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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

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

SUBJECT: No Tax Basis for "Supervisory Goodwill"

This Field Service Advice supplements the Field Service Advice issued on December 29, 1999, in response to your memorandum dated September 29, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corporation =
Subsidiary =
Subsidiary A =
Subsidiary B =
v =
w =
x =
y =
z =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =

ISSUE

Whether a transferee takes a substituted basis in assets acquired pursuant to a "G" reorganization, and whether the taxpayer in the instant case had basis in the “supervisory goodwill" at issue.

CONCLUSION

A transferee takes a substituted basis in assets acquired pursuant to a "G" reorganization, and the taxpayer in the instant case had no basis in the “supervisory goodwill" at issue.

FACTS

Corporation is a bank holding company registered under the Bank Holding Company Act of 1956. Around Date 3, Corporation acquired Subsidiary, which became a federally chartered stock savings bank headquartered in x.

Prior to Corporation’s acquisition of Subsidiary, Subsidiary had acquired two federal savings and loan associations. Specifically, on or about Date 1, Subsidiary acquired Subsidiary A. Subsidiary acquired Subsidiary B around Date 2. Both Subsidiary A and Subsidiary B were acquired in a tax-free reorganization pursuant to section 368(a)(1)(G), and Subsidiary used a carryover basis for the assets acquired. At the time of the acquisitions, Subsidiary was a healthy thrift and Subsidiary A and Subsidiary B were failing thrifts. Subsidiary acquired Subsidiary A and Subsidiary B through supervisory mergers, induced and arranged by the Federal Savings and Loan Insurance Corporation (“FSLIC”) and the Federal Home Loan Bank Board (“FHLBB”).

The FSLIC permitted Subsidiary to account for the acquisitions using the purchase method of accounting. Pursuant to this method, Subsidiary valued each asset and liability acquired at fair market value. As a result, Subsidiary A had a negative net worth of $y, and Subsidiary B had a negative net worth of $z. The excess of the purchase price (which included liabilities assumed by the acquirer) over the fair market value of the acquired assets was referred to as “supervisory goodwill” and was reported on Subsidiary’s balance sheet for regulatory book purposes. Pursuant to the FSLIC’s regulatory policies and procedures in effect during the years in issue, Subsidiary was permitted to (1) amortize the supervisory goodwill by the straight-line method over a 40-year period, and (2) count the supervisory goodwill towards its regulatory capital reserve requirements. At the time of the acquisitions, Subsidiary did not assign any tax basis to the supervisory goodwill.

On August 9, 1989, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”), which phased out, over a five year period, the ability to count supervisory goodwill for the purpose of meeting regulatory capital reserve requirements. Some financial institutions sued the United

States asserting, among other things, that the government had breached its contractual promise to allow the thrifts to count goodwill toward regulatory capital reserve requirements. According to the information provided, Corporation was one of these thrifts. In United States v. Winstar, 518 U.S. 839 (1996), the Supreme Court held that the plaintiff financial institutions, indeed, had an enforceable contract with the Government and that the Government breached that contract as a result of the enactment of FIRREA.

On its tax returns for Year 3 through Year 5, Corporation did not claim a loss deduction resulting from the phase out of its use of supervisory goodwill. Subsequently, however, Corporation filed an amended return for Year 5 claiming a section 165 abandonment loss because the supervisory goodwill became worthless on Date 4 as a result of the enactment of FIRREA. In addition, Corporation asserted in its claim for refund, that it should have assigned a tax basis to the supervisory goodwill created when it acquired Subsidiary A and Subsidiary B. Corporation is claiming refunds of $v for Year 5 and $w for Year 4. The claimed refund for Year 4 is based upon the carryback of a resulting net operating loss from Year 5.

LAW AND ANALYSIS

Our advice was requested concerning a transferee's basis in assets acquired pursuant to a "G" reorganization, and whether the taxpayer in the instant case had basis in the "supervisory goodwill" at issue.

A reorganization under section 368(a)(1)(G) involves a transfer of assets by a transferor corporation to a transferee corporation in a title 11 or similar case where, in pursuance of the plan, stock or securities of the transferee corporation are distributed in a transaction which qualifies under section 354, 355, or 356. The reorganization generally involves tax-free transactions to the transferor, the transferee, and the exchanging stockholders and security holders.

Section 362(b), in part, provides that, if property was acquired by a corporation in connection with a reorganization to which Part III of Subchapter C applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. Accordingly, if the transferor did not recognize gain in the transfer, the transferee's basis in the assets transferred would be the same as the transferor's basis in the assets transferred.

The facts indicate Subsidiary acquired Subsidiary A and Subsidiary B in tax-free G reorganizations on or about Date 1 and Date 2, respectively. For tax purposes, Subsidiary took a carryover basis in the assets it acquired from Subsidiary A and Subsidiary B. In Year 3, Corporation acquired Subsidiary. The facts do not indicate if Corporation acquired Subsidiary in a tax-free or a taxable transaction.

The taxpayer filed an amended return for Year 5 asserting it should have assigned tax basis to the “supervisory goodwill” created at the time Subsidiary acquired Subsidiary A and Subsidiary B. Assuming Subsidiary A and Subsidiary B did not recognize gain in the G reorganizations (which appears to be the case), Subsidiary, as the transferee corporation in the G reorganizations, obtained a carryover basis in the assets that Subsidiary A and Subsidiary B transferred to it in the G reorganizations.

The facts, though, are unclear concerning how Corporation acquired Subsidiary. It appears, however, that Subsidiary stayed in existence and became a subsidiary of Corporation. Assuming Subsidiary stayed in existence and became a subsidiary of Corporation, Subsidiary’s basis in its assets after Corporation acquired it should have been the same as Subsidiary’s basis in its assets before Corporation acquired it --i.e., assuming Corporation did not acquire Subsidiary pursuant to a transaction constituting a taxable event in which Subsidiary obtained (or stepped up) basis in assets (e.g., a section 338 transaction). If Corporation did acquire Subsidiary in a transaction that constituted a taxable event in which Subsidiary obtained (or stepped up) basis in assets, it is possible that Subsidiary had goodwill (or some other assets) for which it previously had no basis, but for which it derived basis in Corporation’s acquisition of it.

Since in the G reorganizations on or about Date 1 and Date 2, Subsidiary A and Subsidiary B had no basis in any “supervisory goodwill,” Subsidiary would have similarly had no basis in any “supervisory goodwill.” Accordingly, at the time of Corporation’s Year 3 acquisition of Subsidiary, Subsidiary had no basis in any “supervisory goodwill” (assuming no intervening transaction or event occurred to otherwise give Subsidiary basis, and assuming Corporation’s acquisition of Subsidiary was not pursuant to a transaction constituting a taxable event in which Subsidiary was able to obtain basis in assets).

Please call if you have any further questions.

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(CC:DOM:FS:CORP)