OFFICE OF
CHIEF COUNSEL

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

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

SUBJECT: Disallowed losses for abandoned "supervisory goodwill"

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

LEGEND

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

Year 5 =

ISSUES

1. Whether Corporation's "supervisory goodwill" qualifies as "money or other property" for purposes of I.R.C. § 597.

2. Whether Corporation properly claimed losses under I.R.C. § 165 for amounts attributable to supervisory goodwill.

CONCLUSIONS

1. Supervisory goodwill is not financial assistance received from the Federal Savings and Loan Insurance Corporation under § 406(f) of the National Housing Act (12 U.S.C. § 1729(f)), accordingly, it does not qualify as money or other property for purposes of section 597 of the Code.

2. Corporation cannot deduct losses under section 165 of the Code for amounts attributable to supervisory goodwill.

FACTS

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

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

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

On August 9, 1989, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), which phased out, over a five year period, the ability to count supervisory goodwill for the purpose of meeting regulatory capital reserve requirements. Some financial institutions sued the United States asserting, among other things, that the government had breached its contractual promise to allow the thrifts to count goodwill toward regulatory capital reserve requirements. According to the information provided, Corporation was one of these thrifts. In United States v. Winstar, 518 U.S. 839 (1996), the Supreme Court held that the plaintiff financial institutions, indeed, had an enforceable contract with the Government and that the Government breached that contract as a result of the enactment of FIRREA.

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

## LAW AND ANALYSIS

### A. Supervisory Goodwill is Not Money or Other Property within the Meaning of Section 597

#### 1. Section 597

At the time Subsidiary acquired Subsidiary A and Subsidiary B, section 597(a) of the Internal Revenue Code of 1954 provided that the gross income of a domestic building and loan association did not include any amount of money or other property received from the FSLIC pursuant to section 406(f) of the National Housing Act (12 U.S.C. § 1729(f)), regardless of whether any note or other instrument was issued in exchange. Further, section 597(b) of the Code provided that such payments would not reduce the basis of the recipient's assets. Although section 597 referred to assistance provided under § 406(f) of the National Housing Act, it appears to contemplate that such assistance would be of a financial nature.

Section 597 was added to the Code effective January 1, 1981. This section was intended to resolve the question of whether financial assistance from the FSLIC was either includible in income because of a quid pro quo, or whether the assistance was a non-shareholder contribution to capital within the meaning of United States v. Chicago, B&Q RR. Co., 412 U.S. 401 (1973), and would have a zero basis itself under section 362(c) or reduce the basis of other property owned by the taxpayer. H.R. Conf. Rep. No. 97-215, 97th Cong., 1st Sess. 284 (1981).

Section 597 applied solely to assistance furnished by the FSLIC. Moreover, it applied solely to financial assistance authorized by section 406(f) of the National Housing Act (12 U.S.C. § 1729(f)). The legislative history underscores the application of section 597 solely to financial assistance. Specifically, the Conference Report states:

> The bill excludes from income of a building and loan association all money or property contributed to the thrift institution by the Federal Savings and Loan Insurance Corporation under its financial assistance program without reduction in basis of property. The amendment applies to assistance payments whether or not the association issues either a debt or equity instrument in exchange therefore.

H.R. Conf. Rep. No. 97-215, 97th Cong., 1st Sess. 284 (1981).

Similarly, in the House of Representative's Ways and Means Committee report accompanying FIRREA, the report describes prior law as providing:

> Payments from the Federal Savings and Loan Insurance Corporation . . . to a financially troubled financial institution are not included in the income of the recipient institution and such institutions need not reduce their basis in property by the amount of such financial assistance. . . . (Code sec. 597).

H.R. Rep. No. 101-54, 101st Cong., 1st Sess., pt. 2, at 24 (1989).

2. The FSLIC and the National Housing Act § 406(f)

The FSLIC was created pursuant to Title 12 U.S.C. § 1725. The statute referred to formation and operation of the FSLIC under the direction of the FHLBB for the purpose of providing insurance for savings and loan accounts. In addition to providing deposit insurance, the FSLIC was authorized to provide assistance from its assets to insolvent savings associations. This assistance included capital contributions, deposits, asset purchases, assumption of liabilities and loans. National Housing Act § 406(f), 12 U.S.C. § 1729(f) (1982). The FSLIC was abolished by FIRREA, and its functions were transferred to the Federal Deposit Insurance Corporation and the Resolution Trust Corporation.

