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Date:
February 20, 2018

Re: Request for a Private Letter Ruling Under § 197

LEGEND

Taxpayer =

Member =

Year1 =

Year2 =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

State1 =

State2 =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

M =

N =

O =

P =

Q =

R =

S =

T =

Dear :

This letter ruling responds to a letter dated August 29, 2017, and subsequent correspondence submitted, by Taxpayer. Taxpayer is requesting a ruling regarding the federal income tax consequences of certain transactions under § 197 of the Internal Revenue Code.

FACTS

Taxpayer represents the facts are as follows:

*Description of Business and Historic Structure*

C is the predecessor of Taxpayer. C, together with its subsidiaries, has historically been in the business of D. Prior to Year1, operations were conducted primarily through multiple corporations (the "Operating Entities") commonly owned by E and F. G is the oldest of such Operating Entities and was incorporated on Date1, which is before the date of enactment of § 197. All other Operating Entities were formed after the date of enactment of § 197.

C was incorporated on Date2, and filed Form 2553, *Election by a Small Business Corporation*, to be treated as a subchapter S corporation for federal income tax purposes, effective Date3. In Date4, E and F contributed H percent of their stock in the Operating Entities (except with respect to one of the Operating Entities that was sold by E and F) to C, creating a holding company structure with C as the parent corporation. Thereafter, C filed Form 8869, *Qualified Subchapter S Subsidiary Election*, to treat each of the Operating Entities as a qualified subchapter S subsidiary ("QSub") for federal income tax purposes, effective Date4. Following the Year1 restructuring, C organized additional limited liability companies (together with the Operating Entities, the "Subsidiaries") to conduct I.

*Pre-Acquisition Restructuring*

Immediately prior to the purchase transaction at issue, the following restructuring steps were undertaken:

a. B was incorporated on Date5, in State1 and elected to be treated as a subchapter S corporation for federal income tax purposes;

b. The shareholders of C contributed all of the issued and outstanding stock of C to B, in exchange for all of the outstanding stock of B;

c. Options to purchase stock of C were converted into options to purchase stock of B;

d. A Form 8869 was filed to treat C as a QSub within the meaning of § 1361(b)(3)(B);

e. C was converted from a State1 corporation to a State2 LLC (*i.e.*, Taxpayer); and

f. The Subsidiaries were converted to entities disregarded as entities separate from their sole owner within the meaning of § 301.7701-3 of the Procedure and Administration Regulations.

As a result of this restructuring, B owned H percent of Taxpayer, which was treated as disregarded as an entity separate from B for federal income tax purposes. B has § 197(f)(9) intangibles consisting of goodwill that is not amortizable under § 197 in the hands of B. These intangibles are associated with the business operated by G.

*Acquisition of Taxpayer by Member*

On Date6, Member, B, and E entered into the Membership Interest Purchase Agreement pursuant to which Member purchased A percent of the membership interests of Taxpayer from B for $J in cash, subject to closing adjustments (the "Purchase"). The Purchase closed on Date7.

The C shareholders' contribution of the stock of C to B, followed by the Purchase, is treated as a transaction described in Situation 1 of Rev. Rul. 99-5, 1999-1 C.B. 434, for federal income tax purposes. Accordingly, Member is treated as purchasing an undivided A percent interest in the assets of Taxpayer and its Subsidiaries which included a significant amount of intangibles described in § 197(f)(9) associated with the business operated by G, followed by Member's contribution of such assets, along with the contribution by B of the remaining K percent undivided interest in the assets of Taxpayer and its Subsidiaries, to Taxpayer, a partnership, pursuant to § 721(a).

Any elections or other decisions related to tax allocations with respect to § 704(c) for federal income tax purposes, including the use of the "curative" or "remedial" methods of allocation under § 1.704-3 of the Income Tax Regulations, are made by Taxpayer's board of managers (the "Board"). By letter dated January 9, 2018, in response to a request for additional information from this office, Taxpayer represents that the Board adopted the remedial allocation method with respect to § 704(c) on

Taxpayer's Year2 federal income return. As a result, H percent of the amortization deductions relating to the § 197(f)(9) intangibles associated with the business operated by G were allocated to Member.

