INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-117928-00/CC:FIP:B2

To:

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

LEGEND:

Taxpayer:

Corporation A:

Corporation B:

Corporation C:

Corporation D:

Thrift A:

Thrift B:

Thrift C:

Thrift D:

Thrift E:

Bank A:

Date a:

Date b:

Date c:

Date d:

Date e:

Date f:

Date g:

Date h:

Date i:

Fiscal Tax Year 1:

Year 1:

Year 2:

State A:

State B:

State C:

Merger Agreement <u>A</u>

Merger Agreement <u>B</u>

Merger Agreement <u>C</u>:

Assistance Agreement <u>A</u>:

Master Agreement <u>A</u>:

Purchase Agreement <u>A</u>:

Exchange Agreement <u>A</u>:

FHLBB Resolution No. <u>1</u>:

FHLBB Resolution No. <u>2</u>:

FHLBB Resolution No. <u>3</u>:

FSLIC Memorandum <u>A</u>:

FSLIC Memorandum <u>B</u>:

$<u>a</u>:

$<u>b</u>:

$<u>c</u>:

$<u>d</u>:

$<u>e</u>:

$<u>f</u>:

$<u>g</u>:

$<u>h</u>:

$<u>i</u>:

$<u>j</u>:

$<u>k</u>:

$<u>l</u>:

$<u>m</u>:

$<u>n</u>:
a%:

<u>b</u>%:

<u>c</u>%:

<u>x</u>:

<u>y</u>:

<u>z</u>

ISSUES:

(1) Whether "supervisory goodwill" qualifies as "money or other property" for purposes of § 597 of the Internal Revenue Code?

(2) Whether the Taxpayer has established a tax basis in supervisory goodwill?

(3) If a tax basis has been established, whether the Taxpayer is entitled to claim a loss for its supervisory goodwill under § 165(a) of the Code based on worthlessness, abandonment, or confiscation?

(4) If a tax basis has been established, whether the Taxpayer is entitled to claim a deduction for the amortization of supervisory goodwill under § 167 of the Code?

CONCLUSIONS:

(1) Supervisory goodwill is not financial assistance received from the Federal savings and Loan Insurance Corporation (FSLIC) under § 406(f) of the National Housing Act (12 C.F.R. § 1729(f)). Accordingly, it does not qualify as money or other property for purposes of § 597 of the Code.

(2) The Taxpayer has not established a tax basis in supervisory goodwill.

(3) Because the Taxpayer can not establish a tax basis in supervisory goodwill, the Taxpayer may not claim a loss under § 165(a) of the Code based on worthlessness, abandonment, or confiscation. Further, even if the Taxpayer can establish a tax basis in supervisory goodwill, the Taxpayer can not establish its entitlement to a deductible loss in Fiscal Tax Year 1.

(4) Because the Taxpayer can not establish a tax basis in supervisory goodwill, the Taxpayer may not claim a deduction under § 167 of the Code for the amortization of supervisory goodwill. Further, even if the Taxpayer can establish a tax basis in supervisory goodwill, the Taxpayer has not met its burden under Newark Morning Ledger Co. v. United States, 507 U.S. 546 (1993), and, therefore, may not claim a depreciation deduction under § 167 of the Code.

FACTS:

I. Taxpayer's Organizational History

The Taxpayer is a group of affiliated corporations that file consolidated returns with Corporation A as the common parent. Thrift A was formed on or about Date a. At some point after Date b, Thrift A became a wholly-owned subsidiary of Corporation A. Thrift A joined in Taxpayer's consolidated return for Fiscal Tax Year 1.

Following the close of Fiscal Tax Year 1, Corporation A merged with and into Corporation B (which was a subsidiary of Corporation C) in a reorganization qualifying under § 368(a)(1)(A) of the Internal Revenue Code (Code). Corporation A, as the surviving entity in the merger, changed its name to that of Corporation B and continued in existence as a subsidiary of Corporation C. As part of this overall business combination, Thrift A also underwent a name change. Subsequently, Thrift A merged with and into Bank A (another subsidiary of Corporation C) in a reorganization qualifying under § 368(a)(1)(A) of the Code.

Corporation C later merged with and into Corporation D, in a reorganization qualifying under § 368(a)(1)(A) of the Code, with Corporation D surviving. As part of that same overall business combination, Bank A underwent a name change and continued in existence as a subsidiary of Corporation D.

For purposes of this technical advice memorandum, however, we will refer to the relevant entities as Taxpayer, Corporation A, and Thrift A.

II. The Three Thrift Acquisitions at Issue

(a) The First Thrift Acquisition

Thrift A was formed as a result of an arranged supervisory merger of Thrift B and Thrift C. On or after Date b, Thrift A began operating as a federally chartered mutual savings and loan association headquartered in State A, with its deposits insured by the Federal Savings and Loan Association (FSLIC).

Thrift B was originally organized as a state chartered mutual savings bank more than x years before the events described here. At the time it entered into negotiations with FSLIC with respect to the acquisition of Thrift C, Thrift B was operating in State B as a federally chartered mutual savings bank, the deposits of which were insured by the Federal Deposit Insurance Corporation (FDIC). Although it reported a net operating loss as of the close of Year 1, Thrift B had a positive tangible net worth for regulatory purposes and met its regulatory capital requirements. See FSLIC Memorandum A.

Prior to its merger with Thrift B, Thrift C was a federally chartered mutual savings and loan association operating in State A. The deposits of Thrift C were insured by FSLIC. As of Date c, the tangible net worth of Thrift C was approximately $a while the value of its assets were approximately $b. Thus, as of Date c, Thrift C had a net worth to asset ratio of approximately a%. See FSLIC Memorandum A.

FSLIC requested that the Federal Home Loan Bank Board (FHLBB) approve the merger of Thrift B and Thrift C, with the resulting association to operate under Thrift C's charter and headquartered in State A. The resulting association would undergo a name change to Thrift A and would be managed by the officers and directors of Thrift B. The acquisition of Thrift C by Thrift B, which took place on Date b, was a FSLIC assisted acquisition. See FSLIC Memorandum A.

In connection with this acquisition, an assistance agreement was entered into between FSLIC and Thrift B. See Assistance Agreement A. That agreement was conditioned in part upon Thrift B's receipt of both a supervisory forbearance letter and a copy of the FHLBB resolution in which the FHLBB determined that financial assistance by FSLIC was required, pursuant to § 406(f) of the National Housing Act (12 U.S.C. § 1729(f)), to prevent the default of Thrift C. Assistance Agreement A further provided that FSLIC would wire transfer a cash contribution in the amount of $c shortly after Date b, and that FSLIC would make additional payments over the following y years (based on an excess FHLB-stock dividend formula) up to a maximum amount of $d. The agreement also provided that the FSLIC would indemnify Thrift A if the cash contribution of $c was determined either to be a taxable event or to result in tax attributable to and measured by the amount of that payment.

The acquisition of Thrift C by Thrift A was approved by the FHLBB. See FHLBB Resolution No. 1. That FHLBB approval set forth a number of specific resolutions in separate and distinct paragraphs. One such paragraph determined that, pursuant to § 406(f) of the National Housing Act, financial assistance from the FSLIC was necessary. Another resolution, contained in a separate paragraph, recited that the FHLBB found that the use of purchase accounting was appropriate, and authorized its use by Thrift A subject to certain conditions as follows:

> [Thrift A] shall furnish an opinion from its independent accountants, . . . , that specifically describes, as of the effective date, any intangible assets, including goodwill, or discount of assets arising from the merger to be recorded on the books of [Thrift A], and substantiates the reasonableness of amounts attributable to intangible assets, including goodwill, and the discount of assets and the resulting amortization periods and methods; and if [Thrift A] desires to use the purchase method of accounting in regard to the merger, [Thrift A] also shall submit a stipulation that any goodwill arising from the transaction shall be determined and amortized in accordance with FHLBB Memorandum R-31b; . . . .

FHLBB Resolution No. 1.

In addition, Merger Agreement A provided that the merger was "conditioned upon the FHLBB's approval of the utilization of purchase accounting" and recited the parties' understanding that "the final accounting entries and adjustments must be approved by the FHLBB's Office of Examination and Supervision."

The merger of Thrift B and Thrift C took place as contemplated on Date b and Thrift A was formed in a reorganization that qualified under § 368(a)(1)(G).

