Computer Sciences Corp. v. Commissioner, 63 T. C. 327 (1974)

Intangible assets, such as computer programs and copyrighted forms, can be considered 'property' produced by a corporation under the collapsible corporation rules of IRC Section 341.

Summary

Computer Sciences Corp. (CSC) developed a proprietary computer program for tax return preparation and transferred it to its subsidiary, Computax. The IRS argued that Computax was a collapsible corporation under IRC Section 341 because CSC sold stock in Computax before substantial income was realized from the program. The Tax Court held that the program was intangible property produced by CSC, but the production was complete before CSC formed a view to sell Computax stock, thus Computax was not a collapsible corporation. This ruling clarifies that intangible assets can be 'property' under Section 341, but the timing of when the production of such property is considered complete is crucial for determining collapsible corporation status.

Facts

CSC, a computer services company, developed a proprietary computer program for tax return preparation in 1963 to utilize its UNIVAC 1107 computer. After initial losses, CSC expanded the program's capabilities. In June 1965, CSC formed Computax Corp. as a wholly owned subsidiary and transferred the program to it. By September 1965, CSC sold a controlling interest in Computax to Commerce Clearing House (CCH) for $4. 3 million. The IRS asserted that Computax was a collapsible corporation under IRC Section 341, treating CSC's gain from the stock sale as ordinary income.

Procedural History

The IRS determined a deficiency in CSC's federal income tax for the fiscal year ended April 1, 1966, treating the gain from the Computax stock sale as ordinary income under Section 341. CSC petitioned the Tax Court for a redetermination. The court heard the case and issued its decision on December 16, 1974.

Issue(s)

1. Whether the computer program developed by CSC constitutes 'property' within the meaning of IRC Section 341.
2. Whether CSC formed or availed of Computax with a view to selling its stock before a substantial part of the taxable income from the program was realized.

Holding

1. Yes, because the program and related forms are intangible assets that meet the

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definition of ‘property’ under Section 341.
2. No, because the production of the program was complete by mid-April 1965, before CSC formed the view to sell Computax stock.

Court’s Reasoning

The court reasoned that the computer program and copyrighted forms were intangible property produced by CSC, as Section 341 does not limit ‘property’ to tangible assets. The court applied the rule that a corporation is collapsible if it is formed or availed of with a view to selling its stock before realizing substantial income from the produced property. The court found that CSC’s view to sell Computax stock was formed no earlier than April 19, 1965, after the program’s production was complete. The court defined ‘production’ as completed when the program was ready for commercial use, which occurred by mid-April 1965. The court distinguished this from ongoing improvements made during commercialization, which do not affect the completion of production for Section 341 purposes.

Practical Implications

This decision establishes that intangible assets can be treated as ‘property’ under the collapsible corporation rules, expanding the scope of Section 341. For practitioners, it is crucial to determine when the production of an intangible asset is complete, as this affects whether a corporation can be considered collapsible. The ruling suggests that once an intangible asset is ready for commercial use, its production is considered complete, even if further improvements are made. This case may influence how companies structure the development and transfer of intellectual property to subsidiaries, particularly in technology and software industries. Subsequent cases have cited this decision when analyzing the collapsible corporation status of entities involved in intangible asset development.

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