Internal Revenue Service

Number: **201710006**
Release Date: 3/10/2017

Index Number: 168.35-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B07
PLR-118934-16

Date:
December 09, 2016

Re: Request for Ruling of When a Disposition Occurs under § 1.168(i)-8

Legend

Taxpayer =

Disregarded Entity 1 =

Disregarded Entity 2 =

Disregarded Entity 3 =

QSub =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

M =

O =

P =

Q =

R =

S =

T =

U =

V =

W =

Dear :

This letter responds to a letter dated June 10, 2016, submitted on behalf of Taxpayer, requesting certain letter rulings under § 1.168(i)-8 of the Income Tax Regulations, relating to when a disposition occurs.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer, a calendar-year taxpayer, is a holding company for subsidiaries engaged in various businesses. Most of these subsidiaries are either disregarded entities (like Disregarded Entity 1, Disregarded Entity 2, and Disregarded Entity 3) under § 301.7701-3 or qualified subchapter S subsidiaries under § 1361(b)(3) of Internal

Revenue Code. One such qualified subchapter S subsidiary is QSub, which designs, manufactures, and distributes .

Since the A, Taxpayer and QSub, through disregarded entities, have sponsored racing car teams in the C under the auspices of the D. A principal purpose of these activities is promoting QSub's brand and . To expand these racing car activities beyond D, Taxpayer's management formed Disregarded Entity 1 in early E to build a championship racing car entry and assemble a championship racing car crew under the auspices of the F. A F racing season runs V, and includes multiple racing events.

F teams do not build, acquire, or carry a finished, complete automobile. Instead, they build or acquire parts that they then assemble and reassemble into different racing cars over a race season, with each entrant registering a particular assemblage for each event. Hereinafter, each such assemblage will be referred to as the racing car entry for an event.

Disregarded Entity 2 and Disregarded Entity 3 have entered into agreements with two G firms, H and I, for the design, testing, and supply of racing car parts; B of the J; and assembly and training of racing car crew members. Disregarded Entity 2, under the B agreement with H, cannot U for the J and are required to return the J to H in the O at the end of each race season. This letter ruling request will only address those parts that Taxpayer owns and not to any W materials.

After each event, Taxpayer's F team will strip down the racing car used in that event into the different parts which the team will inspect, repair, refinish, repaint, and/or replace as appropriate. The team will then assemble the stripped-down parts, and other parts in stock, as a new racing car for the next event. For each entry, Disregarded Entity 2 management will, consistent with F industry and practice, prepare a "bill of materials" ("BOM") listing all parts that Disregarded Entity 2 owns and that are incorporated in that entry.

Most parts that a F team procures in a race season and that appear on a standard BOM are useless for racing purposes after that season for three reasons:

(a) First, parts may be damaged or destroyed in collisions, wipe-outs, or crashes during a race ("damaged parts").

(b) Second, parts become obsolete because racing cars are subject to substantial evolution and development given the nature of F motorsport ("obsolescence parts").

(c) Third, each race subjects parts to high stress and wear and tear. Members of Disregarded Entity 1 management who are also experienced in the F

industry have estimated that, out of parts that are not damaged parts or obsolescence parts, approximately K percent of such parts become unusable after a race and must be replaced; that is, approximately L percent of parts on a standard BOM might be used in the immediately following race. Such parts include parts that each F team builds (or has built for it) according to that team's design specifications and parts that are generic and not manufactured according to any team's specifications. This letter ruling will henceforth refer to parts described in this paragraph as either "worn parts" or "surviving parts." Worn parts means parts that become unusable for racing or other purposes after one or more races because of wear and tear; and surviving parts means parts that remain usable for racing or other purposes after a race despite wear and tear.

For these reasons, F racing teams carry very few parts over from one race season to the next. Members of Disregarded Entity 2 management who are also experienced in the F industry have estimated that, at most, approximately M percent (by number) of the owned parts procured by a F team during a race season remain usable for racing purposes by the end of that season. For purposes of this letter ruling, "owned parts" refer to the damaged parts, obsolescence parts, worn parts, and surviving parts owned by Taxpayer's F team and included on a standard BOM.

With respect to those owned parts that become useless for incorporation into any subsequent vehicle (that is, a racing car or a show or pit car), Disregarded Entity 2's practice, which reflects industry standards, will be to segregate such parts in a bin or other enclosed storage area from other parts. If necessary, Disregarded Entity 2 will score, scratch, bend, warp, or break apart such parts so that it is obvious to even a lay observer that he or she cannot use these parts for any discernible purpose. Disregarded Entity 2 will physically discard such parts from time to time based on availability of storage space, costs of storage on-premises, costs of retaining a hauler or other third party to carry away such parts, and other non-tax business and financial considerations.