(b) The Second and Third Thrift Acquisitions

Prior to their respective mergers with Thrift A, both Thrift D and Thrift E were federally chartered mutual savings and loan associations operating within State C. The deposits of both Thrift D and Thrift E were insured by FSLIC. The agreement and plan of merger between Thrift A and Thrift E was made on or about Date e although the effective date was delayed and, it appears, Thrift A actually acquired Thrift D first. See Merger Agreement B and FHLBB Resolution 2.

As of Date f, Thrift D reported a negative net worth of approximately $f on total assets of $g and a net worth to asset ratio of approximately b% (a negative value). See FSLIC Memorandum B. The merger agreement between Thrift A and Thrift D was made on or about Date g and was expressly conditioned upon the execution of an assistance agreement between Thrift A and FSLIC. See Merger Agreement B, § 16. The merger was also expressly "conditioned upon the grant by the FSLIC and the FHLBB of certain regulatory forbearance including reserve and net worth compliance and scheduled items limitations waivers satisfactory to [Thrift A]" (Merger Agreement B, § 17) and, further "conditioned upon the FHLBB specifically approving the utilization of the purchase method of accounting" (Merger Agreement B, § 18). The acquisition of Thrift D by Thrift A was also conditioned upon Thrift A's receipt of a tax opinion that the merger would be a tax-free reorganization. Merger Agreement B, § 19.

On or about Date d, the FHLBB approved the acquisition of Thrift D by Thrift A. See FHLBB Resolution No. 2. With respect to the subject of assistance, the FHLBB resolved:

> (1) financial assistance by the FSLIC is necessary to prevent the default of [Thrift D] and (2) the amount of such assistance, to be provided in accordance with the terms and conditions [of Master Agreement A and Purchase Agreement A] by and between [Thrift A] and the FSLIC, and the terms of this Resolution, would not exceed the amount that would be reasonably necessary to save the cost of liquidating [Thrift D] through a receivership accompanied by the payment of insurance of accounts;

FHLBB Resolution No. 2, page 3 ("Assistance").

The FHLBB resolved further that Thrift A could account for this merger under "the purchase method of accounting in accordance with generally accepted accounting principles ("GAAP")". FHLBB Resolution No. 2, page 3 ("Accounting"). The GAAP rules in effect on Date e were the controlling rules for purposes of the various agreements entered into by Thrift A and the FSLIC, and for reports made to the FHLBB and the FSLIC. However, the FHLBB resolution expressly stated that "this definition shall not alter [Thrift A's] obligations, if any, to report to any person or agency other than [the FHLBB] or the FSLIC on the basis of different principles which may apply outside [the foregoing identified agreements]." FHLBB Resolution No. 2, page 3 ("Accounting"). As part of the facilitation of the acquisition of Thrift D by Thrift A, the FHLBB also resolved that "the FSLIC is [authorized] to contribute to the capital of [Thrift A] an amount equal to the negative net worth of [Thrift D] as of [Date d]." FHLBB Resolution No. 2, page 3 ("Payment of Negative Net Worth").

As of Date f, Thrift E reported a net worth of approximately $h on total assets of approximately $i and a net worth to asset ratio of approximately c%. See FSLIC Memorandum B. The merger agreement between Thrift E and Thrift A was "conditioned upon the grant by the [FSLIC] and the [FHLBB] of certain regulatory forbearance including reserve and net worth compliance and scheduled items limitations waivers satisfactory to [Thrift A]." See Merger Agreement C ("Regulatory Forbearance"). The merger was further "conditioned upon receipt of an opinion from [Thrift A's] independent tax advisor that this [merger is] a tax free reorganization " (see Merger Agreement C ("Tax Opinion")) and the receipt from the FHLBB "pursuant to § 368(a)((3)(D)(ii)(III) [of the Code] as amended by § 241 of the Economic Recovery Tax Act of 1981, that the grounds set forth under 12 U.S.C. § 1464(d)(6)A) exist with respect to [Thrift E] or will exist in the near future in the absence of action by the FHLBB" (see Merger Agreement C ("FHLBB Tax Certification")).

On or about Date d, the FHLBB approved the acquisition of Thrift E by Thrift A. The FHLBB expressly resolved "[t]hat at the election of [Thrift A] the merger may be accounted for using the purchase method of accounting in accordance with [GAAP]" and that the GAAP rules in effect on Date e were the controlling rules for purposes of the various agreements entered into by Thrift A and the FSLIC, and for reports made to the FHLBB and the FSLIC. See FHLBB Resolution No. 3, pages 2-3 ("Accounting"). The resolution specifically permitted the use of the GAAP rules in effect on Date e for "the Master Agreement and the Purchase Agreement and for reports made to the [FHLBB] and the FSLIC." Id, page 3. However, the FHLBB resolution stated further that "this definition shall not alter [Thrift A's] obligations, if any, to report to any person or agency other than [the FHLBB] or the FSLIC on the basis of different principles which may apply outside [the foregoing identified agreements]." Id.

The acquisitions of Thrift D and Thrift E by Thrift A, although the subject of separate merger agreements and separate FHLBB resolutions on Date d, were addressed by FSLIC in a single memorandum to the FHLBB on Date d that was expressly considered by the FHLBB in connection with both proposed acquisitions. See FSLIC Memorandum B, FHLBB Resolution No. 2, and FHLBB Resolution No. 3. As stated in FSLIC Memorandum B, Thrift D was currently insolvent and, although Thrift E was technically still solvent, it had failed its net worth requirements and was expected to become insolvent within 18 months. Financial assistance was provided by

FSLIC only with respect to Thrift A's acquisition of Thrift D. See FSLIC Memorandum B.

A Master Agreement for Issuance of Income Capital Certificates was also entered into between Thrift A and the FSLIC in connection with Thrift A's acquisition of Thrift D. See Master Agreement A. That agreement authorized the issuance by Thrift A, and the purchase by the FSLIC, of Income Capital Certificates ("ICCs") in an amount not to exceed $j. Promissory notes received by Thrift A in payment for the ICCs purchased by the FSLIC were available for use by Thrift A in making any redemption payments of the ICCs under the Agreement. Master Agreement A, § 4.5. Although a copy of Master Agreement A was provided for our consideration, no copy of a separate Purchase Agreement A (mentioned in the FHLBB and the FSLIC documents related to the same merger) was included in our materials. Nor, was it clear to us from our materials that the Master Agreement referenced in FHLBB Resolution No. 3 (concerning the merger of Thrift E) referred to Master Agreement A. However, because (1) the FSLIC discussed the acquisitions of both Thrift D and Thrift E in FSLIC Memorandum B, (2) the FHLBB made express reference to that FSLIC memorandum in both FHLBB Resolution No. 2 and FHLBB Resolution No. 3, and (3) all of these events occurred on or around Date d, we have considered Master Agreement A to be the sole master agreement involved in these acquisitions. This assumption is further supported by subsequent events surrounding Exchange Agreement A discussed below.

On or about Date h, Thrift A and FSLIC entered into Exchange Agreement A, which made explicit reference to the FSLIC's purchase of ICCs with a face amount of $j pursuant to a Master Agreement entered into on Date d, as well as to a Purchase Agreement, also entered into by the FSLIC and Thrift A on Date d. Exchange Agreement A ("Recital A"). This agreement concerned the "exchange of the [ICCs] and all amounts payable by [Thrift A with respect to the ICCs] for z shares of preferred stock of [Thrift A] . . . and a cash payment [from Thrift A]." Exchange Agreement A ("Recital B"). Further, this agreement provided that the FSLIC would forgive "all amounts payable by [Thrift A] with respect to the [ICCs]" and that both Master Agreement A and Purchase Agreement A would be terminated subject to the conditions set forth in Exchange Agreement A. Exchange Agreement A ("Recital B").

As evident from Exchange Agreement A, at some point between Date d and Date h, Thrift A had undergone yet another charter change and was now a federally chartered stock savings and loan association. Subsequent to these events, and following the close of Fiscal Tax Year 1, Thrift A and Taxpayer underwent the corporate reorganizations described above involving Corporation B.

III. Taxpayer's Claim for Refund

On Date i, Taxpayer filed an amended return (Form 1120X) for Fiscal Tax Year 1 for the purpose of claiming a loss under § 165(a) of the Code in the amount of $n with respect to the worthlessness of its supervisory goodwill. The amended return was premised upon the phase-out, over five years, of the ability to count supervisory goodwill for purposes of calculating regulatory core capital as a result of the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73 (1989). The Taxpayer claimed that such assets were completely worthless as of the first day of Fiscal Tax Year 1.

