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

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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
CC:LM:MCT:CIN:2
ATTN: James Kagy

FROM: ASSOCIATE CHIEF COUNSEL
INCOME TAX & ACCOUNTING CC:ITA

SUBJECT: Donation of Memorabilia and Records

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LEGEND

Individual A:
Individual B:
Individual C:
Entity 1:
Entity 2:
Entity 3:
Location 1:
Location 2:
Location 3:
Trust:
Corporation:
Company:
Corporation 2:
A Corp.:
Subsidiary:
B Corp.:
C Corp.:
D Corp.:
Acquisition Co.:
Acquisition Co. 2:
Taxpayer:
Charitable Organization:
merchandise:

Year 1:	Date 1:
Year 2:	Date 2:
Year 3:	Date 3:
Year 4:	Date 4:
Year 5:	Date 5:
Year 6:	Date 6:
Year 7:	Date 7:
Year 8:	Date 8:
Year 9:	Date 9:
Year 10:	
Year 11:	
Year 12:	
Year 13:	

ISSUE

Whether the corporate records donated by Corporation 2[1] to Charitable Organization are properly excluded from the definition of capital assets in accordance with I.R.C. § 1221(3) for purposes of determining whether the contribution is subject to the limitation imposed by section 170(e)(1)(A).

CONCLUSIONS

The corporate records qualify as property that is "similar" to a letter or memorandum within the meaning of section 1221(3); however, we do not recommend pursuing the argument that the successor entity here is the taxpayer for whom the property was prepared or produced. We do not have sufficient facts to assess the strength of the argument that the basis of the property donated by Corporation 2 can be determined in whole or in part by reference to the basis of such property in the hands of a taxpayer for whom the property was prepared or produced. This is particularly true of the records created on or before Date 3.

FACTS

We rely on the facts set forth in your memorandum requesting advice, including the attachments.

In Year 2, Individual A and Individual B formed Entity 1, a partnership that operated in Location 1 and manufactured merchandise. In Year 3, the company moved to a site in Location 2 owned by Individual C. The name of the company was changed and, eventually, Individual A and Individual B sold their majority interest in this venture to Individual C. In Year 4, Individual A and Individual B reformed their partnership and moved to Location 3. Because of the need for merchandise during the Civil War, the partnership became one of the leading manufacturers of merchandise and related equipment in the United States. It was eventually known as Entity 3.

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[1] Taxpayer is the parent of Corporation 2 and filed a consolidated return in which the charitable contribution now in dispute was claimed. The contribution was made by Corporation 2 and the issue we address is whether the donated property should be included in the definition of a capital asset.

On Date 1, a corporation succeeded Entity 3. On Date 2, Trust was formed to take over the business. Trust operated the business until Date 3, when Corporation was formed.

In Year 6, A Corp. acquired a controlling interest in Corporation. In Year 7, Corporation was merged with Subsidiary, a subsidiary of A Corp. Subsidiary was the surviving entity, with Corporation operating as a division. In Year 9, Subsidiary was merged into A Corp. In Year 10, B Corp. purchased a controlling interest in A Corp. Late in Year 11, B Corp was acquired in a leveraged buyout headed by D Corp. In order to help finance the acquisition, Corporation was immediately placed on the market.

An agreement dated Date 4 between A Corp. and B Corp. provides a plan for the reorganization and liquidation of A Corp. under section 332 of the Internal Revenue Code. A second agreement of the same date between the subsidiaries of A Corp. (including the successor to Corporation), B Corp. and C Corp. provides for the reorganization and liquidation of B Corp. under section 332. The agreement identifies the successor to Corporation as Company (formerly Acquisition Co.). A certificate filed on Date 5 evidences the merger of A Corp. into B Corp. under the name of B Corp. A second certificate filed on Date 5 evidences the merger of B Corp. into C Corp. under the name of B Corp.

On Date 6, the assets of the successor to Corporation were transferred to Company/Acquisition Co. in anticipation of its sale. A certificate dated Date 6 certifies that a resolution has been adopted amending the articles of incorporation of Acquisition Co. to change the name to Company. A second certificate of the same date certifies that Company has adopted a resolution changing the name from Company to Corporation 2.

