

SALE BY TRUSTEE IN BANKRUPTCY

1003.10

Sales by a trustee in bankruptcy are subject to the tax if made during the operation of the business of the debtor to the same extent as sales by other retailers.

~~However, any sales pursuant to a court order directing liquidation of assets are not subject to the sales tax (Board of Equalization v. Goggin, (9th Cir. 1957) 245 F.2d 44, cert. den. (1957) 353 U.S. 961).~~

With respect to bankruptcy liquidation sales, in *California State Board of Equalization v. Sierra Summit Inc.* (1989) 490 US 844, 104 L.Ed.2d 910, the U.S. Supreme Court determined that the trustee in a bankruptcy case is not acting as a representative of the federal government, but is instead a representative of the debtor. The court decision goes on to say a liquidation sale by the trustee is a taxable sale for sales and use tax purposes. All taxable bankruptcy liquidation sales, by trustees or their representatives, occurring on or after June 13, 1989, will be subject to the *Sierra Summit Inc.* decision. See CPPM section 754.155 for guidelines in determining if a particular liquidation sale is taxable.

- (a) Tax does not apply to transfers of all or substantially all the property held or used in an activity for which a seller's permit is required, (or for vehicles, mobile homes and commercial coaches required to be registered under the Vehicle Code or Health and Safety Code, and vessels and aircraft held or used in the course of the seller's business activities), provided that after the transfer the real or ultimate ownership of the property is substantially unchanged. Stockholders, bondholders, partners, LLC members or other persons holding an interest in the corporation or other entity are regarded as having the "real or ultimate ownership."
- (b) Tax does not apply to transfers of tangible personal property to partnerships, joint ventures, limited liability companies, or corporations to the extent that the transfers constitute contributions of capital with no consideration received by the transferee. (See Section 1001.10)
- (c) ~~Tax does not apply to statutory mergers in which the stockholders of the corporation going out of existence receive stock in the existing (surviving) corporation as their sole consideration for the transfer of assets.~~ Tax does not apply to a corporation's transfer of property to a surviving or new corporation pursuant to a statutory merger under California law or similar laws of other states. A statutory merger is not a sale but is instead a transfer by operation of law. Any related transfer of assets is between the corporations, not with the shareholders. Accordingly, if shareholders receive cash or shares of the new or surviving corporation when they surrender their old shares, there has not been a sale of tangible personal property.
- (d) Tax does not apply to the sale of property not held or used by the seller in the course of activities for which the seller is required to hold a seller's permit and not otherwise taxable solely because of the nature of activities carried on in an entirely separate endeavor. For example, a hospital can have an exempt occasional sale of its assets used in the rendering of medical and nursing services provided the assets were not used in its activities requiring a seller's permit, such as the activities of the pharmacy and cafeteria (*Ontario Community Foundation, Inc., et al. v. State Board of Equalization* (1984) 35 Cal.3d 811). The test is whether sales are made in an entirely separate endeavor from the selling enterprise.

Whether a taxpayer is engaged in entirely separate endeavors is determined on a case-by-case basis. The following points should be considered in deciding whether a taxpayer's endeavors are separate for these purposes. When a taxpayer's endeavors reflect all of the following points, they would be regarded as separate endeavors. The fewer of the points satisfied, the greater the burden on the taxpayer to establish that the endeavors are, in fact, entirely separate endeavors for these purposes. (See also Section 1002.10)

- 1) Each "division" has a completely separate set of books, including journal and general ledgers.
- 2) Each set of books is separately maintained.
- 3) Separate bank accounts are maintained.
- 4) Employees are active in only one "division."

- 5) The “divisions” are housed in separate buildings.
- 6) Each “division” has its own fixed assets, including automotive and office equipment which is not used interchangeably.

