Marsh & McLennan, Inc. v. Commissioner, 51 T. C. 56 (1968)

Insurance expirations acquired in the purchase of an insurance brokerage business are not subject to depreciation under Section 167 of the Internal Revenue Code.

Summary

Marsh & McLennan, Inc. acquired Stokes, Packard & Smith, Inc. , an insurance brokerage, and sought to depreciate the cost of the insurance expirations acquired as part of the purchase. The Tax Court held that these expirations were part of the nondepreciable goodwill of the acquired business, as they were inextricably linked with the goodwill and did not have a determinable useful life. The decision clarified that such intangible assets cannot be depreciated, impacting how similar acquisitions are accounted for in the insurance brokerage industry.

Facts

Marsh & McLennan, Inc. purchased all the stock of Stokes, Packard & Smith, Inc. (Stokes), an insurance brokerage and agency business, for $265,383. The purchase included all of Stokes' assets, including insurance expirations for about 2,400 accounts. Marsh & McLennan liquidated Stokes immediately after the purchase, taking over all its assets. The company allocated $69,550. 78 of the purchase price to the cost of insurance expirations, which it attempted to depreciate over five years in its tax returns for 1961 and 1962.

Procedural History

The Commissioner of Internal Revenue disallowed the depreciation deductions claimed by Marsh & McLennan for the insurance expirations. Marsh & McLennan petitioned the United States Tax Court for a redetermination of the deficiencies. The Tax Court reviewed the case and issued a decision in favor of the Commissioner, ruling that the insurance expirations were not subject to depreciation.

Issue(s)

1. Whether the cost of insurance expirations acquired by Marsh & McLennan in the purchase of Stokes is deductible as depreciation under Section 167 of the Internal Revenue Code?

Holding

1. No, because the insurance expirations were part of the nondepreciable goodwill of the acquired business, and their useful life could not be determined with reasonable accuracy.

Court's Reasoning

The Tax Court reasoned that insurance expirations, when acquired as part of a going insurance brokerage business, are considered part of the business's goodwill. The court cited its previous decision in *Alfred H. Thoms*, where insurance expirations were held to be a nondepreciable asset due to their indefinite useful life. The court noted that Marsh & McLennan acquired all of Stokes' assets, including all 2,400 expirations, and could not segregate the cost of specific expirations from the overall goodwill of the business. The court also rejected Marsh & McLennan's argument that the expirations had a limited useful life, stating that the expirations provided an ongoing benefit beyond the initial client contact. The covenants not to compete obtained from Stokes' stockholders were seen as ensuring the effective transfer of goodwill rather than as separate depreciable assets.

Practical Implications

This decision has significant implications for the insurance brokerage industry, particularly for companies acquiring other brokerages. It establishes that insurance expirations acquired in such transactions are part of the nondepreciable goodwill of the business, meaning they cannot be depreciated for tax purposes. This affects the financial planning and tax strategies of acquiring companies, as they cannot claim depreciation deductions on these intangible assets. The ruling also underscores the importance of properly valuing and allocating the purchase price in acquisition transactions, as the court will not allow depreciation deductions for assets that are considered part of goodwill. Subsequent cases, such as *Alfred H. Thoms*, have reinforced this principle, guiding legal and tax professionals in advising clients on similar transactions.