▷

LEGEND:

D =
Agreement =
B =
c =
d =
f =
g =
h =
m =
n =
o =
p =
date 1 =
date 2 =
date 3 =
date 4 =
date 5 =
x =
y =

Dear   :

This is in reply to your request for a ruling dated January 31, 2003, to allow the members of D to use an alternative method of basis recovery under § 15a.453-1(c)(7) of the Temporary Income Tax Regulations to report contingent payments.

D is a broker of electricity, natural gas, coal, and other energy related products. It uses a cash method of accounting for federal income tax purposes and files its returns on a calendar year basis. On date 1, B purchased 100 percent of the outstanding member units of D from its members. Under the Agreement, B agreed to make contingent payments to the members, based on a percentage of D's estimated, annualized Agreed Earnings (as defined in Schedule C of the Agreement) for each of tax years x through y. The total consideration D expects to receive from B is $c. The amount of $c is

calculated by using annualized Agreed Earnings for the 15 months ended date 2 to calculate the projected amount of each future payment. As of date 1, D had recovered basis of $g, leaving a remaining basis of $h to be recovered by date 5.

D proposes that basis be allocated to each payment received by the members based on the percentage that each payment represents of the total expected consideration. D projects that the amount of each future principal payment and the resulting allocated percentages will be as follows:

Date 1	$g	48.3 percent
Date 2	$m	1.2 percent
Date 3	$n	19.9 percent
Date 4	$o	15.1 percent
Date 5	$p	15.5 percent

Total expected consideration: $c   100 percent

The Agreement nevertheless provides that the total purchase price to be paid by B will not exceed $d. D represents that the $d purchase price was included in the Agreement to avoid a shareholder vote and is not indicative of the total value of the transaction. D notes that under § 15a.453-1(c)(2), it is nevertheless required to treat the stated maximum selling price of $d as the expected total sales price. If the members had to allocate basis assuming that the maximum selling price of $d would be the amount ultimately received under the Agreement, then basis would be allocated to the first four payments as follows:

Date 1	$g	15.5 percent
Date 2	$m	0.4 percent
Date 3	$n	6.4 percent
Date 4	$o	4.8 percent

Total percentage: 27.1 percent

This would result in the remaining basis of 72.9 percent being allocated to the final payment on date 5, resulting in a large capital loss to the members in tax year y.

D notes that if it is allowed under § 15a.453-1(c)(7) to recover basis by having B make contingent payments to the members based on a percentage of D's estimated, annualized Agreed Earnings, D will recover basis at a rate twice as fast (100 percent by date 5). Therefore, D asks that it be allowed to recover the remaining $h of basis in its y tax year.

Section 453(a) of the Internal Revenue Code provides that income from an installment sale shall be taken into account under the installment method. Section 453(b)(1) defines the term "installment sale" to mean a disposition of property if at least one payment is to be received after the end of the taxable year in which the disposition

occurs. The term "installment method" is defined in § 453(c) as a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when the payment is completed) bears to the total contract price.

Section 15a.453-1(c)(1) defines a "contingent payment sale" as a sale or other disposition of property in which the aggregate selling price cannot be determined by the close of the taxable year in which such sale or other disposition occurs. Unless a taxpayer makes an election under § 15a.453-1(d)(3), contingent payment sales are to be reported on the installment method.

Section 15a.453-1(c)(2)(i)(A) provides that a contingent payment sale will be treated as having a stated maximum selling price if, under the terms of the agreement, the maximum amount of sale proceeds that may be received by the taxpayer can be determined as of the end of the taxable year in which the sale or other disposition occurs. Generally, the taxpayer's basis shall be allocated to payments received and to be received by treating the stated maximum selling price as the selling price for purposes of § 15a.453-1(b). If, however, application of the foregoing rules in a particular case would substantially and inappropriately accelerate or defer recovery of the taxpayer's basis, a special rule will apply.

Section 15a.453-1(c)(7)(i) provides that the normal basis recovery rules set forth in § 15a.453-1(c)(2) may, with respect to a particular contingent payment sale, substantially and inappropriately defer recovery of the taxpayer's basis.

Section 15a.453-1(c)(7)(ii) provides that the taxpayer may use an alternative method of basis recovery if the taxpayer is able to demonstrate, prior to the due date of the return including extensions for the taxable year in which the first payment is received, that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis. To demonstrate that application of the normal basis recovery rule will substantially and inappropriately defer recovery of basis, the taxpayer must show (A) that the alternative method is a reasonable method of ratably recovering basis, and (B) that, under that method, it is reasonable to conclude that over time the taxpayer likely will recover basis at a rate twice as fast as the rate at which basis would have been recovered under the otherwise applicable normal basis recovery rule. The taxpayer must receive a ruling from the Internal Revenue Service before using an alternative method of basis recovery.

Section 15a.453-1(c)(7)(ii) further provides that the taxpayer must file the request for a ruling prior to the due date for the return including extensions. In demonstrating that application of the normal basis recovery rule would substantially and inappropriately defer recovery of the taxpayer's basis, the taxpayer in appropriate circumstances may rely upon contemporaneous or immediate past relevant sales, profit, or other factual data that are subject to verification. The taxpayer ordinarily is not permitted to rely upon projections of future productivity, receipts, profits, or the like. However, in special circumstances a reasonable projection may be acceptable based upon a specific event

that has already occurred.

Based on the information provided and the representations made, it is reasonable to conclude that D's use of the proposed alternative method of basis recovery will result in basis recovery at a rate twice as fast as the rate at which basis would be recovered under the normal basis recovery rules. The proposed alternative method of basis recovery represents a reasonable method of basis recovery. Accordingly, D's use of the proposed alternative method of basis recovery is approved.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: