

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

Telephone Number:

Refer Reply To:

CC:ITA:4 – PLR-122104-03

Date:

September 29, 2003

Legend

A =
X =
Y =
Z =
Date 1 =
Date 2 =
Date 3 =

Dear _____ :

This is in reply to your request for a private letter ruling to allow the taxpayer, A, to use an alternative method of basis recovery under § 15a.453-1(c)(7) of the Temporary Income Tax Regulations to report contingent payments, because the normal basis recovery rule method will substantially and inappropriately defer recovery of basis.

FACTS:

X is an S corporation with 10 shareholders. On Date 1, all of the stock of X was sold on an installment basis to Y, a wholly owned subsidiary of Z. The X shareholders and Y made elections under § 338(h)(10) of the Internal Revenue Code to have the stock sale treated as a deemed sale of all of the assets, properties, rights, and business of X, subject to certain liabilities, to Y followed by the liquidation of X.

The sales agreement calls for payments of fixed amounts (a payment consisting of cash and Z stock at closing and two cash payments at later dates) followed by four contingent payments. The contingent payments will be calculated based on a

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percentage of the positive pre-tax income of Z for the period Date 2 through Date 3. The contingent payments are payable annually. The sales agreement set no maximum limit on the amount of the contingent payments.

LAW AND ANALYSIS:

Section 453(a) provides that income from an installment sale shall be taken into account under the installment method. Section 453(b)(1) defines the term "installment sale" to mean a disposition of property if at least one payment is to be received after the end of the taxable year in which the disposition occurs. The term "installment method" is defined in § 453(c) as a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year that the gross profit (realized or to be realized when the payment is completed) bears to the total contract price.

Section 15a.453-1(c)(1) defines a "contingent payment sale" as a sale or other disposition of property in which the aggregate selling price cannot be determined by the close of the taxable year in which such sale or other disposition occurs. Unless a taxpayer makes an election under § 15a.453-1(d)(3), contingent payment sales are to be reported on the installment method.

Section 15a.453-1(c)(3)(i) provides generally that when a stated maximum selling price cannot be determined as of the close of the taxable year in which a sale or other disposition occurs, but the maximum period over which payments may be received under the contingent sale price agreement is fixed, the taxpayer's basis (inclusive of selling expenses) shall be allocated to the taxable years in which payments may be received under the agreement in equal annual increments.

Section 15a.453-1(c)(7)(i) provides that the normal basis recovery rules set forth in § 15a.453-1(c)(3) may, with respect to a particular contingent payment sale, substantially and inappropriately defer recovery of the taxpayer's basis.

Section 15a.453-1(c)(7)(ii) provides that the taxpayer may use an alternative method of basis recovery if the taxpayer is able to demonstrate prior to the due date of the return, including extensions for the taxable year in which the first payment is received, that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis. The taxpayer must receive a ruling from the Internal Revenue Service before using an alternative method of basis recovery and must have filed the request for a ruling prior to the due date for the return, including extensions.

To demonstrate that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis, the taxpayer must show (A) that the alternative method is a reasonable method of ratably recovering basis, and (B) that under that

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method it is reasonable to conclude that over time the taxpayer likely will recover basis at a rate twice as fast as the rate at which basis would have been recovered under the otherwise applicable normal basis recovery rule. In demonstrating that application of the normal basis recovery rule would substantially and inappropriately defer recovery of the taxpayer's basis, the taxpayer in appropriate circumstances may rely upon contemporaneous or immediate past relevant sales, profit, or other factual data that are subject to verification. The taxpayer ordinarily is not permitted to rely upon projections of future productivity, receipts, profits, or the like. However, in special circumstances a reasonable projection may be acceptable based upon a specific event that has already occurred.

Under the alternative method of basis recovery proposed by *A*, the amount of basis allocated to an installment payment would bear the same ratio to *A*'s total basis in the property sold that the installment payment bears to the estimated amount of the aggregate payments to be received by *A* during the term of the installment obligation. The estimate of the aggregate payments to be received during the term of the installment obligation was determined on the basis of historical data and earnings trends.

Based on the information provided and the representations made, it is reasonable to conclude that *A*'s use of the proposed alternative method of basis recovery will result in basis recovery at a rate twice as fast as the rate at which basis would be recovered under the normal basis recovery rules. The proposed alternative method of basis recovery represents a reasonable method of basis recovery. Accordingly, *A*'s use of the proposed alternative method of basis recovery is approved.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer and the second authorized representative indicated on the power of attorney.

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures (2)