

Memorandum

395.0077

To : Mr. Charles Tavookjian
Supervising Tax Auditor
Fresno District - DH

Date: December 12, 1996

From : Gary J. Jugum
Assistant Chief Counsel

Subject: S--- F--- I---, Inc.
SR --- XX-XXXXXX

This is in response to your memorandum of November 27, 1996.

We understand that taxpayer, a sawmill, entered into a contract to sell its business operations. The main elements in the sale include the inventory of timber and certain fixed assets referred to as "mill assets." The selling price of the timber inventory is set at \$30,000,000, and the selling price of the fixed assets at \$810,000. Section 1.10 of the sales contract states, in part, ". . . buyer and seller acknowledge that the amount allocated to each asset category represents its fair market value determined pursuant to an arm's length negotiation." The taxpayer reported the \$810,000, and is now requesting a refund.

The contract further states that the "mill assets" purchase price shall be adjusted on the date of the final payment on the "mill assets" payment note to account for the risk associated with the volatility in the White Fir lumber market based on the White Fir average market.

When the predetermined date for the adjustment arrived, the market value of the White Fir apparently dropped in value by over \$929,089. Pursuant to the agreement, the selling price of the "mill assets" was reduced to zero and the Assets Payment Note for purchase/sale of the assets was returned. Records of the purchaser apparently record the assets on the books with no purchase price. Consistent with that accounting, the taxpayer has not claimed depreciation on filed income tax returns.

The seller and purchaser agreed to adjust the selling price of the "mill assets," even though the adjustment was directly related to the timber inventory. You inquire as to whether

the subsequent agreement with respect to the purported price adjustment of the “mill assets” will affect the measure of tax.

The subsequent agreement is without effect for sales and use tax purposes. It is evident that the price adjustment related to the timber inventory, not to the mill assets. The claim for refund should be denied.

GJJ:sr

bc: Mr. David H. Levine
Mr. Ronald L. Dick
Ms. Candice McCanne