With respect to surviving parts at the end of a race season that remain usable for racing purposes specifically, Disregarded Entity 2 may, but not necessarily will, carry over some kinds of parts into a succeeding race season for actual use in races, consistent with F practice and standards. These parts represent replacement parts that are warehoused at the end of the race season, as well as parts extracted from the last entry of the race season which is stripped down almost entirely to the individual component level. Members of Disregarded Entity 2 management who are also experienced in the F industry have advised that, in general, less than M percent (by number) of the various owned parts procured by a F team during a race season would be carried over into a subsequent season for racing purposes in this manner.

Disregarded Entity 2 management will value these parts at invoiced cost adjusted for the proportion (if any) of their life already expired. The unexpired cost of these parts that will be used in the following season in racing car entries equates to their "net

realized value" ("NRV," equivalent to market value) for P financial accounting purposes because the team would retain these parts for their original intended use and not sell them as scrap or incorporate them in a show or pit car. Disregarded Entity 2 management will, to the extent possible, base the cost of parts acquired under blanket contractual arrangements with H and I on individual prices supplied by those firms for extra contractual quantities of the same parts.

Many F teams after a race season gather some of the obsolescence parts or surviving parts that are on hand (and, in the case of surviving parts, whether or not still usable in racing specifically), and incorporate them into assemblages used for a show or pit car. As a practical matter, a show or pit car will incorporate at the very least those elements necessary to provide a realistic practice experience for pit stop crews. A show or pit car need not, and rarely will, incorporate the highly-specialized parts suitable only for racing. In no case does the team use the parts incorporated in a show or pit car for their original function which is racing.

Taxpayer anticipates that Disregarded Entity 2 will construct up to Q show or pit cars at the end of the R race season, and Disregarded Entity 2 management estimates that it will use approximately S percent (by number) of the owned parts procured for the R race season to construct these show or pit cars. Taxpayer will prepare a BOM for each such show or pit car.

Management of Disregarded Entity 2 will build a database to determine the NRV of the show or pit car consistent with P financial accounting practices. The fair market value of a show or pit car depends on the car's race pedigree and the authenticity of its components, such that a championship winning car would command considerably more on the open market that would an uncompetitive car.

Disregarded Entity 2 has acquired and will use T software to identify, inventory, and track those parts where reliability for performance or safety purposes is essential from event to event and from race season to race season. The T software is widely used by F and other motorsport teams. Through the T software Disregarded Entity 2 personnel can identify the location of each part where performance and/or safety reliability is critical; track the history of each part; monitor the wear and tear on each part; and determine whether such part is nearing the end of its useful life.

Taxpayer makes the following representations in connection with this letter ruling request:

1. Taxpayer will capitalize the amounts paid or incurred to produce each racing car and each show or pit car as the costs of producing separate units of tangible property under § 1.263(a)-2(d)(1);

2. To the extent the Taxpayer does not already capitalize amounts under § 1.263(a)-2(d)(1), Taxpayer under § 263A and the regulations thereunder will capitalize to each racing car and each show or pit car that Taxpayer produces all direct costs and a properly allocable portion of indirect costs that directly benefit or are incurred by reason of the performance of such production activity;

3. Disregarded Entity 2 does not and will not place any racing car or show or pit car in a general asset account under § 1.168(i)-1; and

4. Disregarded Entity 2 does and will assign to (as appropriate) a supplies or scrap account the following items: damaged parts; obsolescence parts and worn parts that become useless for incorporation in any subsequent racing car or a show or pit car; and obsolescence parts and surviving parts that can still be incorporated in any subsequent racing car or a show or pit car. In no event does or will Disregarded Entity 2 assign any owned parts to a general asset account under § 1.168(i)-1.

RULINGS REQUESTED

Taxpayer respectfully requests the following rulings:

1. A disposition occurs under § 1.168(i)-8(b)(2) when Taxpayer disassembles each racing car entry into its various parts and permanently withdraws those parts from the Taxpayer's trade or business. In accordance with § 1.168(i)-8(e):

    a. Gain or loss is recognized for any part of a racing car entry that is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by sale, exchange, or involuntary conversion;

    b. Loss is recognized for any part of a racing car entry that is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by physical abandonment;

    c. Gain is not recognized for any part of a racing car entry which part is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a scrap or similar account; loss is recognized for any part of a racing car entry which part is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a scrap or similar account, and such loss is recognized in the amount of the excess of the adjusted depreciable basis of the part at the time of the disposition (taking into account the applicable convention) over the

part's fair market value at the time of the disposition (taking into account the applicable convention); and

d. Gain is not recognized for any part of a racing car entry which part is to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a supplies or similar account; loss is recognized for any part of a racing car entry which part is to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a supplies or similar account, and such loss is recognized in the amount of the excess of the adjusted depreciable basis of the part at the time of the disposition (taking into account the applicable convention) over the part's fair market value at the time of the disposition (taking into account the applicable convention).