*Proposed Transaction*

Member, B, and Taxpayer entered into the Limited Liability Company Agreement of Taxpayer (the "LLC Agreement"), effective Date7 (the "Effective Date"). Pursuant to Section L of the LLC Agreement, on the M anniversary of the Effective Date (*i.e.*, on Date8), Member will purchase from B a portion of the membership units held by B (referred to as the "E Buyout Units") and B will then immediately redeem the entire equity interests of B held by the stockholders and option holders of B, including E and F (collectively, the "Founders") (the "E Buyout") but not N, O, and P (hereinafter, N, O, and P are referred to as "Management"). The Founders own approximately Q percent of the B shares on a fully diluted basis, and the E Buyout Units are approximately R percent of all issued and outstanding Taxpayer membership units. Accordingly, once the E Buyout occurs, Management will own H percent of B, and B will own a S percent partnership interest of Taxpayer, which is less than 20 percent of Taxpayer, and Member will own T percent of Taxpayer. E and F will be completely redeemed out.

Member's plan and expectation is that it will purchase the E Buyout Units on the M anniversary of the Effective Date (*i.e.*, on Date8), according to the terms of the LLC Agreement described above. Under the terms of the LLC Agreement, there are no contingencies related to the E Buyout, apart from the passage of time. In addition, Member is not aware of any legal, economic, or practical impediment that would interfere with its ability to do so. The LLC Agreement establishes a binding commitment for Member to purchase the E Buyout Units that are outstanding at the time of the Purchase and explicitly sets forth the terms for Member's acquisition of these units.

Member's acquisition of Taxpayer was structured in the manner described above in order to allow Member to have the benefit of the industry expertise of the Founders and Management for at least three years following Member's acquisition. Member also wanted the Founders and Management to have an invested interest in Taxpayer for the few years following the Purchase to ensure a smooth transition.

Taxpayer makes the following representations:

1. G (and none of its successors) has never entered into any licensing arrangement (or similar transaction) with any party with respect to any of its intangible assets that are treated as having been acquired by Member in connection with the Purchase.

2. Member's acquisition of the § 197(f)(9) intangibles pursuant to the Purchase was not undertaken to avoid the operation of the anti-churning rules of § 197(f)(9) and § 1.197-2(h)(11).

3. None of the parties have any plan or intention to engage in any transaction that would result in the shareholders of B owning more than 20 percent of Taxpayer after the E Buyout is consummated.

4. Taxpayer did not make an election into the centralized partnership audit regime pursuant to § 301.9100-22T for its Year2 taxable year.

RULINGS REQUESTED

Taxpayer requests the following rulings:

1. Taking into account the E Buyout, § 197(f)(9) does not apply to limit the amount of amortization otherwise allowable with respect to Member's purchased basis in the assets deemed acquired pursuant to Rev. Rul. 99-5 as a result of Member's acquisition of A percent of Taxpayer's membership interests; and

2. Taxpayer commences amortization of Member's tax basis in the § 197 intangibles acquired pursuant to the Purchase in the month of the Purchase.

LAW AND ANALYSIS

Section 197(a) provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable § 197 intangible. Section 197(a) further provides that the amount of such deduction is determined by amortizing the adjusted basis (for purposes of determining gain) of such intangible ratably over the 15-year period beginning with the month in which such intangible is acquired. For purposes of § 197, the term "amortizable § 197 intangible" is defined in § 197(c)(1) as meaning, in general, any § 197 intangible that is acquired by the taxpayer after August 10, 1993, and that is held in connection with the conduct of a trade or business or an activity described in § 212. Pursuant to § 197(c)(2), the term "amortizable § 197 intangible" does not include certain self-created intangibles.

Except as otherwise provided in § 197, the term "§ 197 intangible" is defined in § 197(d)(1) as meaning, among other things, (A) goodwill and (B) going concern value.

