***Vander Hoek v. Commissioner, 51 T. C. 203 (1968)***

When purchasing a business asset, part of the purchase price may be allocable to an intangible asset like a marketing right, which may not be depreciable.

**Summary**

In Vander Hoek v. Commissioner, the U. S. Tax Court addressed the allocation of the purchase price of a dairy herd between the tangible cows and the intangible right to market milk through a cooperative association. The partnership, Vander Hoek & Struikmans Dairy, bought a herd with an associated 'base' right from Protected Milk Producers Association. The court held that the purchase price should be split between the cows and the right to base, with the latter being nondepreciable due to its intangible nature. This ruling underscores the necessity to allocate purchase prices accurately between tangible and intangible assets for tax purposes, affecting how similar transactions are assessed in the future.

**Facts**

In November 1962, the Vander Hoek & Struikmans Dairy partnership purchased a herd of 200 Holstein dairy cows, 6 breeding bulls, and dairy equipment from the Jensens, who had acquired them from Gerald Swager. The purchase was facilitated through Robert McCune & Associates. The total cost was $164,665, with the partnership paying $145,965 for 180 cows, bulls, and equipment. The herd came with a 'right to base' from Protected Milk Producers Association (Protected), a cooperative that allocated milk marketing rights based on pounds of butterfat. The partnership's purchase included Swager's right to base, which was essential for marketing milk in California due to regulatory constraints.

**Procedural History**

The IRS determined deficiencies in the partnership's income taxes for 1962 and 1963, leading to a dispute over the cost basis of the dairy herd. The Tax Court consolidated the cases involving Vander Hoek and Struikmans with others for trial. The court reviewed the transaction and the allocation of the purchase price, ultimately deciding on the allocation between the tangible assets and the intangible right to base.

**Issue(s)**

1. Whether the entire purchase price paid for the dairy herd should be allocated to the cost basis of the cows for depreciation purposes, or whether a portion should be allocated to the right to base.
2. Whether the right to base is a depreciable asset.

**Holding**

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1. No, because the partnership would not have paid the full price without obtaining the right to base, which was an essential part of the transaction. The court allocated $375 per cow to the cost basis, with the remaining $394. 25 per cow to the right to base.
2. No, because the right to base is an intangible asset without an ascertainable useful life, making it nondepreciable.

**Court’s Reasoning**

The court found that the right to base was a separate, valuable asset that the partnership bargained for and obtained from Swager, despite the formal transfer being handled by Protected. The court emphasized the economic reality over formalities, noting that the partnership would not have paid $769. 25 per cow without the right to base. In determining the allocation, the court considered the quality of the herd and market conditions at the time of purchase. The right to base was deemed nondepreciable because it lacked an ascertainable useful life, aligning with existing tax regulations and court precedents.

**Practical Implications**

This decision requires taxpayers to carefully allocate purchase prices between tangible and intangible assets, especially in regulated industries where marketing rights are significant. It impacts how businesses account for such transactions for tax purposes, potentially affecting depreciation deductions and the overall tax burden. The ruling also guides future cases involving the purchase of assets with associated intangible rights, emphasizing the need to recognize and value these rights separately. Subsequent cases have applied this principle in various contexts, reinforcing the importance of accurate asset allocation in tax law.

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