election must be made by the due date (including extensions of time) of the electing taxpayer's Federal income tax return for the election year. If, however, the taxpayer's original Federal income tax return for the election year is filed before April 14, 1994, the election may be made by amending that return no later than September 12, 1994.

(ii) *Manner.* The binding contract election is made by attaching the election statement described in paragraph (e) of this section to the taxpayer's original or amended income tax return for the election year.

(iii) *Effect of nonconforming election.* An attempted election that does not satisfy the requirements of this paragraph (d)(2) is not valid.

(e) *Election statement*—(1) *Filing requirements.* For an election under paragraph (c) or (d) of this section to be valid, the electing taxpayer must:

(i) File (with its Federal income tax return for the election year and with any affected amended returns required under paragraph (c)(4) of this section) a written election statement, as an attachment to Form 4562 (Depreciation and Amortization), that satisfies the requirements of paragraph (e)(2) of this section; and

(ii) Forward a copy of the election statement to the Statistics Branch (QAM:S:6111), IRS Ogden Service Center, ATTN: Chief, Statistics Branch, P.O. Box 9941, Ogden, UT 84409.

(2) *Content of the election statement.* The written election statement must include the information in paragraphs (e)(2) (i) through (vi) and (ix) of this section in the case of a retroactive election, and the information in paragraphs (e)(2) (i) and (vii) through (ix) of this section in the case of a binding contract election. The required information should be arranged and identified in accordance with the following order and numbering system—

(i) The name, address and taxpayer identification number (TIN) of the electing taxpayer (and the common parent if a consolidated return is filed).

(ii) A statement that the taxpayer is making the retroactive election.

(iii) Identification of the transition period property affected by the retroactive election, the name and TIN of the person from which the property was acquired, the manner and date of acquisition, the basis at which the property was acquired, and the amount of depreciation, amortization, or other cost recovery under section 167 or any other provision of the Code claimed with respect to the property.

(iv) Identification of each taxpayer under common control (as defined in paragraph (b)(6) of this section) with the electing taxpayer by name, TIN, and Internal Revenue Service Center where the taxpayer's income tax return is filed.

(v) If any persons are required to be notified of the retroactive election under paragraph (c)(6) of this section, identification of such persons and certification that written notification of the election has been provided to such persons.

(vi) A statement that the transition period property being amortized under section 197 is not subject to the anti-churning rules of section 197(f)(9).

(vii) A statement that the taxpayer is making the binding contract election.

(viii) Identification of the property affected by the binding contract election, the name and TIN of the person from which the property was acquired, the manner and date of acquisition, the basis at which the property was acquired, and whether any of the property is subject to depreciation under section 167 or to amortization or other cost recovery under any other provision of the Code.

(ix) The signature of the taxpayer or an individual authorized to sign the taxpayer's Federal income tax return.

(f) *Effective date.* These regulations are effective March 15, 1994.

[T.D. 8528, 59 FR 11920, Mar. 15, 1994]

§ 1.197–2 Amortization of goodwill and certain other intangibles.

(a) *Overview*—(1) *In general.* Section 197 allows an amortization deduction for the capitalized costs of an amortizable section 197 intangible and prohibits any other depreciation or amortization with respect to that property. Paragraphs (b), (c), and (e) of this section provide rules and definitions for determining whether property is a section 197 intangible, and paragraphs (d) and (e) of this section provide rules and

definitions for determining whether a section 197 intangible is an amortizable section 197 intangible. The amortization deduction under section 197 is determined by amortizing basis ratably over a 15-year period under the rules of paragraph (f) of this section. Section 197 also includes various special rules pertaining to the disposition of amortizable section 197 intangibles, nonrecognition transactions, anti-churning rules, and anti-abuse rules. Rules relating to these provisions are contained in paragraphs (g), (h), and (j) of this section. Examples demonstrating the application of these provisions are contained in paragraph (k) of this section. The effective date of the rules in this section is contained in paragraph (l) of this section.

(2) *Section 167(f) property.* Section 167(f) prescribes rules for computing the depreciation deduction for certain property to which section 197 does not apply. See §1.167(a)–14 for rules under section 167(f) and paragraphs (c)(4), (6), (7), (11), and (13) of this section for a description of the property subject to section 167(f).

(3) *Amounts otherwise deductible.* Section 197 does not apply to amounts that are not chargeable to capital account under paragraph (f)(3) (relating to basis determinations for covenants not to compete and certain contracts for the use of section 197 intangibles) of this section and are otherwise currently deductible. For this purpose, an amount described in §1.162–11 is not currently deductible if, without regard to §1.162–11, such amount is properly chargeable to capital account.

(b) *Section 197 intangibles; in general.* Except as otherwise provided in paragraph (c) of this section, the term *section 197 intangible* means any property described in section 197(d)(1). The following rules and definitions provide guidance concerning property that is a section 197 intangible unless an exception applies:

(1) *Goodwill.* Section 197 intangibles include goodwill. Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor.

(2) *Going concern value.* Section 197 intangibles include going concern value. Going concern value is the additional value that attaches to property by reason of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership, but does not include any of the intangibles described in any other provision of this paragraph (b). It also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

(3) *Workforce in place.* Section 197 intangibles include workforce in place. Workforce in place (sometimes referred to as agency force or assembled workforce) includes the composition of a workforce (for example, the experience, education, or training of a workforce), the terms and conditions of employment whether contractual or otherwise, and any other value placed on employees or any of their attributes. Thus, the amount paid or incurred for workforce in place includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a highly-skilled workforce, an existing employment contract (or contracts), or a relationship with employees or consultants (including, but not limited to, any key employee contract or relationship). Workforce in place does not include any covenant not to compete or other similar arrangement described in paragraph (b)(9) of this section.

(4) *Information base.* Section 197 intangibles include any information base, including a customer-related information base. For this purpose, an information base includes business books and records, operating systems, and any other information base (regardless of the method of recording the information) and a customer-related information base is any information base that includes lists or other information

with respect to current or prospective customers. Thus, the amount paid or incurred for information base includes, for example, any portion of the purchase price of an acquired trade or business attributable to the intangible value of technical manuals, training manuals or programs, data files, and accounting or inventory control systems. Other examples include the cost of acquiring customer lists, subscription lists, insurance expirations, patient or client files, or lists of newspaper, magazine, radio, or television advertisers.

(5) *Know-how, etc.* Section 197 intangibles include any patent, copyright, formula, process, design, pattern, know-how, format, package design, computer software (as defined in paragraph (c)(4)(iv) of this section), or interest in a film, sound recording, video tape, book, or other similar property. (See, however, the exceptions in paragraph (c) of this section.)

(6) *Customer-based intangibles.* Section 197 intangibles include any customer-based intangible. A customer-based intangible is any composition of market, market share, or other value resulting from the future provision of goods or services pursuant to contractual or other relationships in the ordinary course of business with customers. Thus, the amount paid or incurred for customer-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a customer base, a circulation base, an undeveloped market or market growth, insurance in force, the existence of a qualification to supply goods or services to a particular customer, a mortgage servicing contract (as defined in paragraph (c)(11) of this section), an investment management contract, or other relationship with customers involving the future provision of goods or services. (See, however, the exceptions in paragraph (c) of this section.) In addition, customer-based intangibles include the deposit base and any similar asset of a financial institution. Thus, the amount paid or incurred for customer-based intangibles also includes any portion of the purchase price of an acquired financial institution attributable to the value represented by existing checking accounts, savings accounts, escrow accounts, and other similar items of the financial institution. However, any portion of the purchase price of an acquired trade or business attributable to accounts receivable or other similar rights to income for goods or services provided to customers prior to the acquisition of a trade or business is not an amount paid or incurred for a customer-based intangible.

(7) *Supplier-based intangibles.* Section 197 intangibles include any supplier-based intangible. A supplier-based intangible is the value resulting from the future acquisition, pursuant to contractual or other relationships with suppliers in the ordinary course of business, of goods or services that will be sold or used by the taxpayer. Thus, the amount paid or incurred for supplier-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a favorable relationship with persons providing distribution services (such as favorable shelf or display space at a retail outlet), the existence of a favorable credit rating, or the existence of favorable supply contracts. The amount paid or incurred for supplier-based intangibles does not include any amount required to be paid for the goods or services themselves pursuant to the terms of the agreement or other relationship. In addition, see the exceptions in paragraph (c) of this section, including the exception in paragraph (c)(6) of this section for certain rights to receive tangible property or services from another person.

(8) *Licenses, permits, and other rights granted by governmental units.* Section 197 intangibles include any license, permit, or other right granted by a governmental unit (including, for purposes of section 197, an agency or instrumentality thereof) even if the right is granted for an indefinite period or is reasonably expected to be renewed for an indefinite period. These rights include, for example, a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license. The issuance or

renewal of a license, permit, or other right granted by a governmental unit is considered an acquisition of the license, permit, or other right. (See, however, the exceptions in paragraph (c) of this section, including the exceptions in paragraph (c)(3) of this section for an interest in land, paragraph (c)(6) of this section for certain rights to receive tangible property or services, paragraph (c)(8) of this section for an interest under a lease of tangible property, and paragraph (c)(13) of this section for certain rights granted by a governmental unit. See paragraph (b)(10) of this section for the treatment of franchises.)

(9) *Covenants not to compete and other similar arrangements.* Section 197 intangibles include any covenant not to compete, or agreement having substantially the same effect, entered into in connection with the direct or indirect acquisition of an interest in a trade or business or a substantial portion thereof. For purposes of this paragraph (b)(9), an acquisition may be made in the form of an asset acquisition (including a qualified stock purchase that is treated as a purchase of assets under section 338), a stock acquisition or redemption, and the acquisition or redemption of a partnership interest. An agreement requiring the performance of services for the acquiring taxpayer or the provision of property or its use to the acquiring taxpayer does not have substantially the same effect as a covenant not to compete to the extent that the amount paid under the agreement represents reasonable compensation for the services actually rendered or for the property or use of the property actually provided.

(10) *Franchises, trademarks, and trade names.* (i) Section 197 intangibles include any franchise, trademark, or trade name. The term *franchise* has the meaning given in section 1253(b)(1) and includes any agreement that provides one of the parties to the agreement with the right to distribute, sell, or provide goods, services, or facilities, within a specified area. The term *trademark* includes any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others. The term *trade name* includes any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business. A license, permit, or other right granted by a governmental unit is a franchise if it otherwise meets the definition of a franchise. A trademark or trade name includes any trademark or trade name arising under statute or applicable common law, and any similar right granted by contract. The renewal of a franchise, trademark, or trade name is treated as an acquisition of the franchise, trademark, or trade name.

(ii) Notwithstanding the definitions provided in paragraph (b)(10)(i) of this section, any amount that is paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name and that is subject to section 1253(d)(1) is not included in the basis of a section 197 intangible. (See paragraph (g)(6) of this section.)

(11) *Contracts for the use of, and term interests in, section 197 intangibles.* Section 197 intangibles include any right under a license, contract, or other arrangement providing for the use of property that would be a section 197 intangible under any provision of this paragraph (b) (including this paragraph (b)(11)) after giving effect to all of the exceptions provided in paragraph (c) of this section. Section 197 intangibles also include any term interest (whether outright or in trust) in such property.

(12) *Other similar items.* Section 197 intangibles include any other intangible property that is similar in all material respects to the property specifically described in section 197(d)(1)(C)(i) through (v) and paragraphs (b)(3) through (7) of this section. (See paragraph (g)(5) of this section for special rules regarding certain reinsurance transactions.)

(c) *Section 197 intangibles; exceptions.* The term *section 197 intangible* does not include property described in section 197(e). The following rules and definitions provide guidance concerning property to which the exceptions apply:

(1) *Interests in a corporation, partnership, trust, or estate.* Section 197 intangibles do not include an interest in a

corporation, partnership, trust, or estate. Thus, for example, amortization under section 197 is not available for the cost of acquiring stock, partnership interests, or interests in a trust or estate, whether or not the interests are regularly traded on an established market. (See paragraph (g)(3) of this section for special rules applicable to property of a partnership when a section 754 election is in effect for the partnership.)

(2) *Interests under certain financial contracts.* Section 197 intangibles do not include an interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract, whether or not the interest is regularly traded on an established market. However, this exception does not apply to an interest under a mortgage servicing contract, credit card servicing contract, or other contract to service another person's indebtedness, or an interest under an assumption reinsurance contract. (See paragraph (g)(5) of this section for the treatment of assumption reinsurance contracts. See paragraph (c)(11) of this section and §1.167(a)–14(d) for the treatment of mortgage servicing rights.)

(3) *Interests in land.* Section 197 intangibles do not include any interest in land. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral right, timber right, grazing right, riparian right, air right, zoning variance, and any other similar right, such as a farm allotment, quota for farm commodities, or crop acreage base. An interest in land does not include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television service. The cost of acquiring a license, permit, or other land improvement right, such as a building construction or use permit, is taken into account in the same manner as the underlying improvement.

(4) *Certain computer software*—(i) *Publicly available.* Section 197 intangibles do not include any interest in computer software that is (or has been) readily available to the general public on similar terms, is subject to a nonexclusive license, and has not been substantially modified. Computer software will be treated as readily available to the general public if the software may be obtained on substantially the same terms by a significant number of persons that would reasonably be expected to use the software. This requirement can be met even though the software is not available through a system of retail distribution. Computer software will not be considered to have been substantially modified if the cost of all modifications to the version of the software that is readily available to the general public does not exceed the greater of 25 percent of the price at which the unmodified version of the software is readily available to the general public or $2,000. For the purpose of determining whether computer software has been substantially modified—

(A) Integrated programs acquired in a package from a single source are treated as a single computer program; and

(B) Any cost incurred to install the computer software on a system is not treated as a cost of the software. However, the costs for customization, such as tailoring to a user's specifications (other than embedded programming options) are costs of modifying the software.

(ii) *Not acquired as part of trade or business.* Section 197 intangibles do not include an interest in computer software that is not acquired as part of a purchase of a trade or business.

(iii) *Other exceptions.* For other exceptions applicable to computer software, see paragraph (a)(3) of this section (relating to otherwise deductible amounts) and paragraph (g)(7) of this section (relating to amounts properly taken into account in determining the cost of property that is not a section 197 intangible).

(iv) *Computer software defined.* For purposes of this section, computer software is any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. It includes all forms and media in which the software

is contained, whether written, magnetic, or otherwise. Computer programs of all classes, for example, operating systems, executive systems, monitors, compilers and translators, assembly routines, and utility programs as well as application programs, are included. Computer software also includes any incidental and ancillary rights that are necessary to effect the acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. For example, a trademark or trade name that is ancillary to the ownership or use of a specific computer software program in the taxpayer's trade or business and is not acquired for the purpose of marketing the computer software is included in the definition of computer software and is not included in the definition of trademark or trade name. Computer software does not include any data or information base described in paragraph (b)(4) of this section unless the data base or item is in the public domain and is incidental to a computer program. For this purpose, a copyrighted or proprietary data or information base is treated as in the public domain if its availability through the computer program does not contribute significantly to the cost of the program. For example, if a word-processing program includes a dictionary feature used to spell-check a document or any portion thereof, the entire program (including the dictionary feature) is computer software regardless of the form in which the feature is maintained or stored.

(5) *Certain interests in films, sound recordings, video tapes, books, or other similar property.* Section 197 intangibles do not include any interest (including an interest as a licensee) in a film, sound recording, video tape, book, or other similar property (such as the right to broadcast or transmit a live event) if the interest is not acquired as part of a purchase of a trade or business. A film, sound recording, video tape, book, or other similar property includes any incidental and ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. For purposes of this paragraph (c)(5), computer software (as defined in paragraph (c)(4)(iv) of this section) is not treated as other property similar to a film, sound recording, video tape, or book. (See section 167 for amortization of excluded intangible property or interests.)

(6) *Certain rights to receive tangible property or services.* Section 197 intangibles do not include any right to receive tangible property or services under a contract or from a governmental unit if the right is not acquired as part of a purchase of a trade or business. Any right that is described in the preceding sentence is not treated as a section 197 intangible even though the right is also described in section 197(d)(1)(D) and paragraph (b)(8) of this section (relating to certain governmental licenses, permits, and other rights) and even though the right fails to meet one or more of the requirements of paragraph (c)(13) of this section (relating to certain rights of fixed duration or amount). (See §1.167(a)–14(c) (1) and (3) for applicable rules.)

(7) *Certain interests in patents or copyrights.* Section 197 intangibles do not include any interest (including an interest as a licensee) in a patent, patent application, or copyright that is not acquired as part of a purchase of a trade or business. A patent or copyright includes any incidental and ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. (See §1.167(a)–14(c)(4) for applicable rules.)

(8) *Interests under leases of tangible property*—(i) *Interest as a lessor.* Section 197 intangibles do not include any interest as a lessor under an existing

lease or sublease of tangible real or personal property. In addition, the cost of acquiring an interest as a lessor in connection with the acquisition of tangible property is taken into account as part of the cost of the tangible property. For example, if a taxpayer acquires a shopping center that is leased to tenants operating retail stores, any portion of the purchase price attributable to favorable lease terms is taken into account as part of the basis of the shopping center and in determining the depreciation deduction allowed with respect to the shopping center. (See section 167(c)(2).)

(ii) *Interest as a lessee.* Section 197 intangibles do not include any interest as a lessee under an existing lease of tangible real or personal property. For this purpose, an airline lease of an airport passenger or cargo gate is a lease of tangible property. The cost of acquiring such an interest is taken into account under section 178 and §1.162–11(a). If an interest as a lessee under a lease of tangible property is acquired in a transaction with any other intangible property, a portion of the total purchase price may be allocable to the interest as a lessee based on all of the relevant facts and circumstances.

(9) *Interests under indebtedness*—(i) *In general.* Section 197 intangibles do not include any interest (whether as a creditor or debtor) under an indebtedness in existence when the interest was acquired. Thus, for example, the value attributable to the assumption of an indebtedness with a below-market interest rate is not amortizable under section 197. In addition, the premium paid for acquiring a debt instrument with an above-market interest rate is not amortizable under section 197. See section 171 for rules concerning the treatment of amortizable bond premium.

(ii) *Exceptions.* For purposes of this paragraph (c)(9), an interest under an existing indebtedness does not include the deposit base (and other similar items) of a financial institution. An interest under an existing indebtedness includes mortgage servicing rights, however, to the extent the rights are stripped coupons under section 1286.

(10) *Professional sports franchises.* Section 197 intangibles do not include any franchise to engage in professional baseball, basketball, football, or any other professional sport, and any item (even though otherwise qualifying as a section 197 intangible) acquired in connection with such a franchise.

(11) *Mortgage servicing rights.* Section 197 intangibles do not include any right described in section 197(e)(7) (concerning rights to service indebtedness secured by residential real property that are not acquired as part of a purchase of a trade or business). (See §1.167(a)–14(d) for applicable rules.)

(12) *Certain transaction costs.* Section 197 intangibles do not include any fees for professional services and any transaction costs incurred by parties to a transaction in which all or any portion of the gain or loss is not recognized under part III of subchapter C of the Internal Revenue Code.

(13) *Rights of fixed duration or amount.* (i) Section 197 intangibles do not include any right under a contract or any license, permit, or other right granted by a governmental unit if the right—

(A) Is acquired in the ordinary course of a trade or business (or an activity described in section 212) and not as part of a purchase of a trade or business;

(B) Is not described in section 197(d)(1)(A), (B), (E), or (F);

(C) Is not a customer-based intangible, a customer-related information base, or any other similar item; and

(D) Either—

(*1*) Has a fixed duration of less than 15 years; or

(*2*) Is fixed as to amount and the adjusted basis thereof is properly recoverable (without regard to this section) under a method similar to the unit-of-production method.

(ii) See §1.167(a)–14(c)(2) and (3) for applicable rules.

(d) *Amortizable section 197 intangibles*—(1) *Definition.* Except as otherwise provided in this paragraph (d), the term *amortizable section 197 intangible* means any section 197 intangible acquired after August 10, 1993 (or after July 25, 1991, if a valid retroactive election under §1.197–1T has been made), and held in connection with the conduct of a trade or business or an activity described in section 212.

(2) *Exception for self-created intangibles*—(i) *In general.* Except as provided in paragraph (d)(2)(iii) of this section, amortizable section 197 intangibles do not include any section 197 intangible created by the taxpayer (a self-created intangible).

(ii) *Created by the taxpayer*—(A) *Defined.* A section 197 intangible is created by the taxpayer to the extent the taxpayer makes payments or otherwise incurs costs for its creation, production, development, or improvement, whether the actual work is performed by the taxpayer or by another person under a contract with the taxpayer entered into before the contracted creation, production, development, or improvement occurs. For example, a technological process developed specifically for a taxpayer under an arrangement with another person pursuant to which the taxpayer retains all rights to the process is created by the taxpayer.

(B) *Contracts for the use of intangibles.* A section 197 intangible is not a self-created intangible to the extent that it results from the entry into (or renewal of) a contract for the use of an existing section 197 intangible. Thus, for example, the exception for self-created intangibles does not apply to capitalized costs, such as legal and other professional fees, incurred by a licensee in connection with the entry into (or renewal of) a contract for the use of know-how or similar property.

(C) *Improvements and modifications.* If an existing section 197 intangible is improved or otherwise modified by the taxpayer or by another person under a contract with the taxpayer, the existing intangible and the capitalized costs (if any) of the improvements or other modifications are each treated as a separate section 197 intangible for purposes of this paragraph (d).

(iii) *Exceptions.* (A) The exception for self-created intangibles does not apply to any section 197 intangible described in section 197(d)(1)(D) (relating to licenses, permits or other rights granted by a governmental unit), 197(d)(1)(E) (relating to covenants not to compete), or 197(d)(1)(F) (relating to franchises, trademarks, and trade names). Thus, for example, capitalized costs incurred in the development, registration, or defense of a trademark or trade name do not qualify for the exception and are amortized over 15 years under section 197.

(B) The exception for self-created intangibles does not apply to any section 197 intangible created in connection with the purchase of a trade or business (as defined in paragraph (e) of this section).

(C) If a taxpayer disposes of a self-created intangible and subsequently reacquires the intangible in an acquisition described in paragraph (h)(5)(ii) of this section, the exception for self-created intangibles does not apply to the reacquired intangible.

(3) *Exception for property subject to anti-churning rules.* Amortizable section 197 intangibles do not include any property to which the anti-churning rules of section 197(f)(9) and paragraph (h) of this section apply.

(e) *Purchase of a trade or business.* Several of the exceptions in section 197 apply only to property that is not acquired in (or created in connection with) a transaction or series of related transactions involving the acquisition of assets constituting a trade or business or a substantial portion thereof. Property acquired in (or created in connection with) such a transaction or series of related transactions is referred to in this section as property acquired as part of (or created in connection with) a purchase of a trade or business. For purposes of section 197 and this section, the applicability of the limitation is determined under the following rules:

(1) *Goodwill or going concern value.* An asset or group of assets constitutes a trade or business or a substantial portion thereof if their use would constitute a trade or business under section 1060 (that is, if goodwill or going concern value could under any circumstances attach to the assets). See §1.1060–1(b)(2). For this purpose, all the facts and circumstances, including any employee relationships that continue (or covenants not to compete that are entered into) as part of the transfer of the assets, are taken into account in determining whether goodwill or going concern value could attach to the assets.

(2) *Franchise, trademark, or trade name*—(i) *In general.* The acquisition of

a franchise, trademark, or trade name constitutes the acquisition of a trade or business or a substantial portion thereof.

(ii) *Exceptions.* For purposes of this paragraph (e)(2)—

(A) A trademark or trade name is disregarded if it is included in computer software under paragraph (c)(4) of this section or in an interest in a film, sound recording, video tape, book, or other similar property under paragraph (c)(5) of this section;

(B) A franchise, trademark, or trade name is disregarded if its value is nominal or the taxpayer irrevocably disposes of it immediately after its acquisition; and

(C) The acquisition of a right or interest in a trademark or trade name is disregarded if the grant of the right or interest is not, under the principles of section 1253, a transfer of all substantial rights to such property or of an undivided interest in all substantial rights to such property.

(3) *Acquisitions to be included.* The assets acquired in a transaction (or series of related transactions) include only assets (including a beneficial or other indirect interest in assets where the interest is of a type described in paragraph (c)(1) of this section) acquired by the taxpayer and persons related to the taxpayer from another person and persons related to that other person. For purposes of this paragraph (e)(3), persons are related only if their relationship is described in section 267(b) or 707(b) or they are engaged in trades or businesses under common control within the meaning of section 41(f)(1).

(4) *Substantial portion.* The determination of whether acquired assets constitute a substantial portion of a trade or business is to be based on all of the facts and circumstances, including the nature and the amount of the assets acquired as well as the nature and amount of the assets retained by the transferor. The value of the assets acquired relative to the value of the assets retained by the transferor is not determinative of whether the acquired assets constitute a substantial portion of a trade or business.

(5) *Deemed asset purchases under section 338.* A qualified stock purchase that is treated as a purchase of assets under section 338 is treated as a transaction involving the acquisition of assets constituting a trade or business only if the direct acquisition of the assets of the corporation would have been treated as the acquisition of assets constituting a trade or business or a substantial portion thereof.

(6) *Mortgage servicing rights.* Mortgage servicing rights acquired in a transaction or series of related transactions are disregarded in determining for purposes of paragraph (c)(11) of this section whether the assets acquired in the transaction or transactions constitute a trade or business or substantial portion thereof.

(7) *Computer software acquired for internal use.* Computer software acquired in a transaction or series of related transactions solely for internal use in an existing trade or business is disregarded in determining for purposes of paragraph (c)(4) of this section whether the assets acquired in the transaction or series of related transactions constitute a trade or business or substantial portion thereof.

(f) *Computation of amortization deduction*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, the amortization deduction allowable under section 197(a) is computed as follows:

(i) The basis of an amortizable section 197 intangible is amortized ratably over the 15-year period beginning on the later of—

(A) The first day of the month in which the property is acquired; or

(B) In the case of property held in connection with the conduct of a trade or business or in an activity described in section 212, the first day of the month in which the conduct of the trade or business or the activity begins.

(ii) Except as otherwise provided in this section, basis is determined under section 1011 and salvage value is disregarded.

(iii) Property is not eligible for amortization in the month of disposition.

(iv) The amortization deduction for a short taxable year is based on the number of months in the short taxable year.

(2) *Treatment of contingent amounts*—(i) *Amounts added to basis during 15-year*

period. Any amount that is properly included in the basis of an amortizable section 197 intangible after the first month of the 15-year period described in paragraph (f)(1)(i) of this section and before the expiration of that period is amortized ratably over the remainder of the 15-year period. For this purpose, the remainder of the 15-year period begins on the first day of the month in which the basis increase occurs.

(ii) *Amounts becoming fixed after expiration of 15-year period.* Any amount that is not properly included in the basis of an amortizable section 197 intangible until after the expiration of the 15-year period described in paragraph (f)(1)(i) of this section is amortized in full immediately upon the inclusion of the amount in the basis of the intangible.

(iii) *Rules for including amounts in basis.* See §§1.1275–4(c)(4) and 1.483–4(a) for rules governing the extent to which contingent amounts payable under a debt instrument given in consideration for the sale or exchange of an amortizable section 197 intangible are treated as payments of principal and the time at which the amount treated as principal is included in basis. See §1.461–1(a)(1) and (2) for rules governing the time at which other contingent amounts are taken into account in determining the basis of an amortizable section 197 intangible.

(3) *Basis determinations for certain assets*—(i) *Covenants not to compete.* In the case of a covenant not to compete or other similar arrangement described in paragraph (b)(9) of this section (a covenant), the amount chargeable to capital account includes, except as provided in this paragraph (f)(3), all amounts that are required to be paid pursuant to the covenant, whether or not any such amount would be deductible under section 162 if the covenant were not a section 197 intangible.

(ii) *Contracts for the use of section 197 intangibles; acquired as part of a trade or business*—(A) *In general.* Except as provided in this paragraph (f)(3), any amount paid or incurred by the transferee on account of the transfer of a right or term interest described in paragraph (b)(11) of this section (relating to contracts for the use of, and term interests in, section 197 intangibles) by the owner of the property to which such right or interest relates and as part of a purchase of a trade or business is chargeable to capital account, whether or not such amount would be deductible under section 162 if the property were not a section 197 intangible.