Effective February 13, 1997, the Internal Revenue Service (IRS) requires taxpayers to file Form 8594, *Asset Acquisition Statement*, when there is a transfer in the ownership of a business. IRS Form 4797, *Sales of Business Property*, is required when there is a sale of a group of assets that makes up a trade or business. The information contained on these forms may help in determining the value of fixtures and equipment when a business is sold. Sample copies of these forms can be found in Exhibit 1 or check the IRS website: www.irs.gov.

Bulk Sale of a Business – IRS Form 8594

IRS Regulation section 1.1060-1 (e)(1)(ii) and section 338 require that the buyer and the seller in an applicable asset acquisition, each report on Form 8594 the amount of consideration in the transaction and specific information about the allocation of consideration among the assets transferred.

Both the seller and the buyer of a group of assets that make up a trade or business are required to file Form 8594 to report such sales if goodwill or going concern value attaches to, or could attach to, the assets sold or transferred and if the buyer's basis in the assets is determined only by the amount paid for the assets. The IRS requires both the buyer and the seller of the assets to prepare and attach the form to their Federal Income Tax Return.

Generally, Form 8594 would be attached to the Federal Income Tax Return for the year in which the sale occurred. However, Part III, Supplemental Statement, of a new Form 8594 must be filed if the buyer or seller is amending a previously filed form because of an increase or decrease in the buyer's cost of the assets or the amount realized by the seller.

The information that must be reported on Form 8594 includes the following:

1. The name, address, and taxpayer identification number of the buyer and the seller.
2. The purchase date.
3. The total consideration for the assets.
4. The amount of consideration allocated to each class of assets and the aggregate fair market value of assets in each class.
5. A statement as to whether the buyer and seller agreed upon the fair market value of the assets in the contract of sale.
6. The useful life of each class III intangible and amortizable asset. (Class III assets are all tangible and non-tangible assets. Examples of class III assets include furniture and fixtures, land, buildings, equipment, and accounts receivable.)
7. A statement as to whether, in connection with the acquisition of the group of assets, the buyer also obtained a license, a covenant not to compete, or entered into a lease agreement, an employment contract, a management contract, or similar arrangement between the buyer and the seller (or the managers, directors, owners, or employees of the seller).

Exceptions to the requirement for filing IRS Form 8594 include the following:

1. The acquisition is not an applicable asset acquisition. An applicable asset acquisition includes both a direct and indirect transfer of a group of assets, such as a sale of a business, if goodwill or going concern value attaches to, or could attach to, the assets, and the buyer's basis in the assets is wholly determined by the amount paid for the assets.
2. A group of assets that makes up a trade or business is exchanged for like-kind property in a transaction to which Internal Revenue Code (IRC) §1.1031(j)-1 applies. As a general rule, the application of IRC §1031 requires a property-by-property comparison for computing the gain recognized, and the basis of property received in a like-kind exchange.
3. A partnership interest is transferred.

Sale of Business Property – IRS Form 4797

IRS Form 4797 is used to report the sale or exchange of property used in a trade or business; depreciable and amortizable property; oil, gas, geothermal, or other mineral properties; and IRC section 126 (certain cost-sharing payments) property. Form 4797 is also used to report the following:

1. The involuntary conversion of property used in a trade or business and the capital assets held in connection with a trade or business or a transaction entered into for profit, as well as the disposition of non-capital assets other than inventory or property held primarily for sale to customers in the ordinary course of a trade or business.
2. The disposition of capital assets not reported on IRS Schedule D.
3. The recapture of IRC section 179 expense deductions for partners and S Corporation shareholders from property dispositions by partnerships and S corporations. The deduction allows for up to the entire cost of certain depreciable business assets, other than real estate, in the year purchased, which may be used as an alternative to depreciating the asset over its useful life. Taxpayers cannot use the IRC section 179 deduction to the extent that it would cause them to report a loss from their business.
4. The computation of recaptured amounts under IRC section 179 and IRC section 280F(b)(2), when the business use of section 179 or listed property drops to 50% or less (IRC section 179 –The limitation on depreciation for luxury automobiles; limitation where certain property is used for personal purposes).