*Ruling Request #1*

Section 197(f)(2)(A) provides that in the case of any § 197 intangible transferred in a transaction described in § 197(f)(2)(B), the transferee shall be treated as the

transferor for purposes of applying § 197 with respect to so much of the adjusted basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor. Section 197(f)(2)(B) provides that the transactions described in § 197(f)(2) are (i) any transaction described in § 332, 351, 361, 721, 731, 1031, or 1033, and (ii) any transaction between members on the same affiliated group during any taxable year for which a consolidated return is made by such group.

Section 1.197-2(g)(2) provides the rules relating to §197(f)(2). If the rules under § 1.197-2(g)(2) apply to a § 197(f)(9) intangible (within the meaning of § 1.197-2(h)(1)(i)), § 1.197-2(g)(2)(i) provides that the intangible is, notwithstanding its treatment under § 1.197-2(g)(2), treated as an amortizable § 197 intangible only to the extent permitted under § 1.197-2(h).

Section 1.197-2(g)(2)(ii)(A) provides that if a § 197 intangible is transferred in a transaction described in § 1.197-2(g)(2)(ii)(C), the transfer is disregarded in determining: (1) whether, with respect to so much of the intangible's basis in the hands of the transferee as does not exceed its basis in the hands of the transferor, the intangible is an amortizable § 197 intangible; and (2) the amount of the deduction under § 197 with respect to such basis.

Section 1.197-2(g)(2)(ii)(B) provides that if the intangible described in § 1.197-2(g)(2)(ii)(A) was an amortizable § 197 intangible in the hands of the transferor, the transferee will continue to amortize its adjusted basis, to the extent it does not exceed the transferor's adjusted basis, ratably over the remainder of the transferor's 15-year amortization period. Further, the regulation provides that if the intangible was not an amortizable § 197 intangible in the hands of the transferor, the transferee's adjusted basis, to the extent it does not exceed the transferor's adjusted basis, cannot be amortized under § 197. In either event, the intangible is treated, with respect to so much of its adjusted basis in the hands of the transferee as exceeds its adjusted basis in the hands of the transferor, in the same manner for purposes of § 197 as an intangible acquired from the transferor in a transaction that is not described in § 1.197-2(g)(2)(ii)(C). The rules of § 1.197-2(g)(2)(ii) also apply to any subsequent transfers of the intangible in a transaction described in § 1.197-2(g)(2)(ii)(C).

Section § 1.197-2(g)(2)(ii)(C) specifically lists any transaction described in § 721 as among the transactions covered by the rules of § 1.197-2(g)(2).

Section 197(f)(9) provides the anti-churning rules for purposes of § 197. Section 197(f)(9) provides that the term "amortizable § 197 intangible" shall not include any § 197 intangible that is described in § 197(d)(1)(A) or (B) (or for which depreciation or amortization would not have been allowable but for § 197) and that is acquired by the taxpayer after August 10, 1993, if: (i) the intangible was held or used at any time on or after July 25, 1991, and on or before August 10, 1993, by the taxpayer or a related person; (ii) the intangible was acquired from a person who held such intangible at any

time on or after July 25, 1991, and on or before August 10, 1993, and, as part of the transaction, the user of such intangible does not change; or (iii) the taxpayer grants the right to use such intangible to a person (or a person related to such person) who held or used such intangible at any time on or after July 25, 1991, and on or before August 10, 1993.

Section 197(f)(9)(C) defines the term "related person" for purposes of § 197(f)(9). Section 197(f)(9)(C)(i) provides that a person (hereinafter in § 197(f)(9)(C) referred to as the "related person") is related to any person if (I) the related person bears a relationship to such person specified in § 267(b) or § 707(b), or (II) the related person and such person are engaged in trades or businesses under common control within the meaning of § 41(f)(1)(A) and (B). For purposes of § 197(f)(9)(C)(i)(I), in applying § 267(b) or 707(b), "20 percent" is substituted for "50 percent."