(a) GAAP Asset - Purchased Goodwill

Thrift A utilized the purchase method of accounting for each of the three acquisitions discussed above. This method was applied by Thrift A in accordance with the applicable Accounting Principles Board ("APB") opinions, including APB Opinion No. 16, "Business Combinations" and APB Opinion No. 17, "Intangible Assets". Under these opinions, the amounts by which the fair market values of the liabilities of Thrift C, Thrift D, and Thrift E exceeded the fair market values of their respective assets received by Thrift A was reflected on Thrift A's books as "Cost in excess of fair value of net assets acquired" (hereafter, "purchased goodwill"). As reflected on Thrift A's financial books, the amounts of purchased goodwill resulting from it's acquisitions of Thrift C, Thrift D, and Thrift E were $k, $l, and $m, respectively, for a total of $n. For GAAP, the amount of this purchased goodwill was to be amortized over a period of time not to exceed 40 years. These amounts ($k, $l, and $m, respectively) were also recognized as "supervisory goodwill" for purposes of Thrift A's regulatory reporting requirements, and in particular for calculating it's core capital ratios.

(b) FSLIC Financial Assistance

Of the three acquisitions at issue here, only the acquisitions of Thrift C and Thrift D were characterized by Thrift A, FSLIC, and the FHLBB as FSLIC assisted acquisitions in the contemporaneous documentation. See, for example, FSLIC Memorandum A and FHLBB Resolution No. 2; compare FHLBB Resolution No. 3. The acquisition of Thrift E was contemporaneously characterized as an unassisted supervisory merger. See FSLIC Memorandum B.

With respect to the acquisition of Thrift C, FSLIC provided financial assistance in the following forms: (1) a cash contribution of $c (through one or more wire transfers); (2) additional payments up to a maximum amount of $d (the FHLB dividend formula payments); and (3) indemnification if the cash contribution of $c was determined either to be a taxable event or to result in tax attributable to and measured by the amount of that payment.

With respect to the acquisition of Thrift D, FSLIC provided financial assistance in the following forms: (1) a cash contribution of $e; and (2) the purchase of $j of ICCs in exchange for Thrift A's y year notes.

(c) Taxpayer's "Winstar" Suit.

The Taxpayer filed suit in district court seeking damages under the theory of United States v. Winstar Corp, 518 U.S. 839 (1996). The Taxpayer's suit is premised on a breach of contract by the federal government in connection with its bargained-for right to count supervisory goodwill in calculating regulatory core capital ratios. As neither the Taxpayer nor the examining agent has indicated otherwise, we assume that Taxpayer's suit is still pending before the court.

(d) Taxpayer's Original Tax Return Treatment

As stated above, for federal income tax purposes, Taxpayer accounted for the acquisitions of Thrift C, Thrift D, and Thrift E as tax free reorganizations. Taxpayer did not book any goodwill as an asset on its tax books attributable to these acquisitions. Taxpayer also did not claim any amortization or depreciation for such an asset for federal income tax purposes on its original returns for any tax year (including Fiscal Tax Year 1) following these acquisitions. Further, Taxpayer did not claim any losses attributable to the worthlessness of such an asset on its federal income tax returns prior to Date i.

(e) The Taxpayer's Amended Return Position

The Taxpayer takes the position that the contractual "right to use" the purchase method of accounting, along with the resultant purchased goodwill, resulted in an asset on its books properly identified as supervisory goodwill. This supervisory goodwill, according to the Taxpayer, qualifies as other property for purposes of § 597 of the Code and is a form of financial assistance provided by the FSLIC under § 406(f) of the National Housing Act. And, as such, the asset was properly excluded from income pursuant to § 597(a). Taxpayer takes this position with respect to the acquisition of all three thrifts.

The Taxpayer argues that it is entitled to claim a loss under § 165(a) of the Code in the tax year in which its regulatory asset of supervisory goodwill "was abandoned, deemed worthless, or confiscated." Statement, page 19. Taxpayer maintains that this occurred in Fiscal Tax Year 1. Further, the Taxpayer states that although it "has filed a lawsuit against the Federal government for damages relating to the loss of the use of its supervisory goodwill, any damages ultimately received by the Taxpayer would not constitute 'compensation' derived for a 'claim for reimbursement' pursuant to Treas. Reg. § 1.165-1(d)(2)(i)." Statement, pages 19 and 20. Moreover, the Taxpayer states that it "believes there was no 'reasonable prospect of recovery' as that term is used in the context of federal tax law at the relevant time period." Statement, page 19, footnote 2.

In addition to, and as an alternative to, its argument under § 165, the Taxpayer claims entitlement to amortization deductions under § 167 of the Code. Relying on Newark Morning Ledger Co. v. United States, 507 U.S. 546 (1993), the Taxpayer asserts that it has an ascertainable tax basis in its supervisory goodwill and that this asset had a limited useful life that could be ascertained with reasonable accuracy. Taxpayer did not amortize this asset for federal income tax purposes as it believed that the asset "was the equivalent of 'goodwill'" which was not amortizable under § 167 because its life was indeterminate for tax purposes. Subsequently, enactment of FIRREA established a useful life for supervisory goodwill that could be reasonably and accurately measured. The Taxpayer argues that the enactment of FIRREA and the promulgation of regulations by the Office of Thrift Supervision (OTS) phasing out "the use of supervisory goodwill on a sliding scale basis from 1990 through 1994," altered the indeterminate life of the tax asset as the life of this asset "became known with certainty." Statement, page 26.

LAW AND ANALYSIS:

Issue (1): Whether "supervisory goodwill" qualifies as "money or other property" for purposes of § 597 of the Code?

Supervisory goodwill is a creature of regulatory accounting principles ("RAP") although it bears a nexus to the GAAP asset of "purchased goodwill" that results under the purchase method of accounting upon the acquisition of one corporation by another. Based on the following analysis, however, we conclude that supervisory goodwill: (1) is not financial assistance from FSLIC under § 406(f) of the National Housing Act; and (2) does not qualify as money or other property for purposes of § 597 of the Code.

(A) General Background

(i) GAAP

As a general accounting concept, goodwill is an intangible asset that is entered on the books of account of a business at cost.[1] For GAAP, an intangible asset is amortized over its respective term (or useful life) and reflected as an annual expense, with a corresponding offsetting adjustment to the carrying charge (or starting balance) of the asset on the books of account. Generally, intangible assets were required to be amortized under GAAP using a life or term not to exceed 40 years. Siegel and Siegel, at 71-72.

Under GAAP, circa Date b and Date d, for a business combination accounted for under the purchase method any excess of the purchase price paid by the acquirer over the fair market value of the target's assets was required to be shown as purchased goodwill on the acquirer's books of account. Id. at 160. The advantage of the purchase method of accounting, from Thrift A's perspective, was that any existing goodwill (or

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[1] See generally Siegel and Siegel, Accounting and Financial Disclosure: A Guide to Basic Concepts, (West Publishing Co.) (1983) (hereafter referred to as "Siegel and Siegel").

going concern value) so determined could be stated as a separate asset on Thrift A's books of account and on its balance sheet following its acquisitions of Thrift C, Thrift D, and Thrift E. Thrift A did exactly that and reflected such goodwill on its books for GAAP with respect to these three acquisitions.

(ii) RAP

As described by one commentator, RAP requirements are the "accounting standards established by regulatory agencies to monitor compliance with statutory and administrative requirements." See Richard C. Breeden, Thumbs on the Scale: The Role That Accounting Practices Played in the Savings and Loan Crisis, 59 Fordham L. Rev. S71, at S77 (1991) (hereafter referred to as "Breeden"). In the case of federally insured depository institutions, "RAP [requirements] govern the financials that are submitted to the relevant federal oversight agency." Id. For thrifts, the applicable RAP requirements were generally promulgated by the FHLBB and announced in the Federal Register.[2] There was not always complete overlap between GAAP and RAP. Examples of situations where RAP departed from GAAP include the deferral for RAP of losses on the sale of mortgage-backed assets (46 Fed. Reg. 50,048 (1981)) and the acceleration for RAP of certain fee income on construction loans (44 Fed. Reg. 76,567 (1979)). Id. at S78-S79.