On Date 7, Taxpayer formed Acquisition Co. 2 to acquire the stock of Corporation 2. On Date 8, Acquisition Co. 2 entered into an agreement with A Corp., a wholly owned subsidiary of B Corp., to purchase all of the stock of Corporation 2. The sale was completed during Year 12 and on Date 9, Acquisition Co. 2 changed its name to Taxpayer. Taxpayer remained the owner of Corporation 2 during Year 13, the year of the donation.

In Year 13, Corporation 2 donated a large amount of merchandise and boxes of records to Charitable Organization, a qualified charitable organization. The records included the books and records of the predecessors to Corporation 2 dating from Year 1 to Year 8. On its consolidated return for Year 13, Taxpayer claimed a deduction for a charitable contribution in an amount equal to the full market value of the property donated. We understand that the Service does not dispute the

Taxpayer's treatment of the merchandise. In addition, the Service disputes neither the fact that Corporation 2 made a qualified contribution of the books and records, nor the estimation of the fair market value of the books and records. The sole issue for consideration is whether the contribution is subject to the limitation imposed by section 170(e)(1)(A) because the books and records should properly be excluded from the definition of capital assets in accordance with section 1221(3) (now section 1221(a)(3)).

LAW AND ANALYSIS

Section 170(a) provides that for contributions made in property other than money, the amount of the contribution is equal to the fair market value of the property on the date of the contribution, reduced as provided in section 170(e)(1).

Section 170(e)(1) provides that the amount of any charitable contribution of property must be reduced by the sum of the amount of gain which would not have been long-term capital gain if the contributed property had been sold by the taxpayer at its fair market value (determined at the time of the contribution). Generally, for purposes of applying this paragraph, property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset.

Section 1222 defines long-term capital gain as gain from the sale or exchange of a capital asset held for more than one year, if and to the extent such gain is taken into account in computing gross income.

In Year 13, Section 1221 provided that for purposes of Subtitle A, the term "capital asset" meant property held by the taxpayer (whether or not connected with his trade or business), but did not include–

> (3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by–
>
>> (A) a taxpayer whose personal efforts created the property;
>>
>> (B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced; or
>>
>> (C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the

> basis of such property in the hands of a taxpayer described in subparagraph (A) or (B).[2]

Treas. Reg. § 1.1221-1(c)(2) provides, in the case of sales or other dispositions occurring after July 25, 1969, that a letter, a memorandum, or similar property is excluded from the term "capital asset" if held by (i) a taxpayer whose personal efforts created such property, (ii) a taxpayer for whom such property was prepared or produced, or (iii) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subdivision (i) or (ii) above.[3]

Treas. Reg. § 1.1221-1(c)(2) further provides that the phrase "similar property" includes property such as a draft of a speech, a manuscript, a research paper, an oral recording, a transcript of an oral interview or of dictation, a personal or business diary, a log or journal, a corporate archive, including a corporate charter, office correspondence, a financial record, a drawing or a dispatch. A letter, memorandum, or property similar to a letter or memorandum, addressed to a taxpayer shall be considered as prepared or produced for him. However, property such as a corporate archive, office correspondence, or a financial record shall not be considered "similar property" if it is sold or disposed of as part of a going business and it has no significant value separate and apart from its relation to and use in such business.

Treas. Reg. § 1.1221-1(c)(3) provides that a letter, memorandum, or property similar to a letter or memorandum, which is prepared by personnel who are under the administrative control of a taxpayer, such as a corporate executive, shall be deemed to have been prepared or produced for him whether or not such letter, memorandum, or similar property is reviewed by him.

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[2] In 1999, P.L. 106-170, Section 532(a)(1), substituted "(a) In general. For purposes" for "for purposes" in section 1221.

[3] Treas. Reg. § 1.1221-1(c) was amended by Treasury Decision 7369 to conform the regulations to amendments to section 1221 made in the Tax Reform Act of 1969 (Pub. L. 91-172, 83 Stat. 643, 646) (1969-3 C.B. 10). According to T.D. 7369, certain terms suggesting that the regulations applied only to individual taxpayers were replaced to make clear that the references also included corporations. 1975-2 C.B. 335, 336. The final regulations were approved on July 10, 1975.

Section 1231(b)(1)(C) provides that the term “property used in the trade or business” does not include a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by a taxpayer described in paragraph (3) of section 1221.