(B) *Know-how and certain information base.* The amount chargeable to capital account with respect to a right or term interest described in paragraph (b)(11) of this section is determined without regard to the rule in paragraph (f)(3)(ii)(A) of this section if the right or interest relates to property (other than a customer-related information base) described in paragraph (b)(4) or (5) of this section and the acquiring taxpayer establishes that—

(*1*) The transfer of the right or interest is not, under the principles of section 1235, a transfer of all substantial rights to such property or of an undivided interest in all substantial rights to such property; and

(*2*) The right or interest was transferred for an arm's-length consideration.

(iii) *Contracts for the use of section 197 intangibles; not acquired as part of a trade or business.* The transfer of a right or term interest described in paragraph (b)(11) of this section by the owner of the property to which such right or interest relates but not as part of a purchase of a trade or business will be closely scrutinized under the principles of section 1235 for purposes of determining whether the transfer is a sale or exchange and, accordingly, whether amounts paid on account of the transfer are chargeable to capital account. If under the principles of section 1235 the transaction is not a sale or exchange, amounts paid on account of the transfer are not chargeable to capital account under this paragraph (f)(3).

(iv) *Applicable rules*—(A) *Franchises, trademarks, and trade names.* For purposes of this paragraph (f)(3), section 197 intangibles described in paragraph (b)(11) of this section do not include any property that is also described in paragraph (b)(10) of this section (relating to franchises, trademarks, and trade names).

(B) *Certain amounts treated as payable under a debt instrument*—(*1*) *In general.*

For purposes of applying any provision of the Internal Revenue Code to a person making payments of amounts that are otherwise chargeable to capital account under this paragraph (f)(3) and are payable after the acquisition of the section 197 intangible to which they relate, such amounts are treated as payable under a debt instrument given in consideration for the sale or exchange of the section 197 intangible.

(*2*) *Rights granted by governmental units.* For purposes of applying any provision of the Internal Revenue Code to any amounts that are otherwise chargeable to capital account with respect to a license, permit, or other right described in paragraph (b)(8) of this section (relating to rights granted by a governmental unit or agency or instrumentality thereof) and are payable after the acquisition of the section 197 intangible to which they relate, such amounts are treated, except as provided in paragraph (f)(4)(i) of this section (relating to renewal transactions), as payable under a debt instrument given in consideration for the sale or exchange of the section 197 intangible.

(*3*) *Treatment of other parties to transaction.* No person shall be treated as having sold, exchanged, or otherwise disposed of property in a transaction for purposes of any provision of the Internal Revenue Code solely by reason of the application of this paragraph (f)(3) to any other party to the transaction.

(*4*) *Basis determinations in certain transactions*—(*i*) *Certain renewal transactions.* The costs paid or incurred for the renewal of a franchise, trademark, or trade name or any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof are amortized over the 15-year period that begins with the month of renewal. Any costs paid or incurred for the issuance, or earlier renewal, continue to be taken into account over the remaining portion of the amortization period that began at the time of the issuance, or earlier renewal. Any amount paid or incurred for the protection, expansion, or defense of a trademark or trade name and chargeable to capital account is treated as an amount paid or incurred for a renewal.

(*ii*) *Transactions subject to section 338 or 1060.* In the case of a section 197 intangible deemed to have been acquired as the result of a qualified stock purchase within the meaning of section 338(d)(3), the basis shall be determined pursuant to section 338(b)(5) and the regulations thereunder. In the case of a section 197 intangible acquired in an applicable asset acquisition within the meaning of section 1060(c), the basis shall be determined pursuant to section 1060(a) and the regulations thereunder.

(*iii*) *Certain reinsurance transactions.* See paragraph (g)(5)(ii) of this section for special rules regarding the adjusted basis of an insurance contract acquired through an assumption reinsurance transaction.

(g) *Special rules*—(1) *Treatment of certain dispositions*—(i) *Loss disallowance rules*—(A) *In general.* No loss is recognized on the disposition of an amortizable section 197 intangible if the taxpayer has any retained intangibles. The retained intangibles with respect to the disposition of any amortizable section 197 intangible (the transferred intangible) are all amortizable section 197 intangibles, or rights to use or interests (including beneficial or other indirect interests) in amortizable section 197 intangibles (including the transferred intangible) that were acquired in the same transaction or series of related transactions as the transferred intangible and are retained after its disposition. Except as otherwise provided in paragraph (g)(1)(iv)(B) of this section, the adjusted basis of each of the retained intangibles is increased by the product of—

(*1*) The loss that is not recognized solely by reason of this rule; and

(*2*) A fraction, the numerator of which is the adjusted basis of the retained intangible on the date of the disposition and the denominator of which is the total adjusted bases of all the retained intangibles on that date.

(B) *Abandonment or worthlessness.* The abandonment of an amortizable section 197 intangible, or any other event rendering an amortizable section 197 intangible worthless, is treated as a disposition of the intangible for purposes

of this paragraph (g)(1), and the abandoned or worthless intangible is disregarded (that is, it is not treated as a retained intangible) for purposes of applying this paragraph (g)(1) to the subsequent disposition of any other amortizable section 197 intangible.

(C) *Certain nonrecognition transfers.* The loss disallowance rule in paragraph (g)(1)(i)(A) of this section also applies when a taxpayer transfers an amortizable section 197 intangible from an acquired trade or business in a transaction in which the intangible is transferred basis property and, after the transfer, retains other amortizable section 197 intangibles from the trade or business. Thus, for example, the transfer of an amortizable section 197 intangible to a corporation in exchange for stock in the corporation in a transaction described in section 351, or to a partnership in exchange for an interest in the partnership in a transaction described in section 721, when other amortizable section 197 intangibles acquired in the same transaction are retained, followed by a sale of the stock or partnership interest received, will not avoid the application of the loss disallowance provision to the extent the adjusted basis of the transferred intangible at the time of the sale exceeds its fair market value at that time.

(ii) *Separately acquired property.* Paragraph (g)(1)(i) of this section does not apply to an amortizable section 197 intangible that is not acquired in a transaction or series of related transactions in which the taxpayer acquires other amortizable section 197 intangibles (a separately acquired intangible). Consequently, a loss may be recognized upon the disposition of a separately acquired amortizable section 197 intangible. However, the termination or worthlessness of only a portion of an amortizable section 197 intangible is not the disposition of a separately acquired intangible. For example, neither the loss of several customers from an acquired customer list nor the worthlessness of only some information from an acquired data base constitutes the disposition of a separately acquired intangible.

(iii) *Disposition of a covenant not to compete.* If a covenant not to compete or any other arrangement having substantially the same effect is entered into in connection with the direct or indirect acquisition of an interest in one or more trades or businesses, the disposition or worthlessness of the covenant or other arrangement will not be considered to occur until the disposition or worthlessness of all interests in those trades or businesses. For example, a covenant not to compete entered into in connection with the purchase of stock continues to be amortized ratably over the 15-year recovery period (even after the covenant expires or becomes worthless) unless all the trades or businesses in which an interest was acquired through the stock purchase (or all the purchaser's interests in those trades or businesses) also are disposed of or become worthless.

(iv) *Taxpayers under common control*—(A) *In general.* Except as provided in paragraph (g)(1)(iv)(B) of this section, all persons that would be treated as a single taxpayer under section 41(f)(1) are treated as a single taxpayer under this paragraph (g)(1). Thus, for example, a loss is not recognized on the disposition of an amortizable section 197 intangible by a member of a controlled group of corporations (as defined in section 41(f)(5)) if, after the disposition, another member retains other amortizable section 197 intangibles acquired in the same transaction as the amortizable section 197 intangible that has been disposed of.

(B) *Treatment of disallowed loss.* If retained intangibles are held by a person other than the person incurring the disallowed loss, only the adjusted basis of intangibles retained by the person incurring the disallowed loss is increased, and only the adjusted basis of those intangibles is included in the denominator of the fraction described in paragraph (g)(1)(i)(A) of this section. If none of the retained intangibles are held by the person incurring the disallowed loss, the loss is allowed ratably, as a deduction under section 197, over the remainder of the period during which the intangible giving rise to the loss would have been amortizable, except that any remaining disallowed loss is allowed in full on the first date on which all other retained intangibles have been disposed of or become worthless.

(2) *Treatment of certain nonrecognition and exchange transactions*—(i) *Relationship to anti-churning rules.* This paragraph (g)(2) provides rules relating to the treatment of section 197 intangibles acquired in certain transactions. If these rules apply to a section 197(f)(9) intangible (within the meaning of paragraph (h)(1)(i) of this section), the intangible is, notwithstanding its treatment under this paragraph (g)(2), treated as an amortizable section 197 intangible only to the extent permitted under paragraph (h) of this section.

(ii) *Treatment of nonrecognition and exchange transactions generally*—(A) *Transfer disregarded.* If a section 197 intangible is transferred in a transaction described in paragraph (g)(2)(ii)(C) of this section, the transfer is disregarded in determining—

(*1*) Whether, with respect to so much of the intangible's basis in the hands of the transferee as does not exceed its basis in the hands of the transferor, the intangible is an amortizable section 197 intangible; and

(*2*) The amount of the deduction under section 197 with respect to such basis.

(B) *Application of general rule.* If the intangible described in paragraph (g)(2)(ii)(A) of this section was an amortizable section 197 intangible in the hands of the transferor, the transferee will continue to amortize its adjusted basis, to the extent it does not exceed the transferor's adjusted basis, ratably over the remainder of the transferor's 15-year amortization period. If the intangible was not an amortizable section 197 intangible in the hands of the transferor, the transferee's adjusted basis, to the extent it does not exceed the transferor's adjusted basis, cannot be amortized under section 197. In either event, the intangible is treated, with respect to so much of its adjusted basis in the hands of the transferee as exceeds its adjusted basis in the hands of the transferor, in the same manner for purposes of section 197 as an intangible acquired from the transferor in a transaction that is not described in paragraph (g)(2)(ii)(C) of this section. The rules of this paragraph (g)(2)(ii) also apply to any subsequent transfers of the intangible in a transaction described in paragraph (g)(2)(ii)(C) of this section.

(C) *Transactions covered.* The transactions described in this paragraph (g)(2)(ii)(C) are—

(*1*) Any transaction described in section 332, 351, 361, 721, or 731; and

(*2*) Any transaction between corporations that are members of the same consolidated group immediately after the transaction.

(iii) *Certain exchanged-basis property.* This paragraph (g)(2)(iii) applies to property that is acquired in a transaction subject to section 1031 or 1033 and is permitted to be acquired without recognition of gain (replacement property). Replacement property is treated as if it were the property by reference to which its basis is determined (the predecessor property) in determining whether, with respect to so much of its basis as does not exceed the basis of the predecessor property, the replacement property is an amortizable section 197 intangible and the amortization period under section 197 with respect to such basis. Thus, if the predecessor property was an amortizable section 197 intangible, the taxpayer will amortize the adjusted basis of the replacement property, to the extent it does not exceed the adjusted basis of the predecessor property, ratably over the remainder of the 15-year amortization period for the predecessor property. If the predecessor property was not an amortizable section 197 intangible, the adjusted basis of the replacement property, to the extent it does not exceed the adjusted basis of the predecessor property, may not be amortized under section 197. In either event, the replacement property is treated, with respect to so much of its adjusted basis as exceeds the adjusted basis of the predecessor property, in the same manner for purposes of section 197 as property acquired from the transferor in a transaction that is not subject to section 1031 or 1033.

(iv) *Transfers under section 708(b)(1)*—(A) *In general.* Paragraph (g)(2)(ii) of this section applies to transfers of section 197 intangibles that occur or are deemed to occur by reason of the termination of a partnership under section 708(b)(1).

(B) *Termination by sale or exchange of interest.* In applying paragraph (g)(2)(ii) of this section to a partnership that is terminated pursuant to section 708(b)(1)(B) (relating to deemed terminations from the sale or exchange of an interest), the terminated partnership is treated as the transferor and the new partnership is treated as the transferee with respect to any section 197 intangible held by the terminated partnership immediately preceding the termination. (See paragraph (g)(3) of this section for the treatment of increases in the bases of property of the terminated partnership under section 743(b).)

(C) *Other terminations.* In applying paragraph (g)(2)(ii) of this section to a partnership that is terminated pursuant to section 708(b)(1)(A) (relating to cessation of activities by a partnership), the terminated partnership is treated as the transferor and the distributee partner is treated as the transferee with respect to any section 197 intangible held by the terminated partnership immediately preceding the termination.

(3) *Increase in the basis of partnership property under section 732(b), 734(b), 743(b), or 732(d).* Any increase in the adjusted basis of a section 197 intangible under sections 732(b) or 732(d) (relating to a partner's basis in property distributed by a partnership), section 734(b) (relating to the optional adjustment to the basis of undistributed partnership property after a distribution of property to a partner), or section 743(b) (relating to the optional adjustment to the basis of partnership property after transfer of a partnership interest) is treated as a separate section 197 intangible. For purposes of determining the amortization period under section 197 with respect to the basis increase, the intangible is treated as having been acquired at the time of the transaction that causes the basis increase, except as provided in §1.743–1(j)(4)(i)(B)(*2*). The provisions of paragraph (f)(2) of this section apply to the extent that the amount of the basis increase is determined by reference to contingent payments. For purposes of the effective date and anti-churning provisions (paragraphs (l)(1) and (h) of this section) for a basis increase under section 732(d), the intangible is treated as having been acquired by the transferee partner at the time of the transfer of the partnership interest described in section 732(d).

(4) *Section 704(c) allocations*—(i) *Allocations where the intangible is amortizable by the contributor.* To the extent that the intangible was an amortizable section 197 intangible in the hands of the contributing partner, a partnership may make allocations of amortization deductions with respect to the intangible to all of its partners under any of the permissible methods described in the regulations under section 704(c). See §1.704–3.