Prior to August 1981, the FHLBB required that purchased goodwill be amortized over a period not to exceed 10 years. See Breeden, supra, at S82; 46 Fed. Reg. 42274 (1981). On August 20, 1981, however, the FHLBB eliminated this requirement and reverted to using the applicable GAAP period for amortization. See 46 Fed. Reg. 42274 (1981). As stated therein, "the [FHLBB determined] to allow application of [GAAP] in this area without regulatory restriction." For purposes of RAP, the use of purchased goodwill resulting from mergers was generally provided for in 12 CFR § 563.23-3 to the extent that the applicant substantiated, in accordance with 12 CFR § 571.5(f), "the reasonableness of amounts attributed to goodwill, the method and period of amortization and the adequacy of reserves." See 46 Fed. Reg. 42275, discussion of "Accounting Rules." Such information was required to permit the FHLBB to review merger applications "on a flexible basis." Id. This change effectively resulted in the FHLBB's return to "its case by case basis review of merger applications." Id.

The amount booked as purchased goodwill and amortized by Thrift A is the same amount also identified for RAP as supervisory goodwill.[3] For regulatory

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[2] These pronouncements took various formats, including final regulations, proposed regulations, and policy memoranda.

[3] Supervisory goodwill, as generally used in this memorandum, refers only to the amount of purchased goodwill stemming from Thrift A's acquisitions of Thrift C, Thrift D,

(continued...)

accounting purposes, supervisory goodwill was available to meet Thrift A's regulatory capital requirements. See FHLBB Resolution No. 1 (concerning the acquisition of Thrift C), FHLBB Resolution No. 2 (concerning the acquisition of Thrift D), and FHLBB Resolution No. 3 (concerning the acquisition of Thrift E).

Enactment of FIRREA clearly altered Thrift A's ability to use supervisory goodwill to meet its regulatory capital requirements.[4] Although FIRREA altered the ability of Thrift A to use supervisory goodwill for RAP, it did not alter Thrift A's treatment of purchased goodwill for GAAP.

(iii) Book-Tax Differences

Just as RAP may coincide with or depart from GAAP to meet the regulatory requirements of a banking supervisory agency such as the FHLBB, the treatment of an item of income or loss or the significance of an asset or liability for federal income tax purposes may be different than the treatment of it for financial book (that is, GAAP) purposes. See Thor Power Tool Co., v. Commissioner, 439 U.S. 522, 542-544 (1979).

For federal income tax purposes, Thrift A's acquisition of Thrift C, Thrift D, and Thrift E each qualified as a tax-free reorganization under § 368(a)(1)(A) of the Code. Thus, Thrift A took a carryover basis in the assets so acquired and reported no gain or loss on the acquisitions (other than any tax resulting solely from the conforming accounting method changes required under § 381 of the Code). Stated another way, Thrift A inherited the recorded book basis of Thrift C, Thrift D, and Thrift E in their respective assets. Consequently, Thrift A correctly did not book for federal income tax purposes, a corresponding asset for purchased goodwill because:

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[3](...continued)
and Thrift E that was booked as a separate asset for GAAP by Thrift A on Date b or Date d, as applicable. The amount of this asset was $k from the acquisition of Thrift C, $l from the acquisition of Thrift D, and $m from the acquisition of Thrift E, for a total of $n prior to any amortization of the asset.

[4] FIRREA altered the capital requirements for thrifts by extending the general concept of risk-based capital tests to them. Following FIRREA, thrifts had to satisfy three separate standards: (1) tangible capital; (2) core capital; and (3) risk-based capital. See, generally, 12 C.F.R. § 567. Thrifts were no longer permitted to use supervisory goodwill to meet tangible capital although, if an institution qualified as an eligible institution and the supervisory goodwill met the definition of qualifying supervisory goodwill, supervisory goodwill was still available to meet core capital (and, by extension, risk-based capital) requirements for the remaining five year phase-out period. Id.; see also Julie L. Williams, Savings Institutions: Mergers, Acquisitions and Conversions (L. Journal Seminars-Press) (1990), ¶ 6.06[1].

> Qualification as a reorganization for tax purposes bears no relationship to application of purchase or pooling accounting. Therefore, a particular acquisition might result in carryover basis for tax purposes, but an increase in value for accounting purposes, or vice-versa. ...

Siegel and Siegel, supra, at 164.

The consequences of a tax free reorganization are well established and include the carryover of assets and liabilities from the acquired institution at their financial book basis. As a general matter, purchased goodwill is not an acquired asset in a tax-free reorganization. Thus, for federal income tax purposes, there is no acquired asset directly corresponding to purchased goodwill as a result of Thrift A's acquisitions of Thrift B, Thrift D, and Thrift E. Rather, the value otherwise ascribed to purchased goodwill under GAAP was already reflected in the book basis of the assets and liabilities acquired from Thrift C, Thrift D, and Thrift E by Thrift A.[5] Thus, Thrift A could not have intended to recognize a separate intangible asset for federal income tax purposes comparable to its regulatory asset of supervisory goodwill that was booked on its acquisitions of Thrift C, Thrift D, and Thrift E, as that regulatory asset was derived from the GAAP asset of purchased goodwill. Moreover, even when recognized as a tax asset, the federal income tax asset of goodwill is not subject to recovery by depreciation or amortization.[6] See United States v. Winstar, 518 U.S. at 851, n. 7.

(B) Section 597 of the Code

As of Date b and Date d, § 597 required that a domestic building and loan association receive money or other property from the FSLIC pursuant to § 406(f) of the National Housing Act before § 597 could apply. Application of § 597 here, therefore, turns on whether supervisory goodwill was received by Thrift A as money or other

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[5] Any loss attributable to the difference between historic book basis (which carried over to Thrift A) and fair market value would be recognized for tax purposes upon the disposition of the acquired assets or, if such assets were in the nature of bad debts, upon the write-down of those debts. Thus, on Date b and Date d, the lack of a specifically identified tax asset directly corresponding to purchased goodwill does not result in the elimination of any tax loss to which the Taxpayer is otherwise entitled. To the contrary, accepting the Taxpayer's characterization and valuation of the intangible asset may very well permit it to deduct the same loss twice.

[6] Goodwill has been described for federal income tax purposes as the "total of all of the imponderable qualities that attract customers to a business." See Winstar, 518 U.S. 839, 849 at n. 5 (1996) quoting Newark Morning Ledger Co. v. United States, 507 U.S. 546, 556 (1993). This abiding tax principle is unchanged after Newark Morning Ledger. Winstar, supra

property from the FSLIC pursuant to § 406(f) of the National Housing Act.[7] To the extent that Thrift A received any FSLIC assistance within the meaning of § 597, the value of that assistance would be excluded from gross income, pursuant to § 597(a) of the Code, and, pursuant to § 597(b), no reduction in the basis of any asset was required on account of the receipt of such assistance.

(i) Legislative History of § 597

Section 597 of the Code, as added by § 244 of the Economic Recovery Tax Act of 1981, Pub. L. 97-34 (Aug. 13, 1981) (the "Act"), provided:

> (a) Exclusion From Gross Income. - Gross income of a domestic building and loan association does not include any amount of money or other property received from the Federal Savings and Loan Insurance Corporation pursuant to section 406(f) of the National Housing Act (12 U.S.C. sec. 1729(f)), regardless of whether any note or other instrument is issued in exchange therefor.
>
> (b) No Reduction in Basis of Assets. - No reduction in the basis of assets of a domestic building and loan association shall be made on account of money or other property received under the circumstances referred to in subsection (a).

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[7] Section 406(f) of the National Housing Act (12 U.S.C. §1729) dealt with the liquidation of insured institutions. As amended by the Garn-St. Germaine Depository Institutions Act of 1982, Pub. L. 97-320 (October 15, 1982), the FSLIC was expressly authorized "to make loans to, to make deposits in, or to purchase the assets or securities of, to assume the liabilities of, or to make contributions to, any insured institution." 12 U.S.C. § 1729(f)(1). Prior to that amendment, the FSLIC was authorized under § 406(f): (1) "to make loans to, to purchase the assets of, or to make a contribution to an insured institution or an insured institution in default" under 12 U.S.C. § 1729(f)(1); and (2) "to purchase any such assets, or assume any such liabilities, or make loans to such other insured institution, or guarantee such other insured institution against loss" under 12 U.S.C. § 1729(f)(2) with respect to an acquisition (whether by merger or consolidation) by that other insured institution of an insured institution in default or in danger of default. As amended, 12 U.S.C. § 1729(f)(2) also authorized, with respect to an acquiring insured institution, the FSLIC to take any or all of the actions authorized under 12 U.S.C. § 1729(f)(1), as well as to guarantee the acquirer against loss. Additionally, the 1982 amendment explicitly authorized the FSLIC "to increase or maintain the capital of a qualified institution by making periodic purchases of capital instruments to be known as net worth certificates . . . ." 12 U.S.C. § 1729(f)(5)(A)(i).

