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Making the Section 197 Intangibles Election

by Robert W. Wood • San Francisco

Temporary and proposed regulations (TD 8528) have been issued under Sections 197 and 167(f), dealing with elections under the intangibles provisions of the Revenue Reconciliation Act of 1993 ("RRA '93"). While the new Section

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The following illustrates the advantages to exchanging shareholders from the structure of UAL Corp.'s transaction. The use of a complex structure, as opposed to a dividend, illustrates the supreme importance tax plays in structuring financial transactions. ■

Package To Be Received By Current UAL Corp. Shareholders

Cash	\$26.00
Debentures	\$31.00
Prefarred Stock	\$31.00
New Common Stock *	\$58.50
Amount Realized	\$146.50

Taxes to be paid following exchange

Amount Realized	\$146.50
Basis in Old Common Stock	\$120.00
Gain Realized	\$26.50
Boot (Cash & Debentures)	\$57.00
Gain Recognized, Taxable at 28%	\$26.50

Amount Realized	\$146.50
Basis in Old Common Stock	\$90.00
Gain Realized	\$56.50
Boot (Cash & Debentures)	\$57.00
Gain Recognized, Taxable at 28%	\$56.50

Amount Realized	\$146.50
Basis in Old Common Stock	\$75.00
Gain Realized	\$71.50
Boot (Cash & Debentures)	\$57.00
Gain Recognized, Taxable at 28%	\$57.00

* Assuming UAL share price of \$146.50 on date of exchange

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197 intangibles provisions generally apply to intangible property acquired after 8/10/93 (the date of enactment), the law also allows taxpayers to elect to apply intangibles amortization to property acquired after 7/25/91. (For prior coverage, see "Covenants Not To Compete After Section 197," 2 *M&A Tax Rep't* 4 (November 1993), p. 1; "Intangibles Amortization Passes Amidst Rate Changes," 2 *M&A Tax Rep't* 2 (September 1993), p. 1; see also "Is the IRS' Intangibles Settlement Program Good News?," 2 *M&A Tax Rep't* 8 (March 1994), p. 1.)

Once made, the retroactive election applies to all property acquired from 7/25/91 to 8/10/93. Such an election would also apply to all property acquired during that period by a taxpayer under common control with the electing taxpayer. Common control for this purpose will exist if the two taxpayers are treated as one under Section 41(f)(1)(A) or (B) at any time after 8/2/93, and on or before the election date.

Consolidated Return Filers

There can be questions with current or former consolidated return filers, too. If a former member of a consolidated group and its common parent make the retroactive election, RRA '93's intangibles provisions will apply to property acquired by the former member of the group after 7/25/91, while it was a member of the consolidated group.

Partnerships

Special rules are also provided for partnerships for which a Section 754 election was in effect. In that case, a partner obtaining an increased basis in intangibles held through the partnership as a result of either Section 734(b) or 743(b) will be treated as if the increased basis were attributable to the partner's acquisition of a new intangible on the date of the transaction that results in the basis increase.

Manner of Election

The election must generally be made on the taxpayer's timely filed income tax return (including exten-

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sions) for the tax year that includes 8/10/93. Thus, for a calendar-year corporate taxpayer, the election would have to be made before 3/15/94, unless an extension request to file the return was made. However, the temporary and proposed regulations provide transitional rules for taxpayers that have filed tax returns for the year including 8/10/93 before 30 days have expired after the publication of the regulations in the *Federal Register*.

As one might expect, the making of such an election will affect prior-years' returns. The new rules provide that if the election is made, all affected prior-years' returns must be conformed to reflect the application of Section 197.

Additional Binding Contract Election

A taxpayer making an election to apply the law to intangibles acquired prior to the RRA '93 has the opportunity to make an additional election with respect to intangibles acquired after 8/10/93 pursuant to binding contracts. A taxpayer may make an election prior to the acquisition to apply prior law to intangibles acquired after 8/10/93, under a binding written contract in effect on that date and at all times thereafter. In contrast to the basic election under the temporary and proposed regulations (the "retroactive election"), this latter election is a "binding contract" election.

Transfers in Tax-Free Transactions

Under the temporary and proposed regulations, a transferee is bound by a transferor's retroactive election regarding any transferred intangibles. In cases where the transferor does not make the retroactive election regarding any transferred intangibles, the transferee may make the election.

Where this occurs, the transferor is not required to apply the intangibles provisions of the RRA '93 to the transferred intangibles, and the transferee must take into account an adjustment on account of any interim period during which the intangibles provisions of RRA '93 did not apply to the transferred intangibles. ■