(ii) *Allocations where the intangible is not amortizable by the contributor.* To the extent that the intangible was not an amortizable section 197 intangible in the hands of the contributing partner, the intangible is not amortizable under section 197 by the partnership. However, if a partner contributes a section 197 intangible to a partnership and the partnership adopts the remedial allocation method for making section 704(c) allocations of amortization deductions, the partnership generally may make remedial allocations of amortization deductions with respect to the contributed section 197 intangible in accordance with §1.704–3(d). See paragraph (h)(12) of this section to determine the application of the anti-churning rules in the context of remedial allocations.

(5) *Treatment of certain reinsurance transactions*—(i) *In general.* Section 197 applies to any insurance contract acquired from another person through an assumption reinsurance transaction. For purposes of section 197, an assumption reinsurance transaction is—

(A) Any arrangement in which one insurance company (the reinsurer) becomes solely liable to policyholders on contracts transferred by another insurance company (the ceding company); and

(B) Any acquisition of an insurance contract that is treated as occurring by reason of an election under section 338.

(ii) *Determination of adjusted basis*—(A) *Acquisitions (other than under section 338) of specified insurance contracts.* The amount taken into account for purposes of section 197 as the adjusted

basis of specified insurance contracts (as defined in section 848(e)(1)) acquired in an assumption reinsurance transaction that is not described in paragraph (g)(5)(i)(B) of this section is equal to the excess of—

(*1*) The amount paid or incurred (or treated as having been paid or incurred) by the reinsurer for the purchase of the contracts (as determined under § 1.817–4(d)(2)); over

(*2*) The amount of the specified policy acquisition expenses that are attributable to the reinsurer's net positive consideration for the reinsurance agreement (as determined under § 1.848–2(f)(3)).

(B) *Insolvent ceding company.* The reduction of the amount of specified policy acquisition expenses by the reinsurer with respect to an assumption reinsurance transaction with an insolvent ceding company where the ceding company and reinsurer have made a valid joint election under section 1.848–2(i)(4) is disregarded in determining the amount of specified policy acquisition expenses for purposes of this paragraph (g)(5)(ii).

(C) *Other acquisitions.* [Reserved]

(6) *Amounts paid or incurred for a franchise, trademark, or trade name.* If an amount to which section 1253(d) (relating to the transfer, sale, or other disposition of a franchise, trademark, or trade name) applies is described in section 1253(d)(1)(B) (relating to contingent serial payments deductible under section 162), the amount is not included in the adjusted basis of the intangible for purposes of section 197. Any other amount, whether fixed or contingent, to which section 1253(d) applies is chargeable to capital account under section 1253(d)(2) and is amortizable only under section 197.

(7) *Amounts properly taken into account in determining the cost of property that is not a section 197 intangible.* Section 197 does not apply to an amount that is properly taken into account in determining the cost of property that is not a section 197 intangible. The entire cost of acquiring the other property is included in its basis and recovered under other applicable Internal Revenue Code provisions. Thus, for example, section 197 does not apply to the cost of an interest in computer software to the extent such cost is included, without being separately stated, in the cost of the hardware or other tangible property and is consistently treated as part of the cost of the hardware or other tangible property.

(8) *Treatment of amortizable section 197 intangibles as depreciable property.* An amortizable section 197 intangible is treated as property of a character subject to the allowance for depreciation under section 167. Thus, for example, an amortizable section 197 intangible is not a capital asset for purposes of section 1221, but if used in a trade or business and held for more than one year, gain or loss on its disposition generally qualifies as section 1231 gain or loss. Also, an amortizable section 197 intangible is section 1245 property and section 1239 applies to any gain recognized upon its sale or exchange between related persons (as defined in section 1239(b)).

(h) *Anti-churning rules*—(1) *Scope and purpose*—(i) *Scope.* This paragraph (h) applies to section 197(f)(9) intangibles. For this purpose, section 197(f)(9) intangibles are goodwill and going concern value that was held or used at any time during the transition period and any other section 197 intangible that was held or used at any time during the transition period and was not depreciable or amortizable under prior law.

(ii) *Purpose.* To qualify as an amortizable section 197 intangible, a section 197 intangible must be acquired after the applicable date (July 25, 1991, if the acquiring taxpayer has made a valid retroactive election pursuant to § 1.197–1T; August 10, 1993, in all other cases). The purpose of the anti-churning rules of section 197(f)(9) and this paragraph (h) is to prevent the amortization of section 197(f)(9) intangibles unless they are transferred after the applicable effective date in a transaction giving rise to a significant change in ownership or use. (Special rules apply for purposes of determining whether transactions involving partnerships give rise to a significant change in ownership or use. See paragraph (h)(12) of this section.) The anti-churning rules are to be applied in a manner that carries out their purpose.

(2) *Treatment of section 197(f)(9) intangibles.* Except as otherwise provided in this paragraph (h), a section 197(f)(9) intangible acquired by a taxpayer after the applicable effective date does not qualify for amortization under section 197 if—

(i) The taxpayer or a related person held or used the intangible or an interest therein at any time during the transition period;

(ii) The taxpayer acquired the intangible from a person that held the intangible at any time during the transition period and, as part of the transaction, the user of the intangible does not change; or

(iii) The taxpayer grants the right to use the intangible to a person that held or used the intangible at any time during the transition period (or to a person related to that person), but only if the transaction in which the taxpayer grants the right and the transaction in which the taxpayer acquired the intangible are part of a series of related transactions.

(3) *Amounts deductible under section 1253(d) or §1.162–11.* For purposes of this paragraph (h), deductions allowable under section 1253(d)(2) or pursuant to an election under section 1253(d)(3) (in either case as in effect prior to the enactment of section 197) and deductions allowable under §1.162–11 are treated as deductions allowable for amortization under prior law.

(4) *Transition period.* For purposes of this paragraph (h), the transition period is July 25, 1991, if the acquiring taxpayer has made a valid retroactive election pursuant to §1.197–1T and the period beginning on July 25, 1991, and ending on August 10, 1993, in all other cases.

(5) *Exceptions.* The anti-churning rules of this paragraph (h) do not apply to—

(i) The acquisition of a section 197(f)(9) intangible if the acquiring taxpayer's basis in the intangible is determined under section 1014(a); or

(ii) The acquisition of a section 197(f)(9) intangible that was an amortizable section 197 intangible in the hands of the seller (or transferor), but only if the acquisition transaction and the transaction in which the seller (or transferor) acquired the intangible or interest therein are not part of a series of related transactions.

(6) *Related person*—(i) *In general.* Except as otherwise provided in paragraph (h)(6)(ii) of this section, a person is related to another person for purposes of this paragraph (h) if—

(A) The person bears a relationship to that person that would be specified in section 267(b) (determined without regard to section 267(e)) and, by substitution, section 267(f)(1), if those sections were amended by substituting 20 percent for 50 percent; or

(B) The person bears a relationship to that person that would be specified in section 707(b)(1) if that section were amended by substituting 20 percent for 50 percent; or

(C) The persons are engaged in trades or businesses under common control (within the meaning of section 41(f)(1)(A) and (B)).

(ii) *Time for testing relationships.* Except as provided in paragraph (h)(6)(iii) of this section, a person is treated as related to another person for purposes of this paragraph (h) if the relationship exists—

(A) In the case of a single transaction, immediately before or immediately after the transaction in which the intangible is acquired; and

(B) In the case of a series of related transactions (or a series of transactions that together comprise a qualified stock purchase within the meaning of section 338(d)(3)), immediately before the earliest such transaction or immediately after the last such transaction.

(iii) *Certain relationships disregarded.* In applying the rules in paragraph (h)(7) of this section, if a person acquires an intangible in a series of related transactions in which the person acquires stock (meeting the requirements of section 1504(a)(2)) of a corporation in a fully taxable transaction followed by a liquidation of the acquired corporation under section 331, any relationship created as part of such series of transactions is disregarded in determining whether any person is related to such acquired corporation immediately after the last transaction.

(iv) *De minimis rule*—(A) *In general.* Two corporations are not treated as related persons for purposes of this paragraph (h) if—

(*1*) The corporations would (but for the application of this paragraph (h)(6)(iv)) be treated as related persons solely by reason of substituting ''more than 20 percent'' for ''more than 50 percent'' in section 267(f)(1)(A); and

(*2*) The beneficial ownership interest of each corporation in the stock of the other corporation represents less than 10 percent of the total combined voting power of all classes of stock entitled to vote and less than 10 percent of the total value of the shares of all classes of stock outstanding.

(B) *Determination of beneficial ownership interest.* For purposes of this paragraph (h)(6)(iv), the beneficial ownership interest of one corporation in the stock of another corporation is determined under the principles of section 318(a), except that—

(*1*) In applying section 318(a)(2)(C), the 50-percent limitation contained therein is not applied; and

(*2*) Section 318(a)(3)(C) is applied by substituting ''20 percent'' for ''50 percent''.

(7) *Special rules for entities that owned or used property at any time during the transition period and that are no longer in existence.* A corporation, partnership, or trust that owned or used a section 197 intangible at any time during the transition period and that is no longer in existence is deemed, for purposes of determining whether a taxpayer acquiring the intangible is related to such entity, to be in existence at the time of the acquisition.

(8) *Special rules for section 338 deemed acquisitions.* In the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Thus, for example, if a corporation (the purchasing corporation) makes a qualified stock purchase of the stock of another corporation after the transition period, new target will not be treated as the owner during the transition period of assets owned by old target during that period even if old target and new target are treated as the same corporation for certain other purposes of the Internal Revenue Code or old target and new target are the same corporation under the laws of the State or other jurisdiction of its organization. However, the anti-churning rules of this paragraph (h) may nevertheless apply to a deemed asset purchase resulting from a section 338 election if new target is related (within the meaning of paragraph (h)(6) of this section) to old target.

(9) *Gain-recognition exception*—(i) *Applicability.* A section 197(f)(9) intangible qualifies for the gain-recognition exception if—

(A) The taxpayer acquires the intangible from a person that would not be related to the taxpayer but for the substitution of 20 percent for 50 percent under paragraph (h)(6)(i)(A) of this section; and

(B) That person (whether or not otherwise subject to Federal income tax) elects to recognize gain on the disposition of the intangible and agrees, notwithstanding any other provision of law or treaty, to pay for the taxable year in which the disposition occurs an amount of tax on the gain that, when added to any other Federal income tax on such gain, equals the gain on the disposition multiplied by the highest marginal rate of tax for that taxable year.

(ii) *Effect of exception.* The anti-churning rules of this paragraph (h) apply to a section 197(f)(9) intangible that qualifies for the gain-recognition exception only to the extent the acquiring taxpayer's basis in the intangible exceeds the gain recognized by the transferor.

(iii) *Time and manner of election.* The election described in this paragraph (h)(9) must be made by the due date (including extensions of time) of the electing taxpayer's Federal income tax return for the taxable year in which the disposition occurs. The election is made by attaching an election statement satisfying the requirements of paragraph (h)(9)(viii) of this section to the electing taxpayer's original or amended income tax return for that

taxable year (or by filing the statement as a return for the taxable year under paragraph (h)(9)(xi) of this section). In addition, the taxpayer must satisfy the notification requirements of paragraph (h)(9)(vi) of this section. The election is binding on the taxpayer and all parties whose Federal tax liability is affected by the election.

(iv) *Special rules for certain entities.* In the case of a partnership, S corporation, estate or trust, the election under this paragraph (h)(9) is made by the entity rather than by its owners or beneficiaries. If a partnership or S corporation makes an election under this paragraph (h)(9) with respect to the disposition of a section 197(f)(9) intangible, each of its partners or shareholders is required to pay a tax determined in the manner described in paragraph (h)(9)(i)(B) of this section on the amount of gain that is properly allocable to such partner or shareholder with respect to the disposition.

(v) *Effect of nonconforming elections.* An attempted election that does not substantially comply with each of the requirements of this paragraph (h)(9) is disregarded in determining whether a section 197(f)(9) intangible qualifies for the gain-recognition exception.

(vi) *Notification requirements.* A taxpayer making an election under this paragraph (h)(9) with respect to the disposition of a section 197(f)(9) intangible must provide written notification of the election on or before the due date of the return on which the election is made to the person acquiring the section 197 intangible. In addition, a partnership or S corporation making an election under this paragraph (h)(9) must attach to the Schedule K–1 furnished to each partner or shareholder a written statement containing all information necessary to determine the recipient's additional tax liability under this paragraph (h)(9).

(vii) *Revocation.* An election under this paragraph (h)(9) may be revoked only with the consent of the Commissioner.

(viii) *Election Statement.* An election statement satisfies the requirements of this paragraph (h)(9)(viii) if it is in writing and contains the information listed below. The required information should be arranged and identified in accordance with the following order and numbering system:

(A) The name and address of the electing taxpayer.

(B) Except in the case of a taxpayer that is not otherwise subject to Federal income tax, the taxpayer identification number (TIN) of the electing taxpayer.

(C) A statement that the taxpayer is making the election under section 197(f)(9)(B).

(D) Identification of the transaction and each person that is a party to the transaction or whose tax return is affected by the election (including, except in the case of persons not otherwise subject to Federal income tax, the TIN of each such person).

(E) The calculation of the gain realized, the applicable rate of tax, and the amount of the taxpayer's additional tax liability under this paragraph (h)(9).

(F) The signature of the taxpayer or an individual authorized to sign the taxpayer's Federal income tax return.

(ix) *Determination of highest marginal rate of tax and amount of other Federal income tax on gain*—(A) *Marginal rate.* The following rules apply for purposes of determining the highest marginal rate of tax applicable to an electing taxpayer:

(*1*) *Noncorporate taxpayers.* In the case of an individual, estate, or trust, the highest marginal rate of tax is the highest marginal rate of tax in effect under section 1, determined without regard to section 1(h).

(*2*) *Corporations and tax-exempt entities.* In the case of a corporation or an entity that is exempt from tax under section 501(a), the highest marginal rate of tax is the highest marginal rate of tax in effect under section 11, determined without regard to any rate that is added to the otherwise applicable rate in order to offset the effect of the graduated rate schedule.

(B) *Other Federal income tax on gain.* The amount of Federal income tax (other than the tax determined under this paragraph (h)(9)) imposed on any gain is the lesser of—

(*1*) The amount by which the taxpayer's Federal income tax liability (determined without regard to this paragraph (h)(9)) would be reduced if

the amount of such gain were not taken into account; or

(*2*) The amount of the gain multiplied by the highest marginal rate of tax for the taxable year.