Section 1.197-2(h) provides the rules relating to § 197(f)(9). Pursuant to § 1.197-2(h)(1)(i), § 1.197-2(h) applies to § 197(f)(9) intangibles. Section 1.197-2(h)(1)(i) further provides that § 197(f)(9) intangibles are goodwill and going concern value that was held or used at any time during the transition period and any other § 197 intangible that was held or used at any time during the transition period and was not depreciable or amortizable under prior law. Section 1.197-2(h)(1)(ii) provides that the purpose of the anti-churning rules of § 197(f)(9) and § 1.197-2(h) is to prevent the amortization of § 197(f)(9) intangibles unless they are transferred after the applicable effective date in a transaction giving rise to a significant change in ownership or use.

Section 1.197-2(h)(2) provides that, except as otherwise provided in § 1.197-2(h), a § 197(f)(9) intangible acquired by a taxpayer after the applicable effective date does not qualify for amortization under § 197 if --

(i) The taxpayer or a related person held or used the intangible or an interest therein at any time during the transition period;

(ii) The taxpayer acquired the intangible from a person that held the intangible at any time during the transition period and, as part of the transaction, the user of the intangible does not change; or

(iii) The taxpayer grants the right to use the intangible to a person that held or used the intangible at any time during the transition period (or to a person related to that person), but only if the transaction in which the taxpayer grants the right and the transaction in which the taxpayer acquired the intangible are part of a series of related transactions.

Section 1.197-2(h)(4) provides that, for purposes of § 1.197-2(h), the transition period is July 25, 1991, if the acquiring taxpayer has made a valid retroactive election pursuant to § 1.197-1T, and the period beginning on July 25, 1991, and ending on August 10, 1993, in all other cases.

Section 1.197-2(h)(6) provides that, except as otherwise provided in § 1.197-2(h)(6)(ii), a person is related to another person for purposes of § 1.197-2(h) if: (A) the person bears a relationship to that person that would be specified in § 267(b) (determined without regard to § 267(e)) and, by substitution, § 267(f)(1), if those sections were amended by substituting 20 percent for 50 percent; or (B) the person bears a relationship to that person that would be specified in § 707(b)(1) if that section were amended by substituting 20 percent for 50 percent; or (C) the persons are engaged in trades or businesses under common control within the meaning of § 41(f)(1)(A) and (B).

Section 1.197-2(h)(6)(ii) provides that, except as provided in § 1.197-2(h)(6)(iii) (certain taxable stock acquisitions), a person is treated as related to another person for purposes of this § 1.197-2(h) if the relationship exists –

(A) In the case of a single transaction, immediately before or immediately after the transaction in which the intangible is acquired; and

(B) In the case of a series of related transactions (or a series of transactions that together comprise a qualified stock purchase within the meaning of § 338(d)(3) (qualified stock purchase), immediately before the earliest such transaction or immediately after the last such transaction.

Section 1.197-2(h)(7) provides that a corporation, partnership, or trust that owned or used a § 197 intangible at any time during the transition period and that is no longer in existence is deemed, for purposes of determining whether a taxpayer acquiring the intangible is related to such entity, to be in existence at the time of the acquisition.

In this case, Taxpayer represents that: (i) as a result of the Purchase, Member is treated as purchasing an undivided A percent interest in the assets of Taxpayer and its Subsidiaries; (ii) such assets included a significant amount of § 197(f)(9) intangibles associated with the business operated by G; (iii) the LLC Agreement establishes a binding commitment for Member to purchase the E Buyout Units that are outstanding at the time of the Purchase and explicitly sets forth the terms for Member's acquisition of these units; (iv) on the M anniversary of the Effective Date (*i.e.*, on Date8), Member will purchase from B the E Buyout Units and B will then immediately redeem the entire equity interests of B held by all stockholders and option holders of B other than Management; and (v) as a result of (iv), above, Management will own H percent of B, and B will own a S percent partnership interest in Taxpayer, which is less than 20 percent. These are material representations.