3. The Savings and Loan Crisis and the Winstar litigation

As discussed more fully in United States v. Winstar Corp., 518 U.S. 839 (1996), during the years in issue, the savings and loan industry was in crisis, and the FSLIC lacked the funds necessary to liquidate all of the failing thrifts. Accordingly, the FSLIC arranged mergers between healthy thrifts and failing thrifts. As an inducement for these mergers, the FSLIC allowed the acquiring thrifts to count supervisory goodwill toward regulatory capital reserve requirements set forth in 12 C.F.R. § 563.13 and to amortize the goodwill over as much as 40 years. In 1989, Congress enacted FIRREA which impacted a thrift's ability to count supervisory goodwill towards satisfaction of its capital reserve requirements. After many lower court battles, the issue finally reached the Supreme Court in Winstar. In that case, the Court held that the thrifts had an enforceable contract with the FHLBB and the FSLIC and that the Government breached that contract as a result of the enactment of FIRREA.

4. Analysis

In 1981 section 597(a) of the Code applied solely to financial assistance authorized by section 406(f) of the National Housing Act. The supervisory goodwill at issue here does not rise to the level of FSLIC financial assistance. Supervisory goodwill is not listed in section 406(f) of the National Housing Act. Furthermore, it does not resemble any type of financial assistance listed in section 406(f), e.g. capital contributions, deposits, asset purchases, assumption of liabilities and loans. The types of transactions listed in section 406(f) imply that something of value, either cash or an asset, changes hands between the FSLIC and the acquiring thrift. With respect to supervisory goodwill, no money or assets are received by the thrift from the FSLIC.

Rather, the concept of supervisory goodwill was merely part of an accounting regime designed to induce healthy thrifts to acquire failing thrifts. See Winstar, 518 U.S. at 849-56. Indeed, the Court acknowledged that because the FSLIC had insufficient funds to make up the difference between a failed thrift's liabilities and assets, the Bank Board had to offer a "cash substitute" to induce a healthy thrift to assume a failed thrift's obligations. Winstar, 518 U.S. at 849-50.

The Congressional Record accompanying FIRREA further underscores the conclusion that supervisory goodwill was only an accounting gimmick, rather than actual financial assistance. In 1989, Representative Kleczka remarked:

> Goodwill is not cash. It is a concept, and a shadowy one at that. When the Federal Government liquidates a failed thrift, goodwill is simply no good. It is valueless."

135 Cong. Rec. 11795 (1989).

Given the above, we conclude that supervisory goodwill does not qualify as money or other property for purposes of section 597.

**B. Corporation Cannot Deduct Losses under Section 165 for Amounts Attributable to Supervisory Goodwill**

1. Section 165

Corporation claims a loss for supervisory goodwill under section 165(a). Section 165 allows as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. Only a bona fide loss is allowable. Treas. Reg. § 1.165-1(b). Substance and not mere form shall govern in determining a deductible loss. Id.

The requirements for an abandonment loss are found in the regulations under section 165. Specifically, Treas. Reg. § 1.165-2(a) allows a loss incurred in a business and arising from the sudden termination of the usefulness of any nondepreciable property, in a case where the business is discontinued or where the property is permanently discarded from use therein, as a deduction under section 165(a) for the taxable year in which the loss is actually sustained.

Treas. Reg. §1.165-1(b) requires that, to be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, and fixed by identifiable events. See United States v. S.S. White Dental Manufacturing Co., 274 U.S. 398, 401 (1927). Normally, an abandonment loss requires (1) an intention on the part of the owner to abandon the asset, and (2) an affirmative act of abandonment. A.J. Industries, Inc. v. United States, 503 F.2d 660, 670 ($9^{th}$ Cir. 1974); Citron, 97 T.C. at 209; CRST, Inc. v. Commissioner, 92 T.C. 1249, 1257 (1989), aff'd, 909 F.2d 1146 ($8^{th}$ Cir. 1990).

2. Basis

Under Treas. Reg. § 1.165-1(c)(1), the amount of loss allowable as a deduction under section 165(a) shall not exceed the amount prescribed by Treas. Reg. § 1011-1 as the adjusted basis for determining the loss from the sale or other disposition of the property involved. In the case of each such deduction claimed, therefore, the basis of the property must be properly adjusted as prescribed by Treas. Reg. § 1.1011-1. As provided in Treas. Reg. § 1.1001-1, the adjusted basis for determining the gain or loss from the disposition of property is the cost or other basis prescribed in section 1012 or other applicable provisions of subtitle A of the Code.