(x) *Coordination with other provisions*—(A) *In general.* The amount of gain subject to the tax determined under this paragraph (h)(9) is not reduced by any net operating loss deduction under section 172(a), any capital loss under section 1212, or any other similar loss or deduction. In addition, the amount of tax determined under this paragraph (h)(9) is not reduced by any credit of the taxpayer. In computing the amount of any net operating loss, capital loss, or other similar loss or deduction, or any credit that may be carried to any taxable year, any gain subject to the tax determined under this paragraph (h)(9) and any tax paid under this paragraph (h)(9) is not taken into account.

(B) *Section 1374.* No provision of paragraph (h)(9)(iv) of this section precludes the application of section 1374 (relating to a tax on certain built-in gains of S corporations) to any gain with respect to which an election under this paragraph (h)(9) is made. In addition, neither paragraph (h)(9)(iv) nor paragraph (h)(9)(x)(A) of this section precludes a taxpayer from applying the provisions of section 1366(f)(2) (relating to treatment of the tax imposed by section 1374 as a loss sustained by the S corporation) in determining the amount of tax payable under paragraph (h)(9) of this section.

(C) *Procedural and administrative provisions.* For purposes of subtitle F, the amount determined under this paragraph (h)(9) is treated as a tax imposed by section 1 or 11, as appropriate.

(D) *Installment method.* The gain subject to the tax determined under paragraph (h)(9)(i) of this section may not be reported under the method described in section 453(a). Any such gain that would, but for the application of this paragraph (h)(9)(x)(D), be taken into account under section 453(a) shall be taken into account in the same manner as if an election under section 453(d) (relating to the election not to apply section 453(a)) had been made.

(xi) *Special rules for persons not otherwise subject to Federal income tax.* If the person making the election under this paragraph (h)(9) with respect to a disposition is not otherwise subject to Federal income tax, the election statement satisfying the requirements of paragraph (h)(9)(viii) of this section must be filed with the Philadelphia Service Center. For purposes of this paragraph (h)(9) and subtitle F, the statement is treated as an income tax return for the calendar year in which the disposition occurs and as a return due on or before March 15 of the following year.

(10) *Transactions subject to both anti-churning and nonrecognition rules.* If a person acquires a section 197(f)(9) intangible in a transaction described in paragraph (g)(2) of this section from a person in whose hands the intangible was an amortizable section 197 intangible, and immediately after the transaction (or series of transactions described in paragraph (h)(6)(ii)(B) of this section) in which such intangible is acquired, the person acquiring the section 197(f)(9) intangible is related to any person described in paragraph (h)(2) of this section, the intangible is, notwithstanding its treatment under paragraph (g)(2) of this section, treated as an amortizable section 197 intangible only to the extent permitted under this paragraph (h). (See, for example, paragraph (h)(5)(ii) of this section.)

(11) *Avoidance purpose.* A section 197(f)(9) intangible acquired by a taxpayer after the applicable effective date does not qualify for amortization under section 197 if one of the principal purposes of the transaction in which it is acquired is to avoid the operation of the anti-churning rules of section 197(f)(9) and this paragraph (h). A transaction will be presumed to have a principal purpose of avoidance if it does not effect a significant change in the ownership or use of the intangible. Thus, for example, if section 197(f)(9) intangibles are acquired in a transaction (or series of related transactions) in which an option to acquire stock is issued to a party to the transaction, but the option is not treated as having been exercised for purposes of paragraph (h)(6) of this section, this paragraph (h)(11) may apply to the transaction.

(12) *Additional partnership anti-churning rules*—(i) *In general.* In determining whether the anti-churning rules of this paragraph (h) apply to any increase in the basis of a section 197(f)(9) intangible under section 732(b), 732(d), 734(b), or 743(b), the determinations are made at the partner level and each partner is treated as having owned and used the partner's proportionate share of partnership property. In determining whether the anti-churning rules of this paragraph (h) apply to any transaction under another section of the Internal Revenue Code, the determinations are made at the partnership level, unless under §1.701–2(e) the Commissioner determines that the partner level is more appropriate.

(ii) *Section 732(b) adjustments*—(A) *In general.* The anti-churning rules of this paragraph (h) apply to any increase in the adjusted basis of a section 197(f)(9) intangible under section 732(b) to the extent that the basis increase exceeds the total unrealized appreciation from the intangible allocable to—

(*1*) Partners other than the distributee partner or persons related to the distributee partner;

(*2*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner and related persons acquired an interest or interests in the partnership after August 10, 1993;

(*ii*) Such interest or interests were held after August 10, 1993, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests; and

(*3*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner and persons related to the distributee partner acquired an interest or interests in the partnership after the partnership acquired the distributed intangible;

(*ii*) Such interest or interests were held after the partnership acquired the distributed intangible, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests.

(B) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(ii)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(C) *Intangible still subject to anti-churning rules.* Notwithstanding paragraph (h)(12)(ii) of this section, in applying the provisions of this paragraph (h) with respect to subsequent transfers, the distributed intangible remains subject to the provisions of this paragraph (h) in proportion to a fraction (determined at the time of the distribution), as follows—

(*1*) The numerator of which is equal to the sum of—

(*i*) The amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section; and

(*ii*) The total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply; and

(*2*) The denominator of which is the fair market value of such intangible.

(D) *Partner's allocable share of unrealized appreciation from the intangible.* The amount of unrealized appreciation from an intangible that is allocable to a partner is the amount of taxable gain that would have been allocated to that partner if the partnership had sold the

intangible immediately before the distribution for its fair market value in a fully taxable transaction.

(E) *Acquisition of partnership interest by contribution.* Solely for purposes of paragraphs (h)(12)(ii)(A)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each partner's respective proportionate interest in the partnership.

(iii) *Section 732(d) adjustments.* The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197(f)(9) intangible under section 732(d) if, had an election been in effect under section 754 at the time of the transfer of the partnership interest, the distributee partner would have been able to amortize the basis adjustment made pursuant to section 743(b).

(iv) *Section 734(b) adjustments*—(A) *In general.* The anti-churning rules of this paragraph (h) do not apply to a continuing partner's share of an increase in the basis of a section 197(f)(9) intangible held by a partnership under section 734(b) to the extent that the continuing partner is an eligible partner.

(B) *Eligible partner.* For purposes of this paragraph (h)(12)(iv), eligible partner means—

(*1*) A continuing partner that is not the distributee partner or a person related to the distributee partner;

(*2*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after August 10, 1993;

(*ii*) Such interest was held after August 10, 1993 by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest; or

(*3*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after the partnership acquired the relevant intangible;

(*ii*) Such interest was held after the partnership acquired the relevant intangible by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest.

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(iv)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the distributee partner made a valid retroactive election under §1.197–1T.

(D) *Partner's share of basis increase*—(*1*) In general. Except as provided in paragraph (h)(12)(iv)(D)(*2*) of this section, for purposes of this paragraph (h)(12)(iv), a continuing partner's share of a basis increase under section 734(b) is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) A fraction the numerator of which is the amount of the continuing partner's post-distribution capital account (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)), and the denominator of which is the total amount of the post-distribution capital accounts (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)) of all continuing partners.

(*2*) *Exception where partnership does not maintain capital accounts.* If a partnership does not maintain capital accounts in accordance with §1.704–

1(b)(2)(iv), then for purposes of this paragraph (h)(12)(iv), a continuing partner's share of a basis increase is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) The partner's overall interest in the partnership as determined under §1.704–1(b)(3) immediately after the distribution.

(E) *Interests acquired by contribution—*(*1*) *Application of paragraphs (h)(12)(iv)(B) (2) and (3) of this section.* Solely for purposes of paragraphs (h)(12)(iv)(B)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(*2*) *Special rule with respect to paragraph (h)(12)(iv)(B)*(*1*) of this section. Solely for purposes of paragraph (h)(12)(iv)(B)(*1*) of this section, if a distribution that gives rise to an increase in the basis under section 734(b) of a section 197(f)(9) intangible held by the partnership is undertaken as part of a series of related transactions that include a contribution of the intangible to the partnership by a continuing partner, the continuing partner is treated as related to the distributee partner in analyzing the basis adjustment with respect to the contributed section 197(f)(9) intangible.

(F) *Effect of section 734(b) adjustments on partners' capital accounts.* If one or more partners are subject to the anti-churning rules under this paragraph (h) with respect to a section 734(b) adjustment allocable to an intangible asset, taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to the section 734 adjustment is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

(v) *Section 743(b) adjustments*—(A) *General rule.* The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest. In addition, the anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) to the extent that—

(*1*) The partnership interest being transferred was acquired after August 10, 1993, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership on or before August 10, 1993;

(*ii*) The partnership interest being transferred was held after August 10, 1993, by a person or persons (the post-1993 person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-1993 person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest; or

(*2*) The partnership interest being transferred was acquired after the partnership acquired the section 197(f)(9) intangible, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership after August 10, 1993, and is not amortizable with respect to the partnership;

(*ii*) The partnership interest being transferred was held after the partnership acquired the section 197(f)(9) intangible by a person or persons (the post-contribution person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-contribution person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest.

(B) *Acquisition of partnership interest by contribution.* Solely for purposes of paragraph (h)(12)(v)(A) (*1*) and (*2*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(v)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the transferee partner made a valid retroactive election under §1.197–1T.

(vi) *Partner is or becomes a user of partnership intangible*—(A) *General rule.* If, as part of a series of related transactions that includes a transaction described in paragraph (h)(12)(ii), (iii), (iv), or (v) of this section, an anti-churning partner or related person (other than the partnership) becomes (or remains) a direct user of an intangible that is treated as transferred in the transaction (as a result of the partners being treated as having owned their proportionate share of partnership assets), the anti-churning rules of this paragraph (h) apply to the proportionate share of such intangible that is treated as transferred by such anti-churning partner, notwithstanding the application of paragraph (h)(12)(ii), (iii), (iv), or (v) of this section.

(B) *Anti-churning partner.* For purposes of this paragraph (h)(12)(vi), anti-churning partner means—

(*1*) With respect to all intangibles held by a partnership on or before August 10, 1993, any partner, but only to the extent that

(*i*) The partner's interest in the partnership was acquired on or before August 10, 1993, or

(*ii*) The interest was acquired from a person related to the partner on or after August 10, 1993, and such interest was not held by any person other than persons related to such partner at any time after August 10, 1993 (disregarding, for this purpose, a person's holding of an interest if the acquisition of such interest was part of a transaction or series of related transactions in which the partner or persons related to the partner subsequently acquired such interest),

(*2*) With respect to any section 197(f)(9) intangible acquired by a partnership after August 10, 1993, that is not amortizable with respect to the partnership, any partner, but only to the extent that

(*i*) The partner's interest in the partnership was acquired on or before the date the partnership acquired the section 197(f)(9) intangible, or

(*ii*) The interest was acquired from a person related to the partner on or after the date the partnership acquired the section 197(f)(9) intangible, and such interest was not held by any person other than persons related to such partner at any time after the date the partnership acquired the section 197(f)(9) intangible (disregarding, for this purpose, a person's holding of an interest if the acquisition of such interest was part of a transaction or series of related transactions in which the partner or persons related to the partner subsequently acquired such interest).

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(vi)(B) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(vii) *Section 704(c) allocations*—(A) *Allocations where the intangible is amortizable by the contributor.* The anti-churning rules of this paragraph (h) do not apply to the curative or remedial allocations of amortization with respect to a section 197(f)(9) intangible if the intangible was an amortizable section 197 intangible in the hands of the contributing partner (unless paragraph (h)(10) of this section applies so as to cause

the intangible to cease to be an amortizable section 197 intangible in the hands of the partnership).

(B) *Allocations where the intangible is not amortizable by the contributor.* If a section 197(f)(9) intangible was not an amortizable section 197 intangible in the hands of the contributing partner, a non-contributing partner generally may receive remedial allocations of amortization under section 704(c) that are deductible for Federal income tax purposes. However, such a partner may not receive remedial allocations of amortization under section 704(c) if that partner is related to the partner that contributed the intangible or if, as part of a series of related transactions that includes the contribution of the section 197(f)(9) intangible to the partnership, the contributing partner or related person (other than the partnership) becomes (or remains) a direct user of the contributed intangible. Taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to section 704(c) is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

(viii) *Operating rule for transfers upon death.* For purposes of this paragraph (h)(12), if the basis of a partner's interest in a partnership is determined under section 1014(a), such partner is treated as acquiring such interest from a person who is not related to such partner, and such interest is treated as having previously been held by a person who is not related to such partner.

(i) [Reserved]

(j) *General anti-abuse rule.* The Commissioner will interpret and apply the rules in this section as necessary and appropriate to prevent avoidance of the purposes of section 197. If one of the principal purposes of a transaction is to achieve a tax result that is inconsistent with the purposes of section 197, the Commissioner will recast the transaction for Federal tax purposes as appropriate to achieve tax results that are consistent with the purposes of section 197, in light of the applicable statutory and regulatory provisions and the pertinent facts and circumstances.

(k) *Examples.* The following examples illustrate the application of this section:

Example 1. Advertising costs. (i) Q manufactures and sells consumer products through a series of wholesalers and distributors. In order to increase sales of its products by encouraging consumer loyalty to its products and to enhance the value of the goodwill, trademarks, and trade names of the business, Q advertises its products to the consuming public. It regularly incurs costs to develop radio, television, and print advertisements. These costs generally consist of employee costs and amounts paid to independent advertising agencies. Q also incurs costs to run these advertisements in the various media for which they were developed.

(ii) The advertising costs are not chargeable to capital account under paragraph (f)(3) of this section (relating to costs incurred for covenants not to compete, rights granted by governmental units, and contracts for the use of section 197 intangibles) and are currently deductible as ordinary and necessary expenses under section 162. Accordingly, under paragraph (a)(3) of this section, section 197 does not apply to these costs.