Pursuant to § 1.197-2(h)(7), G is treated as still in existence for purposes of applying the anti-churning rules of § 1.197-2(h). Further, based solely on Taxpayer's representation that the LLC Agreement establishes a binding commitment for Member

to purchase the E Buyout Units that are outstanding at the time of the Purchase and explicitly sets forth the terms for Member's acquisition of these units, we find that the § 197 intangibles are acquired in a series of related transactions and the E Buyout is the last transaction. Assuming the E Buyout occurs and based solely on Taxpayer's representation that immediately after the E Buyout occurs, Management, which does not include E and F, will own H percent of B, and B will own a partnership interest of less than 20 percent in Taxpayer, we conclude that the anti-churning rules of § 197(f)(9) and § 1.197-2(h) do not apply with respect to Member's purchased basis in the § 197 intangibles deemed acquired pursuant to Rev. Rul. 99-5 as a result of Member's acquisition of A percent of Taxpayer's membership interests.

*Ruling Request #2*

Section 1.197-2(f)(1)(i) provides that, in general, the basis of an amortizable § 197 intangible is amortized ratably over the 15-year period beginning on the later of (A) the first day of the month in which the property is acquired; or (B) in the case of property held in connection with the conduct of a trade or business or in an activity described in § 212, the first day of the month in which the conduct of the trade or business or the activity begins.

As stated under Ruling Request #1, Taxpayer represents that: (i) as a result of the Purchase, Member is treated as purchasing an undivided A percent interest in the assets of Taxpayer and its Subsidiaries; and (ii) immediately after the E Buyout occurs, Management, which does not include E and F, will own H percent of B and B will own a partnership interest of less than 20 percent in Taxpayer. These are material representations. Based solely on these representations and assuming the E Buyout occurs, we conclude that Taxpayer commences amortization of Member's tax basis in the § 197 intangibles acquired pursuant to the Purchase (*i.e.*, tax basis in A percent of the § 197 intangibles) on the first day of the month of the Purchase.

CONCLUSIONS

Based solely on the facts and representations submitted and the law and analysis as set forth above, we rule that:

1. Assuming the E Buyout occurs and taking into account the E Buyout, § 197(f)(9) does not apply to limit the amount of amortization otherwise allowable with respect to Member's purchased basis in the § 197 intangibles deemed acquired pursuant to Rev. Rul. 99-5 as a result of Member's acquisition of A percent of Taxpayer's membership interests; and

2. Assuming the E Buyout occurs and taking into account the E Buyout, Taxpayer commences amortization of Member's tax basis in the § 197 intangibles acquired pursuant to the Purchase in the month of the Purchase.

Except as expressly set forth above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code or regulations. Specifically, no opinion is expressed or implied concerning: (1) the federal income tax treatment of the formation of B followed by the contribution of C and its QSub election; (2) the federal income tax treatment of the Purchase; (3) except as expressly provided in the rulings above, the federal income tax treatment of the E Buyout; or (4) whether Taxpayer is properly applying the remedial allocation method under § 1.704-3(d).

The effectiveness of this letter ruling is conditioned upon Taxpayer, B, the Founders, and Member agreeing, if requested, to an extension of their respective statutes of limitations on assessment with respect to any issues raised by this letter ruling, provided the extension is for a period acceptable to the Internal Revenue Service. Furthermore, the effectiveness of this letter ruling is also conditioned upon B owning, directly or indirectly, 20 percent or less of the interests in Taxpayer on the M anniversary of the Effective Date (i.e., on Date8).

The rulings contained in this letter ruling are based upon facts and representations submitted by Taxpayer accompanying penalty of perjury statements executed by appropriate parties. While this office has not verified any of the material submitted in support of this letter ruling request, all material is subject to verification on examination.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant. A copy is enclosed for that purpose. Alternatively, a taxpayer filing its federal income tax return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of the letter ruling.

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

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representatives. We are also sending a copy of this letter to the appropriate operating division director.

Sincerely,

Kathleen Reed

KATHLEEN REED
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2):
copy of this letter
copy for section 6110 purposes