Supervisory goodwill is the excess of the purchase price (which included liabilities assumed by the acquirer) over the fair market value of the assets acquired from the failing thrift. It is likely that most of the supervisory goodwill was derived from devalued loans that had declined in value because of rising interest rates. See Winstar, 518 U.S. at 851-52. The Corporation's tax basis was properly in the loans and other assets from which the supervisory goodwill was derived and not in the supervisory goodwill itself.

As a result, the Corporation is attempting to derive basis under former section 597, arguing that the right to count supervisory goodwill toward regulatory capital requirements allegedly constituted "FSLIC assistance." That is, Corporation asserts that the right to use the purchase method of accounting and resulting supervisory goodwill as substitute capital was a valuable right and assistance, albeit not monetary assistance, from the FSLIC.

Absent special circumstances, a taxpayer would have to have gross income result from the receipt of property for that property to obtain a basis derived from the property's fair market value. To explain, the receipt of property can be income to a taxpayer and the amount of income is the property's fair market value. Treas. Reg. § 1.61.-2(d); Strong v. Commissioner, 91 T.C. 627 (1988). The taxpayer's basis in the property is then equal to the amount taken into income, that is, its fair market value. Strong, 91 T.C. at 639; Stahl v. Commissioner, T.C. Memo. 1987-323. Thus, in circumstances like the present case, if the receipt of property does not result in income, no basis is created. Rev. Rul. 92-16, 1992-16 C.B. 15.

Corporation's argument rests in part on the special provisions of former section 597, under which assistance payments were excluded from gross income but also did not reduce basis. As discussed more fully above, we conclude that the supervisory goodwill does not qualify for the exclusion under section 597. However, assuming for purposes of discussion that 597 applies in this case, we conclude that to derive a fair market value basis from the FSLIC assistance, Corporation must have gross income, or at least what would otherwise be gross income, absent the application of former section 597. However, even absent the exclusion under former section 597, the FSLIC's agreement to allow Corporation to use supervisory goodwill toward regulatory capital requirements would not be income to Corporation no matter how valuable the right.

The creation of property rights under an assortment of government regulatory and licensing arrangements has been found not to result in gross income to the recipient of the rights.[1] This position is succinctly demonstrated in Rev. Rul. 92-16, which holds that the issuance of emission allowance by the Environment Protection Agency does not result in gross income to the utility that receives it. Accordingly, under section 1012, a utility's basis in the allowances is not measured by reference to their fair market value. An emission allowance permits the emission of more pollutants and, thus, like the present case, is not a financial payment. Similarly, Rev. Rul. 67-135, 1967-1 C.B. 20, holds that the excess, if any, of the fair market value over the cost of an oil and gas lease obtained by a taxpayer in a lottery conducted by the United States Bureau of Land Management is not includible in gross income of the taxpayer recipient.

This Service position is implicitly supported by court cases holding that the taxpayer's basis in similar property rights obtained from the government is simply the cost of obtaining rights. See, e.g., Nachman v. Commissioner, 191 F.2d 934 (5th Cir. 1951); Nicolazzi v. Commissioner, 79 T.C. 109 (1982), aff'd per curiam, 722 F.2d 324 (6th Cir. 1983); Radio Station WBIR v. Commissioner, 31 T.C. 803 (1959). Because these cases do not include the fair market value of the property received in basis, they assume that no income was imputed from the receipt of the property.

The present case involves facts that are even less likely to result in income than the normal governmental granting of rights because the present case involves a clear quid pro quo. Thus, even if the right involved in the present case were not obtained from the government, it would not be gross income because entering an advantageous agreement does not in the usual case create income to a taxpayer. For example, the purchase of property for less than its fair market does not normally result in income to the purchaser. Palmer v. Commissioner, 302 U.S. 63, 68-69 (1937); Elverson Corporation v. Helvering, 122 F.2d 295, 297 (2d Cir. 1941); Hunt v. Commissioner, 90 T.C. 1289, 1304-05 (1988). Even more basically, Corporation has not shown that the assistance agreement represented anything but an arms length agreement under which both parties provided equivalent consideration. Thus, arguably there was no income because there were no "accessions to wealth" as required by Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955).

[1] Further analysis on this position can be found in GCM 39,606 (Feb. 27, 1987).