Other Similar Property

In Chronicle Publishing Co. v. Commissioner, 97 T.C. 445 (1991), the issue was whether the taxpayer’s contribution of a newspaper clippings library was subject to the limitation under section 170(e). The taxpayer argued that the clippings library was a capital asset because it was not an asset described in section 1221(3). Alternatively, the taxpayer argued that section 1221(3) did not apply to corporate taxpayers.

Addressing the issue of the proper characterization of the clippings library, the Tax Court indicated that the characterization of the library depended on whether it fell within the category of “a letter or memorandum, or similar property” described in section 1221(3). Chronicle Publishing, 97 T.C. at 448. The court cited Treas. Reg. § 1.1221-1(c)(2) with approval and relied on the regulation in analyzing whether the clippings library constituted similar property for purposes of section 1221(3). The court concluded that the library fell within the scope of a corporate archive and, therefore, in accordance with the regulation, was included within the phrase “similar property.” Id. at 449-450.

Similarly, in Rev. Rul. 82-9, 1982-1 C.B. 39, well cuttings, scout tickets and well logs donated by the taxpayer were excluded from the definition of capital assets under section 1221(3). The revenue ruling relied on Treas. Reg. § 1.1221-1(c)(2) in concluding that the donated items provided records of the taxpayer’s well drilling operations and, thus were sufficiently similar to memoranda or business logs to be “similar property” within the meaning of section 1221(3)(B). 1982-1 C.B. at 40.

We have reviewed the list of donated business records that you provided and we agree that the description of “similar property” in Treas. Reg. § 1.1221-1(c)(2) is sufficiently broad to cover the listed documents. Thus, we conclude the records constitute property similar to a letter or memorandum within the meaning of section 1221(3)(B).

Held by the Proper Taxpayer

Once it is determined the records are property similar to a letter or memorandum, a determination must be made whether, at the time of the gift to Charitable Organization, they were held by a taxpayer for whom such property was prepared or produced, or a taxpayer in whose hands the basis of such property would be determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer for whom the property was prepared or produced.[4]

We understand that Corporation 2 donated the records in Year 13. Although there is no question that Corporation 2 is the successor-in-interest to the entities that prepared and produced the records, whether Corporation 2 should be considered the same taxpayer, or a taxpayer in whose hands the basis of the records would be determined by reference to a predecessor's basis is not free from doubt.

The Same Taxpayer

The regulations under section 1221 provide little guidance on this issue. Treas. Reg. § 1.1221(c)(3) merely indicates that a letter or memorandum, or property similar to a letter or memorandum, which is prepared by personnel who are under the administrative control of a taxpayer, such as a corporate executive, shall be deemed to have been prepared or produced for the corporate executive whether or not the document was reviewed by him or her. This does not answer the question in this case, which is whether a taxpayer that has been involved in several reorganizations should be considered the same taxpayer as its predecessor entities for purposes of section 1221(3)(B).

Although we believe arguments could be fashioned to support both affirmative and negative answers to this question, we have concluded it is inadvisable to argue that Corporation 2 is the same taxpayer as the original creators of the records in this case. This position would be inconsistent with Service position in a number of cases concerning issues unrelated to section 1221.

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[4] We conclude section 1221(3)(A) is inapplicable to Corporation 2. Treas. Reg. § 1.1221-1(c)(3) provides generally that property is created in whole or in part by the personal efforts of a taxpayer if the taxpayer performs literary, theatrical, musical, artistic, or other creative or productive work which affirmatively contributes to the creation of the property, or if the taxpayer directs and guides others in the performance of such work. A taxpayer, such as a corporate executive, who merely has administrative control of writers, actors, artists, or personnel and who does not substantially engage in the direction of such persons in the performance of their work, does not create property by his personal efforts. In the instant case, Corporation 2 is a manufacturer and is not involved in the creation of literary or artistic work. Accordingly, Corporation 2 does not create property by its personal efforts.