Section 246(c) of the Act made § 597 of the Code applicable to payments made on or after January 1, 1981. The use of the word "payments" in § 246(c) of the Act, along with the statutory language of § 597 and § 406(f) of the National Housing Act, clearly indicates the congressional intent to limit § 597 to forms of financial assistance provided by the FSLIC.

Although the legislative history to § 244 of the Act is somewhat sparse, what legislative history there is also supports a conclusion that § 597 covers only financial assistance provided by the FSLIC. Section 597, as enacted, appears to have been first added in the version of H.R. 4242 that was passed by the House on July 29, 1981. See 127 Cong. Rec. at H5259 and H5279 (daily ed. July 29, 1981). The legislative history also indicates that this tax provision was initially agreed to in the Senate as a floor amendment (captioned "Section 604 FSLIC Financial Assistance") on July 23, 1981. See 127 Cong. Rec. at S8287 (daily ed. July 23, 1981).

In support of the Senate amendment, the congressional record reflects that the "amendment would facilitate the infusion of capital to a failing savings and loan, or the merger of a savings and loan with another financial institution by clarifying that these transactions are nontaxable events." Id, at S8288. In further support of the amendment, a letter from the then-chairman of the FHLBB, Richard T. Pratt, (the "Pratt Letter") was introduced into the record, relevant excerpts from which follow:

> . . . A new Section 597 would be enacted to ensure that no tax liability would result from FSLIC capital infusions to weakened associations and subsequent repayments of the infusions by rehabilitated associations.
>
> In order to prevent a default or restore an insured institution in default to normal operations, the FSLIC may make loans to purchase the assets of, make contributions to, or arrange the merger of a failing institution. . . . The [FHLBB] recognizes the extraordinary nature of mergers arranged in a supervisory context and exempts them from certain procedural requirements and general rules usually applicable in non-supervisory cases. ...
>
> A literal reading of the Internal Revenue Code might result in FSLIC assistance to an institution in the form of cash or an interest bearing note being treated as a contribution to capital by a non-shareholder, with reductions in the basis of assets required under Section 362(c). Also, if a recipient institution issues a mutual capital certificate or similar equity instrument in consideration for the FSLIC assistance, repayment of the assistance might be determined to be subject to the rules of Section 593(e)

> regarding redemption of capital stock and produce adverse tax consequences to the association. Finally, there are varying degrees of uncertainty concerning the tax-free reorganization status of various types of supervisory mergers . . . .

127 Cong. Rec. at S8288.

The use of terms such as "payment," "capital infusion," and "repayment" during the legislative process are further indications of a congressional intent to limit § 597 solely to forms of financial assistance. The conference report, moreover, indicates that this amendment was intended to resolve the question of whether financial assistance from the FSLIC was to be included in income or treated as a non-shareholder contribution to capital (with a consequential reduction in the tax basis of assets) by the taxpayer. H.R. Conf. Rep. No. 97-215, 97th Cong., 1st Sess. 284 (1981). See also Staff of the Joint Committee on Taxation, 97th Cong., 1st Sess., General Explanation of the Economic Recovery Tax Act of 1981 (H.R. 4242, 97th Cong; Pub. L. No. 97-34) (1981), at 152 ("to facilitate providing of financial assistance by the FSLIC") and 153 (referring to the FSLIC's "financial assistance program" and the proper treatment under prior law of such "assistance payments" from the FSLIC).

(C) <u>Supervisory Goodwill Is Not Assistance Within the Meaning of § 597</u>

The FSLIC was created in 1934 with the passage of the National Housing Act chiefly to insure deposits made by the public. <u>See</u> <u>Winstar</u>, 518 U.S. at 844. Based on the types of assistance that FSLIC was authorized to render under § 406(f) of the National Housing Act (see footnote 6 above), FSLIC assistance given under this provision was intended to increase the capital of an institution so that the institution could meet its obligations to depositors. Supervisory goodwill does not enhance the capital of an institution. Rather, it is the antithesis of capital as it relieves the institution and its shareholders of their obligations to meet otherwise applicable capital requirements. Nothing in the legislative history to § 597 indicates it was intended to apply to forms of assistance other than financial assistance. Under these circumstances, supervisory goodwill is not assistance within the meaning of § 597.

Further, both the statutory language and the legislative history of § 597 limit application of § 597 to assistance provided by the FSLIC. Under Title 12 of the United States Code, the regulatory forbearance that Taxpayer claims created supervisory goodwill was not provided by the FSLIC.

Generally, the clear meaning of a statute will control its application unless it is established that congressional intent would require a different result. Congress clearly differentiated between the FHLBB and the FSLIC for purposes of applying various contemporaneously enacted provisions of the Internal Revenue Code. <u>Compare</u>

§§ 243 and 244 of the Act (in which Congress spoke only to actions by the FSLIC) with § 241 of the Act (in which Congress spoke to actions by either the FHLBB or the FSLIC).[8] The FSLIC, although working with the FHLBB in such matters, was a separate corporation for tax purposes. See Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943). Further, the FSLIC had no authority to allow supervisory goodwill to be counted toward regulatory capital requirements under the rules of the FHLBB. Given the clear statutory reference in § 597, we cannot expand the meaning of FSLIC to encompass actions of the FHLBB.

It was clearly the FHLBB, and not the FSLIC, that provided Thrift A with the "right to use" the purchase method of accounting and the "right to use" any resulting purchased goodwill as supervisory goodwill eligible to meet Thrift A's regulatory capital requirements. Both FHLBB Resolution No. 1 and FHLBB Resolution No. 2 are clear in this regard. Further, it is clear that Thrift A was well aware of this fact as the acquisition of Thrift D was expressly "conditioned upon the FHLBB specifically approving the utilization of the purchase method of accounting . . . ." See Merger Agreement B, § 18.

We do not agree that because the FSLIC and the FHLBB have been treated as indistinguishable for purposes of determining a breach of contract with respect to the use of supervisory goodwill to meet capital requirements for RAP, the same result applies here. We note that the Supreme Court in Winstar, supra, did not hold that supervisory goodwill was provided by the FSLIC under § 406(f) of the National Housing Act within the meaning of § 597 of the Code.

(D) The "Right to Use" Supervisory Goodwill Is Also Not Assistance Within The Meaning of § 597

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[8] Section 597 (§ 244 of the Act) was one of four, simultaneously added, thrift-related amendments to the Internal Revenue Code. The other three provisions were: (1) § 241 of the Act, which amended § 368(a)(3)(D) of the Code dealing with agency proceedings involving financial institutions, clarified that § 368(a)(1)(G) would apply to certain transfers even in the absence of the receipt of stock or securities by the transferring corporation provided certain preconditions (including Board certification) were met and defined "Board" under this provision to include both the FHLBB and the FSLIC; (2) § 242 of the Act, which amended § 382(b)(7) of the Code dealing with limitations on net operating carryover losses of financial institutions in situations similar to bankruptcy cases, treated depositors of the transferring institution as if they were stockholders immediately before the transfer and mentioned neither the FHLBB nor the FSLIC; and (3) § 243 of the Act, which amended § 593(e)(1) of the Code dealing with distributions to shareholders under the thrift bad debt reserve provision, included distributions to FSLIC made in redemption of an interest originally received by the FSLIC in exchange for financial assistance under § 406(f) of the National Housing Act and referred only to actions of the FSLIC.

Taxpayer also argues that § 597 extends to Thrift A's "right to use" supervisory goodwill to meet its regulatory capital requirements and that the FSLIC, on its behalf, obtained that "right" from the FHLBB and then conveyed it to Thrift A in connection with the acquisitions of Thrift C, Thrift D, and Thrift E. Again, the Taxpayer calculates the amount of this benefit to be equal to the face amount of the booked RAP asset. For the reasons set forth above under section (C), we conclude that the "right to use" supervisory goodwill is not assistance provided by the FSLIC under § 597.

Further, we note no material distinction in Thrift A's rights with respect to its acquisitions of Thrift C and Thrift D, and its rights obtained in connection with its acquisition of Thrift E. However, although the FHLBB authorized the FSLIC to provide assistance to Thrift A pursuant to § 406(f) of the National Housing Act in connection with the acquisitions of Thrift C and Thrift D, the FHLBB did not authorize any assistance under § 406(f) of the National Housing Act from the FSLIC in connection with Thrift A's acquisition of Thrift E. Compare FHLBB Resolution No. 1 and FHLBB Resolution No. 2 with FHLBB Resolution No. 3. Therefore, it appears the grant of the "right to use" purchased goodwill (a form of regulatory forbearance) that the Taxpayer argues created supervisory goodwill is unrelated to § 406(f) of the National Housing Act.[9]

Issue (2): Whether the Taxpayer properly established a tax basis in the book asset identified as supervisory goodwill?

(A) Requirements for Establishing a Tax Basis

For federal income tax purposes, a taxpayer's basis in property is generally established by reference to the taxpayer's cost. See § 1012 of the Code. The taxpayer's cost is usually measured by the amount the taxpayer paid (in cash or kind) for the property. See § 1.1012-1(a) of the Federal Income Tax Regulations. When a taxpayer incurs no cost in connection with the acquisition of the property, the taxpayer's basis in that property may be established under other provisions of the Code. However, absent the application of a special provision that provides for the tax-free receipt of property, a taxpayer generally must include the fair market value of the property

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[9] Because we conclude that Thrift A's "right to use" supervisory goodwill to meet its regulatory capital requirements does not qualify as assistance within the meaning of § 597(a), we do not reach the issue of what the correct amount of assistance attributable to such a right might be. Suffice it to say, it is unlikely that the fair market value of such a right is necessarily equal to the face value of the underlying regulatory asset, especially as (1) that asset was subject to amortization under RAP over its GAAP life; (2) Thrift A had not obtained any assurance from either the FSLIC or the FHLBB that its minimum capital requirements would not increase in response to any change in law or regulation; and (3) the parties were not contractually bound to incur an expense in this amount had such a right not been granted.

received in income in order to obtain a tax basis in such property.[10] See, e.g., § 1.61-2(d) of the regulations; Strong v. Commissioner, 91 T.C. 627 (1988). Thus, generally, when a taxpayer acquires property without incurring any cost, the amount of the taxpayer's basis in that property is equal to the amount included in income (that is, the property's fair market value).

(B) Taxpayer Has No Tax Basis in Supervisory Goodwill

Special basis rules apply in connection with assets and liabilities acquired by means of tax-free reorganizations. Under these rules, for federal income tax purposes, a taxpayer (such as Thrift A) generally steps into the shoes of the transferor corporation (such as Thrift C, Thrift D, or Thrift E) with respect to basis. See § 362(b) of the Code. Because supervisory goodwill was not a pre-existing asset on the books of Thrift C, Thrift D, and Thrift E, Thrift A could not obtain a carry over basis in that an asset. See also §§ 357(a) and 1032(a) of the Code.

As Thrift A could not obtain a carryover basis for supervisory goodwill under § 362(b), the Taxpayer must identify a fresh source from which basis can be obtained. The Taxpayer would have § 597 apply to provide a tax-free source of income from which this fresh basis can be said to derive. For the reasons set forth above under Issue 1, § 597 is not applicable to the acquisition of supervisory goodwill by Thrift A. Therefore, Taxpayer was not entitled to exclude the value of supervisory goodwill from gross income under § 597(a) of the Code. As the Taxpayer did not separately pay for the purported asset and did not include the fair market value of that asset in gross income, the Taxpayer cannot now claim that it had a tax basis in that asset. See Treas. Reg. § 1.61-2(d); Strong v. Commissioner, supra.

(C) Taxpayer Has No Tax Basis in the "Right to Use" Goodwill

Even assuming that the Taxpayer received an asset from the regulators that is recognizable for federal income tax purposes, this asset can only be the "right to use" purchased goodwill to meet Thrift A's regulatory capital requirements. Further, for federal income tax purposes, this right is considered "other property" and any tax basis attributable to Thrift A's acquisition of this right would be determined under rules applicable to the receipt of property. See § 1012 of the Code.

As a general matter, the creation of rights under governmental regulatory and licensing arrangements ("property rights") will usually not result in the recognition of

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[10] For example, a transfer of property that is treated as non-shareholder contribution to capital does not create gross income to the transferee. However, the transferee will not have any tax basis in the property so acquired. See §§ 118 and 362(c) of the Code; cf. § 597(b)

gross income to the recipient of those property rights.[11] See, e.g., Rev. Rul. 92-16, 1992-1 C.B. 15 (holding that the issuance of emission allowance by the Environmental Protection Agency does not result in gross income to the taxpayer (a utility) that receives it). Moreover, not even the excess of the fair market value of the property right over the cost of acquisition of that right will be income. See, e.g., Rev. Rul. 67-135, 1967-1 C.B. 20 (holding that the excess of the fair market value over the cost of a lease obtained by a taxpayer in a lottery conducted by the United States Bureau of Land Management is not includable in gross income).

Even where a tax basis in such a property right is properly determined under § 1012, that basis is generally limited to the taxpayer's cost of acquiring the property right (not the fair market value of the right itself). The Service's position with respect to the proper determination of any tax basis to be accorded to the acquisition of these types of property rights has been implicitly adopted by a number of courts in cases holding that taxpayers' bases in similar property rights were the respective taxpayers' costs of obtaining those rights. See, e.g., Nachman v. Commissioner, 191 F.2d 934 (5th Cir. 1951); Nicolazzi v. Commissioner, 79 T.C. 109 (1982), aff'd per curiam, 722 F.2d 324 (6th Cir. 1983); Radio Station WBIR, Inc. v. Commissioner, 31 T.C. 803 (1959).[12] Thus, as the Taxpayer incurred no additional cost in order to obtain Thrift A's "right to use" purchased goodwill for regulatory purposes, its cost basis in such an asset would be zero.[13]

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[11] See GCM 39606 (Feb. 27, 1987) for additional discussion of supporting authority.

[12] Under the holdings in these cases, because the respective taxpayers' bases did not include the fair market value of the underlying property, the courts must have assumed that no income was imputed to the recipients on receipt of the underlying property rights.

[13] Even assuming that tax basis in such a property right could be properly determined by reference to the fair market value of that right, we disagree with Taxpayer's proposed computation of tax basis. Taxpayer argues that Thrift A has a tax basis of $n (an amount equal to the amount booked by Thrift A as purchased goodwill from the three acquisitions). Because Thrift A's tax basis would be limited under § 1012 to the fair market value of Thrift A's acquired "right to use" purchased goodwill to meet its regulatory capital requirements, we fail to see how the fair market value of such a right could itself be worth as much as the face amount of the purchased goodwill. Under GAAP, the value of the asset identified as purchased goodwill was derived as a result of Thrift A's booking the assets and liabilities it acquired from Thrift C, Thrift D, and Thrift E at their then current fair market values. This value, however, was already reflected in the unreduced book values used by Thrift A for federal income tax purposes as a result of the carryover basis rules in § 362 for those same assets and liabilities

(continued...)

Issue (3): If a tax basis has been established, whether the Taxpayer is entitled to claim a loss for its supervisory goodwill under § 165(a) of the Code based on worthlessness, abandonment, or confiscation?

For purposes of our discussion of § 165, we will refer to the relevant asset as supervisory goodwill. Such reference, however, encompasses both the purported tax asset attributable to the RAP asset of supervisory goodwill and the purported tax asset attributable to Thrift A's "right to use" the GAAP asset of purchased goodwill to meet its regulatory capital requirements.

(A) Deductible Losses Under § 165

Section 165(a) of the Internal Revenue Code permits a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." Section 165(b) of the Code provides that the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in § 1011 for determining the loss from the sale or other disposition of property.[14] We concluded above that Taxpayer could not establish a tax basis in supervisory goodwill. Without any basis in that asset, the Taxpayer is precluded from taking a loss deduction under § 165 regardless of whether the theory of loss is premised on worthlessness, abandonment, or confiscation. Stated another way, if the Taxpayer's tax basis in the asset is zero, its deductible loss under § 165 is also zero.

Moreover, §1.165-1(b) of the regulations requires that, to be allowable as a deduction under § 165(a), a loss must be evidenced by closed and completed transactions, and fixed by identifiable events. See United States v. S.S. White Dental Manufacturing Co., 274 U.S. 398, 401 (1927) (interpreting a predecessor to § 165). Thus, a loss shall be allowed as a deduction only for the taxable year in which the loss is sustained. See § 1.165-1(d) of the regulations.

(i) Computing the Correct Amount of Any Tax Loss

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[13](...continued)
acquired from Thrift C, Thrift D, and Thrift E. Even under Taxpayer's suggested fair market value approach, the fair market value of Thrift A's "right to use" purchased goodwill would be affected by factors such as those identified in footnote 8 above.