2. If, after a racing car entry is disassembled into various parts, the part or parts of the racing car entry is or are transferred to a supplies, scrap, or similar account, the basis of such part or parts in such account before the application of § 263A is as follows:

   a. If no gain was recognized upon the disposition of the part when the racing car entry was disassembled into various parts, the part's adjusted depreciable basis at the time of disposition (taking into account the applicable convention); and

   b. If a loss was recognized upon the disposition of the part when the racing car entry was disassembled into various parts, the part's fair market value at the time of disposition (taking into account the applicable convention).

LAW AND ANALYSIS

Ruling Request #1

Pursuant to § 1.168(i)-8(a), § 1.168(i)-8 provides rules pertaining to dispositions of MACRS property (as defined in § 1.168(b)-1(a)(2)). Except as provided in § 1.168(i)-1(e)(3), § 1.168(i)-8 does not apply to dispositions of assets included in a general asset account.

Section 1.168(i)-8(b)(2) provides that, for purposes of § 1.168(i)-8, a disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a

supplies, scrap, or similar account, or when a portion of an asset is disposed of as described in § 1.168(i)-8(d)(1).

Section 1.168(i)-8(c)(1) provides that the manner of disposition (for example, normal retirement, abnormal retirement, ordinary retirement, or extraordinary retirement) is not taken into account in determining whether a disposition occurs or gain or loss is recognized.

Section 1.168(i)-8(c)(4)(i) provides that for purposes of applying § 1.168(i)-8, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The asset for disposition purposes may not consist of items placed in service by the taxpayer on different dates, without taking into account the applicable convention. For purposes of determining what is the appropriate asset disposed of, the unit of property determination under § 1.263(a)-3(e) or in published guidance in the Internal Revenue Bulletin under § 263(a) does not apply. See § 1.168(i)-8(c)(4)(ii) for additional rules for determining what is the appropriate asset disposed of.

Section 1.168(i)-8(e) provides that, solely for purposes of § 1.168(i)-8(e), the term “asset” is an asset within the scope of § 1.168(i)-8 or the portion of such asset that is disposed of in a disposition described in § 1.168(i)-8(d). Except as provided by § 280B and § 1.280B-1, the following rules apply when an asset is disposed of during a taxable year:

(1) If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss must be recognized under the applicable provisions of the Internal Revenue Code.

(2) If an asset is disposed of by physical abandonment, loss must be recognized in the amount of the adjusted depreciable basis (as defined in § 1.168(b)-1(a)(4)) of the asset at the time of the abandonment, taking into account the applicable convention. However, if the abandoned asset is subject to nonrecourse indebtedness, § 1.168(i)-8(e)(1) applies to the asset instead of § 1.168(i)-8(e)(2). For a loss from physical abandonment to qualify for recognition under § 1.168(i)-8(e)(2), the taxpayer must intend to discard the asset irrevocably so that the taxpayer will neither use the asset again nor retrieve it for sale, exchange, or other disposition.

(3) If an asset is disposed of other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use (as, for example, when the asset is transferred to a supplies or scrap account), gain is not recognized. Loss must be recognized in the amount of the excess of the adjusted depreciable basis of the asset at the time of the disposition, taking into account the applicable convention, over the asset's fair market value at the time of the disposition, taking into account the applicable convention.

Section 1.168(i)-8(f)(1) provides that the adjusted basis of an asset disposed of for computing gain or loss is its adjusted depreciable basis at the time of the asset's disposition, as determined under the applicable convention for the asset.

Section 1.168(i)-8(g)(1) provides that, except as provided in § 1.168(i)-8(g)(2) (asset disposed of in a multiple asset account) or (3) (disposition of a portion of an asset), a taxpayer must use the specific identification method of accounting to identify which asset is disposed of by the taxpayer.

Section 1.168(i)-8(h)(1) provides that depreciation ends for an asset at the time of the asset's disposition, as determined under the applicable convention for the asset. *See* § 1.167(a)-10(b). If the asset disposed of is in a single asset account initially or as a result of § 1.168(i)-8(h)(2)(i) or § 1.168(i)-8(h)(3)(i), the single asset account terminates at the time of the asset's disposition, as determined under the applicable convention for the asset.

In this case, Taxpayer does not build, acquire, or carry a finished, complete racing car. Instead, Taxpayer's F team builds or acquires individual parts that they assemble and reassemble into different racing cars over a race season. After each race, Taxpayer strips down each race car to its individual parts and then determines if a part is a damaged part, an obsolescence part, a worn part, or a surviving part. Due to this fact pattern, we conclude that each part that Taxpayer owns and uses to build its race cars for each specific race is the appropriate asset for disposition purposes under § 1.168(i)-8(c)(4). Further, none of the special rules in § 1.168(i)-8(c)(4)(ii) apply in this case.

