10 T.C. 264 (1948)

When determining equity invested capital for excess profits tax purposes, intangible assets acquired for stock with no established market value are included at their fair market value at the time of acquisition.

Summary

Clarence Whitman & Sons, Inc. disputed a deficiency in excess profits tax, arguing it was entitled to a larger excess profits credit. The company claimed the right to include the value of intangible assets (goodwill associated with the "Clarence Whitman" name) acquired in exchange for its common stock when calculating its equity invested capital. The Tax Court determined the goodwill had a value of $500,000 at the time of acquisition, which could be included in the equity invested capital, and found that the prior Board of Tax Appeals case was not res judicata for the valuation in this case. The Court emphasized the importance of valuing intangible assets based on their fair market value at the time of acquisition, especially when the stock exchanged lacks an established market value.

Facts

Clarence Whitman was involved in a dry goods commission business for many years and his name had acquired a high reputation in the trade. In 1918, Clarence Whitman & Sons, Inc. (the petitioner) was organized. Clarence Whitman transferred the exclusive right to use his name to the corporation in exchange for $1,000,000 par value of its common stock. The corporation sought to include the value of this intangible asset in its equity invested capital for excess profits tax purposes. The Commissioner argued the intangible asset had no value. Previously, in 1928, the Board of Tax Appeals had determined that these intangibles had a value of "at least $412,500," which was 25% of the outstanding capital stock.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in excess profits tax against Clarence Whitman & Sons, Inc. for the calendar year 1941. The taxpayer petitioned the Tax Court, contesting the deficiency and arguing that it was entitled to a larger excess profits credit based on a higher equity invested capital. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the assessment of the proposed deficiency is barred by the statute of limitations.
2. Whether petitioner is entitled to include in equity invested capital certain intangible assets (good will) acquired for its common stock in determining excess profits credit, and if so, what is the value thereof.
3. Whether the finding in a prior Board of Tax Appeals case is res judicata as to

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any value of good will paid for stock at the time of petitioner's organization.

Holding

1. No, because waivers were executed by the petitioner extending the period for assessment.
2. Yes, because the intangible assets (goodwill associated with the "Clarence Whitman" name) had a fair market value at the time of acquisition, and the petitioner is entitled to include $500,000 in its equity invested capital.
3. No, because the prior Board of Tax Appeals decision did not fully determine the value of the intangible assets but was limited by the statutory requirements of that earlier case.

Court's Reasoning

The Tax Court rejected the statute of limitations argument because the taxpayer had executed waivers extending the assessment period. As to the valuation of the goodwill, the court noted that the applicable statute, Section 718 (a) (2) of the code, allowed for the inclusion of property paid in for stock at its basis for determining loss, which is generally cost. The regulations stated that when stock has no established market value, the property paid in for the stock should be included at its fair market value at that time. The court determined the petitioner's common stock had no established market value at the time of issuance. The court found that the petitioner established that the right to use the Clarence Whitman name and the associated goodwill had a value of $500,000 at the time of the exchange for stock. The Court emphasized that the prior BTA case was not res judicata because the prior determination was limited by the constraints of the statute at that time, which limited intangibles to 25% of the outstanding capital stock, and that in this case the court could conduct an independent valuation.

Practical Implications

This case demonstrates the importance of accurately valuing intangible assets, particularly goodwill, when determining equity invested capital for tax purposes. It illustrates that the fair market value of the intangible asset at the time of acquisition is the key determinant when the stock used in the exchange has no established market value. Attorneys should focus on gathering evidence to support the fair market value of the intangible asset at the time of the transaction. Moreover, prior tax court decisions on valuation are not necessarily binding in subsequent tax years if the statutory context has changed. This ruling provides a framework for analyzing similar cases involving the valuation of intangible assets for tax purposes and highlights the need for a thorough analysis of the facts and circumstances surrounding the acquisition of such assets.

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