REPORT #700

TAX SECTION

New York State Bar Association

REPORT
on
PROPOSED LEGISLATION
on
AMORTIZATION OF INTANGIBLES
(H.R. 3035)
by the
New York State Bar Association

September 30, 1991

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New York State Bar Association

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September 30, 1991

The Honorable Fred T. Goldberg, Jr.
Commissioner of Internal Revenue
1111 Constitution Avenue, N.W.
Washington, D.C. 20024

Dear Commissioner Goldberg:

I am enclosing our report, prepared by an Ad Hoc Committee on Amortization of Intangibles, on H. R. 3035, introduced on July 25, 1991 by Ways and Means Committee Chairman Rostenkowski (the "Bill"). The Bill would provide for the amortization of most intangible assets, including goodwill and going concern value, acquired after enactment of the Bill over a 14-year period.

For the reasons given in the report, we strongly endorse the approach taken by the Bill. The report also recommends a number of changes in the Bill. The reasons for our support for the Bill, and our recommendations for changes, are summarized in the introduction to the--report.

We would be pleased to discuss the report with you or members of your staff.

Very truly yours,

James M. Peaslee
Chair

Enclosure

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REPORT
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#509 A0018480

I. INTRODUCTION[1]/

H. R. 3035, introduced on July 25, 1991 by Ways & Means Committee Chairman Rostenkowski (the "Bill"), would add new section 197 to the Internal Revenue Code of 1986 (the "Code") under which most intangible assets acquired after enactment of the Bill, including goodwill and going concern value,

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[1]/ This report was prepared by an Ad Hoc Committee on Amortization of Intangibles of the Tax Section, composed of the following members:

Richard G. Cohen (Chair)	Larry Kahn
Reuven Avi-Yonah	George Middleton
William L. Burke	Steve Miller
Dale S. Collinson	Ronald A- Pearlman
Arthur A. Feder	Yaron Z. Reich
Melissa Goldman (Secretary)	Irving Salem
Kenneth Gross	Michael L. Schler
Richard Hiegel	Sterling L. Weaver
Michael Hirschfeld	George E. Zeitlin

In addition, helpful comments were provided by Patrick Carmody, John A. Corry, Harold R. Handler, James M. Peaslee, Richard L. Reinhold, Stanley I. Rubenfeld, David Sachs and Eileen S. Silvers.

would be amortized ratably over a 14-year life.[2]/ For the reasons given below, we strongly endorse the approach taken by H.R. 3035.

In our view, the Bill would have two principal benefits: (1) it would materially reduce controversy between taxpayers and the IRS and the resulting uncertainty of, and lack of uniformity in, outcomes, and (2) it would recognize the economic reality that acquired goodwill and going concern value have a limited economic life.

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[2]/ Amortization of acquired intangibles has received significant legislative attention throughout 1991:

(a) Early this year, Representative Brian Donnelly introduced a bill (H.R. 563) that would eliminate any amortization deduction for customer-based, market share and similar intangible assets; instead those assets would be treated as having an indeterminate useful life.

(b) A competing bill (H.R. 1456), proposed by Representatives Guy Vander Jagt, Barbara Kennelly and Beryl Anthony, was intended to clarify current law. Under the Vander Jagt-Kennelly-Anthony bill, intangible assets are amortizable if the taxpayer can demonstrate that the assets have a limited useful life and an ascertainable value distinct from other assets acquired in the same transaction. A similar bill (S. 1245) was proposed in the Senate by Senators Thomas Daschle and Steve Symms. These bills are intended to overturn an IRS Industry Specialization Program coordinated issue paper, which holds that customer based intangibles are nonamortizable as a matter of law. 91 Tax Notes Today 68-20; 137 Cong. Rec. E969 (daily ed. March 18, 1991).

(c) A General Accounting Office report, Issues and Policy Proposals Regarding Tax Treatment of Intangible Assets (GGD 91-88) (the "GAO Report"), released on August 12, 1991, recommends that Congress consider allowing amortization of purchased intangible assets, including goodwill, over specific statutory cost recovery periods.

An article by Ronald A. Pearlman published in Tax Notes on August 26, 1991, at page 1083, usefully analyzes H.R. 3 035. See also the articles at pages 982 (Tim Gray) and 984 (Lee A. Sheppard) of the same issue of Tax Notes.

(1) Elimination of Controversy. Part II(B) of this report reviews the litigation on this question at some length. It describes more than sixty years of almost constant controversy over amortization of intangibles, particularly customer-based and business opportunity intangibles. Those controversies revolve around three issues:

(a) Does the asset in question have a value that can be separated from goodwill and going concern value?

(b) If so, what is the asset's value?

(c) Does the asset have a readily determinable useful life?

In most taxable acquisitions, the value of the tangible assets and the purchase price of the business can be determined with relatively little controversy. The excess of the purchase price over the value of the tangible assets presumably represents goodwill and going concern value as well as various amortizable intangibles that can potentially be separated from goodwill and going concern value. Over the last twenty years, taxpayers have become increasingly skillful at identifying, valuing and establishing useful lives for a wide variety of intangibles. However, absent Congressional intervention, the issue will continue to provoke extensive controversy between taxpayers and the IRS. For future acquisitions, the Bill would significantly curb such controversy.

By providing a specified amortization period, the Bill also encourages predictability and uniformity. Taxpayers acquiring the assets of a going business can recover the cost of the intangibles over a fixed period, known in advance of the purchase.

(2) Goodwill as a Wasting Asset. While we are not economists, we believe that in many if not all cases acquired goodwill and going concern value are wasting assets with a limited economic life (even though that life can be difficult to predict in advance). This view is supported by the fact that amortization of goodwill required is under U.S. GAAP[3]/ and, as detailed in Part 11(E), is permitted or required under the tax systems of a number of our international trading partners. The Bill would improve the measurement of taxable income by allowing the amortization of goodwill and going concern value.

On the other hand, we recognize that the Bill will require 14-year amortization of some intangibles that have an economic life demonstrably greater or less than 14 years. For those intangibles, the Bill would distort income as compared to present law (assuming that amortization over the greater or lesser period would be the rule under present law). This drawback of the Bill could be ameliorated by expanding somewhat the exceptions in the Bill for contracts having a fixed life and for assets that are acquired separately (i.e., not as part of an active business). However, the exceptions must be carefully drawn so that they do not undermine the Bill's basic objectives.

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[3]/ Accounting Principles Board (A.P.B.) Op. No. 17.

By choosing a 14-year life, the Bill is claimed to be approximately revenue neutral. On the one hand, it will permit amortization of certain assets that were previously not amortizable (in particular, goodwill and going concern value) as well as shorten the life of intangibles that have a longer life. On the other hand, it will increase the life of intangibles such as core deposits, covenants not to compete and other assets that are generally considered to have a life shorter than fourteen years. We have analyzed the Bill as a laudable effort to simplify and rationalize our tax system. Our support for the Bill assumes that the amortization period will not be skewed deliberately to raise or lose material revenues.[4]/

Because H.R. 3035 accomplishes the objectives described above, we strongly endorse its general approach. The Bill is particularly timely since the shift in the U.S. economy from manufacturing to services has meant that the amounts paid for a business are becoming less attributable to tangible assets and more attributable to intangibles.

As discussed in Parts IV and V of this report, we recommend a number of changes and additions to the Bill. Our principal recommendations may be summarized as follows:

- Government licenses of indefinite duration should be included in the definition of a section 197 intangible.

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[4]/ The House version of the bill that became the Omnibus Budget Reconciliation Act of 1987 contained a broad rule preventing amortization of customer-based intangibles that was proposed as a revenue raising measure. H.R. 3545, 100th Cong., 1st Sess. Section 10120 (1987).

- To achieve the Bill's primary objective of eliminating disputes, the administratively-determined separate sale exception should be narrowly construed, so as to apply only in clearly defined situations. On the other hand, to provide certainty for taxpayers, the legislative history should contain extensive examples illustrating when the separate sale exception should apply.

- The separate sale exception should not apply automatically to patents and copyrights. They should be subject to the same administratively imposed rules that apply to other intangibles.

- The separate sale exception should not apply automatically to patents and copyrights. They should be subject to the same administratively imposed rules that apply to other intangibles.

- A broader exclusion from the definition of section 197 intangibles should be adopted for lessee interests. All debtor interests and interests in land should be carved out. A limited exception should also be provided for certain easily valued supply contracts.

- The Bill's loss disallowance rule, while generally necessary, can be narrowed.

- The allocation rules under section 1060[5]/ should be modified so that all amortizable section 197 intangibles are placed in Class IV and all other intangibles are placed in Class III.

- For purposes of determining the deductibility of contingent payments under the Associated Patentees test, the useful life of an intangible should be the same as the period over which a fixed purchase price payment would be amortizable.

- Although the Bill should not be retroactive, the legislative history should encourage use of the 14-year amortization period to settle existing controversies.

Deductibility of Cost of Self-Created Intangibles

In studying the tax treatment of intangibles, we have considered whether, if the Bill is enacted, current deductibility should continue for the cost of self-created customer-based

[5]/ Except where otherwise indicated, all section references herein are to the Code (or, in the case of section 197, the Code as it would be amended by the Bill) or to the regulations thereunder.

intangibles.[6]/ As discussed in Part V(C), we believe that current deductibility should continue to be the rule. In fact, by allowing amortization of goodwill, H.R. 3035 reduces the current law disparity between the expenses of self-created intangibles, which are fully deductible, and the costs of purchased goodwill, which are nondeductible.

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[6]/ H.R. 3035 does not affect the current law deductibility of the cost of self-created intangibles. The GAO Report suggests that a change in the current law to permit amortization of goodwill may require a reconsideration of the tax treatment of costs to create intangible assets, and that, "[a]t a minimum, guidance may be needed to assist taxpayers and the IRS on how to treat such costs." (GAO Report at 39.)

II. CURRENT LAW

A. Overview

Under current law, intangibles are generally amortizable if they have a readily determinable useful life. Treas. Reg. Sec. 1.167(a)-3. Goodwill and going concern value are not amortizable, presumably because they are not considered to have such a life. Id. Thus, in order to amortize an intangible, a taxpayer must distinguish the intangible from goodwill or going concern value. Although the IRS has at times attempted to demonstrate that customer-based and other similar intangibles are "mass assets" that are not amortizable as a matter of law, the courts have generally rejected this view. They have tended to view the issue as factual, to be resolved on a case-by-case basis.[7]/

Given the factual nature of the inquiry, most of the law consists of decided cases rather than rulings, regulations or Code provisions. The case law relating to customer-based intangibles is surveyed in Part B. below. Certain related Code provisions are discussed in Parts C. and D.

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[7]/ See, however, Newark Morning Ledger Co. v. U.S., F.2d (Sept. 12, 1991), pet. for reh. and for consideration en banc filed September 26, 1991. In a decision that is difficult to reconcile with a number of recent cases, both in the Tax Court and at the Court of Appeals level, the 3rd Circuit, reversing a District Court decision that newspaper subscription lists were amortizable, held, apparently as a matter of law, that any intangible that fits the definition of goodwill is not amortizable.

B. Survey of Case Law Relating to Customer-Based Intangibles

Since at least 1925, decided cases have reflected taxpayer attempts to separate from goodwill such acquired intangible assets as insurance expirations, subscription lists, customer files and patient charts and to establish that such assets have a reasonably ascertainable value and a limited useful life over which their cost can be amortized.

Based on a survey of 123 cases primarily from the last thirty years, the following observations can be made.[8]/

- Categories

The cases tend to fall into several categories of intangible:

insurance expirations (24),

customer lists and files (2 0),

franchises (10),

licenses (10),

subscription lists (8),

customer contracts (8),

[8]/ A list of the cases surveyed, some of which involved several claims, is attached as an appendix. The appendix also includes summaries of the cases by intangible, allowance or disallowance of amortization, useful life and values claimed and assigned. For a general survey, see Annotation, Subscription, Mailing, and Customer Lists, Acquired by Taxpayer, as Amortizable Intangible Capital Assets Under 26 uses § 167(a), 24 ALR Fed. 754 (Supp. 1990).

core deposits (5), and

other customer-based or supplier-based intangibles, (e.g., assembled workforce, milk routes, vending machine locations, and mortgage servicing rights).

The cases within each category tend to be concentrated chronologically. For example, most of the early cases dealt with subscription lists (Danville Press, National Weeklies) and customer contracts (US Industrial Alcohol, Thrifticheck). After the taxpayer lost the early subscription list cases (1925, 1943-4), no more such cases were litigated until the Houston Chronicle decision in 1973. The taxpayer's success in Houston Chronicle then encouraged more taxpayers to try to amortize such lists, leading to several cases in this area (General TV, Finoli, Donrev, Newark Morning Ledger). Similarly, the development of bank core deposits as an intangible separate from goodwill has only taken place from 1985 (Banc One) onward.

- Resolution of Cases

Although the IRS has won'[9]/ 83 of a total of 123 of the total disputes litigated (two-thirds), that statistic is misleading for several reasons:

(1) In a few categories the IRS has tended to win a large majority of the cases: insurance expirations (19 of 24), customer contracts (6 of 8), franchises (8 of 10) and licenses (8 of 10). One explanation for this pattern is that most of the cases were decided before Houston Chronicle and the development of more sophisticated valuation techniques; another is that most of these cases concern small businesses, which do not have the resources to introduce the kind of sophisticated proof employed by the banks in the core deposit cases.

(2) After the Fifth Circuit's 1973 decision in Houston Chronicle, the cases reflect a marked change in pattern. Before that decision, the IRS won 53 of 72 cases (74%); after Houston Chronicle, the IRS only won 30 of 50 cases (60%). For example,

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[9]/ For the purposes of this survey, an IRS "win" or a taxpayer "loss" refers to a decision by the court disallowing any amortization whatsoever of the taxpayer's customer-based intangible. A taxpayer "win" or IRS "loss" refers to a decision by the court allowing amortization of the intangible, whether the taxpayer's claim was affirmed in whole or only in part. Although this simplification necessarily results in some distortions, we believe the material cited indicates a significant body of precedent supporting amortization of customer-based intangibles when the taxpayer submits the proper evidence.

in the customer list or file area, the IRS won 6 of 10 cases before 1973, but only 3 of 10 since then. The decision in Houston Chronicle established that amortization of a customer-based intangible is a question of fact and not of law, thereby essentially superseding the “mass asset rule” which tended to develop as a general rule of law in earlier cases (e.g., Golden State Towel & Linen).

- Pattern of Recent Cases

The bank “core deposit” cases illustrate a recurring pattern after Houston Chronicle. Taxpayers seek to establish a new type of customer-based intangible. After a few initial victories for the IRS, the taxpayers develop the necessary level of proof and thereafter the IRS finds it much harder to prevail. Thus, after losing Banc One, AmSouth Bancorooration and Southern Bancorporation, the taxpayer won Citizens and Southern, and thereafter (on harder facts) Colorado National Bankshares.

Until recently, a similar pattern could be observed in the subscription list cases as well. First, the IRS won Danville Press and the two National Weeklies cases; after Houston Chronicle, the taxpayer won in both Donrey and Newark Morning Ledger (trial court), and lost only where the level of proof introduced was minimal (General TV. Finoli). However, the Third Circuit has now reversed Newark Horning Ledger, on the ground that subscription lists fit within the definition of goodwill and

are therefore not amortizable, thus leaving the law applicable to such assets (and other assets with a value dependent on continued customer patronage) uncertain.

Since Houston Chronicle, the outcome of most cases on amortization of customer-based intangibles has rested to a large degree on the sophistication of taxpayer's proof. As a result, even if one taxpayer loses a case, another is now more likely to try again with better proof (and more expensive advice). Unless the government decisively establishes that customer-based intangibles cannot be amortized as a matter of law, this pattern is likely to continue, with more and more taxpayers coming to realize that money spent developing proof of the existence of intangibles will be well spent, and with continuing expansion in the number of intangibles taxpayers are able to amortize. The fact that our economy is becoming increasingly service-based also suggests that taxpayer attempts to amortize intangibles will increase.

C. Tax Treatment of Franchises

A number of insights regarding the appropriate treatment of customer-based intangibles can be drawn from the treatment of franchises under the case law and section 1253.

1. Case law.

A franchise is essentially a customer-based intangible --the right to deal exclusively with the franchisor's customers in a geographic area, generally for a specified period of time.[10]/ In essence, the acquisition of a franchise is the acquisition of the right to use the franchisor's goodwill in a specified area for a specified period of time. The distinction from goodwill is that, in the case of a franchise, the period over which the franchisee can use the goodwill is limited by contract; hence, the useful life of the franchise goodwill is more reasonably ascertainable than the life of goodwill or another customer-based intangible that is purchased outright. While the case law frequently wrestles with the issue of whether the period of a franchise is reasonably ascertainable because of express or implied renewal options, in some cases the courts have been willing to allow amortization if the taxpayer has demonstrated that in fact the period of the franchise/goodwill is reasonably likely to be limited.[11]/

2. Section 1253.

Section 1253, which dates from 1969, provides special rules for the amortization of franchises, which are summarized below. Section 1253 can be viewed as reflecting a Congressional willingness to allow payments for goodwill to be deducted when such deductions clearly reflect income.

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[10]/ In Tele-Communications. Inc. v. Comm'r, 95 T.C. 495 (1990), the Tax Court held that the value of a franchise is the value of the right to deal with existing customers and potential new customers.

[11]/ See, e.g., Chronicle Publishing Co. v. Comm'r. 67 T.C. 964 (1977).

Before the 1989 amendments, section 1253 reflected Congress' intent to distinguish between licenses and sales of franchises. Payments for a franchise were generally deductible or amortizable over a 10-year period if the transaction was similar to a license, i.e., the franchisor retained significant rights in the franchise, whether the payments were contingent or lump sum and regardless of the timing of such payments.

The 1989 amendments to section 1253 appear to reflect a shift in emphasis (although not stated in the legislative history) from the license vs. sale distinction toward a clear reflection of income standard. Under the amendments, the only deductible contingent payments are those paid at least annually for the period of the franchise and which are substantially equal in amount (or calculated under a fixed formula). These payments are clearly tied to the income arising from the use of the franchisor's goodwill, i.e., the payments are made each year that the transferee uses the franchise, even if the useful life of the franchise is not reasonably ascertainable (for example, because of renewal clauses).

The 1989 amendments to section 1253 allow, at the taxpayer's election, 25-year amortization for payments that would have been deductible under prior law (i.e., (i) contingent payments that are not made annually or (ii) lump sum payments where the franchisor retains significant rights in the franchise)[12]/

[12]/ In addition, amortization is allowed over a 10-year period for lump sum payments under $100,000 if the franchisor retains significant rights.

Payments for a franchise that are not deductible under section 1253 (e.g., most non-contingent payments) are generally capitalized. Except to the extent 25-year amortization is available and elected by the taxpayer, such amounts are amortizable under pre-existing law only if the franchise has a reasonably ascertainable useful life.

D. Other Code Provisions Dealing with Amortization of Intangibles

A number of other Code provisions address on a piecemeal basis the problem of valuing and determining the proper useful life of intangibles. Three such provisions are section 178 (dealing with the amortization of leases), section 1056(d) and the so-called super royalty provisions of sections 482 and 367.[13]/

E. Tax Treatment of Intangibles bv Other Countries

Many of the major trading partners of the United States, with the exception of France and the United Kingdom, permit amortization of goodwill for tax purposes. Countries that apparently allow amortization of goodwill for tax purposes include Belgium, Canada, Germany, Greece, Italy, Japan, Korea, Luxembourg, the Netherlands, Sweden and Switzerland.

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[13]/ See also sections 56, 57, 59(e), 173, 174, 195, 248, 263(C), 263(i), 616, 617, 709 and 736.

Japanese tax law permits the depreciation of intangible assets, including goodwill. Intangible assets such as mining rights, fishing rights, water rights, patents, trademarks and design rights are depreciable using the straight-line method over prescribed useful lives.[14]/ Certain deferred assets, including organizational expenses and research and development expenses, are also amortizable.[15]/ Japan's Corporate Tax Law allows amortization of goodwill (limited to the acquisition price)[16]/

Under German tax law, purchased intangible assets (including goodwill) are depreciable. Germany did not allow amortization of goodwill prior to January 1, 1987 when it became depreciable using the straight-line method over fifteen years.[17]/

We understand that in Canada, certain intangible assets, such as rights, franchises and licenses of a fixed duration, are depreciable for tax purposes. In addition, three fourths of the cost of goodwill and other intangible properties may be amortized on a declining-balance basis at a maximum annual rate of 7 percent.

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[14]/ Income Tax Law Articles 2-1-19 & 49, Cabinet Orders Concerning Income Tax Law Articles 6-8 & 120-1-3; Corporate Tax Law Article 2-24 & 31, Cabinet Order Concerning Corporate Tax Law Articles 13-8 & 48-1-3.

[15]/ Income Tax Law Article 2-1-20, Cabinet Order Concerning Income Tax Law, Article 7; Corporate Tax Law Article 2-25, Cabinet Order Concerning Corporate Tax Law, Article 14.

[16]/ Corporate Tax Law Article 31, Cabinet Order Concerning Corporate Tax Law Article 48-1-5.

[17]/ Income Tax Act Sec. 5 subsec. 2; Sec. 7.

United Kingdom tax law does not permit the amortization of goodwill, treating it as a capital expenditure, but it does permit the amortization of certain specified intangible assets, such as know-how, patent rights and scientific research expenditures.[18]/

We understand that under French tax law, goodwill is generally not amortizable. Intangible property with a determinable useful life, such as patents, may be amortized.

Dutch tax law permits the amortization of intangible assets, including goodwill, patents, copyrights, and government permits.[19]/ Goodwill that is acquired in an asset purchase (but not in a stock purchase), by inheritance or gift, or that was contributed to the capital of a business may be amortized.[20]/ In general, intangible assets are amortized in a manner that reflects their decline in value. Goodwill is generally amortized on a straight line basis over five years, but more accelerated methods of amortization have been permitted by certain courts.

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[18]/ Tax Act 1988, s. 520, 530; Capital Allowances 1990, s. 137.

[19]/ Income Tax Act 1964, Article 10 (4).

[20]/ Id.

III. NEED FOR LEGISLATIVE CHANGE

A. Policy Issues Raised by Present Law

1. Law promotes controversy.

As the discussion above indicates, the present law on amortization of intangibles foments disputes between taxpayers and the IRS. Taxpayers are becoming increasingly creative and successful in identifying intangibles other than goodwill or going concern value, measuring their value and demonstrating that they have a limited and ascertainable useful life. On the other hand, the IRS strongly believes that many of these intangible assets, particularly those that are customer-based (such as customer lists and bank core deposits), are part of goodwill or going concern value and, when acquired as part of a going business, are not amortizable.

These conflicting positions can arise in virtually every asset acquisition, and the volume of litigated cases, substantial as it is, represents only a small fraction of the potential controversies in this field.[21] Although repeal of the General Utilities doctrine has diminished the number of post-1986 asset acquisitions, purchases of the assets of a business, or stock purchases that are treated as asset acquisitions by virtue of an election under section 338(h)(10), still occur frequently. Thus, there is a substantial potential for continuing controversy. Controversies are expensive for both taxpayers and the government and outcomes uncertain.

[21] Taxpayers settle many cases with the IRS Appeals Division. Some are resolved or “traded off” at the District level. And some, of course, are never raised on audit.

2. Law results in unequal treatment of taxpayers.

As the survey of case law above indicates, a taxpayer's ability to amortize any particular intangible depends not only on the facts but also on the taxpayer's ability to marshall those facts to its advantage. A taxpayer who has the foresight and resources to hire experts to conduct studies at the time of an acquisition to “find” intangibles is much more likely to win than a similarly situated taxpayer that is less well-advised. Thus, our current system rewards taxpayers sophisticated in anticipating and managing tax controversies.

Given the factual nature of the disputes, and the risk that a taxpayer victory in court may depend as much on the factual record as on the actual facts, we believe the IRS faces a daunting task in maintaining uniform standards for resolving disputes across the country.

3. Inconsistent with economic reality.

Goodwill is plainly a wasting asset, although without a determinable useful life. Goodwill associated with an acquired business would generally disappear if the business did not continue to produce satisfactory products or services for its customers. It has to be maintained by continuing effort and expense. Over time, the value attributable to acquisition cost declines and the value attributable to the new owner's post-acquisition efforts increases. To the extent that acquired goodwill has a limited life but recovery of its cost over time is denied, the tax law violates the fundamental principle that tax is imposed on net income and not on gross income.

The fact that properly-maintained goodwill may last indefinitely does not mean that its initial cost should not be recoverable. Our tax system does not follow that approach for buildings, for example, where cost recovery is allowed over a fixed statutory life even though many buildings, if properly maintained, will last indefinitely (or at least much longer than the fixed statutory life).

4. Violates neutrality principle of taxation.

Not allowing the amortization of limited life intangibles also tends to depart from another basic principle--neutrality--by levying different taxes on persons earning the same level of income (if cost recovery were properly measured). Thus, a taxpayer acquiring a tangible-intensive business (e.g., heavy manufacturing) would be likely to pay less tax on his business income than a taxpayer acquiring an intangible-intensive business (e.g., consumer products).

On the other hand, we recognize that ensuring tax neutrality across industries involves a large number of factors in addition to the tax treatment of intangibles. For example, accelerated depreciation and (when they were allowed) investment tax credits benefitted manufacturing businesses far more than service businesses. Furthermore, if a single amortization period is adopted legislatively for all industries, then those industries that have succeeded in amortizing intangibles over lives shorter than the prescribed period would benefit and those with average lives in excess of that period would be harmed.

The fact that legislation is expected to be revenue neutral would not, of course, ensure that it is revenue neutral for each industry group. Nevertheless, we believe the benefits of the Bill override these considerations.

B. Revenue Considerations

While we are not experts in revenue estimation, the cases in which taxpayers have been successful in amortizing intangibles, when combined with the expansion of the service sector of the economy, may herald the onset of greater losses in tax revenues in the foreseeable future if there is no legislative response. [22]The avoidance of these lost revenues could provide the resources with which to fund the amortization of goodwill and going concern value over a reasonable period.

C. Possible Legislative Responses

The tax policy issues discussed above lead us to support a legislative response that prescribes amortization lives for the most troublesome intangibles.

Legislative change could take several forms:

(1) All intangibles, including goodwill, could be assigned a uniform amortization life.

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[22] Clearly, if taxpayers act rationally, they will spend the dollars to prove their cases where the tax reductions are the greatest, so that taxpayer victories are likely to arise in amortizing multi-million dollar intangibles. The expenditure of IRS resources contesting cases involving amortization of intangibles could also indirectly affect revenues by diverting audits and litigation from other areas.

(2) Every intangible in a specific industry could be assigned a single amortization life.

(3) Different amortization lives could be determined based on the type of asset that would be the same for all industries.

(4) The amortization life of an intangible could be established based on both the type of asset and the kind of industry involved.

Valuation is at the conceptual heart of the problem of amortizing intangibles. Most taxpayers in the cases surveyed who lost did so not because of controversy over the useful life of an asset but because of the difficulty in separating the value of the customer-based intangible from goodwill.[23] Thus, experience to date strongly suggests that if amortization periods are different for different categories of assets (the third and fourth possibilities set forth above), the IRS and taxpayers would continue in many cases to dispute the valuation of intangibles.

The first legislative approach described above is relatively easy to administer because it limits the need to separately identify and value different categories of intangibles. While a single useful life for most intangibles would, on its face, appear to raise issues of fairness, ultimately such a clear-cut rule is likely to be the most effective means of substantially reducing the number of disputes

[23]. There are four typical methods for the valuation of assets: the asset’s historical cost; the asset's replacement cost; the income forecast method; and the cost-savings method. None is without administrative cost to the system, and certainly none can provide a noncontroversial valuation of an intangible.

in this area and the costs related to such disputes. While the second approach (classification of intangibles by industry) might also be administrable, we are concerned that industry classification would in practice result in different industries seeking to gain an advantage through the adoption of shorter lives, which could distort the purposes (and frustrate the achievement) of a legislative solution.[24]

If there are categories of intangibles that in general are not difficult to value and have useful lives that can easily be measured, it may be appropriate to exclude them from the reach of the single amortization life. Excluding them would have relatively little cost in terms of continuing controversy and would promote the goal of properly measuring net income by allowing the excluded intangibles to be amortized based on their true economic lives. Obviously, the exceptions should not encompass intangibles that are close analogues of goodwill, or they will undermine the purposes of the legislation.

One difficulty in adopting a single amortization life is, of course, choosing the right period. For customer-based intangibles alone, the courts have assigned useful lives ranging from 2.5 to 23 years. If a relatively short useful life is chosen, then industries with intangibles that generally have long useful lives would gain significantly.

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[24] We are also concerned that a layer of definitional problems would be added in determining a particular taxpayer's appropriate industry classification.

On the other hand, a long useful life might result in hardship for banks and savings associations with intangibles such as core deposits that have generally been held to have short (3-5 year) useful lives.[25]

The right approach would appear to be first to define the categories of intangibles that will be subject to the uniform rule and then to determine an amortization life for those intangibles that will make the legislation revenue neutral. Assuming accurate revenue estimates (subject to the uncertainties inherent in any revenue estimate), a requirement of revenue neutrality should result in the selection of a period that approximates an average of the amortization lives that would be achieved by all taxpayers holding intangibles subject to the legislation under current law.

with this background, we turn now to a consideration of H.R. 3 035, as described in the next part of this report.

IV. H.R. 3035

A. Summary of Bill

H.R. 3035 would add new section 197 to the Code. The new section would require straight-line amortization over a uniform 14-year period of certain intangible assets ("amortizable section 197 intangibles"), whether or not such intangibles are amortizable under present law.

[25] While the holder of a short-lived intangible may suffer under legislation adopting a single long amortization life, the shorter an asset's life, the more limited its value, and the greater amount allocable to goodwill which would be amortizable.

The new section would cover only “section 197 intangibles” (defined as discussed below) acquired by the taxpayer, either separately or as part of a trade or business, in a recognition transaction after the date of enactment (subject to certain anti-churning rules)[26] Thus, the Bill generally would not apply to self-created intangibles or to intangibles resulting solely from a contract to which the taxpayer is a party (e.g., entering into a lease as lessee). The intangibles must be held in connection with the conduct of a trade or business or section 212 activity.

If an amortizable section 197 intangible is sold or becomes worthless, and the seller retains any other amortizable section 197 intangible acquired in the same transaction, the loss would not be recognized. The adjusted basis of any such retained intangibles would be increased by the amount of loss that is not recognized, in effect allowing the loss over the remainder of the original 14-year period.

Section 197 intangibles would include:

(1) Goodwill and going concern value;

(2) Workforce in place (including acquisition of existing employment contracts);

(3) Information base (including business books, records and systems, customer lists and files, subscription lists, insurance expirations and credit information);

[26] In a nonrecognition or consolidated group transaction the transferee would step into the transferor's shoes to the extent of the carryover basis.

(4) Know-how (including formulas, processes, and the intangible value of software, films, and tapes);

(5) Customer-based intangibles (future value of customer relationships, whether or not contractual, including bank deposit base and insurance in forced[27] but not including (i) accounts receivable, (ii) lessor's rights to above-market rent if the property is also acquired or (iii) creditor's rights to receive above-market interest on a loan with a fixed maturity);

(6) Supplier-based intangibles (future value of relationships, whether or not contractual, with suppliers of goods or services (i) including (x) lessee's rights under a lease unless the lease has a fixed duration, is not renewable, and was not acquired in a transaction involving the acquisition of a trade or business and (y) debtor's rights under a below-market interest rate debt except a non-renewable, fixed term, existing debt, but (ii) not including any interest in land except interests depreciable over less than 30 years under current law);

[27] A special rule would limit amortization of the cost of assumption reinsurance transactions.

(7) Governmental licenses, permits and other rights, unless of indefinite duration or reasonably expected to be renewed for an indefinite period;

(8) Covenants not to compete and similar arrangements entered into in connection with the acquisition of a trade or business[28] or stock or equity therein; and

(9) Franchises, trademarks and trade names, except that contingent payments under section 1253(d)(1) would continue to be deductible under present law (sections 1253(d)(2) through (5) would be repealed).

Section 197 intangibles would not include:

(1) Property of a kind regularly traded on an established market (including stock, securities, futures contracts, etc.);

(2) Patents or copyrights unless acquired as part of the acquisition of a trade or business;

(3) Professional sports franchises and items acquired in connection therewith; and

[28] In general, for purposes of the Bill, the acquisition of a trade or business would include the acquisition of a "substantial portion" of such trade or business or of a "franchise, trademark or trade name".

(4) To the extent provided in Treasury regulations, contract rights or governmental rights of fixed duration and not renewable, unless acquired as part of the acquisition of a trade or business.

The Treasury Department is granted broad regulatory authority under the Bill, including, according to the explanation that accompanied Chairman Rostenkowski's statement on introduction of the Bill ("Explanation"),[29] authority to clarify the types of intangible property that constitute section 197 intangibles.

B. Exclusion of Government Licenses and Sports Franchises

1. Government licenses.

Section 197(d)(4)(E) excludes from the definition of section 197 intangible any license, permit, or other right granted by a government unit or agency, if granted for an indefinite period or reasonably expected to be renewed for an indefinite period. This provision appears to exclude a large number of intangible assets, including, for example, many cable TV franchises, TV and radio station broadcast licenses (or other licenses to use specific radio frequencies), airport landing slots, liquor licenses held by restaurants, taxicab medallions, and restaurant concessions along limited access highways or in national parks.

[29] 137 Cong. Rec. E2707 (daily ed. July 25, 1991).

As a policy matter, we strongly oppose this exclusion. The provision severely undercuts the legislation's goals of creating tax certainty and avoiding controversies between taxpayers and the IRS concerning intangible assets. Taxpayers will have an incentive to minimize the value of government licenses and to allocate purchase price to other intangibles eligible for 14-year amortization; likewise, the IRS would have an incentive to “find” a government license or to increase the value of such a license. Because the exclusion applies not only to government licenses that are granted for an indefinite period, but also to those reasonably expected to be renewed for an indefinite period, the expected life of an intangible would be an issue. These controversies should not continue solely because a government license is involved.

Furthermore, the exclusion appears to discriminate unfairly between businesses that obtain their operating rights from private parties and those that depend on government licenses. We do not see why the purchaser of a McDonald's franchise should be entitled to 14-year amortization while the purchaser of a taxicab medallion is not entitled to any amortization.

The legislation may exclude government licenses because of a concern over revenue loss. If that is so and the legislation as written is revenue neutral, then in order to retain such revenue neutrality the elimination of this exclusion could require extension of the 14-year

amortization period for all assets under section 197.[30] We would reluctantly support such an extension of the amortization period to the extent necessary to bring government licenses within the legislation's ambit.

Government licenses may have been excluded because of a belief that, unlike most intangibles, they truly are perpetual. However, other perpetual assets, such as a perpetual franchise right or a trademark, are included in section 197. Moreover, many “near-perpetual” assets such as know-how and trade secrets fe.g.. the Coca-Cola formula) are included in section 197. similar tangible assets (such as office and apartment buildings) are eligible for ACRS. It is doubtful that the average government license, even if of “indefinite” duration, will outlast such assets. For example, an asset such as a cable TV franchise, even if renewable forever, might become worthless relatively quickly because of technological innovation making house-to-house wiring obsolete. In fact, comparing a newly installed cable system to a newly occupied rental office building (eligible for ACRS), it is not clear which in fact will be earning money for a longer period.

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[30] We note, however, that some government licenses are presently amortizable. See Tele-Communications. Inc. v. Comm'r, 95 T.C. 495 (1990), holding that cable TV franchises are franchises eligible for amortization under section 1253. Current law permits amortization over the lesser of (i) 25 years (10 in Tele-communications) under section 1253 or (ii) under general tax principles, actual life including renewal options or expected renewals. See also Chronicle Publishing Co. v. Comm'r, 67 T.C. 964, 984-5 (1977), and cases cited therein, supporting the proposition that cable TV franchises are not generally renewed (and thus may be amortized over their original term), because they are in due course replaced by a new franchise with substantially different terms.

If government licenses continue to be excluded from section 197 by the legislation, we believe a number of points should be clarified:

(1) The exclusion should not apply to contracts to purchase goods or services from, or to sell goods or services to, a government agency. Such contracts should be covered (if at all) under the general provision for customer-based intangibles or supplier-based intangibles.

(2) The exclusion should not apply to licenses for which the "indefinite" period is the indefinite life of another asset that is itself amortizable or depreciable. For example, a nuclear power plant operating license, good for the life of the plant, should be amortizable. We see no basis for the plant to be depreciable, but the license not to be amortizable.[31]

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[31] As discussed below, we recommend a general exclusion from the definition of section 197 intangible for amounts that would be included under current law in the cost of assets that do not meet the definition of a section 197 intangible.

(3) More generally, the test of the prohibited "indefinite" period should be clarified. An indefinite period with a fixed maximum period such as ten years (e.g., a five-year license with one five-year renewal option) should be treated as having a fixed period (of ten years). Less clear is the appropriate treatment of an indefinite period with a very long fixed maximum (e.g., a five-year license with 19 five-year renewal options). What about a fixed unconditional period of 50 or 100 years, which is literally not an indefinite period under the statute? It would be inappropriate for a 50-year license to be amortizable over 14 years, while a five-year license with (say) nine five-year renewal options would not be amortizable at all.

(4) Finally, it should be made clear that the government license exclusion does not apply to undercut amortization of intangibles such as "workforce in place". For example, on the purchase of an airline, the allocation to workforce in place should not have to be reduced by the value of FAA licenses held by the pilots.

2. Sports franchises.

Under section 197(d)(4)(D), section 197 intangibles do not include a franchise to engage in any professional sport or any item acquired in connection with such a franchise. Existing law would apply, therefore, to such a franchise and any related player contracts, television rights, agreements, etc. We are not aware of any specific legislation relating to this area except for section 1056(d), which creates a presumption that no more than 50% of the purchase price of a sports franchise is allocable to player contracts.

We question the wisdom of this exclusion, since it detracts from the Bill's goals of uniformity and simplification. It may serve as an excuse for other industries to argue for special treatment. However, this is a narrow provision (unlike the exclusion for government licenses), and possibly was inserted because 14-year amortization of player contracts was considered unfair.

C. Definitions of Customer-based and Supplier-based Intangibles

1. Customer-based intangibles.

The definition of a customer-based intangible should be clarified. A customer-based intangible is defined as including, in addition to “composition of market” and “market share”,

> any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.

We think this language should be clarified, so that it cannot be stretched to cover unintended intangibles. Specific definitional issues that we have noted are described below.

a. Exceptions create definitional problems.

Some doubt as to the intended meaning is raised by the exceptions in section 197(d)(2)(B) for interests as a lessor or creditor. While we agree that these interests should not be covered by the Bill, the exceptions raise questions as to the intended scope of a customer-based intangible.

How is a lease or a loan either a “good” or a “service”?[32] Do the drafters believe that a leasehold or a creditor interest might be a customer-based intangible under the other prongs of the definition (composition of market or market share)?

b. Certain ordinary course of business items.

The reference to relationships “in the ordinary course of business with customers” suggests that the term “customer-based intangible” should be construed to include only items that have at least some “goodwill” or “going concern” flavor. A statement to this effect in the legislative history would be helpful. The language also suggests that intangibles arising from “one-of-a-kind” transactions would not count. Also, is it intended, as would seem appropriate, that the term “customer” have the same meaning as under section 1221(1)?

The legislative history should provide examples of contracts to sell property that are not customer-based intangibles, such as contracts entered into by a manufacturing company to sell unneeded machinery or surplus land.

[32] In this connection, see the discussion below of the exclusion of bonds from the definition of supplier-based intangibles.

These sales would not provide goods in the ordinary course of business to customers.[33]

c. Acquisitions of leases, etc., together with underlying property.

The exception for lessor interests referred to above is odd in another respect. As the Explanation notes, when property subject to an existing lease is acquired, current law does not permit a separate allocation to the lease. In effect, no intangible asset of any kind is recognized under current law. As a result, there should be no "intangible" that could fall within the definition of customer-based intangible.[34] This issue might also arise upon a purchase of tangible property that uses technology to which, under current law, no separate allocation is made.

When the cost of an intangible asset would be included in the cost of tangible-property under current law, that intangible should not be treated as a section 197 intangible. We are concerned that the exception for lessor interests implies that the Bill could have this effect.

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[33] There is a special exception from the definition of supplier-based intangible for certain nonamortizable interests in land. We doubt whether a contract to sell land should ever be included as a customer-based intangible, and perhaps this result could be made clear in the legislative history.

[34] The portion of the language of section 197(d)(1)(C) which includes customer-based intangibles refers to "any of the following intangibles".

The exception should be deleted and the Bill changed so that any amount treated as a cost of tangible property (or more generally any other identified property that is not otherwise a section 197 intangible) under current law (including a lessor interest acquired with leased property) is not treated as an intangible for purposes of the Bill.

d. Deposit base.

Under section 197(d)(2)(C), the term “customer-based intangible” includes deposit base and similar items. While perhaps it does not matter, deposit base is more aptly considered a “supplier-based intangible” since it represents the benefit of a cheap source of funds.

e. Stocks, bonds, partnership interests and financial products.

The Explanation of “supplier-based intangibles”, states that

> the portion (if any) of the purchase price of an acquired trade or business that is attributable to stocks, bonds, partnership interests, and other securities is not to be taken into account under the bill [presumably as a supplier-based intangible] ....

The reason given is that

> the value of these intangible interests does not result from the future acquisition of goods or services pursuant to relationships in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.

While we generally agree with these statements, it should be made clear that the assets referred to are also not “customer-based intangibles”.

The reference to “stocks, bonds ... and other securities” is ambiguous. It could be read in a limited manner, to refer only to “portfolio” securities. However, stock of a wholly-owned subsidiary would also not meet the definition of a section 197 intangible.

We also recommend that the list be expanded to include “options, swaps and other financial products (other than insurance) whether or not they are tradable items within the meaning of section 197(d)(4)(A)”. The taxation of financial products is complicated enough without adding 14-year amortization to the list of possible tax regimes.

The exclusion of partnership interests may cause confusion. While it makes sense to exclude partnership interests generally from the definition of section 197 intangibles, so that the cost of such an interest is not amortized automatically over fourteen years, the partnership itself may have section 197 intangibles that should be covered by the Bill. The allocation rules of section 1060 apply to acquisitions of partnership interests as set forth in section 1060(d). A similar rule may be needed for applying section 197.

2. Supplier-based intangibles.

The definition of a supplier-based intangible parallels the definition of a customer-based intangible, but has a number of specific rules for leasehold interests and interests in land (discussed in Part IV(D) below) and debt instruments (discussed in Part IV(E) below).

a. Supply contracts.

One initial question is whether every supply contract should be included as a supplier-based intangible.[35] At least for those contracts involving goods or services with a readily determinable market value, consideration should be given to whether the contract should be a section 197 intangible to the extent its value is attributable to a contract price that differs from that market value.

[35] Certain supply contracts may be excluded under the contract right exception in section 197(e)(4). However, that exception does not apply to transactions in which businesses are acquired. The text questions whether there should not in some circumstances be a broader exclusion for supply contracts.

A fairly narrow exception might be created for contracts relating to commodities, or to any tradable property described in Section 197(d)(4)[36](An example of such a contract might be an oil supply contract.)

b. Treatment of prepaid amounts.

Frequently nonrefundable prepayments are made in connection with the entry into multi-year agreements. Examples include employment contracts with a “signing bonus,” or contracts for the provision of goods or other services. Under present law, the payor must amortize the prepayment over the life of the contract.[37] If the contract is assumed as part of the purchase of the business, under the general rule of section 197 the entire amount allocated to the contract, representing the value of the contract, would be amortized over 14 years. However, a portion of that value is clearly attributable to the prepayment, since the result of the prepayment is to permit “below-market” ongoing payments to the employee or other provider. We believe that consideration should be given to. a rule that, absent unusual circumstances, the contract should be deemed to have a value at least equal to the unamortized portion of the prepayment, and such portion of the purchase price allocated to the contract should be amortizable over the remaining life of the contract (rather than over 14 years).

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[36] A parallel rule should exclude such a contract from the definition of a customer-based intangible in the hands of the supplier.

[37] Treas. Reg. Sec. 1.461-1(a)(1).

For example, assume that Employer signs a three-year employment contract with Employee calling for $100X per year in compensation and a nonrefundable up-front payment of $60X. Presumably the Employee's services are worth $120 per year. Assume that one year after the contract is signed (and the bonus paid), X purchases the assets of the Employer and assumes the contract. Assuming the value of the Employee's services is unchanged, the contract is worth $40 because it permits the receipt of $240 worth of services in exchange for $200 of future compensation. Assuming the absence of a bargain purchase under section 1060, X would allocate $40 to the contract. Under the general rule of section 197, the $40 would be amortized over 14 years; the current salary of $100 per year would be deductible when paid.

The amount of the prepayment on a contract is an objective, third-party determination of the initial value of the contract immediately after the payment is made. Moreover, we believe it would be unusual for the value of such a contract to decline significantly below its original value. As a result, in the absence of demonstrable unusual circumstances, in the interest of administrative simplicity we believe the value of the contract should be deemed to be at least equal to the as-yet-unamortized portion of the seller’s prepayment. In addition, because the amount of the prepayment is objectively determined and not subject to valuation disputes between taxpayers and the IRS, we believe consideration should be given to a rule that the amount of purchase price allocated to the contract,

up to the seller's unamortized prepayment,[38] should be amortizable over the life the contract rather than over 14 years. Any additional purchase price allocated to the contract would, of course, remain amortizable only under the general 14-year rule.

Aside from section 197 considerations, current law (as well as logic) would allow the entire portion of the purchase price allocated to the contract (including the portion corresponding to the value of the contract arising from the prepayment) to be amortized over the life of the contract. Moreover, taking into account the policy behind section 197, there appears to be no room for dispute between taxpayers and the IRS as to the amount of unamortized prepayments.

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[38] Even though the contract is deemed to be worth the unamortized prepayment amount, in the case of a bargain purchase under section 1060 the amount of purchase price allocated to the contract would still be less than the amount of unamortized prepayment.

It thus appears consistent with the policy behind the Bill to exclude from the scope of 14-year amortization the lesser of the unamortized prepayment and the portion of the purchase price allocable to the contract.[39]

D. Leasehold Interests and Interests in Land

Section 197(d)(3)(B) treats all lessee interests in tangible real or personal property as supplier-based intangibles (subject to the exception for land leases described below), unless:

> (i) the lease has a fixed duration and is not renewable and
>
> (ii) the interest is not acquired in a transaction involving the acquisition of assets constituting a trade or business (or substantial portion thereof).[40]

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[39] An exception might be appropriate where the IRS could clearly demonstrate that the value of the contract had declined since it was entered into. For example, if X made a prepayment to Y for the right to purchase oil from Y at a fixed price below then-current market, at the time a third party purchased the contract from X the contract might have a demonstrable value far below the amount of the unamortized prepayment. In such cases, the IRS should be permitted to limit the purchase price allocation to the contract to its actual value, although logically that amount should then be amortizable over the remaining term of the contract to be consistent with our general proposal.

[40] such a leasehold interest apparently need not satisfy the general definition of supplier-based intangible, as arising from a relationship "in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer". Leases would not ordinarily meet this definition because leases are entered into by a business only occasionally.

Section 197(d)(3)(D) excludes from supplier-based intangibles any interest in land (including as a lessee) unless such interest is amortizable (without regard to section 197) over a remaining period of less than 30 years. Because this rule does not affirmatively include any interest in the definition of supplier-based intangible, an interest in land must still meet the general requirements of the definition (or be a leasehold interest subject to section 197(d)(3)(B)) to be a section 197 intangible.

We question whether lessee interests in tangible property or any interests in land should ever be subject to section 197, particularly since there is a potential for significant revenue loss from such inclusions. It should not be significantly more difficult to value most interests in real property or leases of tangible property than to value the underlying property. If the lease has renewal rights, then the rules of section 178 could be applied to determine whether to include the renewal periods. In our experience, uncertainty regarding the valuation of leases of tangible property and interests in land, and the appropriate amortization period, has not been a significant problem.

The Bill's current exception for leasehold interests not acquired on the acquisition of a trade or business (or substantial portion thereof) may have only limited applicability; the leasing of a single item of property may in and of itself qualify as a trade or business. If as a result the exception for assets not used in a trade or business is unavailing, then the net effect of the Bill would be to treat <u>any</u> lease of tangible real or personal property as a supplier-based intangible unless it is a lease of land amortizable over a remaining period of more

than 30 years or more. As the discussion below suggests, this rule would substantially change current law.

Consider the following example:

> Example (1). In 1970 A leases land constituting Blackacre to B for 50 years. B constructs a hotel on Blackacre. In 1980 B leases the land and the hotel to C, with B retaining ownership of the physical assets for the remaining 40-year term of the ground lease. In 1992, after the enactment of section 197, C sells his leasehold to D, who will continue to operate the hotel, for a substantial stun.

Under prior law, D would amortize his investment in the hotel (both land and building) over the remaining 28 year term of the lease.[41] However, section 197 would 41 If D could demonstrate that a portion of his cost for the leasehold should be allocated to the building leased, and that the building's actual expected useful life is shorter than the lease term, then amortization require D to amortize his investment over 14 years (assuming that the leasehold interest is a trade or business asset).

> Example (2). Assume that the original ground lease from A to B had a 70-year term, that B's lease to C was for 60 years and that at the time of D's purchase from C the remaining term of C's lease is 48 years. Under present law, D would generally amortize his basis for the leasehold over 48 years.

Under section 197, D's leasehold investment would have to be divided between his interest in the land and his interest in the building constructed by B. Section 197 would continue to require D to amortize the amount allocated to the land over 48 years (since the ground lease has a term greater than 30 years

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[41] If D could demonstrate that a portion of his cost for the leasehold should be allocated to the building leased, and that the building's actual expected useful life is shorter than the lease term, then amortization of that amount over the shorter useful life might be allowed.

and thus is not a section 197 intangible). However, since D would not be treated as owning an interest in the physical building constructed by B, D would presumably be entitled to amortize the portion of the purchase price allocable to the building over 14 years (rather than the 48 years provided under current law).

Since most leases of the type purchased by D generally have relatively long terms, the overall effect of extending section 197 to such leaseholds may well be a significant revenue loss.

Although less clear, section 197 might also apply to the purchase of improvements on leased land. Under current law if a ground lease is improved with a building or similar asset of which the lessee is the owner (i.e., has a depreciable interest), a purchaser of the lease and the improvements is treated as having a depreciable interest in those improvements. Rev. Rul. 61-217, 1961-2 C.B. 49. The portion of the cost attributable to the improvements is depreciated under section 168 without regard to the lease term, generally over 31.5 years. See section 168(i)(8). The portion of the cost attributable to the ground lease is amortized over the lease term, giving effect to section 178.

Because the improvements are made available under a lease, they might be considered under the Bill as an “interest as a lessee under a lease” resulting in amortization of the purchaser's interest in the building over 14 years. This problem could be solved by clarifying (as recommended in Part IV(D) above) that any amount that is included under current law in the cost of tangible property will not be included in the cost of a section 197 intangible.

Finally, was it intended that mineral interests could be treated as supplier-based intangibles? Mineral interests may be amortizable (through cost depletion) over a period of less than 30 years so that they would not be covered by section 197(b)(2)(D). Will a purchaser of the assets of an oil company that holds oil and gas leases which it uses as a source of supply have to allocate the cost of the leases ratably over 14 years, rather than based on the use of the reserves? What about a waste disposal company that has landfills, or a construction company with rock quarries? As indicated above, we recommend eliminating all interests in land from the definition of a section 197 intangible.

E. Debtor Interests

Debtor interests are treated as supplier-based intangibles, except for debtor interests --

> under any existing indebtedness which has a fixed term and is not renewable.

The inclusion or exclusion of debtor interests should not be based on whether debt has a fixed, nonrenewable term. The problem of determining the proper amortization of loan premium is not a new one, and other Code rules can more properly be relied upon to determine the appropriate recovery period.

Moreover, the requirement of a nonrenewable fixed term will place a premium on form. Virtually all debt has an outside maturity date, and most debt instruments are repayable at the option of the borrower or lender at some time prior to maturity.

Thus, the vast majority of debt instruments could be considered to have a fixed term (the shortest period the instrument could be outstanding according to its terms) subject to renewal at the option of one of the parties. The proposed original issue discount regulations recognize that there is no difference between a right to prepay and a right to extend.[42] The tax system has managed to handle the uncertainty as to the period a debt instrument will remain outstanding without major problems; we do not believe that such uncertainty should subject the premium on a debt instrument to amortization over a 14 year term.

We recognize that some debtor interests may have value not because of the terms of the debt but because of a customer relationship. As indicated above, we would have no objection to treating as a supplier-based intangible deposit base and similar items of a financial institution. However, the distinction between a premium attributable to a goodwill element and one that represents a favorable borrowing rate does not turn on whether an instrument has a fixed, nonrenewable term. Presumably a deposit base could have value even if it consisted of fixed term CDs. We believe that the appropriate result would be reached by excluding debtor interests from the definition of supplier- based intangibles except to the extent the special deposit base rule applies.

F. Separately Purchased Intangibles

The Bill would create a special exclusion from section 197 intangibles for certain intangibles not purchased in a transaction involving the acquisition of a business.

[42] Prop. Treas. Reg. Sec. 1.1272-1(f)(4)(v).

The special exclusion would apply to all separate purchases of patents or copyrights and, to the extent permitted by the IRS in regulations, to the separate purchase of other contract rights with a definite term.

We support both the concept of an exclusion for separate sales and the basic legislative approach of leaving the limits to administrative determination. We believe, however, that certain changes should be made in the exclusion as currently drafted and that additional guidance in the form of illustrative cases should be given in the committee reports.

There is no reason, in principle, for imposing an artificial 14-year amortization period upon isolated sales of a single intangible with a clearly fixed tern. Such a step is not needed to eliminate factual controversies. Consider the following example:[43]

> Example (1): X, a utility company, has a favorable 10-year, fixed price contract with unrelated party A for A to supply coal to X's coal burning power plant in equal quantities each year. X converts the plant to natural gas and sells the then unneeded coal supply contract for a fixed cash price to unrelated party Y, which has no other business dealings with X.

Under current law, the buyer's tax treatment should not be a source of controversy. Amortization of the purchase price over any period other than the remaining term of the contract would seem to move the federal tax law away from, rather than toward, an accurate measurement of income.

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[43] The examples below involve supply contracts. We discuss below the possibility of a limited exclusion for certain supply contracts that can be easily valued even when purchased as part of a business. The exclusion for separate sales discussed here should be in addition to any other exclusions that may be adopted.

However, the scope of what constitutes a “separate” sale of an intangible needs to be clarified. In particular, in appropriate cases the same considerations would support “actual life” amortization even where there has been a simultaneous sale or purchase of a business:

> Example (2): Same as Example (1). Except that X also simultaneously sells the plant (and all the rest of its business) to z, a party unrelated to Y that does not have any dealings with Y.

There seems little reason to make the consequences to Y different from what they would be if X sold the intangible to Z along with the business and Z then sold the intangible to Y.[44] Either way, Y's independence gives credence to its payment being the proper value of the intangible.

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[44] While Z would not qualify for the exception in such a case, this should make little difference to z if it resold the contract to Y shortly after the purchase from X.

Moreover, if the result for Y were different than in Example (1), there would be the very undesirable effect (from the point of view of taxpayer planning and practical IRS auditing considerations) of making the tax consequences to Y depend, within some parameters, upon the subsequent (as well as prior) actions of X with other parties.[45]

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[45] Example (2) may also be viewed as suggesting an incentive, after the new system goes into effect, to sell separately any intangible with a clearly fixed term of less than 14 years (or whatever general statutory period is ultimately set). There may be such an incentive in the proposed system, but it inheres more in the basic system of pooling all intangibles sold together than in any separate sale exception.

If a separate sale rule were not available, x and Y in Example (2) could achieve the equivalent economic result by X keeping the contract and entering into a contract with Y to sell Y the same quantities of supplies each year either (1) at a fixed fair market value price determined initially to be arm's length to both parties, or (2) at the same discount price at which X can acquire the supplies under its own contract (in which case Y will pay X an up-front payment equal to the value of its discount price, i.e., the value of X's own supply contract). In both such cases, Y effectively amortizes the value of X's supply contract over 5 years (in the latter case because the X-Y contract is a “self-created intangible* not subject to the Bill). In both such cases, all that would have been achieved by the elimination (or too narrow drafting) of a separate sale exception is pressure on the parties to make artificial (non-business driven) arrangements and (in the former case) an elimination of the accelerated income recognition that would result from a sale of the intangible from X to Y.

More significantly, while there may be some incentive for the holdback or sale to a third party of short-term intangibles just as is now sometimes seen with appreciated inventory or with accounts receivable in suspected “bargain” purchase situations, the quantitative significance of such cases is sharply limited by the combined effect of such practical factors as whether the intangible is so fungible as to be replaceable easily, the need to find another buyer in the relevant time frame, and the other business interests of buyer or seller in having a “clean* deal. Whatever concerns exist for those practical restraints being negated by the seller leasing selective intangibles to the buyer can be dealt with as a part of the anti-churning rules.

transaction involves a simultaneous purchase of a business and a related intangible:

> Example (3): Same as Example (1), but at the same time as the purchase from X, Y purchases from W, a party unrelated to X, an entire business in which Y will use the intangible purchased from X.

In this case, the consideration paid for (and the life of) the intangible acquired by Y from X are independently established in a way that makes it unnecessary to override the separateness of the transaction between X and Y.

On the other hand, there are circumstances where a "split-up" of a business, as in Example (2), may raise the specter of avoidance of the anti-churning rules:

> Example (4): Same as Example (2), except that Y in turn sells (or otherwise transfers) its supply contract to Z.

If the separate sale exception were to apply to the sale from Y to Z in this case, it would lose all meaning. We recommend that the exception not apply in such a case, or where Y and Z are related parties.

Besides defining what constitutes a "separate" sale, two additional terms that need to be further defined in the legislative history are "acquisition of a business" and "fixed duration". Since much of the previous controversy has arisen when contract rights were sold in connection with transfers of businesses, or when the contract right did not have a clearly fixed term, those factors are appropriate starting points for implementing the exclusion.

If guidance is to be provided and taxpayer/IRS controversy eliminated, the exclusion must be drafted to insure a high level of certainty as to when it applies:

Consider the following examples:

> Example (5): Petro-chemical company X decides to sell an entire refinery (a fully self-sufficient facility at location A) that happens to be the only one that uses certain patented technology owned by X. X sells the patent with the refinery.
>
> Example (6): Same as Example (5), except that the tangible assets sold (and the patent) involve only certain land and equipment that is used in the last step of the refining process and that is located on a corner of the refinery complex next to property where the buyer will construct facilities for further processing.
>
> Example (7): Same as Example (5), except that the asset sold is only a single piece of patented equipment that the buyer immediately moves to an entirely new site.

These examples illustrate the inherent vagueness of what constitutes a "business".[46] In each, the patent is clearly liked to other assets. But if those assets arguably constitute a "business" in Example (5) and not in Example (7). what about Example (6)?

Similarly, once expectations of renewals are introduced, the concept of a fixed term becomes vague, especially if, as we advocate, government licenses are included as section 197 assets:

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[46] The same vagueness is reflected in the history of the continuity of business enterprise requirements of Section 382 and in the reorganization rules (Treas. Reg. Sec. 1.368-l(d)) and the active business requirement in section 355 and more recently in the employee benefit plan rules in section 414. But it is not clear that the concept of what constitutes a "business" for purposes of section 197 should be the same as for any of those provisions. The definition of applicable asset acquisition under section 1060 (which generally looks to the active business requirement of section 355) may be relevant.

Example (8): X purchases separately from Y a network affiliation contract with a fixed term of 2 years. Y has held the contract for sixteen consecutive 2-year terms, and the network has approved the sale to X.

Example (9): Same as Example f (8). Except that the network has told X that it is reviewing its policy of renewing affiliation contracts automatically.

Example (10): Same as Example (8), except that the network disapproved of the sale to X.

There will also be cases where several intangibles will be sold together but not as part of a business, and only some of them will have a fixed duration:

Example (11): Suppose in Examples (5) through (7) that the sale in each instance also involved transfer of trained personnel to operate the equipment (i.e., a possible “workforce in place” intangible).

Example (12): Suppose in Examples (5) and (61 that no tr ansfer of personnel was involved, but the facility transferred took substantial time to construct and test before it could be put in production (i.e., a possible “assembled facility” or “going concern” intangible).

The exception in these cases should only apply to the intangible with a fixed duration (i.e.. the patent). In other cases, there may be more than one intangible with concededly fixed, but different lives, so that allocation of value would still be an issue.

The problems posed by the inability to draw a precise distinction should not, however, override the policy for allowing the stand-alone sale where appropriate (such as in Examples (1) through (3) above). On the other hand, since the consequence of construing the separate sale exclusion narrowly is not to disallow amortization, but only to throw a particular intangible back into a statutory 14-year class, there is some justification

for avoiding a broad exclusionary rule for stand-alone sales, which can only foment controversies.

For this reason, we favor an approach that permits exclusions only where it is determined to be administratively feasible without generating the risk of disputes, a bias, in effect, in favor of construing the exclusion relatively narrowly, to apply only in very clear cases. We therefore support the statute's approach of leaving the exceptions to administrative determination.

But we also believe that such a narrow approach should be coupled with descriptions in the legislative history of specific situations that are expected to fall within the exclusions as well as examples of those that are not. The examples will give better guidance to taxpayers for many transactions where there should be no issue. They will also help elaborate how the “generic” concepts involved in the exclusion should be applied.

In particular, we recommend that the legislative history indicate that the separate sale exclusion would apply to Examples (1) through (3) above but not to Example (4). While we would also lean to not allowing the exclusion in Examples (5) through (12), we would support leaving those decisions for further administrative consideration in light of the cautious bias we have suggested.

Nor do we see any strong reason to single out for special treatment patents or copyrights. As the above examples are meant to suggest, with respect to the concept of “business” or “acquisition of business,” patents and copyrights seem to

raise the same type of issues as other intangibles.[47] In addition, while those assets may have the special feature of statutorily mandated maximum lives (if section 197 does apply to them), it is our experience that taxpayers frequently have claimed (and justified) actual useful lives for such assets that are considerably shorter than the legally protected period (for example, in the case of music copyrights). We recommend, therefore, that the special rule for patents and copyrights in section 197(c)(4)(C) be deleted and that such intangibles be subject to the same rule of exclusion by administrative determination as any other intangible.

Software

It is unclear to us why the administrative authority to exclude separately purchased intangibles should be restricted to contract rights of fixed duration. One example of a separately purchased intangible that we believe should be excluded from the scope of section 197 is the purchase of an item like computer software in the marketplace. Under current law, such software can be written off over a period not to exceed five years. Rev. Proc. 69-21, 1969-2 C.B. 303. Shorter periods may also be justified.

The Bill appears to encompass such intangibles. See section 197(d)(1)(iii) and the Explanation. The Bill should make clear that separately purchased computer software is not a section 197 intangible.

[47]. Indeed, in some cases, a patent can be very similar to a franchise.

G. Partial Dispositions: Disallowance of Loss and Recognition of Gain

When some but not all of the section 197 intangibles acquired in a single purchase become worthless or are sold, issues arise involving recognition of both gains and losses. For the reasons given below, we generally agree with the Bill's treatment of both gains and losses although we believe the rule barring recognition of loss could be both liberalized and strengthened.

1. Proposed rules.

a. Losses.

Under section 197(e)(1), loss is not recognized on the disposition (or worthlessness) of an amortizable section 197 intangible if:

(i) one or more other amortizable section 197 intangibles were acquired in the same transaction or series of related transactions, and

(ii) one or more of such other intangibles are retained.

The amount of any disallowed loss increases the basis of such other intangibles.[48] This rule allows the loss on disposition of a section 197 intangible over the remainder of the original 14-year amortization period that applies to the entire group of intangibles.

b. Gains.

When a section 197 intangible is sold at a gain, the Bill leaves unchanged the current law requirement that gain be recognized at the time of sale.

2. Comments.

a. Some loss disallowance is necessary.

Disallowance of losses is necessary to enforce the Bill's 14-year amortization rule. Absent this provision, while an entire package of purchased intangibles would initially be amortized over 14 years, at the end of the life of any particular intangible (e.g., a five-year covenant not to compete or other contract right) the remaining basis of that intangible would be written off as a worthlessness deduction.

[48] According to the Explanation, the loss is allocated to such other intangibles in proportion to the adjusted basis of such intangibles on the disposition date.

The result would be an average amortization period for purchased intangibles of much less than 14 years, contrary to the purpose of the Bill.[49]

b. The loss disallowance rule can be narrowed.

The loss disallowance rule in the Bill, even if necessary in some cases, appears unjustified in others.

> Example. A purchaser buys from a single seller two separately-run retail clothing chains, one on the East Coast and one on the West Coast. The East Coast chain operates in an upscale market. The West Coast chain sells lower-priced merchandise.
>
> Based on an analysis of each division's assets and earnings, equal value is determined for each chain. However, an unexpected competitor enters the West Coast market, sales of the purchased West Coast chain plummet, and the purchaser sells that chain at a big loss.

Since a significant part of the purchase price of a successful retail chain might properly be allocated to goodwill, going concern value and other intangibles and since most of any loss would probably reflect a decline in the value of these intangible assets,

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[49] Nor is it sufficient to disallow only the deduction for an intangible that is worthless. Absent an additional rule disallowing losses of intangibles that are sold, a taxpayer could sell an intangible shortly before the end of its life and claim a loss, effectively deducting the entire cost of the intangible by the end of its actual life (rather than on a level basis over 14 years). Thus, a rule such as that in the Bill is necessary for at least some losses on sales and claims of worthlessness.

most of the loss I would be disallowed by section 197 (and recovered over the remainder of the 14-year amortization period of the East Coast chain)[50]

We believe the loss on sale on the West Coast chain can be allowed without undercutting section 197's 14- year amortization rule. By allowing the loss only when a full business is sold, the loss can be expected to involve short-lived as well as long-lived intangibles. For these reasons, we believe that disallowance of the loss in such cases is unnecessary and unduly harsh.

We would suggest, therefore, that losses be allowed upon the disposition of all intangibles that as a group are used in activities that do not also use other intangibles that were purchased at the same time. The details of the exception are probably best left to regulations, since rules concerning "separate businesses" will have to be crafted.

c. Need for related party rules.

It is not clear whether the loss disallowance provision in the Bill can be avoided by having related parties purchase different intangibles. For example, if the seller has three intangibles, and three related corporations each purchase one intangible, can any of the corporations subsequently sell its single intangible at a loss even though the other corporations retain their respective intangibles?

[50] This result also provides the taxpayer with the anomalous incentive to then sell the East Coast chain. Assuming its value is unchanged, this would result in immediate recognition of a loss equal to the disallowed loss on the West Coast chain. The taxpayer, poorer but wiser, could then start over and buy another East Coast retail clothing chain.

It might be argued that the Bill precludes the loss in this situation, since it refers to a disposition of an intangible acquired in a transaction *or series of related transactions", where at least one of such intangibles is "retained." Arguably this language is broad enough to cover more than one purchaser acquiring intangibles in related transactions. However, the Bill clearly should not cover unrelated purchasers buying different intangibles from a single seller in related transactions, and the Bill does not distinguish between related and unrelated purchasers. Thus, as an interpretative matter, the existing Bill probably should not be read to cover purchases by related parties.[51]

Thus, if purchases by related parties are to be aggregated, a new provision would have to be added to the Bill. We recognize that any such provision will have to include the usual complex definition of "related party" and will have to have the usual complex incorporation of attribution-of-ownership rules, but we believe that in practice it will not be an excessive burden to taxpayers.

At a minimum, we believe (as suggested above) that unless losses are allowed upon the complete disposition of one business (where more than one separate business has been acquired at the same time), any rule for aggregating related party purchasers should exempt related parties acquiring separate

[51] Note that the proposed statutory language referring to acquisitions in a series of related transactions is the same language that appears elsewhere in the Bill in other contexts (e.g., the exception for separately purchased contracts, and the exceptions for leases and patents). Presumably all such provisions should be interpreted in the same way for acquisitions by multiple related parties.

businesses. We believe it essential that, one way or the other, purchasers buying more than one business at the same time have an opportunity to recognize a loss on the sale of one business even though the other businesses are retained.

d. Recognition of gain.

Under the Bill, when a section 197 intangible is disposed of at a gain, current law rules will apply to require recognition of that gain. There are some advantages to a rule that would delay recognition of any gain until the remaining unamortized cost of all section 197 intangibles is recovered. However, for the reasons given below, after analyzing the advantages and disadvantages of a basis recovery rule, we support continuance of the current law requirement of gain recognition.

(1) Advantages of a basis recovery rule.

If current rules on gain recognition continue to apply, the Bill will not prevent disputes between taxpayers and the IRS concerning the proper allocation of purchase price among various section 197 intangibles purchased at the same time.

> Example (1). Purchaser buys intangibles A and B for a total of $200 and, after seven years, when the remaining unamortized tax basis is $100, sells A for $50.

The sale of A is the first time the allocation of original purchase price between A and B becomes relevant.

Under the Bill, even if the taxpayer did not originally allocate purchase price between A and B, the taxpayer has no incentive to claim that the original allocation to A was properly more than $100 (and so that the present basis was more than $50),

since the Bill disallows any loss that would result from any such allocation. However, whether or not the taxpayer made an original allocation of purchase price between A and B, there is nothing to prevent the IRS from claiming that the proper original allocation to A was less than $100 (and so the present basis is less than $50), resulting in a taxable gain to the taxpayer.[52]

Such continued controversies could be avoided by a rule under which all amounts realized on the sale of an amortizable section 197 intangible would reduce the basis of the "pool" of such intangibles but would not result in the recognition of gain of loss. Gain would be recognized only when (and to the extent) the amount realized exceeded the aggregate remaining basis in the intangibles.

This approach could further the Bill's purpose to avoid valuation controversies between taxpayers and the IRS. It avoids the need for taxpayers to keep ongoing separate basis records for each purchased intangible (which is required under the Bill as written only to calculate gain on the sale of individual intangibles), it removes the present incentive to taxpayers to sell gain and loss intangibles in the "correct" order, and it is consistent with the rule disallowing losses until all intangibles are disposed of.

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[52] The rule in the Bill will provide a peculiar incentive for taxpayers to sell intangibles having a loss before selling intangibles having a gain. For example, suppose three intangibles (A, B, and C) are purchased in the same transaction for $100 each, and, immediately after the purchase, A increases in value to $150, B declines in value to $50, and C remains worth $100. If A and B are both to be sold immediately, (1) a sale of A followed by a sale of B results in taxable gain of $50 on A, a disallowed loss of $50 on B, and amortization of $150 (i.e., C's original basis increased by the disallowed loss on B) over 14 years, while (2) a sale of B followed by a sale of A results in a disallowed loss of $50 on B, allocation of $25 of basis to each of A and c, a $25 gain on the sale of A, and amortization of C's basis of $125 over 14 years. It is difficult to justify this result on tax policy grounds.

Moreover, the benefit to taxpayers is not unlimited, because all sales proceeds will reduce amortizable basis, and after such basis has been recovered all cash receipts will be fully taxable.

(2) Disadvantages of a basis recovery approach.

Despite some undoubted advantages of a basis recovery approach, we are convinced, for the reasons set out below, that much the better rule is provided by requiring, when a section 197 intangible is sold at a gain, that the gain be recognized, just as it would be under current law.

(a) A basis recovery approach can provide some taxpayers with substantial unjustified windfalls.

> Example. In 1992, after enactment of section 197, Consolidated Corporation, an active acquirer of other publicly-traded corporations, acquires for $500 million the assets of Target Company, a major food producer with numerous retail brands, produced in ten divisions. Target has $50 million of tangible assets and $450 million of section 197 intangibles. When Target is acquired, each of its ten divisions is of approximately equal value.
>
> Although each of Target Company's ten divisions is sufficiently independent to be sold to separate buyers, there are also strong centralized features to its operations, including a centralized purchasing division; a central plant for production of all its needs for product containers and shipping cartons; heavily centralized corporate functions such as purchasing, accounting, planning, cash management, product research, etc.
>
> In order to retire the debt it incurred to acquire Target, Consolidated Corporation embarks on an ambitious program of selling off Target assets. Due to strong management by Consolidated and favorable economic conditions, the sales, which begin two years after the acquisition, occur at a time when the value of each of the Target businesses has doubled (solely as the result of the increase in the value of section 197 intangibles).

On these facts, if current law applies and it is eventually established that a Target division sold by Consolidated for $100 million in 1994 was worth $50 million when acquired in 1992, then Consolidated would have a $50 million gain, increased by the amount of any section 197 deductions taken, which should amount to an additional $7 million. Under a basis recovery rule, this gain would not be taxed in the year of sale.

Furthermore, Consolidated would be able to sell another three Target divisions for an additional $300 million, giving it total proceeds of $400 million and a total gain of $200 million before any sale becomes taxable.[53]

We suggested above that loss on disposition of section 197 intangibles be permitted when a separate business is disposed of, even though it was acquired together with other businesses. Such a rule could be applied to gains as well. However, on the facts set out above, it is not clear that Target's divisions are separate businesses. Nor do we think it desirable to have a taxpayer's ability to use basis recovery--with its substantial tax impact--depend on its ability to establish that a division is not separate but instead part of another business conducted by the taxpayer.

(b) Basis recovery is not required for simplification.

The valuation problems that arise when a taxpayer, in order to compute amortization, attempts to separate a customer-based or supplier-based intangible from

[53] By the time of the fifth sale, Consolidated's section 197 deductions on Target intangibles might have used up its remaining intangibles basis, so the fifth sale might be fully taxable.

goodwill, are different, both in kind and in frequency of occurrence, from the valuation problems that arise when gain is recognized on resale of a portion of acquired intangibles.

The controversy over amortization typically involves the separation from goodwill or going concern value of customer-based or supplier-based intangibles, invariably a difficult piece of surgery. Typical customer-based or supplier-based intangibles, such as bank core deposits or subscription lists, are exceedingly difficult to separate from goodwill. Only after a substantial number of failed attempts were appraisal techniques of sufficient accuracy developed to make such separation acceptable to a number of courts. H.R. 3035 cuts through the difficulty of making such determinations and the attendant controversy by providing a common 14-year amortization period for most purchased intangibles.

However, when instead of amortization the tax issue is basis for computing gain on a sale, valuation should be much less controversial. A customer-based intangible, such as a bank's core deposit base, can be separately identified and valued and its useful life determined but, if sold, it will generally be sold with goodwill or going concern value of the entity that created it. Thus determining value for assets of the type that are resold is likely to be much easier to resolve than to determine value when a customer-based intangible has to be separated from goodwill for amortization purposes.

A bank, which in the past has purchased another bank's assets, may sell one of the acquired branches, transferring the deposit base and goodwill to a single purchaser.

Under current tax law, the seller, to determine gain, will have to allocate a portion of its original purchase price to the branch being sold. While there is always room for disagreement on valuation issues, we believe that acquisition-date valuation of such a bank branch (so that its costs can be separated from the costs of the other branches purchased at the same time) is substantially easier than attempting to segregate deposit base from a branch bank's goodwill.

For these reasons, the type of valuation issues that will arise if gain is recognized on a partial disposition of intangibles does not seem to present enough difficulty to justify the revenue loss that will inevitably result from a basis recovery system.[54]

(c) Existing problems with basis recovery.

In those Code areas where it has been applied, basis recovery has not always had felicitous results. Because of the adverse revenue effect of section 731's basis recovery rule for partnership distributions, Congress found it necessary to enact the complex rules of section 707(a)(2)(B). At the cost of considerable complexity, those rules specify when a transaction involving a partnership and several of its partners is a sale (subject to usual methods for calculating gain) and when it is a distribution (subject to a basis recovery calculation). The experience with section 731, where it is difficult to develop a viable alternative to basis recovery, suggests that basis recovery should not be lightly adopted.

[54] A few members of the Section have expressed concern that basis recovery methods, when made a part of the tax law, have shown a tendency to expand to cover transactions other than those envisioned by the legislators that enacted them or the administrators that adopted them. See, e.g., the discussion of §731 in the text below.

H. Covenants Not to Compete; Patents and Copyrights

1. Noncompetition agreement acquired incident to acquisition of stock.

We believe that the Bill could be an effective vehicle for the resolution of a frequently litigated issue under present law: whether there is any substance to an allocation of value to a noncompetition agreement acquired incident to an acquisition of stock. The Explanation simply states that, as under present law, to the extent that an amount paid under a covenant not to compete represents additional consideration for the acquisition of stock, that amount is not within the scope of section 197, but must be capitalized as part of the cost of the stock. Consideration should be given to whether it is appropriate to treat all amounts paid for covenants not to compete that accompany a stock purchase as part of the cost of Stock.[55]

2. When amortization period begins.

Under section 197(e)(3), any amount paid or incurred pursuant to a covenant not to compete (or similar arrangement) referred to in section 197(d)(1)(E) must be capitalized. The Explanation states that any such amount "is to be amortized ratably over the 14-year period specified in the bill." The legislative history should be clarified to provide that the relevant 14-year period is the one beginning on the date of the acquisition, not beginning at the time of the payment.

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[55] Prior to the 1986 Act, the substantial difference between capital gain and ordinary income rates gave the seller of stock an incentive to oppose an allocation to a covenant not to compete (which would have been taxable to the seller at ordinary income rates). The post-1986 reduction in ordinary rates has almost eliminated such adverse interest.

The method we recommend for the amortization of contingent payments set forth in Part V(B) for a contract with a clearly determinable life could be used.

3. Clarification of definition.

The exception for self-created intangibles would apparently not apply to government licenses or covenants not to compete. Since a covenant not to compete may be described in both section 197(d)(1)(C)(i) and (d)(1)(E), the exclusion for such covenants would be clearer if section 197(c)(2)(A) referred to intangibles "described in subparagraph (A),(B), or (C) (and not in (E)) of subsection (d)(1)" (new language underscored).

4. Patents and copyrights; definitional issue.

Section 197(d)(1) does not include patents or copyrights within the list of section 197 intangibles. Nevertheless, section 197(d)(4)(C) specifically excludes separately purchased patents and copyrights from the definition of section 197 intangible. If patents and copyrights acquired as part of the acquisition of a trade or business are subject to the provisions of the Bill, as stated in the Explanation, they should be explicitly included in section 197(d)(1).

I. Effective Date and Retroactivity

The Bill would apply only to property acquired after the date of enactment, and the Explanation states that no inference is intended as to the treatment under present law of earlier acquired assets.

This prospectivity is protected by generally familiar anti-churning and anti-abuse rules.

We have considered the question of retroactivity, particularly in view of the Bill's stated intention to resolve the extensive controversies between taxpayers and the IRS over present treatment of many acquired intangibles. Despite the desirability of settling past as well as future controversies, however, we agree with the Bill's non-retroactive approach. On some issues present law is well settled (e.g., goodwill is not amortizable and covenants not to compete are generally amortizable over their (typically) short lives). Thus, retroactive changes would defeat the legitimate, bargained-for expectations of some taxpayers and shower others with unexpected and unbargained-for windfalls.

Consideration should be given to including language in the Committee Reports encouraging both the IRS and taxpayers to settle existing controversies where the law is unclear by applying the 14-year straight-line amortization rule of the Bill.[56] We recognize that such hortatory statements would have no binding effect, but they may enable the IRS to more freely settle existing cases on this basis, and the availability of a settlement mechanism will not be lost on judges otherwise faced with difficult decisions and protracted trials. In turn, all this may make taxpayers think twice before incurring the formidable expenses of preparing cases claiming amortization under present law, particularly when there are serious risks of losing entirely.

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[56]. We recognize, of course, that goodwill cannot be amortized under existing law.

V. RELATED ISSUES

A. Coordination with Section 1060 Allocations

Adoption of the proposed legislation would require changing the method presently used to allocate the aggregate consideration for a purchased business among the assets of that business, as described below.

1. Background.

As intended by Congress when it adopted section 1060, under the section 1060 regulations, the purchase price for a business must presently be allocated among the assets using the "residual method".[57] Under that method, all assets are divided into Class I (cash equivalents), Class II (publicly traded assets), Class III (all assets not in another class), and Class IV (goodwill and going concern value). Class I and Class II, and the portion of the purchase price equal to the value of the assets in those classes, are disregarded hereinafter for simplicity.

The two key features of the residual method are: (1) to the extent the purchase price exceeds the value of Class III assets, it is allocated to the assets in Class IV, which are presently nondepreciable, and (2) if the purchase price is less than the value of Class III assets (which might occur, for example, where contingent liabilities are being

[57] Section 1060(a) requires allocation in the same manner as under section 338(b)(5). Congress clearly intended to incorporate by reference the then-existing regulations under the latter section, see the 1986 Blue Book at 3 59, which has in fact been done by Temp. Treas. Reg. Sec. 1.1060-lT(d).

assumed or subsequent contingent payments will be made to the seller), each Class III asset is allocated a proportionate part of the purchase price (so that each asset receives an allocation equal to a fixed percentage of its fair market value) [58]

2. Problems with distinction between Class III and Class IV for section 197 assets.

If the proposed legislation is adopted, the existing division of assets between Class III and class IV will no longer make sense and should be abandoned. There are a number of reasons for this conclusion:

(a) The original rationale for Class IV was that purchase price in excess of nongoodwill assets should be entirely nondepreciable (rather than allocated pro rata among all depreciable and nondepreciable assets).That rationale no longer exists when Class IV assets are themselves amortizable.

(b) In fact, since amortizable section 197 assets presently in Class III will have the same amortizable life for tax purposes as will goodwill and going concern value presently in Class IV, in most cases there will be no tax significance as to whether any such asset is in Class III or Class IV.

[58] The adoption of the residual method was a rejection of the “pro rata allocation method” under which some taxpayers attempted to claim that when the purchase price exceeded the alleged aggregate value of all the purchased assets (including goodwill), each asset (including depreciable assets) should be allocated an amount proportionately in excess of its respective fair market value.

This will be true whenever the purchase price exceeds the value of the existing Class III assets, which is the normal situation. As a result, in those cases, all intangible Class III assets, as well as all Class IV assets, would be depreciated in an identical manner. There is no reason for taxpayers to have to separately determine the value of goodwill and going concern value in these situations. A continuing requirement to do so, when it would have no tax significance, would defeat the simplification goal of the legislation.

(c) In one situation, retention of the existing Class III and Class IV categories would continue to have significance following adoption of the legislation. In that situation, retention of the categories would result in continuing controversies between taxpayers and the IRS concerning the nature of intangible assets (i.e., whether or not they are Class IV goodwill) and thus would be directly contrary to the purposes of the legislation.

Suppose, for example, that a purchased business has tangible assets with a value of $50, total intangibles with a value of $50, and is purchased for $75 cash plus the assumption of certain contingent liabilities estimated to be worth $25. If the tangible assets have short depreciable lives, under the new legislation and the existing system of classes it would be in the interest of the taxpayer to claim that the value of assets in Class III does not exceed $75, i.e., that intangible Class III assets have a value of no more than $25, and thus that goodwill is worth at least $25 of the total intangible value of $50.

The result is that the $50 of tangible assets (in Class III) are fully depreciable and the $25 of intangible assets (in Class III and Class IV, regardless of the allocation between these classes) are also fully depreciable over 14 years.

On the other hand, it would be in the interest of the IRS to claim that of the $50 of intangible assets, more than $25 (say all $50) are nongoodwill assets in Class III, so that the value of all Class III assets would be $100. Since the purchase price is only $75, the result is that only 75% of the value of the tangible assets ($3 7.50) and 7 5% of the value of Class III intangible assets (also $37.50) would be depreciable. In effect the IRS, by attempting to move assets from Class IV (goodwill) to Class III (other intangibles), could attempt to move depreciable basis from tangible Class III assets to intangible Class III assets with a 14-year life.[59]

Of course, if the tangible Class III asset was nondepreciable land worth $50, it is the taxpayer that would attempt to maximize the value of intangible Class III assets and minimize the value of Class IV goodwill (to “squeeze down” the allocation of purchase price to the land and maximize the total portion of the purchase price eligible for 14-year amortization). This game-playing is exactly what section 197 is designed to stop.

As a result, it seems clear that all intangible assets eligible for 14-year amortization under the legislation should be in the same class.

[59] Note the counterintuitive result that it is the taxpayer trying to maximize the allocation to goodwill and the IRS trying to minimize the allocation to goodwill.

It remains to be considered whether all such intangibles should be included in Class III, with Class IV being abolished, or else all such intangibles should be in Class IV.

3. Section 197 intangibles as Class IV assets.

If all intangibles (including goodwill) were placed in Class III, it would be necessary in every case to independently value goodwill and going concern value, and such values would in many cases affect the portion of the purchase price allocable to tangible assets. For example, if tangible assets were worth $50 and the purchase price was $75, total intangibles (including goodwill) valued in excess of $25 would result in scaling down the basis of the tangible assets below $50. On the other hand, if total intangibles were worth less than $25, say $20, each asset would be allocated its full fair market value, but what would the remaining $5 of purchase price be allocated to? Note that there is no “residual” category in this scheme.

As a result of the foregoing, the only method of allocation that appears consistent with the proposed legislation is for all amortizable section 197 intangibles to be placed in Class IV. Under this approach, there would never be any need to separately value goodwill, and no room for the IRS or the taxpayer to manipulate valuations of intangibles in order to affect allocations to tangible assets. The resulting simple rules would be that (1) if purchase price exceeded the value of Class III assets (consisting of tangible assets and, as discussed below, intangibles excluded from section 197), the entire excess would be allocable to Class IV and amortizable under section 197, and (2) if the purchase price was less than the value of Class III assets as so defined, the price would be allocated among

those assets without regard to the value of any amortizable section 197 intangibles, and the purchaser's tax basis for the latter would be zero.

It appears that intangible assets that are not amortizable section 197 assets should remain in Class III as at present, rather than being moved to the new class IV. Placing any nonamortizable assets in Class IV would require that the group of amortizable Class IV assets be valued, because of the pro rata allocation requirement within a class. While the nonamortizable intangibles must be separately valued in any event, it seems best to leave Class IV as a true “residual” class whose assets are all treated identically for tax purposes and thus do not need to be separately valued either one by one or in the aggregate.

The desired changes could be accomplished by changing the regulations under sections 338(b)(5) and 1060. However, given the endorsement of the existing section 338(b)(5) regulations in the legislative history of section 1060,[60] and the need for guidance pending the adoption of the regulations, we recommend that the legislative history of the Bill state that Congress intends that the IKS will change the regulations as described above, effective as of the effective date of the Bill.

B. Contingent Purchase Price.

Another issue that needs to be considered is the treatment of contingent purchase price payments for amortizable section 197 intangibles.

[60] See the footnote discussion earlier in this Part V(A).

At present, if a single asset (such as a patent) is purchased for contingent payments, under Associated Patentees[61] the contingent payments are deductible when made if they are payable over the expected life of the asset, while the payments must be spread over the life of the asset if they are payable over a shorter period. On the other hand, if an entire business is purchased in whole or in part for, contingent payments the fixed payments are allocated pro rata over the class III assets (as discussed above), and contingent payments when made increase the allocation to each asset in Class III (up to the fair market value of that asset) and after all possible allocations are made to Class III, subsequent payments are allocated to Class IV.

In light of the proposed legislation, we would suggest the following modifications of the foregoing rules. The concept behind our proposals is that the useful life of an asset for purposes of the Associated Patentees test should be the same as the period over which a fixed purchase price payment would be amortizable.

1. If an asset is excluded from the definition of amortizable section 197 intangible, present rules would apply to contingent payments just as they would for a fixed purchase price. For example, if a five-year supply contract was excluded from section 197 by regulations under section 197(d)(4)(B), just as a fixed purchase price would be amortized over five years, so would contingent payments over five years be currently deductible.

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[61] Associated Patentees, Inc. v, Comm'r, 4 T.C. 979 (1945), acq., 1959-2 C.B. 3.

2. If a separately purchased asset is not excluded from section 197 i.e., it is an amortizable section 197 intangible, it would be deemed to have a 14-year life for purposes of applying Associated Patentees.

(a) Assume first a contract with a clearly determinable life, such as the five-year supply contract in the preceding example. If the contract was not excluded from section 197, a fixed purchase price would therefore be amortized over 14 years. If contingent payments were to be made over five years, amortization deductions would be spread over 14 years.[62] At the end of five years, assuming the rule adopted for the remaining unamortized basis arising from a fixed purchase price was that such basis could be written off as a loss, the same would be true for contingent payments actually made during the five years that had not yet been deducted. If an immediate write-off for a fixed purchase price was not allowed after five years, contingent payments made during the five years and not yet deducted would be treated in the same manner as would such fixed purchase price payments not yet deducted.

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[62] The method of spreading five years of contingent payments over 14 years for deduction purposes is not clear. However, the goal should be to create, for the first five years, deductions that would arise if roughly equal deductions were to be taken over each of the 14 years. One method would be for 5/14 of each payment during the first five years to be currently deducted with the balance being deducted ratably in years 6-14. The goal would not be achieved if the first year payment were amortized over 14 years, the second year payment were amortized over the remaining life of 13 years, and so on. We recognize that the Explanation suggests adoption of the latter approach based on the current law rule for contingent payments for tangible assets. However, we believe that the latter approach should be rejected. We see no reason that the principles of Associated Patentees should not apply in this situation, where the asset has a fixed life and is not expected to decline in value over that life. The separate situation involving assets with an indeterminate life is discussed below in the text.

(b) A much more difficult issue arises when an amortizable section 197 intangible purchased for contingent payments has an indefinite useful life. For example, suppose a customer list is purchased for payments over 5 (or 14) years based on profits derived from those specific customers during each of the years in question. Under section 197, a fixed payment would be amortized straight-line over 14 years regardless of the actual life of the customer list. The goal, therefore, is to apply Associated Patentees to the contingent payments on the assumption of a 14-year life for the customer list.

Suppose first that the contingent payments are to be made over 14 years. Given that the payment period exactly matches the statutory life for the customer list, it might seem obvious that all payments should be currently deductible based on Associated Patentees.

Unfortunately, the obvious answer is not the correct one in this case. Suppose the parties' best estimate is that the customer list will be almost worthless after five years, meaning that the contingent payments are expected to be nominal from years 6 through 14. In that case, allowing the current deductibility of all contingent payments is economically correct based on the actual life of 5 years, but is patently improper based on the statutory life of 14 years. Based on the statutory life, and to make the amortization of contingent payments consistent with the amortization of fixed payments, the 5 years of expected contingent payments must clearly be amortized over 14 years.

The parties can always provide for 14 years of contingent payments, even for an asset with an expected one

year useful life. As a result, if Associated Patentees is applied solely by comparing the stated period for contingent payments (which will always be 14 years, except for cases representing malpractice) with the 14-year statutory amortization period, the result is tantamount to simply allowing current deductibility of all contingent payments (which in turn is equivalent to amortization of contingent purchase price over the actual useful life of an asset). This would be flatly inconsistent with the 14-year amortization period for fixed payments. It would obviously and inevitably result in almost all intangible assets with an expected life of less than 14 years being nominally purchased for 14 years of contingent payments (all of which would be currently deductible over the actual life of the asset), and all assets with an expected life of more than 14 years being purchased either for a lump sum (amortizable over 14 years) or for 14 years of contingent payments (currently deductible).

There are a number of possible solutions to this problem, none entirely satisfactory. The first solution would be to consider the actual expected stream of contingent payments, without regard to the nominal payment period, and then to apply Associated Patentees assuming that such payment stream was to be made for an asset with a 14-year useful life. In other words, if 5 years of payments were actually expected, the payments in the early years would be only partially deductible, in the same manner as they would be today if the asset had an actual life of 14 years. In effect, 5/14 of the first year payment would be deductible.

The obvious problem with this solution is that it requires an estimate of the expected stream of contingent payments.

Such a required estimate would be similar to a determination of the fair market value of the intangible, and would bring with it the numerous uncertainties and conflicts with the IRS that the legislation is designed to avoid.[63] This state of affairs seems completely inconsistent with the goals of the legislation.

A second possible solution to this problem is for taxpayers to be allowed amortization deductions in any year by in effect being required to take the most pro-government position that is possible based on the facts known through that year, i.e., by assuming that the asset's actual useful life had ended in that year and that no contingent payments would be made thereafter. Under this approach, any contingent payment paid during the first year would be assumed to be the only payment ever to be made, and thus only 1/14 would be deductible each year for 14 years. If a contingent payment was paid during the second year, 2/14 of that payment would be deducted in the second year and 1/14 of that payment would be deducted in each of the next 12 years. Likewise, of any third year contingent payment, 3/14 would be deductible in the third year and 1/14 in each of the next 11 years, and so on. While perhaps not immediately apparent, this simple rule allows accumulated amortization deductions through any year equal to the accumulated amortization deductions that would be allowable if no contingent payments were to be made at

[63] Curiously enough, taxpayers would be claiming that the assets had a long useful life (ideally at least 14 years) to support current deductibility of as much of the contingent payments as possible, while the IRS would be claiming that the assets had a short useful life to support capitalization of as much of the early-year contingent payments as possible.

any time thereafter (because the actual useful life of the asset had expired) but nevertheless all contingent payments made to date were required to be amortized over the statutory 14-year life.[64] Any rate of amortization faster than this rate would allow the creation of artificially short payment periods as described above, and any rate of amortization slower than this rate is unnecessary to protect the government against such schemes.

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[64] For example, after the second year, aggregate amortization deductions will equal 2/14 of the first year payment and 2/14 of the second year payment, which is exactly the deductions that would be allowable over the first two years if the total purchase price were the sum of the first and second year payments and that purchase price were to be amortized over 14 years. Likewise, after the third year, aggregate amortization deductions will equal 3/14 of each payment made to date, again exactly equal to the allowable deduction over the first three years if the payments to date were the total purchase price and amortization of that purchase price was allowed over 14 years.

Note that this approach is analogous to that in the installment sale regulations when an installment sale is made for contingent payments with a stated maximum payment.[65]

A third possible approach is that suggested in the Explanation of the Bill. Under this approach, at the time each contingent payment was made the adjusted basis of the intangible would be increased by the amount of the payment, and the increase in basis would be amortized over the remainder of the 14-year period. This approach is similar to the rule for contingent payments in the existing proposed ACRS regulations.[66] However, this approach always results in slower amortization of contingent payments than does the second approach described above.[67]

Of the three approaches discussed so far, we prefer the second. As between the first and the second approaches, the first requires individualized determinations similar to those under present law, which we believe would be unacceptable under the policy behind the Bill. We would much prefer an arbitrary rule in this situation, even if it hurts certain taxpayers, in order to create the simplest possible system. As between the second and third approaches, we believe the second approach is as simple as the third, and, although it results in faster amortization than does the third approach, it is sufficient to prevent all possible taxpayer abuses.

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[65] For purposes of allocating the seller's tax basis of the property to the payments received, it is assumed at all times that the maximum possible future contingent payment will be made (thus minimizing the rate of basis recovery). See Temp. Treas. Reg. Sec. 15A.453-1(c)(2).

[66] Prop. Treas. Reg. Sec. 1.168-2(d)(3).

[67] For example, this approach results in 1/12 of the third year contingent payment being amortized in each of years 3 through 14. The second approach results in 3/14 of that payment being amortized in year 3 and 1/14 of that payment being amortized in each of years 4 through 14.

We thus see no reason to favor the third approach.

However, this is not to say that we are satisfied with the second approach. The only reason to disallow current deductibility of all contingent payments payable for 14 years is to prevent taxpayers from arbitrarily providing for 14-year contingent payment periods for short-lived assets. The second approach, which is entirely directed at this abuse, has the effect of significantly and adversely affecting taxpayers who provide for 14-year payment periods for assets that truly are expected to have a 14-year life. Such taxpayers are entitled under current law (as well as under the policy behind the Bill) to current deductions for all contingent payments under Associated Patentees, and the approach described above would result in significantly back-loaded deductions for such ordinary business transactions.

We therefore believe consideration should be given to a rule for amortization of contingent payments that is somewhere in between current deductibility (assuming a stated 14-year payment period) and amortization calculated under our second approach. Perhaps, for example, if in form contingent amounts were payable for 14 years, a taxpayer could elect to deduct each contingent payment over a period of four years beginning in the year the payment was made. If, after five years or after 10 years, it turned out that the size of the contingent payments had declined by more than an arbitrary predetermined amount (e.g., 30%), the taxpayer could be forced thereafter to amortize future contingent payments under our second approach, and an interest charge could be imposed on the taxpayer for tax deferral attributable to the amortization deductions already taken during the first or second

five-year periods in excess of those allowable under the second approach. While an approach such as this seems complicated, the complexity is only in the mathematics. It does not depend upon any factual determinations relating to the underlying assets. Moreover, this proposal is only illustrative, and a variety of similar approaches are possible in order to limit the adverse effect of our second approach on nonabusive transactions.

3. In the case of a transfer of an intangible asset presently subject to section 1253 (i.e., a franchise, trademark, or trade name), the proposed legislation defines such assets as section 197 intangibles and limits the special section 1253 rule to the situation where level contingent payments are made over the life of the transfer agreement (in which case contingent payments are currently deductible under section 1253). Unless this special rule applies, fixed or contingent payments are subject to the usual 14-year amortization.

Where the 14-year rule applies, contingent payments for a section 1253 asset would, under our proposal, be amortized under the rules of paragraph 2(a) or 2(b) above, whichever is applicable. However, where the special rule of section 1253 applies, it might be questioned why that rule permits contingent payments payable for five years for a five-year franchise to be currently deductible, while contingent payments payable for five years for other assets with a demonstrable five-year life (such as a five-year supply contract) can only be amortized over 14 years and in a back-loaded manner.

4. In the case of an entire business purchased in part for contingent payments, as at present the section 1060 allocation rules would apply. To the extent a contingent payment was allocable under the normal rules to an intangible which was not an amortizable section 197 intangible, the rules of paragraph 1 would apply, as at present. To the extent a contingent payment was allocable under the normal rules to an amortizable section 197 intangible, the rules of paragraph 2 would apply. To the extent a contingent payment was allocable to a section 1253 asset and was eligible for the new limited version of that section, the payment would be currently deductible.

It should be noted that the rules in the preceding paragraph would be necessary regardless of whether the suggestions made above for redefining the assets in Class III and Class IV are accepted. However, the rules for the amortization of contingent payments would be simpler to implement if, as suggested, Class IV consisted solely of all amortizable section 197 intangibles. In that case, at any one time contingent payments would either not be applied at all to amortizable section 197 intangibles (i.e., while allocations were still being made to assets in Class III) or else contingent payments would be applied pro rata to all amortizable section 197 intangibles (after the fair market value limitation to Class III allocations had been reached). On the other hand, if some amortizable section 197 intangibles were in Class III and some were in Class IV, separate ongoing adjustments would have to be made to the intangibles in each class.

C. Expenses Attributable to Self-Created Intangibles

We recognize that the continued current deductibility of all expenses that create intangible assets will create anomalies. For example, a distributor that enters into a new territory by incurring sales and marketing expenses will be able to currently deduct all such costs, while another distributor that enters the same territory by buying out an existing distributor will only be entitled to 14-year amortization of the customer list and other intangibles.

However, it is not the new legislation that creates this disparity. The disparity exists under current law, under which such expenses are fully deductible and purchased goodwill fully nondeductible. In fact, the legislation reduces the disparity by allowing amortization of goodwill.

It could also be argued that because the proposed legislation recognizes the economic reality that goodwill and other intangibles are wasting assets and allows amortization of such assets when purchased, it is logical at the same time to recognize the additional economic reality that some currently deductible expenses in fact create assets with lives extending beyond the current year and thus should be capitalized and amortized.

However, we do not believe that legislative recognition of the former economic reality requires a legislative recognition of the latter economic reality. The legislative recognition

of the former is revenue neutral and thus does not require recognition of the latter to be fair to the Treasury. Moreover, the former lends itself to a simple solution in legislation that will greatly reduce controversies between taxpayers and the IRS; legislative recognition of the latter would, unless done in an arbitrary manner, create exactly the Kind of controversies in the area of expenses that the new legislation is designed to end in the area of purchased intangibles.

While it would be possible to arbitrarily require capitalization of a fixed percentage of certain types of expenses (such as advertising), we would oppose such a rule. The rule would be unfair to the numerous businesses whose expenditures of such types were level from year to year and not designed to expand the business into new products or territories. Moreover, we believe an arbitrary rule for purchased intangibles is acceptable because it applies only to occasional discrete transactions in which the parties to the transaction can take the rule into account in setting the purchase price. An arbitrary rule for expenses deemed in part to be attributable to self-created intangibles would be much broader in application -- it would adversely affect every ongoing business in the country, and such businesses would not have any opportunity to offset the loss of deductions by a mechanism such as a purchase price adjustment.

Finally, even if we were to conclude that certain expenses incurred in connection with self-created intangibles should be capitalized in whole or in part, it is realistic to assume that such a conclusion would be highly controversial.

We think it would be unfortunate if debate over the treatment of costs associated with self-created intangibles were to jeopardize the potential improvement to the current state of the law that we expect will result from enactment of legislation adopting the approach taken by H.R. 3035.

Cases re: Amortization of Customer-Based Intangibles,

ABCO Oil Corp. v. Commissioner, 58 T.C.M. (CCH) 1280 (1990)

Amphessetche v. Commissioner, 27 T.C.M. (CCH) 929 (1968)

AmSouth Bancorporation v. United Sates, 681 F. Supp. 698 (N.D. Ala. 1988)

Anchor Cleaning Serv., Inc. v. Commissioner, 22 T.C, 1029 (1954)

Banc One Corp. v. Commissioner, 84 T.C. 476 (1985)

Bennati v. Commisioner, 25 T.C.M. (CCH) 727 (1966)

Birmingham News Co. v. United States, 224 F. Supp. 670 (N.D. Ala. 1963)

Blaine v. United States, 441 F.2d 917 (5th Cir.), cert. denied, 404 U.S. 952 (1971)

Boe v. Commissioner, 35 T.C. 720 (1961), aff'd, 307 F.2d 339 (9th Cir. 1962)

Business Serv. Indus, v. Commissioner, 51 T.C.M. (CCH) 539 (1986)

Charleston v. Commissioner, 52 T.C.M. (CCH) 174 (1986)

Chronicle Publishing Co. v. Commissioner, 67 T.C. 964 (1977)

Citizens and Southern Corp. v. Commissioner, 91 T.C. 463 (1988), aff’d, 900 F.2d 266 (11th Cir. 1990)

Colorado Nat'1 Bankshares, Inc. v. Commissioner, 60 T.C.M. (CCH) 771 (1990).

Commissioner v. Indiana Broadcasting Corp., 41 T.C. 793 (1964), rev'd, 350 F.2d 580 (7th Cir. 1965), cert. denied, 382 U.S. 1027 (1966)

Commissioner v. Seaboard Fin. Co., 23 T.C.M. (CCH) 1512 (1964), aff'd, 367 F.2d 646 (9th Cir. 1966)

Computing & Software, Inc. v. Commissioner, 64 T.C. 223 (1975)

Credit Bureau of Erie, Inc. v. Commissioner, 54 T.C. 726 (1970)

Danco Prods., Inc. v. Commissioner, 21 T.C.M. (CCH) 287 (1962)

Danville Press, Inc. v. Commissioner, 1 B.T.A. 1171 (1925)

Decker v. Commissioner 864 F.2d 51 (7th Cir. 1988)

Dobson v. United States, 551 F. Supp. 1152 (Cl. Ct. 1982)

Donrey, Inc. v. United States, 309 F.2d 534 (8th Cir. 1987)

Dunn v. United States, 259 F. Supp. 828 (W.D. Okla. 1966), aff'd, 400 F.2d 679 (10th Cir. 1968)

est, An Educ. Corp. v. United States, 52 T.C.M. (CCH) 920 (1986)

Finoli v. Commissioner, 86 T.C. 697 (1986)

First Nat'1 Bank of Omaha v. Commissioner, 34 T.C.M. (CCH) 360 (1975)

First Northwest Indus. of America, Inc. v. Commissioner, 70 T.C. 817 (1978)

First Pa. Banking and Trust Co. v. Commissioner, 56 T.C. 677 (1971)

Fletcher v. Commissioner, 24 T.C.M. (CCH) 1489 (1965)

Formico v. Commissioner, 491 F.2d 788 (9th Cir. 1974)

Forward Communications Corp. v. United States, 608 F.2d 485 (Ct. Cl. 1979)

Fullerton Co. v. United States, 74-2 U.S.T.C. (CCH) 9518 (D. Or. 1974)

Gant v. Commissioner, 16 T.C.M. (CCH) 990 (1957), aff'd, 263 F.2d 558 (6th Cir. 1959)

General Television, Inc. v. United States, 449 F. Supp. 609 (D. Minn. 1978)

Golden State Towel and Linen Serv., Ltd. v. United States, 373 F.2d 938 (Ct. Cl. 1967)

Grimm v. Commissioner, 29 T.C.M. (CCH) 530 (1970)

Griswold v. Commissioner, 45 T.C. 463 (1966), aff'd. 400 F.2d 427 (5th Cir. 1968)

Gulf Television Corp. v. Commissioner, 52 T.C. 1038 (1969)

Hall v. Commissioner, 50 T.C. 186 (1968), aff’d, 406 F.2d 706 (5th Cir. 1969)

Hampton Pontiac, Inc. v. United States, 294 F. Supp. 1073 (D.S.C. 1969)

Hennis v. Commissioner, 27 T.C.M. (CCH) 1165 (1968)

Hill v. Commissioner, 38 T.C.M. (CCH) 481 (1979)

Hillside Dairy Co. v. Commissioner, 3 T.C.H. (CCH) 174 (1944)

Hodges v. Commissioner, 50 T.C. 428 (1968)

Holden Fuel Oil Co. v. Commissioner, 479 F.2d 613 (6th Cir. 1973)

Houston Chronicle Publishing Co. v. United States, 339 F. Supp. 1314 (S.D. Tex. 1972), aff'd, 481 F.2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974)

Hyde v. Commissioner, 42 T.C.M. (CCH) 954 (1981)

Imperial News Co. v. United States, 576 F. Supp. 865 (E.D.N.Y. 1983)

International Life Ins. Co. v. Commissioner, 51 T.C. 765 (1969)

Ithaca Industries, Inc. v. Commissioner, 97 T.C. No. 16 (Aug. 12, 1991)

J.C. Cornillie Co. v. United States, 298 F. Supp. 887 (E.D. Mich. 1968)

Johnson v. United States, 61-1 U.S.T.C. (CCH) 9278 (W.D. Tex. 1961)

Klein v. Commissioner, 24 T.C.M. (CCH) 1082 (1965), aff'd, 372 F.2d 261 (2d Cir. 1966)

KWTX Broadcasting Co. v. Commissioner, 272 F.2d 406 (5th Cir. 1959)

Laird v. United States, 391 F. Supp. 656 (N.D. Ga. 1975), aff'd, 556 F.2d 1224 (5th Cir. 1977), cert. denied, 434 U.S. 1014 (1978)

Lawless v. Commissioner, 25 T.C.M. (CCH) 49 (1966)

Leisure Dynamics. Inc. v. Commissioner, 32 T.C.M. (CCH) 159 (1973)

Lemmen v. Commissioner, 77 T.C. 1326 (1981)

Los Angeles Cent. Animal Hosp. v. Commissioner, 68 T.C. 269 (1977)

Manhattan Co. of Va. v. Commissioner, 50 T.C. 78 (1968)

In re Margulies, 271 F. Supp. 50 (D.N.J. 1967)

Marsh & McLennan, Inc. v. Commissioner, 51 T.C. 56 (1968), aff'd, 420 F.2d 667 (3d Cir. 1969)

McCarthy v. United States, 807 F.2d 1306 (6th Cir. 1986)

Meredith Broadcasting Co. v. United States, 405 F.2d 1214 (Ct. Cl. 1969)

Metro Auto Auction of Kansas City, Inc. v. Commissioner, 48 T.C.M. (CCH) 894 (1984)

Midlantic Nat'1 Bank/Merchants v. Commissioner, 46 T.C.M. (CCH) 1464 (1983)

Mills Pharmaceuticals, Inc. v. Commissioner, 57 T.C. 308 (1971)

Misegades v. Commissioner, 53 T.C. 477 (1969)

Morris v. Commissioner, 27 T.C.M. (CCH) 1558 (1968)

Nachman v. Commissioner, 12 T.C. 1204 (1949), aff'd, 191 F.2d 934 (5th Cir. 1951)

National Serv. Indus, v. United States, 379 F. Supp. 831 (N.D. Ga. 1973)

National Weeklies v. Commissioner, 43 B.T.A. 1209 (1941), aff'd, 137 F.2d 39 (8th Cir. 1943)

National Weeklies v. Reynolds, 43 F. Supp. 554 (D. Minn. 1942)

Newark Morning Ledger Co. v. United States, 734 F. Supp. 176 (D.N.J. 1990), rev'd, F.2d (3d Cir. Sept. 12, 1991)

Panichi v. United States, 834 F.2d 300 (2d Cir. 1987)

Phillips v. United States, 73-2 U.S.T.C. (CCH) 9707 (S.D. Fla. 1973)

Pohlen v. Commissioner, 6 T.C.M. (CCH) 226 (1947), aff'd, 165 F.2d 258 (5th Cir. 1948)

Potts, Davis & Co. v. Commissioner, 431 F.2d 1222 (9th Cir, 1970)

Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976)

Richmond Television Corp. v. United States, 345 F.2d 901 (4th Cir.), rev'd, 382 U.S 68, on remand, 354 F.2d 410 (4th Cir. 1965)

Robins & Weill, Inc. v. United States, 382 F. Supp. 1207 (M.D. N.C. 1974)

Rost v. United States, 371 F. Supp. 670 (S.D. Tex. 1973)

Roy H. Park Broadcasting, Inc. v. Commissioner, 78 T.C. 1093 (1982)

Rudie v. Commissioner, 49 T.C. 131 (1967)

Salome v. United States, 395 F.2d 990 (5th Cir. 1968)

Savings Assurance Agency v. Commissioner, 22 T.C.M. (CCH) 200 (1963)

Scalish v. Commissioner, 21 T.C.M. (CCH) 260 (1962)

Securities-Intermountain v. United States, 460 F.2d 261 (9th Cir. 1972)

Shufflebarger v. Commissioner, 24 T.C. 980 (1955)

Skilken v. Commissioner, 50 T.C. 902 (1968), aff'd, 420 F.2d 266 (6th Cir. 1969)

Southern Bancorporation v. United States, 732 F.2d 374 (4th Cir. 1984)

Southern Bancorporation v. Commissioner, 847 F.2d 131 (4th Cir. 1988)

Squires v. United States, 289 F, Supp. 597 (C.D. Cal. 1968)

S.S. Ballin Agency v. Commissioner, 446 F.2d 554 (3d Cir. 1971)

Stewart v. United States, 372 F. Supp. 407 (N.D. Tex. 1974)

Stewart v. United States, 65-2 U.S.T.C. (CCH) 9607 (N.D. Okla. 1965)

Stromsted v. Commissioner, 53 T.C. 330 (1969)

Sunset Fuel Co. v. United States, 375 F. Supp. 1011 (D, Or. 1974), rev'd, 519 F.2d 781 (9th Cir. 1975)

Super Food Servs. v. United States, 416 F.2d 1236 (7th Cir. 1969)

Thoms v. Commissioner, 50 T.C. 247 (1968)

Thrifticheck Serv. Corp. v. United States, 33 T.C. 1038 (1960), aff'd, 287 F.2d 1 (2d Cir. 1961)

Times-World Corp. v. United States, 251 F. Supp. 43 (W.D. Va. 1966)

Toledo TV Cable Co. v. Commissioner, 55 T.C. 1107 (1971)

Tomlinson v. Commissioner, 507 F.2d 723 (9th Cir, 1974)

Uecker v. Commissioner, 81 T.C. 983 (1983)

United States Indus. Alcohol Co. v. Helvering, 42 B.T.A. 1323 (1940), aff'd in part, rev'd in part, 137 F.2d 511 (2d Cir. 1943)

Vaaler Ins., Inc. v. United States, 68-1 U.S.T.C. (CCH) 9183 (D.N.D. 1968)

Vander Hoek v. Commissioner, 51 T.C. 203 (1968)

Van de Steeg v. Commissioner, 60 T.C, 17 (1973)

Watson v. Commissioner, 37 T.C.M. 857 (1978)

WDEF Broadcasting Co. v. United States, 215 F. Supp. 818 (E.D. Tenn. 1963)

Weaver v. United States, 65-1 U.S.T.C. (CCH) 9410 (W.D. Okla. 1965)

Wells-Lee v. Commissioner, 23 T.C.M. (CCH) 1931 (1964), rev'd, 360 F.2d 665 (8th Cir. 1966)

Western Mortgage Corp. v. United States, 308 F. Supp. 333 (C.D. Cal. 1969)

Westinghouse Broadcasting Co. v. Commissioner, 36 T.C. 912 (1961), aff'd, 309 F.2d 279 (3d Cir. 1962), cert. denied, 372 U.S. 935 (1963)

Wikle v. United States, 65-1 U.S.T.C. (CCH) 9403 (N.D. Ala. 1965)

W.K. Co. v. Commissioner, 56 T.C. 434 (1971)

Yates Indus, v. Commissioner, 58 T.C. 961 (1972)

Insurance expirations

Result	ct.	case
X	T	Saving Assurance – 63
X	D_{OX}	Stewart – 65
	D_{AL}	Wikle – 65
X	D_{OX}	Weaver – 65
	T	Fletcher – 65
X	D_{ND}	Vaaler – 68
	T	Thomas – 68
	D_{TX}-5	Salome – 68
	T	Hodges – 68
	D_{CA}	Squires – 68
	T	Morris – 68
	T-3	Marsh & McLennan – 69
	T	Grim – 70
	T-9	Potts – 70
	T	S. S. Ballin – 71
	D_{TX}-5	Blaine – 71
	T-9	Tomlinson – 72
	D_{TX}	Rost – 73
	D_{FL}	Phillips – 73
	D_{TX}	Stewart – 74
	D_{NC}	Robins – 74
X	C	Richard S. Miller – 76
	D_{OR}	Fullerton – 77
	T-7	Decker – 87

customer list/file

result	ct.	case
X	T-5	Pohten – 48
	T	Anchor – 54
X	D_{TX}	Johnson – 61
	C	Golden State – 67
X	D_{NJ}	Margulies – 67
	T	Rudie 67
X	T	Manhattan Co. of Va. – 68
	D_{MI}	J. C. Cornillie – 68
	T	Misegades – 69
	T	Credit Bureau – 70
X	D_{GA}	NSI – 73
X	T-6	Holden – 73
	D_{OR}-9	Sunset – 75
X	T	Computing & Software
X	T	L. A. Central – 77
X	T	Midlantic – 83
X	T	Metro Auto – 84
	T	Metro Auto – 86
X	D_{NY}-2	Panichi – 87
X	T	ABCO – 90

result:	X	=	Some amortization at lowed
Ct.:	D_X	=	District Ct.
	T	=	Tax Ct.
	C	=	Ct. of Claims
	S	=	United States Supreme Ct.
	1,2,3,	=	Circ. Ct., When Appealec

core deposits

result	ct.	case
	Dsc-4	Southern Banc. ("SBC I")-84
	T-6	Banc One – 85/87
	D_{AL}	Amsouth – 88
X	T-11	Citizens & Southern 88/90
X	T	Colorado – 90

mtg. servicing right

result	ct.	case
X	D_{CA}	Western – 69
X	T	First Penn – 71
X	D_{OR}-9	Sec. Intermin. – 72
X	T	First Net'L – 75

Subscription List

result	ct.	case
	T	Danville – 25
	D_{MN}	Nat'l Weeklies V. R – 42
	T-8	Nat'l Weeklies V.
X	D_{TX}-5	Houston Chronicle – 73
	D_{MN}	General TV – 78
X	T	Finoli – 86
X	D_{ARK}-8	Donrey – 87
	D_{NJ}-3	Newak – 91

Subscriber/customer contracts

result	ct.	caese
	T-2	U.S. Ind. Alcohol – 43
	T-2	Thrifticheck – 61
	T	Danco – 62
	T-2	Klein – 66
X	D_{IL}-7	Super Food – 69
	T	Mills – 71
	D_{NY}	Imperial News – 83
X	T	BSI – 86

network affiliation contracts

result	ct.	case
	T-3	Westinghouse – 42
	T-7	Indiana – 65
X	C	Meredith – 69
	T	Gulf TV – 69
X	T	Roy N. Park – 82

vending machine location list

result	ct.	case
	T	Scalish – 62
	T-5	Griswold – 68
	T	Skilken – 69

Franchises

Result	ct.	case
	T	Lawless – 66
	T	Bennati – 66
	DOK-10	Dunn – 68
	T	Herris – 68
X	DSC	Hampton – 69
	T	Stromsted – 69
	T	Toledo – 71
X	T	Chronicle – 77
	T	First Northwest – 78
	C	Dobson – 82

licenses

result	ct.	case
	T-5	Nachman – 51
	T-5	KWTX – 59
X	DAL	Birmingham – 63
X	DTN	WDEF – 63
	DVA	Times World – 66
	T	W.K. Co. – 71
	T	Hill – 79
	C	Forward Comm. – 79
	T	Uecker – 83
	T	est. an Educ. Corp. – 86

milk distribution rights

result	ct.	case
X	T	Amphessetche – 68
	T	Vander Hoek – 68
X	T	Van de Stees – 73

ins. management contract

result	ct.	case
	T-5	Hall – 69
	T	Int’l Life – 69
	T-9	Formico – 74

Trade secrets/tradename

Result	ct.	case
	T	Yates – 72
	T	Leisure – 73
	T	Watson – 73

miscellaneous

intangible	result	ct.	case
broadcasting contracts		DGA-5	Laird – 77
		DOH-6	McCarthy – 86
Loan premium	X	T-9	Seaboard – 66
		T-4	SBC II – 88
med. Service contracts		T-9	Boe – 62
milk route		T	Hillside – 44
players’ contracts	X	DGA-5	Laird – 77
employee training for licensing		DVA-4-S-4	Richmond - 65
hospital affil. Contract	X	T-8	Wells-Lee – 66
herd maintenance contract	X	T	Lemmen – 81
one-yr. employment contract		T	Hyde – 81
Special draft participation rt.		T	First NW – 78
Advertising contracts		C	Meredith – 69
		C	Forward – 79
guaranteed distributor payments		T-6	Gant – 59
grazing preference		T	Shufflebarger – 55
assembled work force		T	Ithaca Industries – 91

USEFUL LIFE IH CASES WHERE SOME AMORTIZATION IS ALLOWED

CASE	ASSET	USSFUL LIFE (yrs.)
Donrey	Newspaper subscription list	23
Houston Chron.	Newspaper subscription list	5
Savings Assur.	Insurance expirations	$ 5
Richard S. Miller	Insurance expirations	$ 10
Vaaller	Insurance expirations	5
Stewart	Insurance expirations	$ 5
Weaver	Insurance expirations	2.5
Metro Auto	Card File	5
ABCD	Oil distributor cust. list	5
Holden	Oil distributor cust. list	15
Manhattan Co.	Laundry customer list	5
Panichi	Trash collection cust. list	15
Midlantic	Insolvent bank customer list	14
National Serv.	Customer List	6.7
LA Central	Veterinarian customer files	7
Johnson	Gynecologist patient charts	6
Computing & Sotf.	Credit info files	6
Cotorado Banksh.	Core deposits	3.2 to 10
Citizens & So.	Core deposits	?
Seaboard Finance	Loan Premium	3 to 5
Western Mtg.	Right to service Loans	7
First Penn.	Mortgage servicing contracts	5.5 to 10
First Natl.	Mortgage servicing right	8*
Sec. Intl’l.	Mortgage servicing	8
Business Serv.	Customer franchise contracts	15
Super Food	Grocery franchise contracts	7 yrs 2 mos.
Laird	Players’ contracts	5.25
Chronicle	Cable TV franchises	remaining K life
First NW	Draft participation righ	5*
Hampton Pontiac	Dealership franchise	Life expectancy of Franchise
Roy H. Park	Network affiliation K	4
Van de Steeg	Milk base marketing right	end of statute (1-4yrs)
Amphessetche	Milk base market right	10
Birmingham	Agency K for newspaper publication	30 (length of K)
Wells Lee	Hospital affiliation K	Life of hospital
Lemmen	Herd maintenance contracts (2)	12 and 3
WDEF	TV License & construction permit	Permit of Construction + 3 yr. License

VALUES CLAIMED AND ASSIGNED IN CASES WHERE SOME AMORTIZATION IS ALLOWED

Case	TP Claimed		CT Held	
	Intangible	Goodwill	Intangible	Goodwill
Johnson (med. Charts)	25,000	0	90%	10%
WDEF (License + permit)	21,787.17	0	21,787.17	0
Birmingham (agency K)	?	?	3,009,000[4]	0
Savings Assur. (ins. exp.)	20,000	0	20,000	0
Stewart (ins. exp.)	0	500	1,000	1,500
Weaver (ins. exp.)	32,060	0	32,060	0
Seaboard (Loan prem.)	100%	0	70&	30%
Vaaler (ins. exp.)	24,000	0	24,000	0
Manhattan Co. (cust. List)	56,719	7	75%	25%
Aphessetche (milk market K)	56,100	0	56,100	0
Meredith (network affil. K)	459,706		50%	50%[5]
Hampton Pontiac (dealership)	15,000[6]	0	15,000	0
Western (mtg. servicing)	1.9M	7	91%	9%
First Penn (mtg. serv.)	2,000,000	0	1,700,000	300,000
RH Par (network affil. K)	695,640	0	420,660*	0
Sec. Int'l. (mtg. serv.)	?	?	510,000	0
Van de Steeg (milk market)	100%	0	100%	0
Houston Chronicle	71,200	?	71,200	775,400
Holden (cust. lists)	85,000	0	85,000	0
First Nat'I (mtg. serv.)	471,072	0	372,147	98,925
	23,235.47	0	18,356.02	4,879.45
Computing & Software	1,715,000	173,000	1M	888,000*
	1,335,000	0	750,000	335,000*
	106,800	0	55,000	51,800*
R.S. Hitler (ins. exp.)	61,175	0	47,644	13,531
L.A. Central (cust. files)	120,500	50,000[1]	85,000	85,500*
Chronicle (CATV franchise)	100%	0	100%	0
Laird (players' Ks)	7,772,914.04	0	3,035,000	4,687,914.04*
Lemmen (herd maintenance K)	excess over FMV	0	excess over FMV	0
Hidlantic (cust. list)	803,347	0	90%	10%
Metro Auto (cust. file)	23,000	10,000	15,000	18,000
BSI (cust. contracts)	646,098	7,886[2]	518,363	?

Donrey Csubscrip. list)	?	?	559,406	156,775
Citizens & South, (core dep)	41,785,070	10,496,372	34,959,411	17,322,031
Colorado (core dec.)	41,660,740	5,751,087	37,667,837	9,743,990*
ABCO (cust. list)	305,000	0	75%	25%

* Calculated figure

1 Goodwill and tradename

2 Goodwill and franchis

3 FCC license, advertising value

4 Parties stipulated value if ct. found

intangible amortizable

5 Going concern, advert. Ks Ks, going-concern

6 Plus a percentage of profit