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From:
Sent: Tuesday, December 18, 2012 1:56:40 PM
To:
Cc:
Subject: Deduction Question

You asked for our views concerning the tax consequences to Seller Corp of (1) $X received by Seller Corp and (2) the payment by Seller of a portion of the $X to Buyer Corp. Specifically, you asked whether Seller has income upon its receipt of the $X payment and whether Seller gets a deduction for its payment to Buyer.

FACTS:

Seller, the common parent of a consolidated group, sold 100 percent of the stock of Sub 1 and Sub 2 to Buyer. Buyer is the common parent of another consolidated group. Prior to the sale, Subs 1 and 2 were included in Seller's consolidated group. The Purchase and Sale Agreement (Sales Agreement) executed by Seller and Buyer stated that Buyer would carryforward all net operating losses (NOLs) incurred by Sub 1 and Sub 2. Thus, Seller had no right to any NOL carryback attributable to Subs 1 and 2 arising in a taxable year after the sale date.

In a taxable year subsequent to the execution of the Sales Agreement, the Subs incurred NOLs. Buyer contacted Seller and offered to execute a new agreement concerning the use of the NOLs incurred by the Subs. Seller and Buyer then entered into another agreement (the NOL Agreement) providing that Buyer would not elect to waive the carryback of the NOLs incurred by the Subs. Thus, the NOLs would be carried back to Seller's pre-sale consolidated return years.

Pursuant to the NOL Agreement, Seller filed the amended consolidated return for the carryback year, received the refund of $X, paid a portion of that tax refund to Buyer, and retained the remaining portion, $Y.

LAW and ANALYSIS:

Section 61(a) of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived. Under § 61, Congress intends to tax all gains and undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co*.,

348 U.S. 426 (1955), 1955-1 C.B. 207; Rev. Rul. 2005-46, 2005-2 C.B. 120. In general, a federal income tax refund is not gross income to the recipient of the refund. Based on the given facts, Seller is treated as the agent of the Seller group in receiving the refund. Treas. Reg. § 1.1502-77(a)(2)(v). Furthermore, Sub 1 and Sub 2, the entities that incurred the NOLs that generated the refund, are the owners of the refund under both consolidated return regulations and state law. *See* Treas. Reg. §§ 1.1502-32(b)(3)(iv)(D), 1.1502-33(d); *In re Bob Richards Chrysler-Plymouth Corp., 473 F.2d 262 (9th Cir. 1973).* Consequently, since Seller had no claim to the $X refund, Seller is not treated as having received a nontaxable federal income tax refund. Rather, the $Y retained by Seller should be treated as consideration to Seller for agreeing to enter into the NOL Agreement. Moreover, because Seller is not entitled to receive $X, Seller does not incur a deductible expense when it transfers $X to Buyer. Thus, Seller is not allowed a deduction for any amount received by Buyer under the NOL Agreement.

CONCLUSION:

Seller has gross income of $Y in the taxable year it received the $Y. Seller is not entitled to a deduction for the portion of the $X refund paid to Buyer**.**

If you have any questions, please contact us. Thank you.