IRS grants consent to taxpayer to change its asset method for apportioning interest expense pursuant to Section 861 regulations

Executive summary

On 30 January 2015, the Internal Revenue Service (the Service) issued Private Letter Ruling (PLR) 201505036 consenting to a taxpayer’s request to change from the fair market value method to the tax book value method of asset valuation for purposes of apportioning interest expense under Section 861 for subsidiaries of an acquired corporation that previously used the fair market value method.

Background

Section 864(e) provides that all allocations and apportionments of interest expense shall be made on the basis of assets rather than gross income. Treas. Reg. Sections 1.861-8 through 1.861-12 and Temp. Reg. Sections 1.861-8T through 1.861-13T set forth the rules specific to the allocation and apportionment of interest expense. Temp. Reg. Section 1.861-9T(g)(1Xii) provides that the apportionment must be made on the basis of either the tax book value, or the fair market value of the assets. Temp. Reg. Section 1.861-8T(c)(2) provides that if the taxpayer uses the fair market value method, the taxpayer must continue to use that method unless the Commissioner grants consent to a change.
Detailed discussion

Corp X is a domestic corporation that is the common parent of an affiliated group of corporations that file a consolidated federal income tax return on a calendar year basis. Corp X had used the tax book value method of asset valuation for purposes of apportioning its interest expense for more than 10 years prior to Date 1. Corp Y is the common parent of a US consolidated group of corporations that for more than five years prior to Date 1 used the fair market value method of asset valuation.

On Date 1, Corp X merged with Corp Y, and the subsidiaries of Corp Y were included in Corp X's consolidated federal income tax return starting from the day after Date 1.

The Service granted consent for Corp Y's subsidiaries to change from the fair market value method to the tax book value method of asset valuation for the purposes of apportioning interest expense for all operative sections of the Internal Revenue Code, starting from the time that the Corp Y subsidiaries became part of the consolidated group of Corp X, and for all subsequent taxable years.

Implications

This PLR signals the Service's continued consent to granting taxpayers the right to change their asset method for purposes of interest expense allocation and apportionment as a result of an acquisition, where one party uses the fair market value method and the other does not. The Service may consent to a change from the fair market value method in other circumstance but, based on experience, taxpayers will need to provide some justification for such a request.

It should be noted that, while Temp. Reg. Section 1.861-8T(c)(2) requires taxpayers using the fair market value method to obtain consent from the Commissioner to change to either the tax book value method or the alternative tax book value method; Treas. Reg. Section 1.861-9(i)(1), by contrast, permits taxpayers using the alternative tax book value method to change to the fair market value method without consent at any time, or to the tax book value method without consent, unless the request is for a taxable year prior to the sixth taxable year for which the alternative tax book value method has been used. Where consent of the Commissioner is necessary, such consent must be received before the tax return is due for the year of the change, and is typically granted three to four months after the submission of the request.

Endnotes

1. See PLR 200307002 where the Service granted consent with facts virtually identical to this one. See also PLR 201423001 where the facts were substantially similar except the acquirer had used the alternative tax book value method since 2012; and PLR 200112056 where the taxpayer requested to change to the tax book value method used by the acquired corporation.
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