3. Amount of the Loss

Even if Corporation were allowed to have some loss based on fair market value of the right received, the fair market value of the loss would not approach the full amount of the supervisory goodwill. Corporation did not lose an amount equal to the supervisory goodwill, but only the right to use the supervisory goodwill toward regulatory capital requirements. This is made clear in a case determining the damages to another plaintiff in the Winstar litigation, which stated:

> Plaintiff argues that its loss of goodwill as capital was a cost for which it should be reimbursed. However, goodwill is not a cost that should be reimbursed dollar for dollar. [Plaintiff] quantified goodwill on its books and used that number to meet its capital requirements. While goodwill was used as capital for those purposes, it is not equivalent to capital and does not have a dollar for dollar value.

California Federal Bank v. United States, 43 Fed. Cl. 445, 449 (1999), appeal docketed, 99-5108 and 99-5119 (Fed. Cir. June 14 & 28, 1999).

4. Reimbursement

In determining the amount of loss actually sustained for purposes of section 165(a), proper adjustment shall be made for any insurance or other compensation received. Reg. § 1.165-1(c)(4)

Treas. Reg. § 1.165-1(d)(2)(i) provides that, if an event occurs which may result in a loss and, in the year of the event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim or by an abandonment of the claim.

The determination of whether reasonable certainty as to reimbursement exists is an objective inquiry into the facts and circumstances surrounding the loss as of the close of the taxable year in which the deduction is claimed. Boehm v. Commissioner, 326 U.S. 287, 292-93 (1945); Ramsey Scarlett & Co. v. Commissioner, 61 T.C. 795, 811 (1974), aff'd, 521 F.2d 786 (4th Cir. 1975); Brown v. Commissioner, T.C. Memo. 1996-284.

We understand that Corporation has filed a claim to receive damages under the Winstar litigation.[2] That Corporation filed a lawsuit to recover the deducted loss is evidence that Corporation had a reasonable prospect of recovery. Ramsey Scarlett, 61 T.C. at 812-13. In fact, filing suit has been held to give rise to an inference of such a reasonable prospect. Dawn v. Commissioner, 675 F.2d 1077, 1078 (9th Cir. 1982); Estate of Scofield v. Commissioner, 266 F.2d 154, 159 (6th Cir. 1959); Brown, supra. In this sense, Corporation's subjective belief in the reasonable prospect of recovery becomes objective evidence of that prospect. See Boehm, 326 U.S. at 292-93; Jeppson v. Commissioner, T.C. Memo. 1995-342, aff'd, 128 F.3d 1410 (10th Cir. 1997).

If the Corporation's claim was not speculative or wholly without merit, and if Corporation believes that the chance of recovering the loss is sufficiently probable to warrant prosecuting a law suit with reasonable diligence to a conclusion, Corporation generally should wait until the conclusion of the lawsuit to claim the loss. Estate of Scofield, 266 F.2d at 159; Jeppson, supra. See Ramsay Scarlett, 61 T.C. at 811. The amount of time and money spent by Corporation investigating and prosecuting the claim and whether Corporation ultimately recovered the loss is also relevant. National Home Products, Inc. v. Commissioner, 71 T.C. 501, 526 (1979); Huey v. Commissioner, T.C. Memo. 1985-348.

Since the Winstar litigation was already successful in the Court of Federal Claims by the end of Year 5 and was pursued successfully to the Supreme Court, Corporation should not have recognized any loss in Year 5. There is also every indication that the Winstar litigation would consume a substantial amount of time and money. Thus, we conclude Corporation should not have claimed any loss attributable to the supervisory goodwill in Year 5, because it had a reasonable prospect of recovering any loss sustained.

5. Abandonment of Intangible Assets

It is clear that intangible assets may be the subject of an abandonment loss. Parmelee Transportation Co. v. United States, 351 F.2d 619 (Ct. Cl. 1965). See Massey-Ferguson, Inc. v. Commissioner, 59 T.C. 220 (1959), acq. 1973-2 C.B. 2; Solar Nitrogen Chemicals, Inc. v. Commissioner, T.C. Memo. 1978-486.