Requesting Copies of Forms

Staff should request a copy of IRS Forms 8594 and Form 4797 from the taxpayer to determine the sales price of the tangible personal property when it is either sold or transferred under the above conditions. If the information is not readily available from the taxpayer, staff may request the information through Form BOE-33, Request for Federal Tax Information. Requests should be directed to the Sales and Use Tax Department, Program Planning Manager, MIC: 92. After the pertinent information has been obtained from the return it should be returned immediately to the designated custodian of records and sent back to the Program Planning Manager. Staff should observe guidelines for use of confidential information as outlined in BEAM 7216.

STOCK AND CONSIDERATION RECEIVED FOR ASSETS TRANSFERRED

(CONT.) 1005.10

A transfers motor vehicles, machinery, inventory, and real estate to **B**, a commencing corporation, in exchange for stock and consideration of \$10,000 cash and an assumption of all of **A's** liabilities of \$35,000. The computation of the measure of tax will be as follows:

| Assets Transferred * | | Consideration Received | |
|----------------------------|-------------------|----------------------------------|------------------|
| Inventory | \$ 25,000 | Cash ³ | \$ 10,000 |
| Motor Vehicle ¹ | 6,000 | | |
| Machinery ² | 49,000 | Liabilities assumed ³ | 35,000 |
| Real estate | <u>20,000</u> | | |
| Total | <u>\$ 100,000</u> | Total | <u>\$ 45,000</u> |

1. DMV will assess use tax at time of registration.
2. Tangible personal property not for resale.
3. Total consideration.

* book value presumed to reflect selling price.

Formula:

(Selling Price of the Tangible Personal Property Transferred for Use, Not Resale / Selling Price of All Property Transferred) X All Consideration = Taxable Measure

(\$55,000/\$100,000) X (\$10,000+\$35,000) = \$24,750 taxable

The measure of tax for the transfer of the motor vehicle is \$2,700 (\$6,000 Motor Vehicle / \$100,000 Selling Price of All Property Transferred X \$45,000 All Consideration), and use tax measured by that amount shall be paid to the DMV. The measure of tax for the other tangible personal property transferred for use by the corporation is \$22,050.

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

Name(s) shown on return _____ Identifying number _____

1 Enter the gross proceeds from sales or exchanges reported to you for 2002 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) **1**

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (See instructions.)

| (a) Description of property | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | (d) Gross sales price | (e) Depreciation allowed or allowable since acquisition | (f) Cost or other basis, plus improvements and expense of sale | (g) Gain or (loss) Subtract (f) from the sum of (d) and (e) |
|-----------------------------|-----------------------------------|-------------------------------|-----------------------|---|--|---|
| 2 | | | | | | |
| | | | | | | |
| | | | | | | |

| | |
|--|----------|
| 3 Gain, if any, from Form 4684, line 39 | 3 |
| 4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 | 4 |
| 5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 | 5 |
| 6 Gain, if any, from line 32, from other than casualty or theft | 6 |
| 7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: | 7 |
| Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 6, or Form 1120S, Schedule K, line 5. Skip lines 8, 9, 11, and 12 below | |
| All others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on Schedule D and skip lines 8, 9, 11, and 12 below. | |
| 8 Nonrecaptured net section 1231 losses from prior years (see instructions) | 8 |
| 9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on Schedule D (see instructions) | 9 |

Part II Ordinary Gains and Losses

10 Ordinary gains and losses not included on lines 11 through 17 (include property held 1 year or less):

| | | | | | | |
|--|--|--|--|--|--|--|
| | | | | | | |
| | | | | | | |
| | | | | | | |

| | |
|--|---------------|
| 11 Loss, if any, from line 7 | 11 () |
| 12 Gain, if any, from line 7 or amount from line 8, if applicable | 12 |
| 13 Gain, if any, from line 31 | 13 |
| 14 Net gain or (loss) from Form 4684, lines 31 and 38a | 14 |
| 15 Ordinary gain from installment sales from Form 6252, line 25 or 36 | 15 |
| 16 Ordinary gain or (loss) from like-kind exchanges from Form 8824 | 16 |
| 17 Recapture of section 179 expense deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions) | 17 |
| 18 Combine lines 10 through 17. Enter the gain or (loss) here and on the appropriate line as follows: | 18 |
| a For all except individual returns. Enter the gain or (loss) from line 18 on the return being filed. | |
| b For individual returns: | |
| (1) If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 27, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 22. Identify as from "Form 4797, line 18b(1)." See instructions | 18b(1) |
| (2) Redetermine the gain or (loss) on line 18 excluding the loss, if any, on line 18b(1). Enter here and on Form 1040, line 14 | 18b(2) |

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

| 19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property: | | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | | |
|---|--|--------------------------------------|----------------------------------|------------|------------|
| A | | | | | |
| B | | | | | |
| C | | | | | |
| D | | | | | |
| These columns relate to the properties on lines 19A through 19D. ► | | Property A | Property B | Property C | Property D |
| 20 | Gross sales price (Note: See line 1 before completing) | 20 | | | |
| 21 | Cost or other basis plus expense of sale | 21 | | | |
| 22 | Depreciation (or depletion) allowed or allowable | 22 | | | |
| 23 | Adjusted basis. Subtract line 22 from line 21 | 23 | | | |
| 24 | Total gain. Subtract line 23 from line 20 | 24 | | | |
| 25 If section 1245 property: | | | | | |
| a | Depreciation allowed or allowable from line 22 | 25a | | | |
| b | Enter the smaller of line 24 or 25a | 25b | | | |
| 26 If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291. | | | | | |
| a | Additional depreciation after 1975 (see instructions) | 26a | | | |
| b | Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions) | 26b | | | |
| c | Subtract line 26a from line 24. If residential rental property or line 24 is not more than line 26a, skip lines 26d and 26e | 26c | | | |
| d | Additional depreciation after 1969 and before 1976 | 26d | | | |
| e | Enter the smaller of line 26c or 26d | 26e | | | |
| f | Section 291 amount (corporations only) | 26f | | | |
| g | Add lines 26b, 26e, and 26f | 26g | | | |
| 27 If section 1252 property: Skip this section if you did not dispose of farmland or if this form is being completed for a partnership (other than an electing large partnership). | | | | | |
| a | Soil, water, and land clearing expenses | 27a | | | |
| b | Line 27a multiplied by applicable percentage (see instructions) | 27b | | | |
| c | Enter the smaller of line 24 or 27b | 27c | | | |
| 28 If section 1254 property: | | | | | |
| a | Intangible drilling and development costs, expenditures for development of mines and other natural deposits, and mining exploration costs (see instructions) | 28a | | | |
| b | Enter the smaller of line 24 or 28a | 28b | | | |
| 29 If section 1255 property: | | | | | |
| a | Applicable percentage of payments excluded from income under section 126 (see instructions) | 29a | | | |
| b | Enter the smaller of line 24 or 29a (see instructions) | 29b | | | |

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

| | | | |
|----|---|----|--|
| 30 | Total gains for all properties. Add property columns A through D, line 24 | 30 | |
| 31 | Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13 | 31 | |
| 32 | Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6 | 32 | |

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less
(See instructions.)

| | | (a) Section 179 | (b) Section 280F(b)(2) |
|----|---|-----------------|------------------------|
| 33 | Section 179 expense deduction or depreciation allowable in prior years | 33 | |
| 34 | Recomputed depreciation. See instructions | 34 | |
| 35 | Recapture amount. Subtract line 34 from line 33. See the instructions for where to report | 35 | |



General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

A Change To Note

New temporary regulations under sections 1060 and 338 clarified the rules for allocating assets acquired after February 13, 1997. Under the new rules, all section 197 intangibles (other than goodwill and going concern value) are included in Class IV. Goodwill and going concern value are assigned to a new class, Class V. See "Class IV" and "Class V" under **Definitions** below.

