34 T.C. 205 (1960)

For purposes of excess profits tax relief, an intangible asset must directly contribute to income, not merely facilitate cost savings; an agreement establishing a joint agency operating arrangement for cost reduction does not qualify as an intangible asset.

Summary

The Topeka State Journal, Inc. sought relief from excess profits taxes, claiming a joint operating agreement with a competitor constituted an intangible asset under Section 722(c)(1) of the 1939 Internal Revenue Code, which would allow for a higher excess profits credit based on income. The Tax Court held that the agreement, which established a joint agency to manage certain operations, was not an intangible asset making important contributions to income, as required by the statute. The Court distinguished between an asset that directly produces income and a cost-saving arrangement. Therefore, the taxpayer was not entitled to relief. The dissenting opinion argued that the agreement did, in fact, make important contributions to income and therefore, the taxpayer should have qualified for relief under the statute.

Facts

The Topeka State Journal, Inc. (the "Journal") was formed in February 1940, purchasing an evening newspaper and its assets. The Journal entered into a joint operating agreement on July 17, 1941, with a competitor, Capper Publications, Inc., publisher of The Topeka Daily Capital. The agreement created Topeka Newspaper Printing Company, Inc. ("TNPC"), a joint agency, to manage the mechanical and managerial operations of both newspapers, with ownership split between the Journal and Capper. The purpose was to achieve economies of scale. The Journal sought relief under the excess profits tax provisions. The Commissioner of Internal Revenue denied the relief. The Journal contended that the agreement was an intangible asset that qualified it for relief under Section 722(c)(1) of the 1939 Code because it was of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income.

Procedural History

The Journal filed its tax returns for 1944 and 1945, and subsequently filed applications for excess profits tax relief under Section 722 of the Internal Revenue Code. The Commissioner denied the applications. The case was heard before the United States Tax Court.

Issue(s)

1. Whether the joint operating agreement between Topeka State Journal, Inc. and Capper Publications, Inc. constituted an intangible asset of the taxpayer within the

meaning of Section 722(c)(1) of the 1939 Code?

Holding

1. No, because the agreement was a cost-saving device that did not directly produce income, and therefore did not qualify as an intangible asset under Section 722(c)(1).

Court's Reasoning

The Court framed the issue as whether the agreement was an intangible asset that made important contributions to the Journal's income. The Court acknowledged that the agreement was a contract, but determined that the essential nature of the arrangement was a cost-cutting device. It held that the agreement was not a typical intangible asset, such as a patent or copyright, but was a method to cut costs, which then indirectly contributed to income. The Court distinguished the agreement from assets that directly produce income, such as a secret process, a brand name or trademark, a license, copyright, or a patent. The Court stated, "We think that a joint operating agreement which may increase profits by reducing the respective and separate costs of the two competing business entities must be distinguished from an asset which directly produces income." The Court noted the arrangement was more like a partial merger, without the tax consequences. Since the agreement's primary impact was cost savings and not direct income generation, it did not meet the statutory requirements for an intangible asset.

Practical Implications

This case clarifies what constitutes an