Wyler v. Commissioner, 14 T.C. 1251 (1950)

A professional's accounting practice, including its goodwill, can be a capital asset, and the sale of that practice can result in capital gains rather than ordinary income.

Summary

Wyler, an accountant, sold his accounting practice to Peat, Marwick, Mitchell and Company. The IRS argued that the $50,000 Wyler received was compensation for personal services, taxable as ordinary income. Wyler argued it was payment for his practice's goodwill, taxable as a capital gain. The Tax Court held that the $50,000 was indeed payment for the sale of Wyler's accounting practice and its associated goodwill. Therefore, the profit from the sale was taxable as a capital gain under Section 117 of the Internal Revenue Code.

Facts

Wyler, an accountant, entered into an agreement with Peat, Marwick, Mitchell and Company to sell his accounting practice. Negotiations indicated that Peat was willing to pay Wyler $50,000 for his practice. The final contract stipulated that Wyler would transfer his goodwill to Peat, and in return, Peat would pay Wyler $50,000 upon signing the agreement. Wyler also entered into a service agreement with Peat. Wyler did not claim any cost basis for the goodwill.

Procedural History

The Commissioner of Internal Revenue determined that the $50,000 received by Wyler was not a capital gain but ordinary income. Wyler petitioned the Tax Court for a redetermination. The Tax Court reviewed the facts, evidence, and arguments presented by both parties.

Issue(s)

Whether the $50,000 received by Wyler from Peat, Marwick, Mitchell and Company constituted payment for the sale of his accounting practice (goodwill), taxable as a capital gain, or compensation for personal services, taxable as ordinary income.

Holding

Yes, because the evidence, including the contract terms and the parties' intent, indicated that the $50,000 was specifically designated as the purchase price for Wyler's accounting practice and its associated goodwill, not compensation for future services.

Court's Reasoning

The Tax Court determined that the $50,000 payment was specifically for the transfer

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of Wyler's accounting practice and its goodwill. The court emphasized that, despite the presence of a separate agreement for personal services, the evidence clearly demonstrated that Peat intended to purchase Wyler's practice. The court cited testimony from both Wyler and a senior partner at Peat, as well as internal memoranda, to support its conclusion. The court distinguished the case from *E.C. O'Rear, 28 B.T.A. 698*, noting that in *O'Rear*, the agreements did not represent contracts for the sale of goodwill. The court quoted *Rodney B. Horton, 13 T.C. 143*: "The purchaser certainly thought it was buying good will and agreed to pay for it. We agree that good will was a part of the assets transferred, and that payment was made for it. Good will is a capital asset and any gains resulting from the sale thereof are capital gains." Since Wyler had no cost basis for the goodwill, the entire $50,000 was taxable as a capital gain.

Practical Implications

This case clarifies that even professionals can sell their practice's goodwill as a capital asset. When structuring the sale of a professional practice, it's crucial to clearly delineate the portion of the purchase price attributable to goodwill versus compensation for services or a covenant not to compete. This impacts the tax treatment of the transaction for both the seller (capital gain vs. ordinary income) and the buyer (capital asset vs. deductible expense). Post-*Wyler*, attorneys should advise clients to create clear documentation (contracts, memos, valuations) to support the allocation of purchase price to goodwill. Later cases would distinguish *Wyler* by emphasizing the importance of the contractual language and the economic realities of the transaction in determining whether goodwill was actually transferred.

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