The present case involves an intangible that has been characterized by the Supreme Court as goodwill. See Winstar, 518 U.S. at 848-49. Normally, goodwill

[2] The discussion regarding reimbursement assumes that Corporation has a valid Winstar claim and had not clearly lost all rights regarding the use of supervisory goodwill prior to the enactment of FIRREA.

may not be abandoned until the business to which it relates ceases to operate. Thrifticheck Service Corp. v. Commissioner, 33 T.C. 1038 (1960), aff'd, 287 F.2d 1 (2d Cir. 1961); Illinois Cereal Mills, Inc. v. Commissioner, T.C. Memo. 1983-469, aff'd, 789 F.2d 1234 (7th Cir.), cert. denied, 479 U.S. 995 (1986); Danco Products, Inc. v. Commissioner, T.C. Memo. 1962- 52. Otherwise, the transaction is not considered to be a closed and completed transaction within the meaning of Reg. §1.165-1(b). Illinois Cereal Mills.

Exceptions arise when the taxpayer abandons a portion of its business that has "distinct transferrable value," as defined by Metropolitan Laundry Co. v. United States, 100 F. Supp. 803 (N.D. Cal. 1951). In Metropolitan Laundry, the taxpayer was permitted an abandonment loss on a portion of a customer list that was attributable to a specific geographic area. The taxpayer had purchased the customer lists of several laundry businesses in San Francisco and Oakland. During World War II, the government seized the taxpayer's San Francisco plant for military purposes. After the war, the taxpayer had trouble reestablishing its business and abandoned its San Francisco routes while it continued its operations in Oakland.

Customer lists are closely associated with goodwill. See Metropolitan Laundry, 100 F. Supp. at 806. Thus, in answering the government's argument that a portion of the customer list could not be abandoned for this reason, the court in Metropolitan Laundry stated:

> It may be granted that good will cannot exist in the abstract, apart from a going business, and that, generally speaking, the good will of a business cannot be entirely disposed of or destroyed while the business continues. But certainly a going concern can dispose of its business in a particular area or in respect to a particular product or service along with incidental good will without abandoning its entire business....So also, certain types of concerns can dispose of their business and good will apart from their physical properties....And, in either instance, so long as the business and the good will disposed of may be assigned a distinct transferable value, the transaction may properly be recognized, for tax purposes, as a closed one.

100 F. Supp. at 806-07 (citations omitted). The court found that the costs attributable to the abandoned San Francisco customer lists met this test and were deductible.

The Tax Court has followed Metropolitan Laundry holding that "if there is a clearly identifiable and severable asset, its abandonment entitles the taxpayer to a loss deduction." Massey-Ferguson, 59 T.C. at 225. Specifically, Massey-Ferguson allowed an abandonment loss for a line of business the taxpayer had purchased from another party and operated at a distinct location, even though the taxpayer continued to manufacture similar products under a different trade name at another location.

Corporation has not abandoned a segment of its business that is analogous to either Metropolitan Laundry or Massey-Ferguson. Nor has it shown that supervisory goodwill is a "clearly identifiable and severable asset" within the meaning of Massey-Ferguson. Because supervisory goodwill is derived from all the assets and liabilities of the acquired savings and loan, we think it cannot be severed from them and separately abandoned.

6. Act of Abandonment

As indicated above, the intention to abandon standing alone is not sufficient to establish a recognition event; instead, there must be an affirmative act of abandonment. See Brountas v. Commissioner, 692 F.2d 152 (1st Cir. 1982), cert. denied, 462 U.S. 1106 (1983); Beus v. Commissioner, 261 F.2d 176, 180 (9th Cir. 1958); Citron, 97 T.C. at 210; Zurn v. Commissioner, T.C. Memo. 1996-386. As a result, there is arguably an inherent requirement for an abandonment loss that the taxpayer, rather than some other party, take the action to abandon permanently the property in question. Further, an abandonment does not result simply from cessation of use. Beus, at Id.; Citron, at Id.

Thus, participation in a government program which required a taxpayer to discontinue his dairy operation, was not an abandonment where there was no showing of the irrevocable intent to abandon or never use the property again. Strandley v. Commissioner, 99 T.C. 259 (1992), aff'd on another issue, 73 AFTR 2d (RIA) 2118 (9th Cir. 1994). Other cases have similarly held that the actions of the government only affect the value of the property a taxpayer continues to hold. See CRST, 92 T.C. at 1259-61; Beatty v. Commissioner, 46 T.C. 835 (1966); Consolidated Freight Lines, Inc. v. Commissioner, 37 BTA 576 (1938), aff'd, 101 F.2d 813 (9th Cir. 1939).

