OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL

FROM: ASSISTANT CHIEF COUNSEL
CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated March 23, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

A=
B=
C=
D=
E=
Date 1=
Date 2=
Date 3=
Date 4=
Date 5=
Date 6=
Date 7=
Date 8=
Date 9=
Date 10=

Date 11=
#1=
#2=
$1=

ISSUE:

Whether taxpayer may rely on Proposed Treas. Reg. § 1.168-6(a)(3) to take a loss deduction on its fiscal year Date 1 tax return for a manufacturing facility actually sold in fiscal year Date 2.

CONCLUSION:

Proposed Treas. Reg. § 1.168-6(a)(3) applies to assets disposed of by permanent withdrawal from a taxpayer's trade or business other than by sale, exchange, or abandonment. Therefore, this regulation contemplates that the asset will not be sold. Instead, taxpayer falls under Proposed Treas. Reg. § 1.168-6(a)(1), because the asset was disposed of by sale and the loss should be taken in the year of the sale under Internal Revenue Code section 165.

FACTS:

Taxpayer, A, is located in B. It is primarily a manufacturer of C products for sale to industrial and retail customers. The company uses the accrual method of accounting and has a fiscal year ending on June 30th.

In Date 3, A purchased #1 percent of D, a publicly traded company. In Date 4, A increased its ownership to #2 percent. On Date 5, A completed the acquisition, by acquiring the outstanding minority interest.

In connection with the D acquisition, A decided to close the manufacturing facility located in E, which had been operated by D's subsidiary. The move was an effort to realign and consolidate certain operations and better position itself to achieve corporate objectives.

The corporate minutes of Date 6 stated that the E facility was scheduled to be closed by the end of Date 11 and that there was little or no interest by potential buyers to purchase the facility as a going concern and that the company would proceed with trying to sell the equipment, inventory and facility separately. By Date 10, however, all orders were not complete and the facility was kept open until Date 7.

Power was disconnected from the plant on Date 7. In addition the facility was placed in an account labeled "Assets Held for Sale." The machinery and the equipment were sold or transferred to other plants by Date 8. The facility was not sold until Date 9, which was in taxpayer's fiscal year Date 2. Nonetheless, taxpayer claimed a $1 loss under Proposed Treas. Reg. § 1.168-6(a)(3) on its fiscal year Date 1 return.

The amount of the loss is not in dispute. The timing of the loss is. This case is currently in nondocketed status.

LAW AND ANALYSIS

Taxpayer is attempting to claim a loss in Date 1, the same year it purportedly placed the facility in a "Assets Held for Sale" account and had the electricity turned off. In claiming this loss, the taxpayer cited Proposed Treas. Reg. § 1.168-6(a)(3). Proposed regulations are not binding upon taxpayers or the Service, however, as a general practice, we do not challenge a taxpayer's efforts to avail itself of the benefits of a proposed regulation. However, this applies only where the taxpayer fits within the strict confines of that proposed regulation.

Proposed Treas. Reg. § 1.168-6 provides in relevant part:

> (a) . . . [W]here recovery property is disposed of during a taxable year, the following rules shall apply:
>
> (1) If the asset is disposed of by sale or exchange, gain or loss shall be recognized as provided under the applicable provisions of the Code. . . . .
>
> (3) If the asset is disposed of **other than by sale or exchange** or physical abandonment (as, for example, where the asset is transferred to a supplies or scrap account), gain shall not be recognized. Loss shall be recognized in the amount of the excess of the adjusted basis of the asset over its fair market value at the time of the disposition. No loss shall be recognized upon the conversion of property to personal use.
>
> (b) *Definitions.* (1) See § 1.168-2(l)(1) for the definition of "disposition," which excludes the retirement of a structural component of 15-year real property.

Proposed Treas. Reg. § 1.168-2(l)(1) further provides:

> For purposes of section 168 and §§ 1.168-1 through 1.168-6-
>
> (1) *Disposition*. The term "disposition" means the permanent withdrawal of property from use in the taxpayer's trade or business or use for the production of income. Withdrawal may be made in several ways, including sale, exchange, retirement, abandonment, or destruction. A disposition does not include a transfer of property by gift or by reason of the death of the taxpayer. . . . The manner of disposition (*e.g.* ordinary retirement, abnormal retirement) is not a consideration. . . .

Taxpayer did in fact sell the facility. Therefore it clearly falls under Proposed Treas. Reg. § 1.168-6(a)(1) and the loss should be taken under section 165 in the year of the sale. Further, even under the terms of section (3) of the proposed regulation, taxpayer did not dispose of the asset by placing it in a supplies or scrap account. It was placed in a "Assets Held for Sale" account. This brings us back to section (1): Taxpayer intended, and in fact accomplished, a disposition by sale.

Further, the definition of disposition found in Proposed Treas. Reg. § 1.168(2)(l)(1) states that the asset may be disposed of by being permanently withdrawn from the taxpayer's trade or business, for instance, by sale, exchange, retirement, abandonment, or destruction. Instead, taxpayer placed the idle facility in a "Assets Held for Sale" account. See also, Kittredge v. Commissioner, 88 F.2d 632, 634 (2nd Cir. 1937) ("To read the phrase 'used in the trade or business' as meaning only active employment of property devoted to the business would lead to results which we cannot believe Congress intended.") If the proposed regulations had intended the preparation for a sale and not just the sale itself to trigger loss, such would have been provided under the definition of disposition. Plainly, the placing of an asset in a held for sale account predates the actual sale, and provides a different date for taking a loss. To assume that placing an asset in an account held for sale triggers the same type of loss as the actual sale is not consistent with the proposed regulations. Accordingly, the taxpayer is only entitled to take a loss on the facility in the year the facility was actually sold.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

There is some uncertainty in District Counsel's submission over when taxpayer placed the facility into the account "Assets Held for Sale." For the purposes of this FSA, we assumed it was in the year the taxpayer attempted to take the loss. [redacted]

[redacted]

Additionally, because we determined that taxpayer should take a loss in its fiscal year Date 2, it is entitled to depreciate the property for fiscal year Date 1. An adjustment should be made to account for this. See Kittredge, 88 F.2d 632.

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