Revenue Ruling 84-145

1984-2 C.B. 47

ISSUE

Has a domestic commercial air carrier, subject to the regulations of the Civil Aeronautics Board (CAB), sustained a deductible loss under section 165 (a) of the Internal Revenue Code because of a devaluation of its route authorities resulting from the enactment of the Airline Deregulation Act of 1978.

FACTS

The taxpayer, a commercial air carrier, is engaged in the interstate and international transportation of passengers, mail, and property. The taxpayer is subject to the Federal Aviation Act of 1958, as amended, (the Act), which regulates the economic aspects of air transportation. The Act established the CAB and granted it authority to issue regulations that govern interstate and international air transportation. Pursuant to this authority, the CAB granted taxpayer the rights to service several cities. These rights were represented by route authorities.

In order to obtain a route authority to service a particular geographic location, the taxpayer had to apply to the CAB. The CAB would issue a permanent certificate authorizing the whole route or any part of the route authority covered by the taxpayer's application, if it found the taxpayer fit, willing, and able to perform the transportation properly and to conform to the law, rules, regulations, and requirements of the CAB and if it found that the transportation was required by the public convenience and necessity. The application of this standard to the taxpayer and other carrier applicants resulted in the CAB granting a limited number of route authorities to any one destination. The application process was highly competitive, and the taxpayer typically incurred considerable expense in its efforts to prevail in the awarding of a route authority.

Rev. Rul. 56-600, 1956-2 C.B. 171, and Rev. Rul. 67-113, 1967-1 C.B. 55, require air carriers to keep the costs they incur in the acquisition and development of air routes in separate capital accounts. These costs remain capitalized until the routes are abandoned. In the years prior to 1979, the taxpayer capitalized the costs it incurred in obtaining permanent air route authorities from the CAB.

The Deregulation Act changed the standards the CAB used to grant route authorities. The air transportation offered by a carrier no longer needed to be required by the public convenience and necessity. Under the new standard, the air transportation needed merely to be consistent with the public convenience and necessity. However, from the date of enactment until December 31, 1981, when the new standard became fully effective, carriers in order to obtain new route authorities were still obligated to obtain certificates issued by the CAB authorizing the carrier to fly the routes. Under the

Deregulation Act, as fully effective after December 31, 1981, most of the CAB's control over domestic routes terminated.

When the Deregulation Act became fully effective on December 31, 1981, the exclusiveness of route authorities considerably lessened because restrictions on entry into a particular market was significantly reduced. Under the new law, commercial air carriers must still obtain the CAB's permission to operate in a specific market, but they are no longer required to show anything other than that they are not unfit to provide the service. Thus, it is now relatively easy for all commercial air carriers to obtain route authorities from the CAB. In the instant situation, although the taxpayer continued its normal operations, the value of its route authorities declined substantially because its right to operate in a particular market was affected by the potential for increased competition for other commercial air carriers.

LAW AND ANALYSIS

Section 165 (a) of the Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise.

Section 1.165-1 (b) of the Income Tax Regulations provides that to be allowable as a deduction under section 165 (a) of the Code, a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Only a bona fide loss is allowable.

In *Reporter Publishing Co., Inc. v. Commissioner*, 201 F.2d 743 (10th Cir. 1964), the court held that the taxpayer, a newspaper publisher, did not sustain a deductible loss as a result of a decision of the Supreme Court of the United States that held that the by-laws of the Associated Press, which granted the taxpayer an exclusive right to Associated Press services in its community, violated the Sherman Anti-Trust Act. Although the value of the membership in the Associated Press was reduced because of the Supreme Court's decision, it was not eliminated because the taxpayer retained the same rights to receive all the services it received before the decision.

In *Consolidated Freight Lines v. Commissioner*, 37 B.T.A. 576 (1938), *aff'd*, 1011 F.2d 813 (9th Cir. 1939), the lowest court denied a deduction for the cost of certificates of convenience and necessity that a motor carrier claimed had no value because a new law was enacted that repealed the monopolistic characteristics of the old law under which the certificates were issued. The United States Court of Appeals for the Ninth Circuit held that a monopoly was not granted by the certificates but rather sprang from the provisions of the old law. The certificates were merely a means by which a carrier might take advantage of the monopoly that was conferred by the statute. The monopoly, not the certificates themselves, was the thing destroyed by the repeal of the old law.

In the instant situation, the taxpayer did not sell or abandon as completely worthless its route authorities. Although the value of its route authorities was substantially reduced after the Deregulation Act became law, the mere diminution in value of the operating rights does not constitute the elimination or abandonment of a completely worthless asset. In addition, there was no closed and completed transaction fixed by identifiable events because the taxpayer's operating rights remained unchanged even though more competition was introduced.

HOLDING

A commercial air carrier subject to the regulations of the CAB did not sustain a deductible loss of its capitalized costs under section 165 (a) of the Code because of the devaluation of its route authorities that resulted when the Deregulation Act became fully effective on December 31, 1981.