

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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December 14, 2009

**Re: Request for Private Letter Ruling Regarding § 1245**

Taxpayer =  
State =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
Date 6 =  
Company A =  
  
Company B =  
Company C =  
Company D =  
Shareholder =  
Appraiser =  
Year 1 =  
Year 2 =  
Year 3 =  
A =  
B =  
C =  
D =  
E =  
F =  
G =  
H =

J =  
\$K =

Dear \_\_\_\_\_ :

This letter is in response to your letter dated Date 1, and subsequent correspondence, submitted on behalf of Taxpayer, requesting a letter ruling on whether any gain upon the sale of certain self-created customer based intangibles will be subject to recapture under § 1245 of the Internal Revenue Code as a result of amortization deductions claimed for certain acquired customer based intangibles.

### FACTS

Taxpayer represents that the facts are as follows:

Taxpayer, a holding company, operates \_\_\_\_\_ businesses in the United States, offering services to \_\_\_\_\_ customers. Taxpayer offers \_\_\_\_\_

services.

Taxpayer was organized in State during Year 1 and completed an initial public offering of its Class A common stock in Date 2. Taxpayer's principal assets as of Date 3 consist of a A percent controlling common equity interest and a B percent voting interest in Company A. Taxpayer's only business is to act as the sole manager and control the affairs of Company A and Company A's subsidiaries.

Shareholder is Taxpayer's controlling shareholder. Shareholder also owns the remaining C percent of Company A through Company B, Shareholder's wholly-owned S corporation, as well as a note convertible into Company A's membership units through affiliated entities.

Company A owns a D percent partnership interest in Company C. Shareholder owns the remaining E percent partnership interest in Company C through Company B. Company C owns interests in various subsidiaries. Company A also owns a F percent partnership interest in Company D and Company A's subsidiaries own the remaining G percent partnership interest in Company D. Company A, Company A's subsidiaries, Company C, Company C's subsidiaries, and Company D each own the customer based intangibles that are the subject of this letter ruling.

, Taxpayer will acquire Shareholder's E percent partnership interest in Company C that is owned through Company B.

### Taxpayer's Customer Relationships

In Year 1 through Year 2, Taxpayer acquired approximately H customers through a series of acquisitions. Hereinafter, these customers are referred to as "Acquired Customer Relationships."

The Acquired Customer Relationships represent mostly written terminable-at-will contracts between Taxpayer and its then existing customers. These relationships provided Taxpayer with the right to service the existing customers with the services offered by Taxpayer. At the time of its last significant acquisition in Date 6, Taxpayer primarily offered services. The Acquired Customer Relationships gave Taxpayer the right to service those customers. At the time of each respective asset acquisition, Taxpayer took a cost basis in the Acquired Customer Relationships and began amortizing this tax basis together with other amortizable § 197 intangibles over the 15-year period prescribed under § 197.

Since its last significant acquisition in Date 6, Taxpayer expanded its service offerings from primarily services to also include services. Further, Taxpayer grew its to be able to provide services to customers it had previously been unable to. Taxpayer expended significant amounts of capital to solicit and service new customers (hereinafter, these new customers are referred to as "Self-Created Customer Relationships")

Currently, Taxpayer offers its services to customers under two types of contracts, . The majority of Taxpayer's contracts are terminable-at-will

Because the \_\_\_\_\_ industry is highly competitive, Taxpayer's continual capital investments are necessary to maintain an edge in the market. Taxpayer spent approximately \$K on capital expenditures from Year 1 to Year 3 in order to maintain and attract customers. Taxpayer claims that absent efforts made by Taxpayer

\_\_\_\_\_, it is reasonable to conclude that potential customers would have enlisted the services of competitors

Due to the significant affirmative efforts that Taxpayer made to \_\_\_\_\_ and create new customer relationships, Taxpayer's current customer relationships consist of Acquired Customer Relationships and Self-Created Customer Relationships.

As of Date 5, Taxpayer has approximately J customers, which are not identical to the H Acquired Customer Relationships.

