taxpayer. Further, Taxpayer will not use the recurring item exception provided for in § 1.461-5, nor will Taxpayer use the 3½ month rule provided for in § 1.461-4(d)(6)(ii).

Taxpayer represents that it will compute any adjustment necessary to reflect its change in method of accounting for service liabilities pursuant to § 1.381(c)(4)-1(d)(1)(iii) and will take any increase or decrease in tax into account on its tax return for the taxable year that includes the date of the transfer.

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.

This ruling is directed only to the taxpayer 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. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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,

Thomas D. Moffitt
Branch Chief, Branch 2
(Income Tax & Accounting)