In Thomas v. Commissioner, 92 T.C. 206 (1989), the primary issue was the propriety of changing a business' method of accounting. Taxpayer-husband operated a publishing business as a sole proprietorship. The change in method of accounting included an adjustment under section 481(a) and the taxpayers argued that, if the court determined section 481(a) was applicable, the adjustment should not include amounts attributable to the business' pre-1954 years. According to the taxpayers, under section 481(a)(2), the business was entitled to limit the section 481(a) adjustment in respect of any taxable year to which section 481 did not apply.[5]

The Commissioner argued that the taxpayers were not entitled to relief under section 481(a)(2) because the entity that existed prior to 1954 was a different taxpayer from the taxpayer that existed in the year of change.

The taxpayers' publishing business had been founded in 1927 by petitioner-husband's parents and operated as a partnership. In 1946, petitioner-husband became a partner, causing the partnership to be reorganized. In 1968, when petitioner-husband's father died, the partnership was reorganized again, with petitioner-husband and his mother as the partners. In 1975, when petitioner-husband's mother died, the business became a sole proprietorship. Based on these facts, the Commissioner took the position that the business existing in 1978, the year in dispute, was not the same entity or the same taxpayer as had been in existence in 1954 and in prior years. Accordingly, the Commissioner argued the business was not entitled to a reduction in the section 481(a) adjustment for years prior to 1954.

The Tax Court agreed, indicating that the benefits of the pre-1954 Code exclusion under section 481(a)(2) were available only to the person or entity who is the taxpayer within the meaning of section 481(a). Id. at 230. According to the court, for purposes of applying section 481(a), a successor entity whose existence arose after 1954 should be treated as a different taxpayer from its predecessor.

In Marion-Reserve Power Co. v. Commissioner, 1 T.C. 513 (1943), the Tax Court denied the taxpayer a dividend carryover credit based on a similar argument. The taxpayer in Marion-Reserve Power had been formed through the consolidation of

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[5] Section 481(a)(2) reads as follows: "there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted, except there shall not be taken into account any adjustment in respect of any taxable year to which this section does not apply unless the adjustment is attributable to a change in the method of accounting initiated by the taxpayer."

four companies. Prior to the consolidation in 1936, one of the four companies had paid dividends which exceeded its adjusted net income. That company, thus, became entitled to a dividends paid credit. After the four companies consolidated, the resulting company, the taxpayer, claimed the credit on its 1937 return. The Commissioner disallowed the credit carryover based on a determination that the taxpayer claiming the credit was not the same taxpayer as the taxpayer that had earned the credit.

Again the court agreed with the Commissioner. The Tax Court rejected the taxpayer's argument that a successor corporation in a statutory merger consolidation was, as a matter of law, the continuing corporate entity of its constituent companies. Despite the fact that there were no material differences in business operations and the fact that the resulting corporation was clearly related to the predecessor company, the court was not persuaded that the taxpayer was the same entity after the consolidation. Id. at 515. Because the credit was allowable only to the extent a corporate taxpayer had paid dividends and the taxpayer was not the same taxable entity, the court concluded it was not entitled to the deduction.

Similarly, in Standard Silica Co. v. Commissioner, 22 B.T.A. 97 (1931), the Board of Tax Appeals upheld the Commissioner's disallowance of net operating loss carryovers by a successor corporation. The Board agreed that the taxpayer was not the same taxpayer as had generated the losses and that it, accordingly, was not entitled to claim the carryover losses.

In 1957, the Supreme Court changed the focus of the test for determining whether a successor corporation should be allowed to carry over net operating losses of a predecessor. In Libson Shops, Inc. v. Koehler, 353 U.S. 382 (1957), the Government argued that a net loss carryover was not available unless the corporation claiming the loss was the same taxable entity as that which sustained the loss. The Supreme Court specifically declined to reach this issue. Instead, it upheld the disallowance of the loss carryover based on the fact that the income against which the offset was claimed was not produced by substantially the same businesses as those incurring the losses.

Before the loss carryover issue was resolved through legislation, the cases subsequent to Libson generally applied the "substantially the same business" test. However, the fact remains that in three different situations the Commissioner has fashioned arguments based on a narrow interpretation of what constitutes "the same taxpayer."   Under the circumstances, we do not recommend arguing, for purposes of section 1221, that Corporation 2 is the same taxpayer as the entity responsible for the preparation or production of the books and records in years before Year 12.

A Taxpayer in Whose Hands the Basis of Such Property Would be Determined

Section 351(a) generally provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control of the corporation. Under section 368(a), certain transactions (such as statutory mergers) are treated as reorganizations and, as such, are non-taxable.

Section 362(a) generally provides that the basis of property acquired by a corporation in a section 351 transfer shall be the same as the basis of the transferor increased by gain recognized to the transferor. Section 362(b) provides the same basic rule if the property is received in a reorganization under section 368(a).

The records donated by Corporation 2 would be excluded from the definition of capital assets under section 1221(3)(C) if, at the time of the donation, Corporation 2's basis in the records was determined in whole or in part by reference to the basis of such property in the hands of a taxpayer whose personal efforts created such property or by reference to the basis of such property in the hands of a taxpayer for whom such property was prepared or produced. Corporation 2 would receive such basis in the property if the property was received in a transaction in which gain or loss was not (at least partially) recognized. A corporate taxpayer generally recognizes no gain or loss on the receipt of property under section 351 and the reorganization provisions of section 368(a).

Our research did not reveal authority directly on point under the circumstances presented in this case. However, the legislative history to section 1221(3)(C) and Rev. Rul. 75-202, 1975-1 C.B. 170, shed some light. The legislative history to section 1221(3) indicates that paragraph (C) was intended to apply to situations where the taxpayer receives property in a transaction that is partly or wholly subject to non-recognition, such as transfer by gift. <u>See</u> S. Rep. 2375, 81st Cong., 2nd Sess. 84 (1950).

In Rev. Rul. 75-202, an author organized Corporation X and transferred his copyright to a work he had written in exchange for all the stock of the corporation. Corporation X subsequently transferred its rights in the copyright to Corporation Y. The issue was whether the amounts received by Corporation X were the proceeds of a sale of the copyright, or royalty income from the license of the copyright. It was determined that the amounts constituted proceeds from the sale of the copyright. Further, the Service held that section 1221(3)(C) excluded the copyright property from the definition of a capital asset and that, hence, Corporation X received ordinary income on the transfer. Although the revenue ruling did not elaborate on why the property fell within the definition of section 1221(3)(C), it is apparent that this is because Corporation X determined its basis in the property by reference to the author. Thus, it appears likely that the transfer to Corporation X of the copyright qualified for non-recognition under section 351 of the Code.

Our analysis of the transactions submitted for our review begins with Year 6 because we do not have adequate records with respect to the earlier transactions. With regard to the transactions entered into beginning in Year 6, our analysis is as follows:

1. Year 6–A controlling interest in Corporation was acquired by A Corp.

   This acquisition appears to be a taxable stock acquisition. However, Corporation, the corporate owner of the records, remains in existence as the same entity before and after the acquisition. Accordingly, Corporation's basis in assets would be the same before and after the acquisition and the records probably would be excluded from capital assets under section 1221(3)(B) or (C).

2. Year 7–Corporation was merged with Subsidiary.

   This merger may have been a tax-free reorganization as defined in section 368(a)(1)(A) since both entities were owned by A Corp. Under section 381, Subsidiary would probably be treated as the successor to Corporation and the basis of the assets of Corporation in its hands would probably be the same as the basis of the assets in the hands of Corporation. Consequently, this transaction might fall within the exclusion of section 1221(3)(C).

3. Year 9–Subsidiary was merged with A Corp.

   This transaction may qualify for non-recognition treatment under section 332. Under section 381, A Corp. would be treated as the successor to Subsidiary and, in accordance with (2) above as the successor to Corporation. Consequently, the basis of Corporation's assets in the hands of A Corp. would probably be the same and the transaction would appear to fall within the exclusion of section 1221(3)(C).

4. Year 10–B Corp. purchased a majority of the stock of A Corp. and merged the two companies.

We would need to know the details of the transaction; however, it appears that the merger may not constitute a reorganization under the principles of Yoc Heating v. Commissioner, 61 T.C. 168 (1973).

5. Year 11–B Corp. was purchased by D Corp. which immediately put Corporation up sale.

   This transaction appears to be a taxable stock acquisition, with Corporation remaining intact. The transaction would appear to fall under section 1221(3)(B). The transaction, however, may not fall under section 1221(3) if a valid section 338 election was made. Section 338(a) provides that if a purchasing corporation makes an election under the section, then, in the case of any qualified stock purchase (80% or more stock purchase), the target corporation shall be treated as having sold all of its assets and shall be treated as a new corporation which purchased all of the assets sold by the target corporation. Consequently, under section 1221(3)(B), Corporation (the target corporation) would not be treated as the same entity following the stock purchase. The transaction would not fall under section 1221(3)(C) because the inside assets of Corporation would be treated as having been acquired in a purchase by the new target corporation.

6. Year 12–Corporation’s name was changed to Corporation 2 and Taxpayer acquired all of Corporation 2's stock.

   This transaction appears to be a taxable stock acquisition. The transaction would appear to fall under section 1221(3)(B) because Corporation 2, the corporate owner of the records, remains in existence as the same entity before and after the acquisition. Similar to (5) above, however, this result could change if a valid section 338 election was made by the purchasing corporation.

As we have indicated, the facts concerning these mergers and acquisitions, particularly concerning the transactions that occurred before Year 6, are not fully developed. Thus, we are unable to assess the strength of our argument that the basis of the property donated by Corporation 2 is determined in whole or in part by reference to the basis of the property in the hands of a taxpayer whose personal efforts created the records or for whom such records were prepared or produced.

<u>CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS</u>

The agent does not appear to question the validity of the consolidated return filed by Taxpayer. Under the facts before us, the purchaser of Corporation 2 appears to be listed as Taxpayer, PLC, incorporated in Great Britain. The facts also state that Taxpayer filed a consolidated return with Corporation 2. It is not clear whether the purchasing corporation and the corporation that filed the consolidated return with Corporation 2 are the same corporations. We note that only domestic corporations are entitled to file U.S. consolidated returns. See §§ 1501 and 1504. Taxpayer, PLC would not be entitled to file a consolidated return with Corporation 2 if it is a foreign corporation. [redacted] even if Corporation 2 is precluded from filing a return with Taxpayer, Corporation 2 would probably be able to claim the charitable contribution deduction, assuming the deduction is otherwise valid, on its own behalf.

In terms of additional factual development, [redacted]

In addition, while we have attempted to analyze these transactions as thoroughly as possible, we note that the facts surrounding each merger, acquisition and restructuring must be fully developed in order for the Service to make a meaningful determination on the application of section 1221(3). [redacted]

We also acknowledge the fact that there is little direct authority under section 1221 in support of the position that Corporation 2 is either the taxpayer for whom the donated property was prepared or a taxpayer in whose hands basis would be is determined by reference to a taxpayer for whom the property was prepared. [redacted]

Finally, we point out that in <u>Martin Ice Cream Co. v. Commissioner</u>, 110 T.C. 189 (1998), the Tax Court concluded that business records were not covered under section 1221(3). In <u>Martin Ice Cream</u>, one of the issues in dispute was whether the stock of a subsidiary was a capital asset in the hands of the taxpayer. The taxpayer argued that because business records that were transferred to the subsidiary were not capital assets under section 1221(3), the stock received in exchange could not be a capital asset. The court held that the stock was a capital asset and, in dicta, relied on section 1221(3) to reject the taxpayer's argument that the business records were excluded from the definition of capital assets. The court reasoned that because the legislative history of the predecessor to section 1221(3) indicated that the provision was intended to deal only with writings and artistic works, business records did not fall within the narrow category of assets described in the provision.

The argument made by the taxpayer in Martin does not appear to have been addressed by the Service on brief, so we cannot tell how the court reached its conclusion. In any event, while we agree with the court's conclusion in Martin Ice Cream that the stock was a capital asset, we do not agree with the court's interpretation of section 1221(3). Section 1221(3) was amended in 1969 to include letters, memoranda and property similar to letters and memoranda, as well as copyrights and compositions of a literary, musical or artistic nature. The court relied on legislative history that did not reflect the expansion in the scope of the statute. Service position on the scope of section 1221(3), as amended, is reflected in the regulations, which have already been discussed. These regulations, which were promulgated in 1975, make it clear that section 1221(3) is no longer intended to be limited to literary or artistic works and that business records may be excluded from the definition of capital assets under certain circumstances.

In light of the regulations, we view it unlikely that Taxpayer will make an argument based on the court's conclusion in Martin Ice Cream. Nevertheless, we wanted to bring Martin Ice Cream to your attention as a precautionary measure.

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(CC:ITA:1)