

Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: September 05, 2008

to: David J. Mungo
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(Large & Mid-Size Business)

from: Dianna K. Miosi,
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(Passthroughs & Special Industries)

subject: Trade or business expenses under § 162

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

X =

Y =

D1 =

ISSUES

1. Whether X may claim net capital losses for the payments of certain liabilities described below.
2. Whether X is entitled to take deductions under § 162 with respect to its payments of certain medical liabilities.

CONCLUSIONS

1. X may not claim net capital losses for the payments of certain liabilities it assumed.

2. X is entitled to take deductions under § 162 with respect to its payments of certain medical liabilities.

FACTS

Through a series of transactions, X acquired for federal tax purposes the medical liabilities, Payment Obligation, and Indemnity Obligation that were the subject of PLR 8429014. In PLR 8429014, an entity, identified as P in the PLR, sold all stock of a wholly owned subsidiary, identified as S, to another entity, identified as N. As part of the transaction, P agreed with N to make payments for S's medical liabilities under S's medical plan ("Payment Obligation"). P and N also entered into an indemnity agreement under which N would pay to P an amount equal to the value of S's tax deduction for a medical liability paid by P ("Indemnity Obligation").

The PLR concludes in part that P's payments for Payment Obligation increase P's basis in its S stock and N's payments for Indemnity Obligation increase the price of the S stock, both relating back to the sale of S stock. The increase in P's basis in S stock due to P's payments for Payment Obligation is necessarily larger than the increase in the price of S stock due to N's payments for Indemnity Obligation. Therefore, the arrangement under the PLR generates net capital losses for P.

Several years after the sale of S stock, N and S merged into X. As a result, X acquired S's medical liabilities and Indemnity Obligation. In D1, Y, successor to Payment Obligation and a subsidiary of X, converted from a corporation into a limited liability company and became an entity disregarded as separate from its owner X. Thus, X is treated for federal tax purposes as owning Payment Obligation.

X asserts that, as successor in interest to the taxpayers to whom PLR 8429014 was issued, X may claim ordinary loss deductions and net capital losses as described in PLR 8429014.

LAW AND ANALYSIS

Section 162(a) provides in part that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 6110(k)(3) provides in part that unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent. Further, A taxpayer may not rely on a letter ruling issued to another taxpayer under § 6110(k)(3)¹.

Section 301.7701-2(a) provides in part that a business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

¹ Section 11.02, Rev. Proc. 2008-1, 2008-1 I.R.B. 50.

Section 301.7701-3(b)(1) provides that except provided in paragraph (b)(3) of this section, unless the entity elects otherwise, a domestic eligible entity is – (i) A partnership if it has two or more members; or (ii) Disregarded as an entity separate from its owner if it has a single owner.

The facts upon which PLR 8429014 was based have substantially changed. As a result of the series of transactions described above, the medical liabilities, Indemnity Obligation and Payment Obligation no longer belong to separate taxpayers producing the results described in PLR 8429014. Thus, X is not permitted to claim net capital losses as described in PLR 8429014. However, when S merged into X, S's medical liabilities under its medical plan became X's liabilities. Therefore, X is entitled to claim deductions under § 162 as it pays for the medical liabilities.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Sean Kahng at (202) 622-3050 if you have any further questions.

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