

MEMORANDUM FOR LMSB AND SB/SE EMPLOYEES

FROM:

Larry R. Langdon
Commissioner Large and Mid-Size Business Division

Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT:

Guidelines for Intangibles Under IRC §263(a)

This memorandum is intended to provide guidance on the effective use of resources in choosing the appropriate capitalization issues to develop. This memorandum is not an official pronouncement of the law or the position of the Service and cannot be used, cited, or relied upon as such.

On January 24, 2002, the Service and Treasury issued an advanced notice of proposed rulemaking (ANPRM) regarding the application of section 263(a) to expenditures incurred in acquiring, creating, or enhancing intangible assets or benefits. The ANPRM describes and explains rules and standards the Service and Treasury expect to propose during 2002 in a notice of proposed rulemaking.

As explained in the ANPRM, the Service and Treasury expect to propose a rule that requires capitalization not only for amounts paid to acquire, create, or enhance certain intangible assets or benefits, but for the transaction costs that facilitate such acquisition, creation, or enhancement (including transaction costs that facilitate certain business reorganization or restructuring transactions). However, this rule would not require capitalization for certain employee compensation, fixed overhead, or de minimis costs.

On February 26, 2002, this office issued a memorandum indicating that the rules and standards proposed in the ANPRM alone should not provide authority for resolving existing cases. Since that memorandum was issued, the associate Chief counsel (Income tax and Accounting) issued a Change in Litigating Position Notice (Notice) regarding the treatment of transaction costs. See CC-2002-021.

The Notice concludes that it is an inefficient use of resources to litigate certain transaction cost issues while in the process of proposing regulations that may ultimately allow a current deduction for such costs. The Notice provides that, until further guidance is finalized, capitalization will not be asserted under section 263(a) for employee compensation (other than bonuses and commissions that are paid with respect to the transaction), fixed overhead, or de minimis costs related to the acquisition, creation, or enhancement of intangible assets or benefits. For purposes of the Notice, costs are considered de minimis to the extent they do not exceed \$5,000 per transaction.

The effective of the Notice is that Counsel will not support or pursue capitalization of the described transaction costs. We have considered whether it is an efficient utilization of our examination resources to continue to propose capitalization of these expenditures, in light of Counsel's change in litigating position. Based on tax administration considerations, we have concluded that Service examination resources would be better utilized on other high- risk compliance areas rather than to continue to propose capitalization of costs as described in the Notice. Accordingly, examiners should not propose capitalization under section 263(a) for employee compensation (except for bonuses and commissions that are paid with respect to the transaction unless they fall within the de minimis threshold), fixed overhead, or de minimis transaction costs (as defined in the Notice) related to the acquisition, creation or enhancement of intangible assets or benefits.

We recognize that there may be transaction costs for which the Service, as a result of this memorandum, does not propose capitalization and for which future guidance ultimately requires capitalization. Where future guidance requires taxpayers to capitalize some portion of transaction costs, and where the taxpayer deducts such costs currently under its method of accounting, the Service will make appropriate adjustments to the taxpayer's taxable income in accordance with section 481.

Further, examiners should be aware that the requirements respecting the adoption and change of accounting method pursuant to section 446(e) continue to be applicable. If a taxpayer has adopted a method of accounting, the taxpayer may not change the method on an original tax return without first obtaining consent, nor may a taxpayer change a method of accounting by filing an amended tax return.

If you have any questions concerning this memorandum, please contact Sharon Russell, Capitalization Technical Advisor, at 216-328-2824.