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

FROM: DEBORAH A. BUTLER, ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

Field Service Advice
Deduction for Value of Stock Warrants as Consideration
in Technology Licensing Agreement

This Field Service Advice responds to your memorandum dated April 9, 1999. It is not binding on Examination or Appeals and is not a final case determination. This document may not be cited as precedent.

LEGEND:

Taxpayer	=
Corp. A	=
B	=
C	=
D	=
E	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=

$Amount =
$$Amount =
$$$Amount =
$$$$Amount =

ISSUE:

Whether Taxpayer, in exchange for license to certain technology, should be required to capitalize the independently established value of stock warrants it granted to an unrelated firm to the license it acquired.

CONCLUSION:

We believe that Taxpayer is required to capitalize its cost, i.e., the value of property transferred (its stock warrants), to the technology license it acquired, with any residual unamortized amount deducted in the year in which the technology was abandoned--the total value of the stock eventually issued upon exercise of the warrants and the actual timing thereof are immaterial.

FACTS:

Taxpayer entered into an agreement with an unrelated party whereby Taxpayer acquired a license to certain technology in exchange for a cash payment and additional consideration of a grant to the licensor of certain stock warrants. Use of the acquired technology was apparently abandoned by Taxpayer two or three years after licensing. In a subsequent year or years, after that purported abandonment, the warrants were exercised and stock of the Taxpayer was transferred to an assignee of the original licensor. Taxpayer then sought to take a current deduction for the full market value of the stock actually transferred at the time of the warrants' exercise.

LAW AND ANALYSIS:

The basis of property acquired by a taxpayer, such as a license, is its cost. I.R.C. § 1012. A part of the cost of the license here was the value of the warrants. That amount should be included in the basis of the license. Taxpayer's reliance upon Sun Microsystems, Inc. v. Commissioner, T.C. Memo. 1993-467, and Convergent Technologies, Inc. v. Commissioner, 1995-320, to support a current deduction is misplaced. Despite the mere superficial resemblance to the circumstances

involved here (i.e., the transfer of stock warrants as consideration in a transaction with an unrelated party), those cases do not lend support to Taxpayer's position.

We believe that a number of distinctions set the facts in this situation apart from the adverse opinions rendered in Sun Microsystems and Convergent Technologies; consequently, we believe that, notwithstanding the decisions in those two earlier cases, capitalization of the value of the warrants when issued to the license received is proper in this case.

Key among those factual differences presented here are: (1) the ability to place a value with reasonable certainty on the warrants in issue; (2) the fact that such value was independently determined and was specifically used by Taxpayer and the technology licensor to calculate the considerations transferred in the bargain; (3) no contingencies attached to the warrants other than the mere lapse of time; and, probably most importantly, (4) the warrants were in exchange for a genuine technology transfer to Taxpayer, rather than serving as a mere incentive to purchase Taxpayer's goods.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

[redacted]

[redacted][1]

[redacted]

[1] [redacted]

[redacted]

[redacted][2]

[redacted]

[redacted][3]

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2 [redacted]

3 [redacted]

4 [redacted]

[redacted]

[redacted]

By: _____
THOMAS D. MOFFITT
Senior Technician Reviewer
Income Tax & Accounting Branch

[redacted]