Purpose of Form

Both the seller and buyer of a group of assets that makes up a trade or business must use Form 8594 to report such a sale if goodwill or going concern value attaches, or could attach, to such assets and if the buyer's basis in the assets is determined only by the amount paid for the assets ("applicable asset acquisition," defined below). Form 8594 must also be filed if the buyer or seller is amending an original or a previously filed supplemental Form 8594 because of an increase or decrease in the buyer's cost of the assets or the amount realized by the seller.

Who Must File

Subject to the exceptions noted below, both the buyer and the seller of the assets must prepare and attach Form 8594 to their Federal income tax returns (Forms 1040, 1041, 1065, 1120, 1120S, etc.).

Exceptions. You are not required to file Form 8594 if any of the following apply:

1. The acquisition is not an applicable asset acquisition (defined below).
2. A group of assets that makes up a trade or business is exchanged for like-kind property in a transaction to which section 1031 applies. However, if section 1031 does not apply to all the assets transferred, Form 8594 is required for the part of the group of assets to which section 1031 does not apply. For information about such a transaction, see Regulations section 1.1060-1T(b)(4).
3. A partnership interest is transferred. See Regulations section 1.755-2T for special reporting requirements.

When To File

Generally, attach Form 8594 to your Federal income tax return for the year in which the sale date occurred. If the amount allocated to any asset is increased or decreased after Form 8594 is filed, the seller and/or buyer (whoever is affected) must complete Part I and the supplemental statement in Part III of a new Form 8594 and attach the form to the Federal tax return for the year in which the increase or decrease is taken into account.

Penalty

If you fail to file a correct Form 8594 by the due date of your return and you cannot show reasonable cause, you may be subject to a penalty. See sections 6721 through 6724.

Definitions

"Applicable asset acquisition" means a transfer of a group of assets that makes up a trade or business in which the buyer's basis in such assets is determined wholly by the amount paid for the assets. An applicable asset acquisition includes both a direct and indirect transfer of a group of assets, such as a sale of a business.

A group of assets makes up a "trade or business" if goodwill or going concern value could under any circumstances attach to such assets. A group of assets could qualify as a trade or business whether or not they qualify as an active trade or business under section 355 (relating to controlled corporations). Factors to consider in making this determination include (a) any excess of the total paid for the assets over the aggregate book value of the assets (other than goodwill or going concern value) as shown in the buyer's financial accounting books and records, or (b) a license, a lease agreement, a covenant not to compete, a management contract, an employment contract, or other similar agreements between buyer and seller (or managers, directors, owners, or employees of the seller).

The buyer's "consideration" is the cost of the assets. The seller's "consideration" is the amount realized.

"Fair market value" is the gross fair market value unreduced by mortgages, liens, pledges, or other liabilities. However, for determining the seller's gain or loss, generally, the fair market value of any property is not less than any nonrecourse debt to which the property is subject.

The following definitions apply to applicable acquisitions after February 13, 1997. For transitional rules that apply to acquisitions before February 14, 1997, see **Transitional Rules** on page 4.

"Class I assets" are cash, demand deposits, and similar accounts in banks, savings and loan associations, and other depository institutions, and other similar items that may be designated in the Internal Revenue Bulletin.

"Class II assets" are certificates of deposit, U.S. Government securities, readily marketable stock or securities, foreign currency, and other items that may be designated in the Internal Revenue Bulletin.

"Class III assets" are all tangible and intangible assets that are not Class I, II, IV, or V assets. Amortizable section 197 intangibles are Class IV assets. Examples of Class III assets are furniture and fixtures, land, buildings, equipment, and accounts receivable.

"Class IV assets" are all amortizable section 197 intangibles, except for goodwill and going concern value. Amortizable section 197 intangibles include:

- Workforce in place,
- Business books and records, operating systems, or any other information base,
- Any patent, copyright, formula, process, design, pattern, know-how, format, or similar item,
- Any customer-based intangible,
- Any supplier-based intangible,

- Any license, permit, or other right granted by a governmental unit,
- Any covenant not to compete entered into in connection with the acquisition of an interest in a trade or a business, and
- Any franchise (other than a sports franchise), trademark, or trade name.

However, the term "section 197 intangible" **does not** include any of the following:

- An interest in a corporation, partnership, trust, or estate,
- Interests under certain financial contracts,
- Interests in land,
- Certain computer software,
- Certain separately acquired interests in films, sound recordings, video tapes, books, or other similar property,
- Certain separately acquired rights to receive tangible property or services,
- Certain separately acquired interests in patents or copyrights,
- Interests under leases of tangible property,
- Interests under indebtedness,
- Professional sports franchises,
- Certain transaction costs.

See section 197(e) for further information.

"Class V assets" are section 197 intangibles in the nature of goodwill and going concern value.

Allocation of Consideration

An allocation of the purchase price must be made to determine the buyer's basis in each acquired asset and the seller's gain or loss on the transfer of each asset. Use the residual method for the allocation of the sales price among the amortizable section 197 intangibles and other assets transferred. See Regulations section 1.1060-1T(d). The amount allocated to an asset, other than a Class V asset, cannot exceed its fair market value on the purchase date. The amount you can allocate to an asset also is subject to any applicable limits under the Internal Revenue Code or general principles of tax law. For example, see section 1056 for the basis limitation for player contracts transferred in connection with the sale of a franchise.

Consideration should be allocated as follows: (a) reduce the consideration by the amount of Class I assets transferred, (b) allocate the remaining consideration to Class II assets in proportion to their fair market values on the purchase date, (c) allocate to Class III assets in proportion to their fair market values on the purchase date, (d) allocate to Class IV assets in proportion to their fair market values on the purchase date, and (e) allocate to Class V assets.

Reallocation After an Increase or Decrease in Consideration

If an increase or decrease in consideration that must be taken into account to redetermine the seller's amount realized on the sale, or the buyer's cost basis in the assets, occurs after the purchase date, the seller and/or buyer must allocate the increase or decrease among the assets. If the increase or decrease occurs in the same tax year as

the purchase date, consider the increase or decrease to have occurred on the purchase date. If the increase or decrease occurs after the tax year of the purchase date, consider it in the tax year in which it occurs.

For an increase or decrease related to a patent, copyright, etc., see **Specific Allocation** below.

Allocation of Increase

Allocate an increase in consideration as described under **Allocation of Consideration**. If an asset has been disposed of, depreciated, amortized, or depleted by the buyer before the increase occurs, any amount allocated to such asset by the buyer must be properly taken into account under principles of tax law applicable when part of the cost of an asset (not previously reflected in its basis) is paid after the asset has been disposed of, depreciated, amortized, or depleted.

Allocation of Decrease

Allocate a decrease in consideration as follows: **(a)** reduce the amount previously allocated to Class V assets, **(b)** reduce the amount previously allocated to Class IV assets in proportion to their fair market values on the purchase date, **(c)** reduce the amount previously allocated to Class III assets in proportion to their fair market values on the purchase date, and **(d)** reduce the amount previously allocated to Class II assets in proportion to their fair market values on the purchase date.

You cannot decrease the amount allocated to an asset below zero. If an asset has a basis of zero at the time the decrease is taken into account because it has been disposed of, depreciated, amortized, or depleted by the buyer, the decrease in consideration allocable to such asset must be properly taken into account under principles of tax law applicable when the cost of an asset (previously reflected in basis) is reduced after the asset has been disposed of, depreciated, amortized, or depleted. An asset is considered to have been disposed of to the extent the decrease allocated to it would reduce its basis below zero.

Transitional Rules

For acquisitions before February 14, 1997, that do not include section 197 intangibles, you must use the prior rules (the rules in effect before the issuance of new temporary regulations on January 9, 1997). See **Allocation of consideration under prior rules** below.

For acquisitions before February 14, 1997, that include section 197 intangibles, you may consistently:

- Apply the rules and definitions contained in these instructions and in Temporary regulations section 1.1060-1T;
- Apply the prior rules and definitions described below under **Allocation of consideration under prior rules**; or
- Apply the prior rules and definitions, but treat amortizable section 197 intangibles as Class IV assets.

Allocation of consideration under prior rules. Under the prior rules, purchase price is allocated to the following four classes:

“Class I assets,” which include cash and demand deposits.

“Class II assets,” which include highly liquid assets (e.g., readily marketable securities and certificates of deposit).

“Class III assets,” which include all transferred assets that are not in Classes I, II, and IV. This includes tangible and intangible assets, whether or not depreciable, depletable, or amortizable (e.g. furniture, equipment, buildings, accounts receivable, and covenants not to compete).

“Class IV assets,” which include assets in the nature of goodwill and going concern value.

Patents, Copyrights, and Similar Property

You must make a specific allocation (defined below) if an increase or decrease in consideration is the result of a contingency that directly relates to income produced by a particular intangible asset, such as a patent, a secret process, or a copyright, and the increase or decrease is related only to such asset and not to other assets. If the specific allocation rule does not apply, make an allocation of any increase or decrease as you would for any other assets as described under **Allocation of Increase and Allocation of Decrease**.

Specific Allocation

Limited to the fair market value of the asset, any increase or decrease in consideration is allocated first specifically to the patent, copyright, or similar property to which the increase or decrease relates, and then to the other assets in the order described under **Allocation of Increase and Allocation of Decrease**. For purposes of applying the fair market value limit to the patent, copyright, or similar property, the fair market value of such asset is redetermined when the increase or decrease is taken into account by considering only the reasons for the increase or decrease. The fair market values of the other assets are not redetermined.

Specific Instructions

For an original statement, complete Parts I and II. For a Supplemental Statement, complete Parts I and III.

Enter your name and taxpayer identification number (TIN) at the top of the form. Then check the box for buyer or seller.

Part I

Line 1. Enter the name, address, and TIN of the other party to the transaction (buyer or seller). You are required to enter the TIN of the other party. If the other party is an individual or sole proprietor, enter the social security number. If the other party is a corporation, partnership, or other entity, enter the employer identification number.

Line 2. Enter the date on which the sale of the assets occurred.

Line 3. Enter the total consideration transferred for the assets.

Part II

Line 4. For a particular class of assets, enter the total fair market value of all the assets in the class and the total allocation of the sales price. For Classes IV and V, enter the total fair market value of Class IV and Class V combined, and the total portion of the sales price allocated to Class IV and Class V combined.

Line 6. This line must be completed by the buyer and the seller. To determine the maximum consideration to be paid, assume that any contingencies specified in the agreement are met and that the consideration paid is the highest amount possible. If you cannot determine the maximum consideration, state how the consideration will be computed and the payment period.

Part III

Complete Part III and file a new Form 8594 for each year that an increase or decrease in consideration occurs. Give the reason(s) for the increase or decrease in allocation. Also, enter the tax year(s) and form number with which the original and any supplemental statements were filed. For example, enter “1997 Form 1040.”

Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping** 8 hr., 51 min.
- Learning about the law or the form** 1 hr., 35 min.
- Preparing and sending the form to the IRS** 1 hr., 49 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the IRS at the address listed in the instructions for the tax return with which this form is filed.