In addition, when a taxpayer decides that it is not going to pursue an opportunity under a contract, it must act to abandon the opportunity before a deduction is allowed. International Educational Publishing Co. v. Commissioner, 79 F.2d 343 (3d Cir. 1935). On the other side, when the other party decides that it wishes to cancel a contract, it has been held that the recognition event occurs when the taxpayer accepts the cancellation. George Freitas Dairy, Inc. v. United States, 582 F.2d 500, 502 (9th Cir. 1978).

In the present case, Corporation did not act to abandon the supervisory goodwill, even though it decreased in value when it no longer could be used toward regulatory reserve requirements. The mere diminution in value of property is not enough to establish an abandonment loss. Kraft, Inc. v. United States, 30 Fed. Cl. 739, 785-86 (1994); Lakewood Associates v. Commissioner, 109 T.C. 450, 456 (1997), aff'd, 99-1 USTC ¶50,127 (4th Cir. 1998). See S.S. White Dental, 274 U.S. at 401. Specifically, diminution in value fails to satisfy the requirement under the regulations that a loss be "evidenced by closed and completed transactions, fixed by identifiable events." Sunset Fuel Co. v. United States, 519 F.2d 781, 783 (9th Cir. 1975). See S.S. White Dental, at Id.

7. Timing of the Loss

We have provided a number of reasons why Corporation may not take a loss on the supervisory goodwill in any taxable year or, in the alternative, should postpone the loss past the current time. In addition, there is some indication that Corporation lost its ability to use supervisory goodwill toward regulatory capital reserve requirements after only five years and in a tax year prior to the enactment of FIRREA. If this is true and if it is determined that Corporation is allowed a loss for supervisory goodwill in any past taxable year, then any loss should have been in the year its ability to use supervisory goodwill ended rather than subsequently in Year 5.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We conclude that this case presents few litigating hazards. Initially, we note that Corporation's position in this case is abusive, since Corporation may be attempting to deduct a loss twice for which it may have been or will be reimbursed twice. We have already discussed that supervisory goodwill has no tax basis and any tax basis must reside in the assets from which supervisory goodwill was derived. In addition, we have discussed how Corporation is attempting to deduct supervisory goodwill even though it will be reimbursed for any loss in its Winstar litigation.

Further, it is likely that Corporation was reimbursed by the FSLIC for any the losses sustained on the original assets. Lastly, similarly situated taxpayers were taking the position that even though they were reimbursed for these losses, they could still deduct them. See Report on Tax Issues Relating to the 1988/89 Federal Savings and Loan Insurance Corporation Assisted Transactions (March 3, 1991); TAM 8637005. [3]

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[3] Despite the holding of this technical advice memorandum, this position subsequently determined not to be correct treatment. See Treasury Report cited.

Although we think we have a strong case, we alert you to the following litigation hazards.

Basis

We think this is a very strong argument. However, there is little case law supporting the proposition that the grant of governmental rights is not income, because this is a position that is normally advantageous to the taxpayer. But, we doubt Corporation will be able to convince any court that merely entering in an advantageous contract will result in income to Corporation.

Reimbursement

Again, whether there is a reasonable prospect for reimbursement looks at the facts at the end of the taxable year for which the loss is claimed. As explained in Ramsey Scarlett, 61 T.C. at 811-12:

> The standard is to be applied by foresight, and hence, we do not look at facts whose existence and production for use in later proceedings was not reasonably foreseeable as of the close of the particular year. Nor does the fact of a future settlement or favorable judicial action on the claim control our determination, if we find that as of the close of the particular year, no reasonable prospect of recovery existed.

As a result, we should properly look only to the facts as they were known at the end of Year 5, even though the federal income tax claim for that year was not filed until sometime later. We do not know when the suit was filed in the present case but it need not have been filed by the end of Year 5 for the Service to prevail. For despite the quoted language, Ramsey Scarlet inferred that a reasonable prospect of recovery existed in the tax year, 1965, even though suit was not filed in that case until 1967. See also Dawn, 675 F.2d at 1078; National Home Products, 71 T.C. at 526.

Even if the suit were filed sometime later in the present case, we have rather unusual facts in that exactly the same claim was being pursued by similarly situated taxpayers and Corporation could reasonably have been waiting to see how the litigation would turn out without giving up its claim or its reasonable prospect of reimbursement. [4] At the end of Year 5, the plaintiffs had won the Winstar case in

[4] The statute of limitations for filing suit in this case was six years from the breach of contract as required by 28 U.S.C.A. § 2501. The Court of Federal Claims

the Court of Federal Claims, although the case had been reversed in the first opinion issued by the Court of Appeals. Corporation may try to make something of this temporary set back, although we doubt Corporation would be successful.

Goodwill

Supervisory goodwill is like the classic goodwill in that it represents the difference between liabilities and assets. However, supervisory goodwill clearly does not meet the classic definition of goodwill as the "expectancy of continued patronage." Newark Morning Ledger, 507 U.S. at 555-56, citing Boe v. Commissioner, 307 F.2d 339, 343 (9th Cir. 1962). This was recognized by the Supreme Court in Winstar, which stated:

> In the ordinary case, the recognition of goodwill as an asset makes sense; a rational purchaser in a free market, after all, would not pay a price for a business in excess of the value of that business's assets unless there actually were some intangible "going concern" value that made up the difference.

528 U.S. at 849.

Subsequently, Winstar explains that supervisory goodwill is quite different.

> Indeed, the rationale for recognizing goodwill stands on its head in a supervisory merger: ordinarily, goodwill is recognized as valuable because a rational purchaser would not pay more than assets are worth; here, however, the purchase is rational only because of the accounting treatment of the shortfall.

518 U.S. at 854.

The question then is whether the present case should be distinguishable from the cases holding that goodwill may not be abandoned until the business is terminated. Corporation could argue that the intangible it is valuing is the contract right to use the supervisory goodwill and not the supervisory goodwill itself. The case law recognizes the difference between a severable intangible asset that is

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has held that the breach occurred on December 7, 1989, when final regulations mandated by FIRREA were published. Thus, all claims filed before December 8, 1996, were timely. Plaintiffs in Winstar-Related Cases v. United States, 37 Fed. Cl. 174, 181 (1997), aff'd sub nom., Ariane Financial Services Pty. Ltd. v. United States, 133 F.3d 874 (Fed. Cir.), cert. denied, 119 S.Ct. 67 (1998).

related to goodwill and the goodwill that is the favorable customer relations or, more broadly, the going concern value of a company itself. See Meredith Broadcasting Co. v. United States, 405 F.2d 1214, 1224-25 (Ct. Cl. 1969); Massey-Ferguson, 59 T.C. at 225. The first may be abandoned while the business continues; the second cannot. See Meredith Broadcasting, at Id. Still, we believe there is a viable argument that the right to use supervisory goodwill is not severable from all the assets and liabilities from which at least its value is directly derived. Certainly, it is distinguishable from assets that are considered severable such as patents, trademarks, leases and franchises, which have an independent value that is normally severable from the taxpayer that owns them.

Act of Abandonment

In regard to a loss based on worthlessness, we note that Echols v. Commissioner, 950 F.2d 209 (5th Cir. 1991), allowed a loss on a partnership interest in the year of an affirmative act of abandonment, but also allowed the same loss on the separate grounds of worthlessness. This holding may not be followed in other circuits. See Corra Resources Ltd. v. Commissioner, 945 F.2d 224, 226-27 (7th Cir. 1991); Gulf Oil Corp. v. Commissioner, 914 F.2d 396, 402 (3d Cir. 1990). The Service does not follow Echols. Also, the Tax Court position on this issue is not completely clear. See Norwest v. Commissioner, 111 T.C. 105, 139-40 (1998). But see Thrifticheck, 33 T.C. at 1046; Oak Harbor Freight Lines, Inc. v. Commissioner, T.C. Memo. 1999-291.

In addition, in regard to the requirement of an affirmative act, losses have been found to result from the actions of the government if future use of the property is seen as impossible. See, e.g., Sheffield Denifrice Co. v. Commissioner, 13 BTA 877 (1928), nonacq. 1929-1 C.B. 60; Zakon v. Commissioner, 7 BTA 687 (1927), nonacq. 1928-2 C.B. 53, nonacq. withdrawn and acq., 1947-2 C.B. 5, which allowed resulting losses when alcohol was banned during Prohibition.

Corporation has a good argument that the supervisory goodwill was worthless when it could no longer be used toward regulatory capital reserve requirements. Further, this case is not as strong for the Service as the cases previous cited where the government's action left the taxpayer's property right much less valuable but not completely worthless. See CRST, supra; Consolidated Freight, supra; Beatty, supra.

Further Factual Development

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Please call if you have any further questions.

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