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Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

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CC:ITA:B05
PLR-140406-14

Date:
April 27, 2015

In Re:

TY:

Legend

Taxpayer =

Parent =

State Z =

Company =

Products =

AA =

BB =

Territory 1 =

Territory 2 =

Territory 3 =

Territory 4 =

Territory 5 =

Dual Activity Agreements =

Replacement Dual Activity Agreements =

Single Activity Agreements =

Replacement Single Activity Agreements =

Transferred Agreements =

R =

S =

T =

U =

V =

W =

Date =

Dear :

This responds to your request for a private letter ruling dated October 24, 2014, on whether gain from the exchange of certain manufacturing and distribution agreements may be deferred under § 1031 of the Internal Revenue Code.

Facts

Taxpayer is a corporation and a member of an affiliated group of which Parent is the common parent. The affiliated group files a consolidated return using a calendar year

taxable year and the accrual method as its overall method of accounting. Taxpayer and Parent are incorporated in State Z.

Taxpayer has two types of agreements: the Dual Activity Agreements and the Single Activity Agreements. The agreements are with Parent and its subsidiaries, and R, S, T, U, and V that are unrelated parties to Parent. Under the Dual Activity Agreements, Taxpayer has rights to manufacture and distribute AA, a group of Products of various different brand names. Products are nondepreciable tangible personal property. The Dual Activity Agreements grant Taxpayer the right to manufacture and distribute AA within Territory 1, Territory 2, or Territory 3. Under the Single Activity Agreements, Taxpayer has rights to distribute BB, another group of Products of various different brand names that are different from AA, within Territory 1, Territory 2, or Territory 3. The length of the term, the renewable periods, and the geographical territories covered for the rights vary among the agreements within the Dual Activity Agreements and the Single Activity Agreements. In addition, the conditions imposed in connection with the manufacturing and distribution rights such as marketing, quality control, and inventory maintenance also vary among the agreements.

Just like Taxpayer, Company has two types of agreements: the Replacement Dual Activity Agreements and the Replacement Single Activity Agreements. These agreements have the same set of counterparties as Taxpayer's agreements.

The Replacement Dual Activity Agreements grant Company the right to manufacture and distribute AA within Territory 4 or Territory 5. The Replacement Single Activity Agreements grant Company the right to distribute BB within Territory 4 or Territory 5. The length of the term, the renewable periods, and the geographical territories covered for the rights vary among the agreements within the Replacement Dual Activity Agreements and the Replacement Single Activity Agreements. In addition, the conditions imposed in connection with the distribution rights such as marketing, quality control, and inventory maintenance also vary among the agreements.

On Date, Taxpayer and Company entered into an exchange agreement. Pursuant to the exchange agreement, Taxpayer is scheduled to enter into two exchanges with Company. In the first exchange, Taxpayer will simultaneously exchange its Dual Activity Agreements for Company's Replacement Dual Activity Agreements as one exchange group. In the second exchange, Taxpayer will simultaneously exchange its Single Activity Agreements with Company's Replacement Single Activity Agreements as another exchange group.

Taxpayer represents that the rights under the Dual Activity Agreements and the Single Activity Agreements are held by Taxpayer for productive use in a trade or business. Taxpayer further represents that the rights under the Replacement Dual Activity Agreements and the Replacement Single Activity Agreements will be held by Taxpayer for productive use in a trade or business. Taxpayer represents that, to the best of its

knowledge, the proportionate values of the manufacturing and distribution rights are roughly similar across both the Dual Activity Agreements and the Replacement Dual Activity Agreements.

Rulings Requested

(1) The rights under the Dual Activity Agreements to be transferred by Taxpayer in the exchange are of a like kind, within the meaning of § 1031, to the rights under the Replacement Dual Activity Agreements to be transferred by Company in the exchange.

(2) No gain or loss will be recognized by Taxpayer on the exchange of rights under the Dual Activity Agreements, except to the extent of any gain required to be recognized under § 1.1031(j)-1(b)(3)(i).

(3) The rights under the Single Activity Agreements to be transferred by Taxpayer in the exchange are of a like kind, within the meaning of § 1031, to the rights under the Replacement Single Activity Agreements to be transferred by Company in the exchange.

(4) No gain or loss will be recognized by Taxpayer on the exchange of rights under the Single Activity Agreements, except to the extent of any gain required to be recognized under § 1.1031(j)-1(b)(3)(i).

Law and Analysis

Section 1031(a)(1) provides generally that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of a like kind which is to be held either for productive use in a trade or business or for investment.

Section 1.1031(a)-1(b) of the Income Tax Regulations provides, in part, that as used in § 1031(a), the words “like kind” have reference to the nature or character of the property and not to its grade or quality, and that an exchange of one kind or class of property for a different kind or class is not a like-kind exchange.