Example 2. Computer software. (i) X purchases all of the assets of an existing trade or business from Y. One of the assets acquired is all of Y's rights in certain computer software previously used by Y under the terms of a nonexclusive license from the software developer. The software was developed for use by manufacturers to maintain a comprehensive accounting system, including general and subsidiary ledgers, payroll, accounts receivable and payable, cash receipts and disbursements, fixed asset accounting, and inventory cost accounting and controls. The developer modified the software for use by Y at a cost of $1,000 and Y made additional modifications at a cost of $500. The developer does not maintain wholesale or retail outlets but markets the software directly to ultimate users. Y's license of the software is limited to an entity that is actively engaged in business as a manufacturer.

(ii) Notwithstanding these limitations, the software is considered to be readily available to the general public for purposes of paragraph (c)(4)(i) of this section. In addition, the software is not substantially modified because the cost of the modifications by the

developer and Y to the version of the software that is readily available to the general public does not exceed $2,000. Accordingly, the software is not a section 197 intangible.

Example 3. Acquisition of software for internal use. (i) B, the owner and operator of a worldwide package-delivery service, purchases from S all rights to software developed by S. The software will be used by B for the sole purpose of improving its package-tracking operations. B does not purchase any other assets in the transaction or any related transaction.

(ii) Because B acquired the software solely for internal use, it is disregarded in determining for purposes of paragraph (c)(4)(ii) of this section whether the assets acquired in the transaction or series of related transactions constitute a trade or business or substantial portion thereof. Since no other assets were acquired, the software is not acquired as part of a purchase of a trade or business and under paragraph (c)(4)(ii) of this section is not a section 197 intangible.

Example 4. Governmental rights of fixed duration. (i) City M operates a municipal water system. In order to induce X to locate a new manufacturing business in the city, M grants X the right to purchase water for 16 years at a specified price.

(ii) The right granted by M is a right to receive tangible property or services described in section 197(e)(4)(B) and paragraph (c)(6) of this section and, thus, is not a section 197 intangible. This exclusion applies even though the right does not qualify for exclusion as a right of fixed duration or amount under section 197(e)(4)(D) and paragraph (c)(13) of this section because the duration exceeds 15 years and the right is not fixed as to amount. It is also immaterial that the right would not qualify for exclusion as a self-created intangible under section 197(c)(2) and paragraph (d)(2) of this section because it is granted by a governmental unit.

Example 5. Separate acquisition of franchise. (i) S is a franchiser of retail outlets for specialty coffees. G enters into a franchise agreement (within the meaning of section 1253(b)(1)) with S pursuant to which G is permitted to acquire and operate a store using the S trademark and trade name at the location specified in the agreement. G agrees to pay S $100,000 upon execution of the agreement and also agrees to pay, throughout the term of the franchise, additional amounts that are deductible under section 1253(d)(1). The agreement contains detailed specifications for the construction and operation of the business, but G is not required to purchase from S any of the materials necessary to construct the improvements at the location specified in the franchise agreement.

(ii) The franchise is a section 197 intangible within the meaning of paragraph (b)(10) of this section. The franchise does not qualify for the exclusion relating to self-created intangibles described in section 197(c)(2) and paragraph (d)(2) of this section because the franchise is described in section 197(d)(1)(F). In addition, because the acquisition of the franchise constitutes the acquisition of an interest in a trade or business or a substantial portion thereof, the franchise may not be excluded under section 197(e)(4). Thus, the franchise is an amortizable section 197 intangible, the basis of which must be recovered over a 15-year period. However, the amounts that are deductible under section 1253(d)(1) are not subject to the provisions of section 197 by reason of section 197(f)(4)(C) and paragraph (b)(10)(ii) of this section.

Example 6. Acquisition and amortization of covenant not to compete. (i) As part of the acquisition of a trade or business from C, B and C enter into an agreement containing a covenant not to compete. Under this agreement, C agrees that it will not compete with the business acquired by B within a prescribed geographical territory for a period of three years after the date on which the business is sold to B. In exchange for this agreement, B agrees to pay C $90,000 per year for each year in the term of the agreement. The agreement further provides that, in the event of a breach by C of his obligations under the agreement, B may terminate the agreement, cease making any of the payments due thereafter, and pursue any other legal or equitable remedies available under applicable law. The amounts payable to C under the agreement are not contingent payments for purposes of §1.1275–4. The present fair market value of B's rights under the agreement is $225,000. The aggregate consideration paid excluding any amount treated as interest or original issue discount under applicable provisions of the Internal Revenue Code, for all assets acquired in the transaction (including the covenant not to compete) exceeds the sum of the amount of Class I assets and the aggregate fair market value of all Class II, Class III, Class IV, Class V, and Class VI assets by $50,000. See §1.338–6(b) for rules for determining the assets in each class.

(ii) Because the covenant is acquired in an applicable asset acquisition (within the meaning of section 1060(c)), paragraph (f)(4)(ii) of this section applies and the basis of B in the covenant is determined pursuant to section 1060(a) and the regulations thereunder. Under §§1.1060–1(c)(2) and 1.338–6(c)(1), B's basis in the covenant cannot exceed its fair market value. Thus, B's basis in the covenant immediately after the acquisition is $225,000. This basis is amortized ratably over the 15-year period beginning on the first day of the month in which the agreement is entered into. All of the remaining consideration after allocation to the convenant and other Class VI assets ($50,000) is allocated to Class VII assets (goodwill and going concern value). See §§1.1060–1(c)(2) and 1.338–6(b).

Example 7. Stand-alone license of technology. (i) X is a manufacturer of consumer goods that does business throughout the world through subsidiary corporations organized under the laws of each country in which business is conducted. X licenses to Y, its subsidiary organized and conducting business in Country K, all of the patents, formulas, designs, and know-how necessary for Y to manufacture the same products that X manufactures in the United States. Assume that the license is not considered a sale or exchange under the principles of section 1235. The license is for a term of 18 years, and there are no facts to indicate that the license does not have a fixed duration. Y agrees to pay X a royalty equal to a specified, fixed percentage of the revenues obtained from selling products manufactured using the licensed technology. Assume that the royalty is reasonable and is not subject to adjustment under section 482. The license is not entered into in connection with any other transaction. Y incurs capitalized costs in connection with entering into the license.

(ii) The license is a contract for the use of a section 197 intangible within the meaning of paragraph (b)(11) of this section. It does not qualify for the exception in section 197(e)(4)(D) and paragraph (c)(13) of this section (relating to rights of fixed duration or amount because it does not have a term of less than 15 years, and the other exceptions in section 197(e) and paragraph (c) of this section are also inapplicable. Accordingly, the license is a section 197 intangible.

(iii) The license is not acquired as part of a purchase of a trade or business. Thus, under paragraph (f)(3)(iii) of this section, the license will be closely scrutinized under the principles of section 1235 for purposes of determining whether the transfer is a sale or exchange and, accordingly, whether the payments under the license are chargeable to capital account. Because the license is not a sale or exchange under the principles of section 1235, the royalty payments are not chargeable to capital account for purposes section 197. The capitalized costs of entering into the license are not within the exception under paragraph (d)(2) of this section for self-created intangibles, and thus are amortized under section 197.

Example 8. License of technology and trademarks.

(i) The facts are the same as in *Example 7*, except that the license also includes the use of the trademarks and trade names that X uses to manufacture and distribute its products in the United States. Assume that under the principles of section 1253 the transfer is not a sale or exchange of the trademarks and trade names or an undivided interest therein and that the royalty payments are described in section 1253(d)(1)(B).

(ii) As in *Example 7*, the license is a section 197 intangible. Although the license conveys an interest in X's trademarks and trade names to Y, the transfer of the interest is disregarded for purposes of paragraph (e)(2) of this section unless the transfer is considered a sale or exchange of the trademarks and trade names or an undivided interest therein. Accordingly, the licensing of the technology and the trademarks and trade names is not treated as part of a purchase of a trade or business under paragraph (e)(2) of this section.

(iii) Because the technology license is not part of the purchase of a trade or business, it is treated in the manner described in *Example 7.* The royalty payments for the use of the trademarks and trade names are deductible under section 1253(d)(1) and, under section 197(f)(4)(C) and paragraph (b)(10)(ii) of this section, are not chargeable to capital account for purposes of section 197. The capitalized costs of entering into the license are treated in the same manner as in example 7.

Example 9. Disguised sale. (i) The facts are the same as in *Example 7*, except that Y agrees to pay X, in addition to the contingent royalty, a fixed minimum royalty immediately upon entering into the agreement and there are sufficient facts present to characterize the transaction, for federal tax purposes, as a transfer of ownership of the intellectual property from X to Y.

(ii) The purported license of technology is, in fact, an acquisition of an intangible described in section 197(d)(1)(C)(iii) and paragraph (b)(5) of this section (relating to know-how, etc.). As in *Example 7*, the exceptions in section 197(e) and paragraph (c) of this section do not apply to the transfer. Accordingly, the transferred property is a section 197 intangible. Y's basis in the transferred intangible includes the capitalized costs of entering into the agreement and the fixed minimum royalty payment payable at the time of the transfer. In addition, except to the extent that a portion of any payment will be treated as interest or original issue discount under applicable provisions of the Internal Revenue Code, all of the contingent payments under the purported license are properly chargeable to capital account for purposes of section 197 and this section. The extent to which such payments are treated as payments of principal and the time at which any amount treated as a payment of principal is taken into account in determining basis are determined under the rules of §1.1275–4(c)(4) or 1.483–4(a), whichever is applicable. Any contingent amount that is included in basis after the month in which the acquisition occurs is amortized under the rules of paragraph (f)(2)(i) or (ii) of this section.

Example 10. License of technology and customer list as part of sale of a trade or business. (i) X is a computer manufacturer that produces, in separate operating divisions, personal computers, servers, and peripheral

equipment. In a transaction that is the purchase of a trade or business for purposes of section 197, Y (who is unrelated to X) purchases from X all assets of the operating division producing personal computers, except for certain patents that are also used in the division manufacturing servers and customer lists that are also used in the division manufacturing peripheral equipment. As part of the transaction, X transfers to Y the right to use the retained patents and customer lists solely in connection with the manufacture and sale of personal computers. The transfer agreement requires annual royalty payments contingent on the use of the patents and also requires a payment for each use of the customer list. In addition, Y incurs capitalized costs in connection with entering into the licenses.

(ii) The rights to use the retained patents and customer lists are contracts for the use of section 197 intangibles within the meaning of paragraph (b)(11) of this section. The rights do not qualify for the exception in 197(e)(4)(D) and paragraph (c)(13) of this section (relating to rights of fixed duration or amount) because they are transferred as part of a purchase of a trade or business and the other exceptions in section 197(e) and paragraph (c) of this section are also inapplicable. Accordingly, the licenses are section 197 intangibles.

(iii) Because the right to use the retained patents is described in paragraph (b)(11) of this section and the right is transferred as part of a purchase of a trade or business, the treatment of the royalty payments is determined under paragraph (f)(3)(ii) of this section. In addition, however, the retained patents are described in paragraph (b)(5) of this section. Thus, the annual royalty payments are chargeable to capital account under the general rule of paragraph (f)(3)(ii)(A) of this section unless Y establishes that the license is not a sale or exchange under the principles of section 1235 and the royalty payments are an arm's length consideration for the rights transferred. If these facts are established, the exception in paragraph (f)(3)(ii)(B) of this section applies and the royalty payments are not chargeable to capital account for purposes of section 197. The capitalized costs of entering into the license are treated in the same manner as in Example 7.

(iv) The right to use the retained customer list is also described in paragraph (b)(11) of this section and is transferred as part of a purchase of a trade or business. Thus, the treatment of the payments for use of the customer list is also determined under paragraph (f)(3)(ii) of this section. The customer list, although described in paragraph (b)(6) of this section, is a customer-related information base. Thus, the exception in paragraph (f)(3)(ii)(B) of this section does not apply. Accordingly, payments for use of the list are chargeable to capital account under the general rule of paragraph (f)(3)(ii)(A) of this section and are amortized under section 197. In addition, the capitalized costs of entering into the contract for use of the customer list are treated in the same manner as in *Example 7*.

Example 11. Loss disallowance rules involving related persons. (i) Assume that X and Y are treated as a single taxpayer for purposes of paragraph (g)(1) of this section. In a single transaction, X and Y acquired from Z all of the assets used by Z in a trade or business. Z had operated this business at two locations, and X and Y each acquired the assets used by Z at one of the locations. Three years after the acquisition, X sold all of the assets it acquired, including amortizable section 197 intangibles, to an unrelated purchaser. The amortizable section intangibles are sold at a loss of $120,000.

(ii) Because X and Y are treated as a single taxpayer for purposes of the loss disallowance rules of section 197(f)(1) and paragraph (g)(1) of this section, X's loss on the sale of the amortizable section 197 intangibles is not recognized. Under paragraph (g)(1)(iv)(B) of this section, X's disallowed loss is allowed ratably, as a deduction under section 197, over the remainder of the 15-year period during which the intangibles would have been amortized, and Y may not increase the basis of the amortizable section 197 intangibles that it acquired from Z by the amount of X's disallowed loss.

Example 12. Disposition of retained intangibles by related person. (i) The facts are the same as in *Example 11*, except that 10 years after the acquisition of the assets by X and Y and 7 years after the sale of the assets by X, Y sells all of the assets acquired from Z, including amortizable section 197 intangibles, to an unrelated purchaser.

(ii) Under paragraph (g)(1)(iv)(B) of this section, X may recognize, on the date of the sale by Y, any loss that has not been allowed as a deduction under section 197. Accordingly, X recognizes a loss of $50,000, the amount obtained by reducing the loss on the sale of the assets at the end of the third year ($120,000) by the amount allowed as a deduction under paragraph (g)(1)(iv)(B) of this section during the 7 years following the sale by X ($70,000).

Example 13. Acquisition of an interest in partnership with no section 754 election. (i) A, B, and C each contribute $1,500 for equal shares in general partnership P. On January 1, 1998, P acquires as its sole asset an amortizable section 197 intangible for $4,500. P still holds the intangible on January 1, 2003, at which time the intangible has an adjusted basis to P of $3,000, and A, B, and C each have an adjusted basis of $1,000 in their partnership interests. D (who is not related to A) acquires A's interest in P for $1,600. No section 754 election is in effect for 2003.

(ii) Because there is no change in the basis of the intangible under section 743(b), D merely steps into the shoes of A with respect to the intangible. D's proportionate share of P's adjusted basis in the intangible is $1,000, which continues to be amortized over the 10 years remaining in the original 15-year amortization period for the intangible.