Taxpayer makes the following specific representations:

1. Taxpayer has sufficient records and information to identify which of its current customers represent components of either Self-Created Customer Relationships or Acquired Customer Relationships.

Further, Taxpayer represents it can individually identify each customer, determine when they became a customer, and

Taxpayer maintains a customer data base which provides various information regarding its customers for purposes of providing services and billing for those services. Included in this information are

. Taxpayer

\_\_\_\_\_ identify each customer as either an Acquired Customer Relationship or a Self-Created Customer Relationship.

2. Each of the identified types of customer relationships that are Acquired Customer Relationships and that are Self-Created Customer Relationships has a reasonably ascertainable value.

3. Each of the identified types of customer relationships that are Acquired Customer Relationships and that are Self-Created Customer Relationships has a reasonably determinable life.

With respect to the last two representations, Taxpayer represents that as part of its annual financial reporting process

, Taxpayer engaged Appraiser to value its identifiable intangible assets. Appraiser identified several categories of intangible assets that are apart from goodwill, including customer relationships and . The rights to future economic benefits of these two assets are associated with the and were segregated into two categories, the portion of these rights with a limited useful life, or customer relationships, and the portion of these rights with an indefinite useful life, or . Appraiser identified three types of customer relationships:

. Based upon

, Appraiser was able to assign a value to each type of customer relationship. Appraiser is then able to allocate the value of each type of customer relationship to Taxpayer's business units, ."

#### Taxpayer's taxable exchange

pursuant to an exchange agreement entered into by Taxpayer, Company B, and Shareholder, Company B has the right and option to exchange all or any portion of its partnership interest in Company A with Taxpayer for Taxpayer's stock in a taxable exchange. This transaction will result in the application of § 1245 because Company A holds intangible assets that consist primarily of customer relationships (i.e., the Acquired Customer Relationships and the Self-Created Customer Relationships), , and trademarks, and all of Company A's acquired intangible assets, including the Acquired Customer Relationships, have been subject to amortization under § 197. Shareholder and Company B also have the right under certain circumstances to enter into a subsequent tax-free or taxable exchange for any remaining Company A interests held after the initial exchange.

#### RULING REQUESTED

Taxpayer requests that the Service issue the following ruling:

The Self-Created Customer Relationships are a severable and distinct asset from the Acquired Customer Relationships, such that any gain with respect to a sale of the Self-Created Customer Relationships will not be subject to § 1245 recapture as a result of amortization deductions claimed with respect to the Acquired Customer Relationships.

## LAW AND ANALYSIS

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the taxpayer's trade or business.

Section 1.167(a)-3(a) of the Income Tax Regulations provides in pertinent part that if an intangible is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Section 1.167(a)-3(a) further provides that no allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life.

Section 197(a) provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable § 197 intangible. The amount of the deduction is determined by amortizing the adjusted basis of such intangible ratably over the 15-year period beginning with the month in which the intangible was acquired.

Section 197(b) provides that except as provided in §197(a), no depreciation or amortization deduction shall be allowable with respect to any amortizable § 197 intangible.

Section 197(c)(1) provides that, in general, the term "amortizable section 197 intangible" means any § 197 intangible that is acquired after August 10, 1993, and that is held in connection with the conduct of a trade or business or an activity described in § 212. Section 197(c)(2) provides that the term "amortizable section 197 intangible" does not include any § 197 intangible that is not described in § 197(d)(1)(D), (E), or (F), and that is created by the taxpayer.

The term "section 197 intangible" is defined in § 197(d) and the regulations thereunder. Section 197(d)(1)(C)(iv) provides that a "section 197 intangible" includes any customer-based intangible. Section 197(d)(2)(A) defines the term "customer-based intangible" as meaning, in general, composition of market, market share, and any other value resulting from the future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers. See also § 1.197-2(b)(6).

Thus, the term "amortizable section 197 intangible" includes customer-based intangibles. Generally amortization under § 197 is not allowed for self-created intangibles, unless certain exceptions apply. In this case, we find the acquired customer-based intangibles at issue are an amortizable § 197 intangible, and the self-created customer-based intangibles at issue are not an amortizable § 197 intangible.

Section 197(f)(7) provides that for purposes of § 197, any amortizable § 197 intangible shall be treated as property which is of a character subject to the allowance for depreciation provided in § 167. See also § 1.197-2(g)(8).

In general, § 1245(a)(1) provides that if §1245 property is disposed of the amount by which the lower of (i) the recomputed basis of the property, or (ii) the amount realized on a sale, exchange, or involuntary conversion (or the fair market value of the property on any other disposition), exceeds the adjusted basis of such property shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of the Code.

Section 1245(a)(3) defines the term “section 1245 property” as meaning any property that is or has been property of a character subject to the allowance for depreciation provided in § 167 and is, among other things, personal property. Pursuant to § 1.1245-3(a)(i) and (b), the term “personal property” includes intangible personal property.

Prior to the enactment of § 197, numerous court cases discuss the test a taxpayer must meet to prove a particular intangible asset is separate and distinct from goodwill. The U.S. Supreme Court in Newark Morning Ledger Co. v. United States, 507 U.S. 546, 566 (1993), held that an intangible asset that would otherwise fall within the concept of goodwill is depreciable provided a taxpayer is able to prove the intangible asset has an ascertainable value and a limited useful life that can be determined with reasonable accuracy. The Court further stated that the taxpayer’s burden of proof often will prove too great to bear. Id.

Moreover, the mass-asset rule does not prevent taking an amortization deduction if the taxpayer properly carries the taxpayer’s dual burden of proving that the intangible asset involved has an ascertainable value separate and distinct from goodwill, and has a limited useful life, the duration of which can be ascertained with reasonable accuracy. Id. at 558 (citing to Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240, 1250 (5<sup>th</sup> Cir. 1973), cert. denied, 414 U.S. 1129). See also Citizens and Southern Corporation v. Commissioner, 91 T.C. 463, 482 (1988), aff’d, 919 F.2d 1492 (11th Cir. 1990). When a taxpayer has been able to satisfy this perhaps extremely difficult burden, depreciation expense deductions have been allowed. Citizens and Southern Corporation, at 482.

In this case, Taxpayer represents that it has sufficient records and information to identify which of its current customers represent the Acquired Customer Relationships and which represent the Self-Created Customer Relationships. Taxpayer also represents that each of the identified types of customer relationships (

) that are

Acquired Customer Relationships and that are Self-Created Customer Relationships has a reasonably ascertainable value and a reasonably determinable life. Further, Taxpayer represents that it has expended significant amounts of capital to solicit and service new customers

. Thus, by analogy, these representations that Taxpayer can separately identify, value, and life the Acquired Customer Relationships and the Self-Created Customer Relationships support treating the Self-Created Customer Relationships as being a separate and distinct asset from the Acquired Customer Relationships. See Newark Morning Ledger and Citizens and Southern Corporation.

### CONCLUSION

Based solely on the facts and representations submitted and the relevant law and analysis as set forth above, we conclude that the Self-Created Customer Relationships are a severable and distinct asset from the Acquired Customer Relationships, such that any gain with respect to a sale of the Self-Created Customer Relationships will not be subject to § 1245 recapture as a result of amortization deductions claimed with respect to the Acquired Customer Relationships.

We note that amortization deductions claimed for the Acquired Customer Relationships are subject to § 1245 upon disposition of such intangibles. Similarly, depreciation or amortization deductions claimed, if any, for the Self-Created Customer Relationships are subject to § 1245 upon disposition of such intangibles.

Except as set forth above, we express no opinion concerning the Federal income tax consequences of the facts described above under any other provisions of the Code. Specifically, no opinion is expressed or implied on (i) the application of § 1245(b)(8), (ii) whether the Acquired Customer Relationships and the Self-Created Customer Relationships can be separately identified, or (ii) whether each of the identified types of customer relationships ( ) that are Acquired Customer Relationships and that are Self-Created Customer Relationships has a reasonably ascertainable value and a limited useful life.

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



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

Sincerely,

Kathleen Reed  
KATHLEEN REED  
Chief, Branch 7  
Office of Associate Chief Counsel  
(Income Tax and Accounting)

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