Section 1.1031(a)-2(a) provides, in part, that personal properties of a like class are considered to be of “like kind” for purposes of § 1031, and an exchange of properties of a like kind may qualify under § 1031 regardless of whether the properties are also of a like class. In determining whether exchanged properties are of a like kind, no inference is to be drawn from the fact that the properties are not of a like class. Further, under § 1.1031(a)-2(b), depreciable tangible personal properties are of a like class if they are either within the same General Asset Class (as defined in § 1.1031(a)-2(b)(2)) or within the same Product Class (as defined in § 1.1031(a)-2(b)(3)).

Section 1.1031(a)-2(c)(1) provides that an exchange of intangible personal property qualifies for nonrecognition of gain or loss under § 1031 only if the exchanged intangible properties are of a like kind. No like classes are provided for intangible properties. Whether intangible personal property is of a like kind to other intangible personal property generally depends on (i) the nature or character of the rights involved (e.g., a patent or a copyright) and (ii) the nature or character of the underlying property to which the intangible personal property relates.

Section 1.1031(a)-2(c)(3) illustrates the application of this paragraph (c) with the following examples:

> Example (1). Taxpayer K exchanges a copyright on a novel for a copyright on a different novel. The properties exchanged are of a like kind.
> Example (2). Taxpayer J exchanges a copyright on a novel for a copyright on a song. The properties exchanged are not of a like kind.

Section 1.1031(j)-1(b) provides the rules for computing gain with respect to exchanges of multiple properties qualifying for nonrecognition of gain or loss under § 1031. Section 1.1031(j)-1(b)(2) provides that to the extent possible the properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group. Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or a like class. A residual group is created if the aggregate fair market value of the properties transferred in all of the exchange groups differs from the aggregate fair market value of the properties received in all of the exchange groups. Section 1.1031(j)-1(b)(2)(iii).

Section 1.1031(j)-1(b)(3) provides that the amount of gain or loss realized with respect of each exchange group and the residual group is the difference between the aggregate fair market value of the properties transferred in that exchange group or residual group and the properties' aggregate adjusted basis. The gain realized with respect to each exchange group is recognized to the extent of the lesser of the gain realized and the amount of the exchange group deficiency, if any. An exchange group deficiency is the excess aggregate fair market value of the properties transferred in an exchange group over the aggregate fair market value of the properties received (less the amount of any excess assumed liabilities). The amount of gain or loss realized and recognized with respect to property not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code.

Dual Activity Agreements and Replacement Dual Activity Agreements

The Dual Activity Agreements and the Replacement Dual Activity Agreements are intangible property that grant rights related to the manufacturing and distribution of AA. Because Taxpayer and Company will simultaneously exchange the agreements, the only issue is whether the Dual Activity Agreements and the Replacement Dual Activity

Agreements are of a like kind. This depends on (i) the nature or character of the rights involved and (ii) the nature or character of the underlying property to which the agreements relate. Section 1.1031(a)-2(c)(1).

The Dual Activity Agreements and the Replacement Dual Activity Agreements are both in the nature of AA manufacturing and distribution agreements. Manufacturing and distribution are two distinct business activities and the rights to each would not, absent some close connection between these activities, be of a like kind.

For economic and historical reasons, manufacturers of AA have long acted as distributors of AA. The inclusion of both business activities in the Dual Activity Agreements and Replacement Dual Activity Agreements reflects the underlying economics and longstanding historical relationship between the two. Though not completely inseparable, manufacturing and distribution of AA is frequently best performed by a single entity as part of an integrated business process. In addition, manufacturing rights and the distribution rights granted under the agreements can only be exercised in conjunction with each other under the agreements. It was represented that proportionate values of the manufacturing rights and the distribution rights are roughly the same across all of the in the Dual Activity Agreements and Replacement Dual Activity Agreements. Accordingly, while manufacturing and distribution are business activities of a different nature or character, the close economic and unique historical connection between the manufacturing and the distribution of AA demands that they be treated as two aspects of a single business activity where the rights to manufacturing and distribution are contained within the same integrated agreement.

The terms of the agreements are broadly and substantially similar in granting rights to manufacture and distribute AA. Each agreement grants rights and creates obligations related to a single business activity, the integrated manufacturing and distribution of AA. The differences in the length of the term, renewable periods, geographical territories covered, quality control provisions, marketing activity obligations, restrictions on manufacturing and distribution of similar products, and termination events vary among the Dual Activity Agreements and the Replacement Dual Activity Agreements. These differences, however, are insubstantial, relating as they do to the grade or quality of the rights rather than to their nature or character. Consequently, the nature or character of the manufacturing and distribution rights in the Dual Activity Agreements and Replacement Dual Activity Agreements are of a like kind.

The second requirement for the agreements to be of a like kind is that the underlying property subject to the Dual Activity Agreements and the Replacement Dual Activity Agreements must itself be of a like kind. The underlying property to which the intangible rights to manufacture and distribute relate is AA, a group of Products that share substantially similar manufacturing and distribution processes. AA includes Products with different brand names, appearances, ingredients, packaging, and marketing strategies. Nevertheless, all of AA are manufactured using a substantially similar

process in facilities of a common design, and they are distributed in a substantially similar manner to a largely common set of customers who resell them to end customers who, in turn, use each of the Products of AA for a substantially similar purpose. Any differences among AA that are relevant to manufacturing or distribution are differences in grade or quality, and not differences in nature or character. Accordingly, under the second prong of the test in § 1.1031(a)-2(c), the underlying property to which the tangible rights granted by the Dual Activity Agreements and the Replacement Dual Activity Agreements relate is of a like kind.

Single Activity Agreements and Replacement Single Activity Agreements

The Single Activity Agreements and the Replacement Single Activity Agreements are intangible property that grant rights related to the distribution of BB. Because Taxpayer and Company will simultaneously exchange the agreements, as with the Dual Activity Agreements and the Replacement Dual Activity Agreements, the only issue is whether the Single Activity Agreements and the Replacement Single Activity Agreements are of a like kind. This depends on (i) the nature or character of the rights involved and (ii) the nature or character of the underlying property to which the agreements relate.

The Single Activity Agreements and the Replacement Single Activity Agreements are both in the nature of BB distribution agreements. Distribution of BB is a single business activity. The terms of the agreements are substantially similar, and any difference among them is a difference in grade or quality. Accordingly, the nature or character of the Single Activity Agreements and the Replacement Single Activity Agreements are of a like kind.

The second requirement for the agreements to be of a like kind is that the underlying property subject to the Single Activity Agreements and Replacement Single Activity Agreements must itself be of a like kind. The underlying property to which the intangible rights relate is BB, a group of Products that are distributed in a largely similar manner. BB includes Products with different brand names, appearances, ingredients, packaging, manufacturing processes, and marketing strategies. Nevertheless, all of BB are distributed in a substantially similar manner to a largely common set of customers who resell them to end customers who, in turn, use each of the Products of BB for a substantially similar purpose. Any differences among BB that are relevant to distribution are differences in grade or quality, and not differences in nature or character. Accordingly, the underlying property subject to the Single Activity Agreements and the Replacement Single Activity Agreements is of a like kind.

Rulings

The rights under the Dual Activity Agreements to be transferred by Taxpayer in the exchange are of a like kind, within the meaning of § 1031, with the rights under the Replacement Dual Activity Agreements to be transferred by Company in the exchange,

and no gain or loss will be recognized by Taxpayer on the exchange of rights under the Dual Activity Agreements, except to the extent of any gain required to be recognized under § 1.1031(j)-1(b)(3)(i).

The rights under the Single Activity Agreements to be transferred by Taxpayer in the exchange are of a like kind, within the meaning of § 1031, with the rights under the Replacement Single Activity Agreements to be transferred by Company in the exchange, and no gain or loss will be recognized by Taxpayer on the exchange of rights under the Single Activity Agreements, except to the extent of any gain required to be recognized under § 1.1031(j)-1(b)(3)(i).

Caveats

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 limited only to specific agreements identified as the Dual Activity Agreements, the Replacement Dual Activity Agreements, the Single Activity Agreements, and the Replacement Single Activity Agreements. No opinion is expressed or implied as to any other agreement.

Taxpayer represents that it will transfer to and acquire from Company expired or unwritten agreements to manufacture and/or distribute Products. Taxpayer also represents that it will transfer the Transferred Agreements, which it will acquire from Company at the same time it acquires the Replacement Dual Activity Agreements and the Replacement Single Activity Agreements, to W. This ruling is expressly not applicable to these additional agreements that are not part of the Dual Activity Agreements, the Replacement Dual Activity Agreements, the Single Activity Agreements, and the Replacement Single Activity Agreements.

No opinion is expressed or implied as to any subsequent transfers of rights and obligations under the Replacement Dual Activity Agreements or the Replacement Single Activity Agreements, including any affect these transfers might have on the requirement under § 1031(a) that Taxpayer hold the Replacement Dual Activity Agreements or the Replacement Single Activity Agreements for productive use or investment.

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.

The ruling contained in this letter is based upon information and representations submitted by 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. Taxpayer

should apply and the examiner should verify the correct application of § 1031(b) of the Code and § 1.1031(j)-1. This ruling will not prevent assessments based on the taxability of boot received by Taxpayer.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, if Taxpayer files its returns electronically, it may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

Sincerely,

Seoyeon Sharon Park
Assistant to the Branch Chief, Branch 5
(Income Tax & Accounting)