Example 14. Acquisition of an interest in partnership with a section 754 election. (i) The facts are the same as in *Example 13,* except that a section 754 election is in effect for 2003.

(ii) Pursuant to paragraph (g)(3) of this section, for purposes of section 197, D is treated as if P owns two assets. D's proportionate share of P's adjusted basis in one asset is $1,000, which continues to be amortized over the 10 years remaining in the original 15-year amortization period. For the other asset, D's proportionate share of P's adjusted basis is $600 (the amount of the basis increase under section 743 as a result of the section 754 election), which is amortized over a new 15-year period beginning January 2003. With respect to B and C, P's remaining $2,000 adjusted basis in the intangible continues to be amortized over the 10 years remaining in the original 15-year amortization period.

Example 15. Payment to a retiring partner by partnership with a section 754 election. (i) The facts are the same as in *Example 13,* except that a section 754 election is in effect for 2003 and, instead of D acquiring A's interest in P, A retires from P. A, B, and C are not related to each other within the meaning of paragraph (h)(6) of this section. P borrows $1,600, and A receives a payment under section 736 from P of such amount, all of which is in exchange for A's interest in the intangible asset owned by P. (Assume, for purposes of this example, that the borrowing by P and payment of such funds to A does not give rise to a disguised sale of A's partnership interest under section 707(a)(2)(B).) P makes a positive basis adjustment of $600 with respect to the section 197 intangible under section 734(b).

(ii) Pursuant to paragraph (g)(3) of this section, because of the section 734 adjustment, P is treated as having two amortizable section 197 intangibles, one with a basis of $3,000 and a remaining amortization period of 10 years and the other with a basis of $600 and a new amortization period of 15 years.

Example 16. Termination of partnership under section 708(b)(1)(B). (i) A and B are partners with equal shares in the capital and profits of general partnership P. P's only asset is an amortizable section 197 intangible, which P had acquired on January 1, 1995. On January 1, 2000, the asset had a fair market value of $100 and a basis to P of $50. On that date, A sells his entire partnership interest in P to C, who is unrelated to A, for $50. At the time of the sale, the basis of each of A and B in their respective partnership interests is $25.

(ii) The sale causes a termination of P under section 708(b)(1)(B). Under section 708, the transaction is treated as if P transfers its sole asset to a new partnership in exchange for the assumption of its liabilities and the receipt of all of the interests in the new partnership. Immediately thereafter, P is treated as if it is liquidated, with B and C each receiving their proportionate share of the interests in the new partnership. The contribution by P of its asset to the new partnership is governed by section 721, and the liquidating distributions by P of the interests in the new partnership are governed by section 731. C does not realize a basis adjustment under section 743 with respect to the amortizable section 197 intangible unless P had a section 754 election in effect for its taxable year in which the transfer of the partnership interest to C occurred or the taxable year in which the deemed liquidation of P occurred.

(iii) Under section 197, if P had a section 754 election in effect, C is treated as if the new partnership had acquired two assets from P immediately preceding its termination. Even though the adjusted basis of the new partnership in the two assets is determined solely under section 723, because the transfer of assets is a transaction described in section 721, the application of sections 743(b) and 754 to P immediately before its termination causes P to be treated as if it held two assets for purposes of section 197. See paragraph (g)(3) of this section. B's and C's proportionate share of the new partnership's adjusted basis is $25 each in one asset, which continues to be amortized over the 10 years remaining in the original 15-year amortization period. For the other asset, C's proportionate share of the new partnership's adjusted basis is $25 (the amount of the basis increase resulting from the application of section 743 to the sale or exchange by A of the interest in P), which is amortized over a new 15-year period beginning in January 2000.

(iv) If P did not have a section 754 election in effect for its taxable year in which the sale of the partnership interest by A to C occurred or the taxable year in which the deemed liquidation of P occurred, the adjusted basis of the new partnership in the amortizable section 197 intangible is determined solely under section 723, because the transfer is a transaction described in section 721, and P does not have a basis increase in the intangible. Under section 197(f)(2) and paragraph (g)(2)(ii) of this section, the new partnership continues to amortize the intangible over the 10 years remaining in the original 15-year amortization period. No additional amortization is allowable with respect to this asset.

Example 17. Disguised sale to partnership. (i) E and F are individuals who are unrelated to each other within the meaning of paragraph

(h)(6) of this section. E has been engaged in the active conduct of a trade or business as a sole proprietor since 1990. E and F form EF Partnership. E transfers all of the assets of the business, having a fair market value of $100, to EF, and F transfers $40 of cash to EF. E receives a 60 percent interest in EF and the $40 of cash contributed by F, and F receives a 40 percent interest in EF, under circumstances in which the transfer by E is partially treated as a sale of property to EF under §1.707–3(b).

(ii) Under §1.707–3(a)(1), the transaction is treated as if E had sold to EF a 40 percent interest in each asset for $40 and contributed the remaining 60 percent interest in each asset to EF in exchange solely for an interest in EF. Because E and EF are related persons within the meaning of paragraph (h)(6) of this section, no portion of any transferred section 197(f)(9) intangible that E held during the transition period (as defined in paragraph (h)(4) of this section) is an amortizable section 197 intangible pursuant to paragraph (h)(2) of this section. Section 197(f)(9)(F) and paragraph (g)(3) of this section do not apply to any portion of the section 197 intangible in the hands of EF because the basis of EF in these assets was not increased under any of sections 732, 734, or 743.

Example 18. Acquisition by related person in nonrecognition transaction. (i) A owns a nonamortizable intangible that A acquired in 1990. In 2000, A sells a one-half interest in the intangible to B for cash. Immediately after the sale, A and B, who are unrelated to each other, form partnership P as equal partners. A and B each contribute their one-half interest in the intangible to P.

(ii) P has a transferred basis in the intangible from A and B under section 723. The nonrecognition transfer rule under paragraph (g)(2)(ii) of this section applies to A's transfer of its one-half interest in the intangible to P, and consequently P steps into A's shoes with respect to A's nonamortizable transferred basis. The anti-churning rules of paragraph (h) of this section apply to B's transfer of its one-half interest in the intangible to P, because A, who is related to P under paragraph (h)(6) of this section immediately after the series of transactions in which the intangible was acquired by P, held B's one-half interest in the intangible during the transition period. Pursuant to paragraph (h)(10) of this section, these rules apply to B's transfer of its one-half interest to P even though the nonrecognition transfer rule under paragraph (g)(2)(ii) of this section would have permitted P to step into B's shoes with respect to B's otherwise amortizable basis. Therefore, P's entire basis in the intangible is nonamortizable. However, if A (not B) elects to recognize gain under paragraph (h)(9) of this section on the transfer of each of the one-half interests in the intangible to B and P, then the intangible would be amortizable by P to the extent provided in section 197(f)(9)(B) and paragraph (h)(9) of this section.

Example 19. Acquisition of partnership interest following formation of partnership. (i) The facts are the same as in *Example 18* except that, in 2000, A formed P with an affiliate, S, and contributed the intangible to the partnership and except that in a subsequent year, in a transaction that is properly characterized as a sale of a partnership interest for Federal tax purposes, B purchases a 50 percent interest in P from A. P has a section 754 election in effect and holds no assets other than the intangible and cash.

(ii) For the reasons set forth in *Example 16* (iii), B is treated as if P owns two assets. B's proportionate share of P's adjusted basis in one asset is the same as A's proportionate share of P's adjusted basis in that asset, which is not amortizable under section 197. For the other asset, B's proportionate share of the remaining adjusted basis of P is amortized over a new 15-year period.

Example 20. Acquisition by related corporation in nonrecognition transaction. (i) The facts are the same as *Example 18*, except that A and B form corporation P as equal owners.

(ii) P has a transferred basis in the intangible from A and B under section 362. Pursuant to paragraph (h)(10) of this section, the application of the nonrecognition transfer rule under paragraph (g)(2)(ii) of this section and the anti-churning rules of paragraph (h) of this section to the facts of this *Example 18* is the same as in *Example 16*. Thus, P's entire basis in the intangible is nonamortizable.

Example 21. Acquisition from corporation related to purchaser through remote indirect interest. (i) X, Y, and Z are each corporations that have only one class of issued and outstanding stock. X owns 25 percent of the stock of Y and Y owns 25 percent of the outstanding stock of Z. No other shareholder of any of these corporations is related to any other shareholder or to any of the corporations. On June 30, 2000, X purchases from Z section 197(f)(9) intangibles that Z owned during the transition period (as defined in paragraph (h)(4) of this section).

(ii) Pursuant to paragraph (h)(6)(iv)(B) of this section, the beneficial ownership interest of X in Z is 6.25 percent, determined by treating X as if it owned a proportionate (25 percent) interest in the stock of Z that is actually owned by Y. Thus, even though X is related to Y and Y is related to Z, X and Z are not considered to be related for purposes of the anti-churning rules of section 197.

Example 22. Gain recognition election. (i) B owns 25 percent of the stock of S, a corporation that uses the calendar year as its taxable year. No other shareholder of B or S is related to each other. S is not a member of a controlled group of corporations within the meaning of section 1563(a). S has section 197(f)(9) intangibles that it owned during the

transition period. S has a basis of $25,000 in the intangibles. In 2001, S sells these intangibles to B for $75,000. S recognizes a gain of $50,000 on the sale and has no other items of income, deduction, gain, or loss for the year, except that S also has a net operating loss of $20,000 from prior years that it would otherwise be entitled to use in 2001 pursuant to section 172(b). S makes a valid gain recognition election pursuant to section 197(f)(9)(B) and paragraph (h)(9) of this section. In 2001, the highest marginal tax rate applicable to S is 35 percent. But for the election, all of S's taxable income would be taxed at a rate of 15 percent.

(ii) If the gain recognition election had not been made, S would have taxable income of $30,000 for 2001 and a tax liability of $4,500. If the gain were not taken into account, S would have no tax liability for the taxable year. Thus, the amount of tax (other than the tax imposed under paragraph (h)(9) of this section) imposed on the gain is also $4,500. The gain on the disposition multiplied by the highest marginal tax rate is $17,500 ($50,000 × .35). Accordingly, S's tax liability for the year is $4,500 plus an additional tax under paragraph (h)(9) of this section of $13,000 ($17,500—$4,500).

(iii) Pursuant to paragraph (h)(9)(x)(A) of this section, S determines the amount of its net operating loss deduction in subsequent years without regard to the gain recognized on the sale of the section 197 intangible to B. Accordingly, the entire $20,000 net operating loss deduction that would have been available in 2001 but for the gain recognition election may be used in 2002, subject to the limitations of section 172.

(iv) B has a basis of $75,000 in the section 197(f)(9) intangibles acquired from S. As the result of the gain recognition election by S, B may amortize $50,000 of its basis under section 197. Under paragraph (h)(9)(ii) of this section, the remaining basis does not qualify for the gain-recognition exception and may not be amortized by B.

Example 23. Section 338 election. (i) Corporation P makes a qualified stock purchase of the stock of T corporation from two shareholders in July 2000, and a section 338 election is made by P. No shareholder of either T or P owns stock in both of these corporations, and no other shareholder is related to any other shareholder of either corporation.

(ii) Pursuant to paragraph (h)(8) of this section, in the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Because there are no relationships described in paragraph (h)(6) of this section among the parties to the transaction, any nonamortizable section 197(f)(9) intangible held by old target is an amortizable section 197 intangible in the hands of new target.

(iii) Assume the same facts as set forth in paragraph (i) of this *Example 23,* except that one of the selling shareholders is an individual who owns 25 percent of the total value of the stock of each of the T and P corporation.

(iv) Old target and new target (as these terms are defined in §1.338–2(c)(17)) are members of a controlled group of corporations under section 267(b)(3), as modified by section 197(f)(9)(C)(i), and any nonamortizable section 197(f)(9) intangible held by old target is not an amortizable section 197 intangible in the hands of new target. However, a gain recognition election under paragraph (h)(9) of this section may be made with respect to this transaction.

Example 24. Relationship created as part of public offering. (i) On January 1, 2001, Corporation X engages in a series of related transactions to discontinue its involvement in one line of business. X forms a new corporation, Y, with a nominal amount of cash. Shortly thereafter, X transfers all the stock of its subsidiary conducting the unwanted business (Target) to Y in exchange for 100 shares of Y common stock and a Y promissory note. Target owns a nonamortizable section 197(f)(9) intangible. Prior to January 1, 2001, X and an underwriter (U) had entered into a binding agreement pursuant to which U would purchase 85 shares of Y common stock from X and then sell those shares in a public offering. On January 6, 2001, the public offering closes. X and Y make a section 338(h)(10) election for Target.

(ii) Pursuant to paragraph (h)(8) of this section, in the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Further, for purposes of determining whether the nonamortizable section 197(f)(9) intangible is acquired by new target from a related person, because the transactions are a series of related transactions, the relationship between old target and new target must be tested immediately before the first transaction in the series (the formation of Y) and immediately after the last transaction in the series (the sale to U and the public offering). See paragraph (h)(6)(ii)(B) of this section. Because there was no relationship between old target and new target immediately before the formation of Y (because the section 338 election had not been made) and only a 15% relationship between old target and new target immediately after, old target is not

related to new target for purposes of applying the anti-churning rules of paragraph (h) of this section. Accordingly, Target may amortize the section 197 intangible.

Example 25. Other transfers to controlled corporations. (i) In 2001, Corporation A transfers a section 197(f)(9) intangible that it held during the transition period to X, a newly formed corporation, in exchange for 15% of X's stock. As part of the same transaction, B transfers property to X in exchange for the remaining 85% of X stock.

(ii) Because the acquisition of the intangible by X is part of a qualifying section 351 exchange, under section 197(f)(2) and paragraph (g)(2)(ii) of this section, X is treated in the same manner as the transferor of the asset. Accordingly, X may not amortize the intangible. If, however, at the time of the exchange, B has a binding commitment to sell 25 percent of the X stock to C, an unrelated third party, the exchange, including A's transfer of the section 197(f)(9) intangible, would fail to qualify as a section 351 exchange. Because the formation of X, the transfers of property to X, and the sale of X stock by B are part of a series of related transactions, the relationship between A and X must be tested immediately before the first transaction in the series (the transfer of property to X) and immediately after the last transaction in the series (the sale of X stock to C). See paragraph (h)(6)(ii)(B) of this section. Because there was no relationship between A and X immediately before and only a 15% relationship immediately after, A is not related to X for purposes of applying the anti-churning rules of paragraph (h) of this section. Accordingly, X may amortize the section 197 intangible.