[14] Section 1011 of the Code provides that the adjusted basis for determining the gain or loss from the sale or other disposition of property shall be the basis (determined under § 1012 or other applicable section of the Code) adjusted as provided in § 1016. See § 1011(a); § 1.1011-1 of the Federal Income Tax Regulations. The effect of these provisions is that a taxpayer may not, with respect to the disposition of property, claim a deduction for an otherwise allowable tax loss in excess of basis.

As the discussion of tax basis under Issue 2 reflects, determining the correct amount of any deductible loss under § 165 is not as simple as Taxpayer urges. Even assuming that the Taxpayer were allowed a fair market value tax basis for supervisory goodwill, that fair market value would not approach the full amount of the purchased goodwill booked by Thrift A on Date b and Date d for GAAP and RAP. For both GAAP and RAP purposes, goodwill is an amortizable asset. Thus, Thrift A should have been writing off amounts attributable to such goodwill under both GAAP and RAP in tax years prior to Fiscal Tax Year 1. Moreover, a tax loss for supervisory goodwill would not be allowed in an amount equal to the RAP asset, but only in an amount equal to Thrift A's "right to use" that RAP asset to meet its regulatory capital requirements. This was made clear in a case determining the damages to another plaintiff in a case identical to the Winstar litigation, which stated as follows:

> Plaintiff argues that its loss of goodwill as capital was a cost for which it should be reimbursed. However, goodwill is not a cost that should be reimbursed dollar for dollar. [Plaintiff] quantified goodwill on its books and used that number to meet its capital requirements. While goodwill was used as capital for those purposes, it is not equivalent to capital and does not have a dollar for dollar value.

California Federal Bank v. United States, 43 Fed. Cl. 445, 459 (1999), appeal docketed, 99-5108 and 99-5119 (Fed. Cir. June 14 & 28, 1999); see also, Castle v. United States, 2000 U.S. Claims Lexis 233 (Fed. Cl. Nov. 9, 2000) (No. 90-1291 C) (plaintiffs entitled to restitution amount only).

(ii) Proper Time for Claiming a Tax Loss

Even if the Taxpayer had established a tax basis in supervisory goodwill, the Taxpayer would be entitled to claim a tax loss only in the taxable year in which the loss was sustained and only to the extent that it was not compensated for that loss. The regulations under § 165 also provide that if an event occurs which may result in a loss and, in the year of the event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of § 165, until it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Section 1.165-1(d)(2)(i) of the regulations.

Whether a reasonable prospect for recovery exists with respect to a claim for reimbursement of the loss is a question of fact to be determined upon examination of all of the facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or by an abandonment of the claim. The determination of whether reasonable certainty exists as to reimbursement is an objective inquiry into the facts and circumstances surrounding the loss as of the close of the taxable year in which the deduction is claimed. See Boehm v. Commissioner, 326 U.S. 287, 292-93 (1945); Ramsey Scarlett & Co. v. Commissioner, 61 T.C. 795, 811 (1974), aff'd, 521 F.2d 786 (4th Cir. 1975); Brown v. Commissioner, T.C. Memo. 1996-284.

The Taxpayer would not have recognized a loss under § 165 in Fiscal Tax Year 1 because of the timing of its Winstar litigation. The Taxpayer is actively pursuing its own litigation for its FIRREA claims (which are similar to the successfully pursued claims of the litigants in the Winstar case) and there is a strong likelihood that its litigation of these claims will consume a substantial amount of time and money. See Castle, supra, slip. op. at 46 (successful contest of the plaintiffs' suit in Castle apparently took "more than ten years of litigation and four full months of trial.")

The Taxpayer has a claim for reimbursement and there is a reasonable prospect of recovery under that claim in its suit for recovery under a Winstar theory.[15] In Winstar, the United States Supreme Court held that institutions that had been promised the "right to use" supervisory goodwill in meeting regulatory capital requirements had a cause of action for breach of contract due to the phase-out of the favorable accounting treatment. United States v. Winstar Corp., 518 U.S. 839 (1996). The term "claim for reimbursement," as used in the Code § 165 regulations, has a broader definition than only insurance claims and would encompass Taxpayer's claim in this case. The Tax Court interpreted the estate tax counterpart to § 165(a) in Estate of Bryan v. Commissioner, 74 T.C. 725 (1980).[16] In that case, the taxpayer received money from a trust fund established to compensate individuals who had been defrauded by attorneys. The issue was whether the payment constituted compensation so as to preclude a loss

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[15] For example, in Castle v. United States, 2000 U.S. Claims Lexis 233 (Fed. Cl. Nov. 9, 2000) (No. 90-1291 C), plaintiffs in a similar Winstar action were awarded monetary damages in restitution. In granting the award, the court stated that "Plaintiffs' contract entitled them to the very contract remedies they have come here to pursue — remedies which now afford them recovery in restitution ... ." Castle, supra, slip. op. at 46. Further, the court (citing to the Supreme Court's opinion in Winstar) noted that it was the FHLBB and the FSLIC which were contractually bound to recognize supervisory goodwill and the amortization periods reflected in the parties' agreements. In so doing, the court "read this promise [concerning supervisory goodwill] as the law of contracts has always treated promises to provide something beyond the promisor's absolute control, that is as a promise to insure the promisee against loss arising from the promised condition's nonoccurrence." Id, at fn. 25 (citing to Restatement (Second) of Contracts § 264, Comment a). As the court in Castle recognized, the plaintiffs were entitled under contract law to damages in response to the breach of the agreements they had negotiated with the FHLBB and the FSLIC. Id.

[16] The court commented that the provision should be interpreted in the same manner as § 165(a).

deduction. In holding that the payment was compensatory and therefore reduced the allowable deduction, the court explained that the statutory language "insurance or otherwise" refers to payments that are "structured to replace what was lost" and that are "similar to insurance." 74 T.C. at 727-28.

The Taxpayer argues that its Winstar claim is collateral to its loss and cites Forward Communications Corp. v. United States, 608 F.2d 485 (Ct. Cl. 1979), as support for its argument. In that case, the taxpayer, a local television station, claimed a § 165 loss based on termination of its affiliation agreement with CBS, the television network. A trial judge upheld disallowance of the deduction on the theory that increased revenues from affiliation with ABC, another television network, compensated taxpayer for loss of the CBS affiliation. In reversing this finding, the Court of Claims states, "[T]he statute does not bar a deduction for a loss actually incurred merely because the taxpayer is able to effect an offsetting gain on a different although contemporaneous transaction." Id. at 501. The circumstances in Forward Communications Corp. are very different from those in the present case. In Forward Communications Corp., it was happenstance that taxpayer received revenues from ABC that offset the loss of its affiliation with CBS. Here, by contrast, any recovery pursuant to Taxpayer's Winstar claim would be structured to compensate Taxpayer for the loss of its "right to" use supervisory goodwill in meeting regulatory capital requirements.

In the present case, the Taxpayer has filed a claim against the United States government to receive damages based on FIRREA. Plaintiffs in the Winstar litigation prevailed on the breach of contract claim. The Taxpayer's filing of a lawsuit to recover the same loss as deducted on its refund claims is evidence that the taxpayer had a reasonable prospect of recovery. See Ramsey Scarlett, 61 T.C. at 812-13. In fact, filing suit has been held to give rise to an inference of such a reasonable prospect. Dawn v. Commissioner, 675 F.2d 1077, 1078 (9th Cir. 1982); Estate of Scofield v. Commissioner, 266 F.2d 154, 159 (6th Cir. 1959); Brown, supra. In such circumstances, the claimant's subjective belief in the reasonable prospect of recovery becomes objective evidence of that prospect. See Boehm, 326 U.S. at 292-93; Jeppson v. Commissioner, T.C. Memo. 1995-342, aff'd, 128 F.3d 1410 (10th Cir. 1997).

Where the claim involved in a suit is neither speculative nor meritless (which would seem to be the case in these Winstar Contract Claims), and where the claimant believes that there is a reasonable chance of recovery (which is indicated by prosecuting the law suit with reasonable diligence), claiming a tax loss should wait until the conclusion of the lawsuit.[17] Estate of Scofield, 266 F.2d at 159; Jeppson, supra; see also Ramsay Scarlett, 61 T.C. at 811.

(iii) No Loss Based on Confiscation of Supervisory Goodwill

Taxpayer also argues that in cases of government "confiscation," the "reasonable prospect of recovery" standard under § 165 is not applicable and cites United States v. S.S. White Dental Manufacturing Co., 274 U.S. 398 (1927). In that case, the taxpayer had a German subsidiary, the assets of which were confiscated by the German government in 1918. In allowing a deduction equal to the taxpayer's investment in the subsidiary, the Supreme Court remarked, "[I]t would require a high degree of optimism to discern in the seizure of enemy property by the German government in 1918 more than a remote hope of ultimate salvage from the wreck of war. The Taxing Act does not require the taxpayer to be an incorrigible optimist." Id. at 403. Nothing in the opinion indicates that a loss is deductible for confiscated property even if there is a reasonable prospect of reimbursement. Rather, the opinion indicates that a "remote" prospect of reimbursement does not preclude a loss deduction. But in this case, Taxpayer has a pending lawsuit pursuing compensation under a theory that has been successfully pursued by similarly-situated claimants. See, e.g., Castle v. United States, supra. Taxpayer's prospect of recovery cannot be characterized as remote.

The mere existence of facts supporting a cause of action has been held sufficient to bar a loss deduction. In Premji v. Commissioner, 98-1 USTC ¶ 50,218 (10th Cir. 1998), taxpayers were victims of a Ponzi scheme. The taxpayers claimed loss deductions in the year in which the perpetrator of the fraud filed for bankruptcy. But the trustee had claims against various parties under fraudulent conveyance and other theories. The court denied the loss deductions, and noted that

> As long as facts exist at the end of the year the loss is claimed and provide a reasonable prospect of recovery, it is irrelevant if the taxpayer had not uncovered the facts to prosecute legal action or chose to delay legal action. See Qureshi v. Commissioner, [1987 T.C. Memo. 153], 53 T.C.M. (CCH) 414 (1098), aff'd. without published opinion, 843 F.2d 1388 (4th Cir.), and cert. denied, 488 U.S. 852 (1988); Florman v. Commissioner, [1979 T.C. Memo. 254], 38 T.C.M. (CCH) 1018 (1979).

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[17] The amount of time and money spent by a taxpayer investigating and prosecuting a claim, as well as whether a taxpayer ultimately recovered the loss, are also relevant factors. National Home Products, Inc. v. Commissioner, 71 T.C. 501, 526 (1979); Huey v. Commissioner, T.C. Memo. 1985-348.

Id., fn. 6.

Consequently, even assuming that a tax basis in supervisory goodwill could be established, the Taxpayer is not entitled to claim a deduction in Fiscal Tax Year 1 under § 165(a) of the Code for the loss of Thrift A's supervisory goodwill regardless of whether such tax claim is based on worthlessness, abandonment, or confiscation of that asset.

Issue (4): If a tax basis has been established, whether the Taxpayer is entitled to claim a deduction for the amortization of supervisory goodwill under § 167 of the Code?

(A) Requirements for Depreciation Deductions

Section 167(a) of the Code provides, as a depreciation deduction, a reasonable allowance for the exhaustion, wear and tear, and including obsolescence of property used in a trade or business or of property held for the production of income. Section 167(c) generally provides that the basis on which exhaustion, wear and tear, and obsolescence are allowed shall be the adjusted basis provided in § 1011, for the purpose of determining the gain on the sale or other disposition of the property. As indicated in our discussion of basis above under Issue 2, generally this basis is the taxpayer's cost. Section 1016(a)(2) provides, in part, that proper adjustment in respect of the property shall be in all cases made for the exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent of the amount allowed as deductions in computing taxable income, but not less than the amount allowable.

Section 1.167(a)-1(a) of the Federal Income Tax Regulations provides that the allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan, so that the aggregate of the amounts set aside will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of that property. The allowance shall not reflect amounts representing a mere reduction market value.

Section 1.167(a)-1(b) of the regulations provides that the estimated useful life of an asset is not necessarily the useful life of the asset but the period over which the asset may reasonably be expected to be useful to the taxpayer in its trade or business or in the production of the taxpayer's income.

Section 1.167(a)-3 of the regulations provides that an intangible asset that is known from experience or other factors to be of use in the business or the production of income for only a limited time, the length of which can be estimated with reasonable accuracy, may be the subject of a depreciation allowance. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No deduction for depreciation is allowable with respect to goodwill.

Section 1.167(a)-10 of the regulations provides that the period for depreciation shall begin when the asset is placed in service and shall end when the asset is retired from service.

Section 1.167(g)-1 of the regulations provides that the basis upon which the allowance for depreciation is computed with respect to any property shall be the adjusted basis provided in § 1011 for the purpose of determining gain on the sale or other disposition of the property.

(B) Lack of A Tax Basis Results in A Zero Depreciation Deduction

As determined above, the Taxpayer does not have a tax basis in the claimed intangible asset regardless of whether that asset is considered to be the RAP asset of supervisory goodwill or merely Thrift A's "right to use" such supervisory goodwill to meet its regulatory capital requirements. Without a tax basis in that intangible asset, even if we were to conclude that such asset was a depreciable asset, Taxpayer's depreciable basis would be zero pursuant to § 167(c)(1) of the Code and § 1.167(g)-1 of the regulations. Thus, the amount of the depreciation deduction that would be allowable in any taxable year would be zero.

(C) Taxpayer Has Not Identified A Depreciable Asset

Even assuming that Thrift A had established a tax basis in this intangible asset, that asset is not depreciable under § 167. Taxpayer states that for GAAP, Thrift A's acquisitions of Thrift C, Thrift D, and Thrift E were accounted for under the purchase method for business combinations. Taxpayer further states that the amount by which the fair market value of the liabilities assumed by Thrift A (the "acquisition price") exceeded the fair market value of the assets received by Thrift A as a result of these acquisitions was recognized on Thrift A's books as purchased goodwill. For RAP, this purchased goodwill corresponded to Thrift A's regulatory asset identified as supervisory goodwill.

If the acquisitions of Thrift C, Thrift D, and Thrift E created tax basis as Taxpayer alleges, then the calculation of the excess acquisition costs would be consistent with the residual method of determining tax accounting goodwill. See, e.g., Banc One v. Commissioner, 84 T.C. 476 (1985), aff'd, 815 F.2d 75 (6th Cir. 1986). In order to be depreciable, an identified asset requires a determination of value (basis) and a reasonably determinable useful life. Newark Morning Ledger Co. v. United States, 507 U.S. 546 (1993). These two requirements are to be made based on information available as of the transaction date. See Banc One, supra.

At most, the Taxpayer received a "right to use" supervisory goodwill to meet Thrift A's regulatory capital requirements. The mere fact that Thrift A's ability to use supervisory goodwill for regulatory purposes was eliminated over a fixed time period by the enactment of FIRREA does not establish that any tax accounting goodwill now has a reasonably determinable useful life. The Taxpayer has failed to substantiate that the fair market value of the right to use is equal to the residual amount of $n. Likewise, the remaining useful life determined by the Taxpayer is for the right to use and not necessarily for the residual amount of $n. Therefore, the Taxpayer has failed to distinguish the right to use from nondepreciable goodwill.

Consequently, the Taxpayer has not met its burden of separately identifying, valuing, and lifing the right to use as required by the Supreme Court in Newark Morning Ledger, supra, in order for such right to be subject to a depreciation deduction under § 167. Even assuming that the asset recognizable for federal income tax purposes is the RAP asset of supervisory goodwill, the Taxpayer also has not met its burden of separately valuing and lifing such asset as required by the Supreme Court in Newark Morning Ledger, supra. Therefore, the claimed intangible asset (regardless of whether that asset is considered to be the RAP asset of supervisory goodwill or merely Thrift A's "right to use" such supervisory goodwill to meet its regulatory capital requirements) is not depreciable under § 167 and the Taxpayer is not entitled to a deduction for depreciation or amortization under § 167 for this asset for the taxable years at issue.

Even assuming that the Taxpayer established a tax basis in the claimed intangible asset and a separately determined value and a reasonable useful life of this asset, the Taxpayer's change on its amended return for Fiscal Tax Year 1 from treating the claimed intangible asset as a non-depreciable asset to a depreciable asset is a change in method of accounting that requires the consent of the Commissioner pursuant to § 446(e) and the regulations thereunder. See Diebold, Inc. v. United States, 16 Cl. Ct. 193 (1989), aff'd 891 F.2d 1579 (Fed.Cir. 1989), cert. denied, 498 U.S. 823 (1990). Accordingly, the Taxpayer may not make this change in method of accounting by filing amended returns.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.