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

Sale of renewal commissions on multi-year insurance policies results in ordinary income to the seller, while the buyer can amortize the cost over the period commissions are expected to be received.

Summary

Hugh and Ottie Hodges sold their insurance agency, which included rights to renewal commissions on 5-year policies, to Glenn Wells, Leslie Wells, and Wilmer Parker for $54,000. The Tax Court held that the portion of the sales price attributable to the renewal commissions ($9,000) was ordinary income to Hodges, not capital gain. The buyers could amortize this cost over the 4 years following the sale, when they expected to receive the commissions. The court also ruled that the value of the agency's intangible assets, such as expirations and goodwill, could not be depreciated or allocated to individual policies for loss deduction purposes.

Facts

Hugh and Ottie Hodges operated the Hodges Insurance Agency as a partnership until October 1961, when they sold it to Glenn Wells, Leslie Wells, and Wilmer Parker for $54,000. The sale included office furniture and equipment valued at $500, and the rights to renewal commissions on existing 5-year fire and casualty insurance policies, totaling $12,444. 48 in anticipated commissions. The buyers formed Hodges-Wells Agency, Inc. , to operate the business. The Hodges reported the entire sales price as capital gain, while the Commissioner of Internal Revenue determined that a portion should be treated as ordinary income.

Procedural History

The Hodges and the buyers filed petitions with the U. S. Tax Court challenging the Commissioner's deficiency notices. The Commissioner had determined that $17,556. 56 of the sales price represented ordinary income from the sale of renewal commissions, but later conceded this figure was incorrect and stipulated to $12,444. 48. The Tax Court heard the case and issued its opinion on June 4, 1968.

Issue(s)

1. Whether the portion of the sales price received by Hugh and Ottie Hodges attributable to the right to renewal commissions on 5-year insurance policies constitutes ordinary income or capital gain.
2. Whether Hodges-Wells Agency, Inc. , is entitled to deduct the amount paid for the right to receive commissions on renewal premiums on 5-year policies over the 4 years following the date of sale.
3. Whether Hodges-Wells Agency, Inc. , is entitled to deduct depreciation or losses on intangible assets such as insurance expirations and goodwill purchased from Hodges Insurance Agency.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the right to receive renewal commissions on multi-year policies is considered a transfer of anticipated income, resulting in ordinary income to the seller.
2. Yes, because the buyer is entitled to amortize the cost of the renewal commissions over the period they are expected to be received.
3. No, because the intangible assets purchased, such as expirations and goodwill, do not have a reasonably ascertainable useful life and cannot be allocated to individual policies for loss deduction purposes.

Court's Reasoning

The court reasoned that the sale of the right to renewal commissions on multi-year policies is analogous to the sale of anticipated income, which has been held to result in ordinary income in cases involving life, health, and accident insurance policies. The court rejected the argument that the need to send renewal notices distinguished the case from those involving automatic renewals. The court allocated $9,000 of the $54,000 sales price to the renewal commissions, based on three times the average yearly premium income on such policies over a 4-year period. The court allowed the buyers to amortize this cost over the 4 years following the sale, when they expected to receive the commissions. Regarding the intangible assets, the court held that they constituted an indivisible asset without a reasonably ascertainable useful life, and could not be allocated to individual policies for loss deduction purposes.

Practical Implications

This decision clarifies that the sale of renewal commissions on multi-year insurance policies results in ordinary income to the seller, while the buyer can amortize the cost over the period the commissions are expected to be received. Practitioners advising clients on the sale or purchase of insurance agencies should consider allocating a portion of the sales price to renewal commissions and structuring the transaction accordingly. The decision also highlights the difficulty in deducting losses on intangible assets such as expirations and goodwill, as they are considered indivisible assets without a determinable useful life. This may impact the valuation and tax planning for insurance agency transactions. Later cases have applied this ruling in similar contexts, such as the sale of management contracts with insurance companies.