Ruling Request #2

Section 1012(a) provides that the basis of property shall be the cost of such property, except as otherwise provided in subchapter O (relating to gain or loss on the disposition of property), C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), or P (relating to capital gains or losses) of the Code. Section 1.1012-1(a) provides that the cost is the amount paid for the property in cash or other property.)

After the race car is disassembled into its various parts after each race, Taxpayer in some situations transfers such part or parts to a supplies, scrap, or similar account. As previously mentioned, we have concluded that each part that Taxpayer owns and uses to build its race cars for each specific race is the appropriate asset for disposition purposes under § 1.168(i)-8(c)(4). As a result, the transfer of such a part to a supplies, scrap, or similar account is a disposition under § 1.168(i)-8(b)(2). Pursuant to § 1.168(i)-8(e)(3), no gain is recognized upon such disposition; however, loss must be recognized in the amount of the excess of the adjusted depreciable basis of the asset at

the time of the disposition, taking into account the applicable convention, over the asset's fair market value at the time of the disposition, taking into account the applicable convention. Accordingly, when the race car is disassembled into various parts after each race and Taxpayer transfers such part or parts to a supplies, scrap, or similar account, we conclude that the basis of such transferred part (that is, the disposed asset) in the supplies, scrap, or similar account is (1) the part's adjusted depreciable basis at the time of disposition (taking into account the applicable convention) if no gain was recognized upon disposition, and (2) the part's fair market value at the time of disposition (taking into account the applicable convention) if loss was recognized upon disposition.

CONCLUSIONS

Based solely on the facts and representations submitted and the law and analysis as set forth above, we rule as follows:

1. A disposition occurs under § 1.168(i)-8(b)(2) when Taxpayer disassembles each racing car entry into its various parts and permanently withdraws those parts from the Taxpayer's trade or business. In accordance with § 1.168(i)-8(e):

    a. Gain or loss is recognized for any part of a racing car entry that is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by sale, exchange, or involuntary conversion;

    b. Loss is recognized for any part of a racing car entry that is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by physical abandonment;

    c. Gain is not recognized for any part of a racing car entry which part is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a scrap or similar account; loss is recognized for any part of a racing car entry which part is not to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a scrap or similar account, and such loss is recognized in the amount of the excess of the adjusted depreciable basis of the part at the time of the disposition (taking into account the applicable convention) over the part's fair market value at the time of the disposition (taking into account the applicable convention); and

    d. Gain is not recognized for any part of a racing car entry which part is to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a supplies or similar

account; loss is recognized for any part of a racing car entry which part is to be reused to produce another racing car entry or a show or pit car and that is disposed of by a transfer of such part to a supplies or similar account, and such loss is recognized in the amount of the excess of the adjusted depreciable basis of the part at the time of the disposition (taking into account the applicable convention) over the part's fair market value at the time of the disposition (taking into account the applicable convention).

2. If, after a racing car entry is disassembled into various parts, the part or parts of the racing car entry is or are transferred to a supplies, scrap, or similar account, the basis of such part or parts in such account before the application of § 263A is as follows:

    a. If no gain was recognized upon the disposition of the part when the racing car entry was disassembled into various parts, the part's adjusted depreciable basis at the time of disposition (taking into account the applicable convention); and

    e. If a loss was recognized upon the disposition of the part when the racing car entry was disassembled into various parts, the part's fair market value at the time of disposition (taking into account the applicable convention).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the facts described above under any other provisions of the Code (including other subsections of § 168). Specifically, no opinion is expressed or implied on: (1) whether any item of depreciable property is placed in service by Taxpayer; (2) the applicable depreciation method, recovery period, and convention of each part at issue; (3) the fair market value of each part, show car, or pit car; (4) the unit of property for purposes of § 1.263(a)-3(e); (5) whether Taxpayer properly capitalizes the amounts paid or incurred to produce each racing car and each show or pit car under § 263(a) and § 1.263(a)-2(d)(1); and (6) whether under § 263A and the regulations thereunder Taxpayer properly capitalizes to each racing car and each show or pit car that Taxpayer produces all direct costs and a properly allocable portion of indirect costs that directly benefit or are incurred by reason of the performance of such production activity.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant. A copy is enclosed for that purpose. Alternatively, a taxpayer filing its federal income tax return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of the letter ruling.

The rulings contained in this letter ruling are based upon facts and representations submitted by Taxpayer with accompanying penalty of perjury statements executed by an appropriate party. While this office has not verified any of the material submitted in support of this letter ruling request, all material is subject to verification on examination.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney, we are sending a copy of this letter ruling to Taxpayer's authorized representatives. We are also sending a copy of this letter ruling to the appropriate operating division director.

Sincerely,

Kathleen Reed

Kathleen Reed
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures (2):
copy of this letter
copy for section 6110 purposes