BASF Wyandotte Corp. v. Commissioner, 62 T. C. 704 (1974)

Depreciation recapture under section 1245 for assets sold from a multiple-asset account should be computed on an individual asset basis where possible, but if allocation of the sale price is impossible, the entire sale may be treated as a single asset.

Summary

In BASF Wyandotte Corp. v. Commissioner, the U. S. Tax Court addressed the issue of depreciation recapture under section 1245 when selling assets from a multiple-asset account. BASF sold two powerplants, which were fully depreciated, for a lump sum. The court held that recapture should be calculated on an individual asset basis if feasible, but since BASF failed to prove an acceptable allocation method, the court upheld the Commissioner's treatment of the sale as a single asset. The decision clarified the application of section 1245 to sales of multiple-asset accounts, emphasizing the necessity of proving allocation methods for individual asset treatment.

Facts

BASF Wyandotte Corp. sold two powerplants to Detroit Edison Co. for $4 million in December 1965. The sale price was allocated $850,000 to buildings and $3,150,000 to machinery and equipment. Prior to 1962, BASF depreciated the machinery and equipment in approximately 1,500 separate item accounts. In 1962, BASF placed these assets into a multiple-asset account with an 11-year guideline life. By the time of the sale, the account was fully depreciated with a zero adjusted basis. BASF reported the sale on its 1965 tax return, treating the gain as partly section 1245 recapture and partly capital gain, based on an appraisal report.

Procedural History

The Commissioner determined deficiencies in BASF's 1964 and 1965 federal income taxes, asserting that the entire gain from the sale should be treated as section 1245 recapture. BASF petitioned the U. S. Tax Court, which heard the case and issued its decision on August 28, 1974.

Issue(s)

1. Whether depreciation recapture under section 1245 should be computed separately for each of the 1,500 items sold or treated as one aggregate property?
2. If computed separately, whether recapture on items owned by BASF as of December 31, 1961, is limited to their adjusted bases on that date?
3. Whether BASF carried its burden of proving an acceptable method of allocating the lump-sum sales price to the individual component parts?

Holding

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1. Yes, because section 1245 gain should be computed individually for each asset where possible, but if allocation is impossible, the sale can be treated as one asset.
2. Yes, because the recapture is limited to the undepreciated basis of each asset at the time it was placed in the multiple-asset account.
3. No, because BASF failed to provide sufficient evidence of an acceptable allocation method, thus the Commissioner's method of treating the sale as one asset was upheld.

Court's Reasoning

The court reasoned that section 1245 requires computation of recapture on an individual asset basis when possible. It referred to regulations stating that the amount of section 1245 gain should be determined separately for each item. However, the court noted that if the assets are sold in one transaction without an acceptable allocation method, the Commissioner can treat the sale as one asset, limited by the aggregate adjusted bases of the properties at the time they were placed in the multiple-asset account. The court found that BASF did not provide sufficient evidence to allocate the lump-sum sale price among the individual assets, thus upholding the Commissioner's approach. The decision was influenced by the need to ensure accurate computation of section 1245 gain, and the lack of evidence supporting BASF's allocation method.

Practical Implications

This decision impacts how section 1245 depreciation recapture is calculated for sales of assets from multiple-asset accounts. Taxpayers must provide clear evidence of an acceptable allocation method to compute recapture on an individual asset basis. If unable to do so, the entire sale may be treated as a single asset, potentially affecting the tax treatment of the gain. Practitioners should advise clients on maintaining detailed records of asset values and sales agreements to support allocation methods. This case has been referenced in subsequent rulings and decisions, reinforcing the importance of proving allocation in similar sales scenarios.

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