Example 26. Relationship created as part of stock acquisition followed by liquidation. (i) In 2001, Partnership P purchases 100 percent of the stock of Corporation X. P and X were not related prior to the acquisition. Immediately after acquiring the X stock, and as part of a series of related transactions, P liquidates X under section 331. In the liquidating distribution, P receives a section 197(f)(9) intangible that was held by X during the transition period.

(ii) Because the relationship between P and X was created pursuant to a series of related transactions where P acquires stock (meeting the requirements of section 1504(a)(2)) in a fully taxable transaction followed by a liquidation under section 331, the relationship immediately after the last transaction in the series (the liquidation) is disregarded. See paragraph (h)(6)(iii) of this section. Accordingly, P is entitled to amortize the section 197(f)(9) intangible.

Example 27. Section 743(b) adjustment with no change in user. (i) On January 1, 2001, A forms a partnership (PRS) with B in which A owns a 40-percent, and B owns a 60-percent, interest in profits and capital. A contributes a nonamortizable section 197(f)(9) intangible with a value of $80 and an adjusted basis of $0 to PRS in exchange for its PRS interest and B contributes $120 cash. At the time of the contribution, PRS licenses the section 197(f)(9) intangible to A. On February 1, 2001, A sells its entire interest in PRS to C, an unrelated person, for $80. PRS has a section 754 election in effect.

(ii) The section 197(f)(9) intangible contributed to PRS by A is not amortizable in the hands of PRS. Pursuant to section (g)(2)(ii) of this section, PRS steps into the shoes of A with respect to A's nonamortizable transferred basis in the intangible.

(iii) When A sells the PRS interest to C, C will have a basis adjustment in the PRS assets under section 743(b) equal to $80. The entire basis adjustment will be allocated to the intangible because the only other asset held by PRS is cash. Ordinarily, under paragraph (h)(12)(v) of this section, the anti-churning rules will not apply to an increase in the basis of partnership property under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest. However, A is an anti-churning partner under paragraph (h)(12)(vi)(B)(*2*)(*i*) of this section. As a result of the license agreement, A remains a direct user of the section 197(f)(9) intangible after the transfer to C. Accordingly, paragraph (h)(12)(vi)(A) of this section will cause the anti-churning rules to apply to the entire basis adjustment under section 743(b).

Example 28. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest prior to the effective date. (i) In 1990, A, B, and C each contribute $150 cash to form general partnership ABC for the purpose of engaging in a consulting business and a software manufacturing business. The partners agree to share partnership profits and losses equally. In 2000, the partnership distributes the consulting business to A in liquidation of A's entire interest in ABC. The only asset of the consulting business is a nonamortizable intangible, which has a fair market value of $180 and a basis of $0. At the time of the distribution, the adjusted basis of A's interest in ABC is $150. A is not related to B or C. ABC does not have a section 754 election in effect.

(ii) Under section 732(b), A's adjusted basis in the intangible distributed by ABC is $150, a $150 increase over the basis of the intangible in ABC's hands. In determining whether the anti-churning rules apply to any portion of the basis increase, A is treated as having owned and used A's proportionate share of partnership property. Thus, A is treated as holding an interest in the intangible during the transition period. Because the intangible was not amortizable prior to the enactment of section 197, the section 732(b) increase in the basis of the intangible

may be subject to the anti-churning provisions. Paragraph (h)(12)(ii) of this section provides that the anti-churning provisions apply to the extent that the section 732(b) adjustment exceeds the total unrealized appreciation from the intangible allocable to partners other than A or persons related to A, as well as certain other partners whose purchase of their interests meet certain criteria. Because B and C are not related to A, and A's acquisition of its partnership interest does not satisfy the necessary criteria, the section 732(b) basis increase is subject to the anti-churning provisions to the extent that it exceeds B and C's proportionate share of the unrealized appreciation from the intangible. B and C's proportionate share of the unrealized appreciation from the intangible is $120 (2/3 of $180). This is the amount of gain that would be allocated to B and C if the partnership sold the intangible immediately before the distribution for its fair market value of $180. Therefore, $120 of the section 732(b) basis increase is not subject to the anti-churning rules. The remaining $30 of the section 732(b) basis increase is subject to the anti-churning rules. Accordingly, A is treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $120 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $30.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-third of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 − $120 = $60), over the fair market value of the distributed intangible ($180).

Example 29. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest after the effective date. (i) The facts are the same as in *Example 28*, except that B and C form ABC in 1990. A does not acquire an interest in ABC until 1995. In 1995, A contributes $150 to ABC in exchange for a one-third interest in ABC. At the time of the distribution, the adjusted basis of A's interest in ABC is $150.

(ii) As in *Example 28*, the anti-churning rules do not apply to the increase in the basis of the intangible distributed to A under section 732(b) to the extent that it does not exceed the unrealized appreciation from the intangible allocable to B and C. Under paragraph (h)(12)(ii) of this section, the anti-churning provisions also do not apply to the section 732(b) basis increase to the extent of A's allocable share of the unrealized appreciation from the intangible because A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by the partnership before A acquired the ABC interest. Under paragraph (h)(12)(ii)(E) of this section, A is deemed to acquire the ABC partnership interest from an unrelated person because A acquired the ABC partnership interest in exchange for a contribution to the partnership of property other than the distributed intangible and, at the time of the contribution, no partner in the partnership was related to A. Consequently, the increase in the basis of the intangible under section 732(b) is not subject to the anti-churning rules to the extent of the total unrealized appreciation from the intangible allocable to A, B, and C. The total unrealized appreciation from the intangible allocable to A, B, and C is $180 (the gain the partnership would have recognized if it had sold the intangible for its fair market value immediately before the distribution). Because this amount exceeds the section 732(b) basis increase of $150, the entire section 732(b) basis increase is amortizable.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-sixth of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 − $150 = $30), over the fair market value of the distributed intangible ($180).

Example 30. Distribution of section 197(f)(9) intangible contributed to the partnership by a partner. (i) The facts are the same as in *Example 29*, except that C purchased the intangible used in the consulting business in 1988 for $60 and contributed the intangible to ABC in 1990. At that time, the intangible had a fair market value of $150 and an adjusted tax basis of $60. When ABC distributes the intangible to A in 2000, the intangible has a fair market value of $180 and a basis of $60.

(ii) As in *Examples 28* and *29*, the adjusted basis of the intangible in A's hands is $150 under section 732(b). However, the increase in the adjusted basis of the intangible under section 732(b) is only $90 ($150 adjusted basis after the distribution compared to $60 basis before the distribution). Pursuant to paragraph (g)(2)(ii)(B) of this section, A steps into the shoes of ABC with respect to the $60 of A's adjusted basis in the intangible that corresponds to ABC's basis in the intangible

and this portion of the basis is nonamortizable. B and C are not related to A, A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by ABC before A acquired the ABC interest. Therefore, under paragraph (h)(12)(ii) of this section, the section 732(b) basis increase is amortizable to the extent of A, B, and C's allocable share of the unrealized appreciation from the intangible. The total unrealized appreciation from the intangible that is allocable to A, B, and C is $120. If ABC had sold the intangible immediately before the distribution to A for its fair market value of $180, it would have recognized gain of $120, which would have been allocated $10 to A, $10 to B, and $100 to C under section 704(c). Because A, B, and C's allocable share of the unrealized appreciation from the intangible exceeds the section 732(b) basis increase in the intangible, the entire $90 of basis increase is amortizable by A. Accordingly, after the distribution, A will be treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $90 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $60.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-half of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($60) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($120 − $90 = $30), over the fair market value of the distributed intangible ($180).

Example 31. Partnership distribution causing section 734(b) basis adjustment to section 197(f)(9) intangible. (i) On January 1, 2001, A, B, and C form a partnership (ABC) in which each partner shares equally in capital and income, gain, loss, and deductions. On that date, A contributes a section 197(f)(9) intangible with a zero basis and a value of $150, and B and C each contribute $150 cash. A and B are related, but neither A nor B is related to C. ABC does not adopt the remedial allocation method for making section 704(c) allocations of amortization expenses with respect to the intangible. On December 1, 2004, when the value of the intangible has increased to $600, ABC distributes $300 to B in complete redemption of B's interest in the partnership. ABC has an election under section 754 in effect for the taxable year that includes December 1, 2004. (Assume that, at the time of the distribution, the basis of A's partnership interest remains zero, and the basis of each of B's and C's partnership interest remains $150.)

(ii) Immediately prior to the distribution, the assets of the partnership are revalued pursuant to §1.704–1(b)(2)(iv)(*f*), so that the section 197(f)(9) intangible is reflected on the books of the partnership at a value of $600. B recognizes $150 of gain under section 731(a)(1) upon the distribution of $300 in redemption of B's partnership interest. As a result, the adjusted basis of the intangible held by ABC increases by $150 under section 734(b). A does not satisfy any of the tests set forth under paragraph (h)(12)(iv)(B) and thus is not an eligible partner. C is not related to B and thus is an eligible partner under paragraph (h)(12)(iv)(B)(*1*) of this section. The capital accounts of A and C are equal immediately after the distribution, so, pursuant to paragraph (h)(12)(iv)(D)(*1*) of this section, each partner's share of the basis increase is equal to $75. Because A is not an eligible partner, the anti-churning rules apply to A's share of the basis increase. The anti-churning rules do not apply to C's share of the basis increase.

(iii) For book purposes, ABC determines the amortization of the asset as follows: First, the intangible that is subject to adjustment under section 734(b) will be divided into three assets: the first, with a basis and value of $75 will be amortizable for both book and tax purposes; the second, with a basis and value of $75 will be amortizable for book, but not tax purposes; and a third asset with a basis of zero and a value of $450 will not be amortizable for book or tax purposes. Any subsequent revaluation of the intangible pursuant to §1.704–1(b)(2)(iv)(*f*) will be made solely with respect to the third asset (which is not amortizable for book purposes). The book and tax attributes from the first asset (*i.e.*, book and tax amortization) will be specially allocated to C. The book and tax attributes from the second asset (*i.e.*, book amortization and non-amortizable tax basis) will be specially allocated to A. Upon disposition of the intangible, each partner's share of gain or loss will be determined first by allocating among the partners an amount realized equal to the book value of the intangible attributable to such partner, with any remaining amount realized being allocated in accordance with the partnership agreement. Each partner then will compare its share of the amount realized with its remaining basis in the intangible to arrive at the gain or loss to be allocated to such partner. This is a reasonable method for amortizing the intangible for book purposes, and the results in allocating the income, gain, loss, and deductions attributable to the intangible do not contravene the purposes of the anti-churning rules under section 197 or paragraph (h) of this section.

(l) *Effective dates*—(1) *In general.* This section applies to property acquired after January 25, 2000, except that paragraph (c)(13) of this section (exception from section 197 for separately acquired rights of fixed duration or amount) applies to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T), and paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section (anti-churning rules applicable to partnerships) apply to partnership transactions occurring on or after November 20, 2000.

(2) *Application to pre-effective date acquisitions.* A taxpayer may choose, on a transaction-by-transaction basis, to apply the provisions of this section and §1.167(a)–14 to property acquired (or partnership transactions occurring) after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and—

(i) On or before January 25, 2000; or

(ii) With respect to paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section, before November 20, 2000.

(3) *Application of regulation project REG–209709–94 to pre-effective date acquisitions.* A taxpayer may rely on the provisions of regulation project REG–209709–94 (1997–1 C.B. 731) for property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and on or before January 25, 2000.

(4) *Change in method of accounting*—(i) *In general.* For the first taxable year ending after January 25, 2000, a taxpayer that has acquired property to which the exception in §1.197–2(c)(13) applies is granted consent of the Commissioner to change its method of accounting for such property to comply with the provisions of this section and §1.167(a)–14 unless the proper treatment of such property is an issue under consideration (within the meaning of Rev. Proc. 97–27 (1997–21 IRB 10)(see §601.601(d)(2) of this chapter)) in an examination, before an Appeals office, or before a Federal court.

(ii) *Application to pre-effective date acquisitions.* For the first taxable year ending after January 25, 2000, a taxpayer is granted consent of the Commissioner to change its method of accounting for all property acquired in transactions described in paragraph (l)(2) of this section to comply with the provisions of this section and §1.167(a)–14 unless the proper treatment of any such property is an issue under consideration (within the meaning of Rev. Proc. 97–27 (1997–21 IRB 10)(see §601.601(d)(2) of this chapter)) in an examination, before an Appeals office, or before a Federal court.

(iii) *Automatic change procedures.* A taxpayer changing its method of accounting in accordance with this paragraph (l)(4) must follow the automatic change in accounting method provisions of Rev. Proc. 99–49 (1999–52 IRB 725)(see §601.601(d)(2) of this chapter) except, for purposes of this paragraph (l)(4), the scope limitations in section 4.02 of Rev. Proc. 99–49 (1999–52 IRB 725) are not applicable. However, if the taxpayer is under examination, before an appeals office, or before a Federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the National Office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

[T.D. 8865, 65 FR 3827, Jan. 25, 2000; 65 FR 16318, Mar. 28, 2000; 65 FR 60585, Oct. 12, 2000, as amended by T.D. 8907, 65 FR 69671, Nov. 20, 2000; T.D. 8940, 66 FR 9929, Feb. 13, 2001; 66 FR 17363, Mar. 30, 2001; 67 FR 22286, May 3, 2002]

ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

§1.211–1 Allowance of deductions.

In computing taxable income under section 63(a), the deductions provided by sections 212, 213, 214, 215, 216, and 217 shall be allowed subject to the exceptions provided in Part IX, Subchapter B, Chapter 1 of the Code (section 261 and following, relating to items not deductible).

[T.D. 6796, 30 FR 1037, Feb. 2, 1965]

§1.212–1 Nontrade or nonbusiness expenses.

(a) An expense may be deducted under section 212 only if: