Cordura Corp. v. Commissioner, 67 T. C. 304 (1976)

Credit information files can be depreciated if they have an ascertainable value separate from goodwill and a limited useful life.

Summary

Cordura Corp. and its subsidiary sought to depreciate the cost of credit information files acquired from other companies, claiming a 6-year useful life and the 150-percent declining-balance method. The Tax Court allowed depreciation on the files, finding they had value separate from goodwill and a limited useful life due to the need for current credit information. However, the court rejected the accelerated depreciation method, requiring use of the straight-line method instead. The decision clarifies the criteria for depreciating intangible assets and the importance of separating their value from goodwill and going-concern value.

Facts

Cordura Corp. and its subsidiary, Computing & Software, Inc. , acquired credit information files from Consumer Credit Clearance, Inc. (CCC), Retail Merchants Credit Association (RMCA), and Credit Bureau of Compton and Lynwood. The files contained credit data on individuals in Los Angeles and Orange Counties. CCC's files were stored in 60 steel cabinets and included blue inquiry cards and white legal cards, with information purged based on criteria like age of data. RMCA's files included both manual and computerized data, while Compton's were similar to RMCA's manual files. Cordura allocated portions of the purchase price to these files and claimed depreciation deductions, which the IRS disallowed.

Procedural History

The IRS determined deficiencies in Cordura's income taxes for the years 1966-1969, disallowing the depreciation deductions claimed on the credit information files. Cordura petitioned the Tax Court for a redetermination of these deficiencies, arguing that the files were depreciable assets with a limited useful life.

Issue(s)

1. Whether the credit information files purchased by Cordura are subject to a depreciation allowance under section 167.
2. If so, whether the allowance may be computed under the 150-percent declining-balance method for computing depreciation.

Holding

1. Yes, because the credit information files had an ascertainable value separate from goodwill and a limited useful life of 6 years, making them depreciable.
2. No, because Cordura failed to show that the 150-percent declining-balance

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method produced a reasonable allowance for depreciation; the straight-line method must be used instead.

Court's Reasoning

The court applied section 167(a) of the Internal Revenue Code, which allows a reasonable allowance for depreciation of property used in business, including intangibles with a limited useful life. The court found that the credit files were separate from goodwill, as they were the primary productive asset of the business, not merely a reflection of customer relationships. The court rejected the IRS's argument that the files were an indivisible mass with goodwill, emphasizing that the files were a major factor in the transactions.

The court also determined that the credit information had a limited useful life due to the need for current data in credit reporting. The purge criteria used by the companies ensured that most information became obsolete within 6 years. The court rejected the IRS's contention that the files were self-regenerative and thus had an indefinite life, focusing instead on the purchased information's limited utility.

Regarding the depreciation method, the court noted that section 167(c) limits the use of accelerated methods like the declining-balance method to tangible property. Even if the method could apply to intangibles under section 167(a), Cordura failed to show that the declining-balance method produced a reasonable allowance, as required by the regulations.

The court cited several cases to support its reasoning, including Houston Chronicle Publishing Co. v. United States and Commissioner v. Seaboard Finance Co. , which allowed depreciation of intangibles with limited lives. The court also relied on the Cohan rule to allocate the purchase price among the assets acquired.

Practical Implications

This decision clarifies that businesses can depreciate the cost of credit information files if they can establish a separate value from goodwill and a limited useful life. This ruling may encourage companies in the credit reporting industry to carefully document the value and obsolescence of their data to support depreciation claims.

Attorneys should advise clients to maintain clear records of the purchase price allocation and the useful life of intangible assets like credit files. The decision also highlights the importance of distinguishing between tangible and intangible assets when applying depreciation methods, as the straight-line method is required for intangibles.

Businesses acquiring credit reporting agencies or similar operations should consider the tax implications of asset allocation and depreciation methods. The ruling may impact the valuation of credit reporting businesses in mergers and acquisitions, as the depreciable value of credit files can affect the overall purchase price.

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Later cases, such as those involving the depreciation of other types of intangible assets, may cite Cordura Corp. v. Commissioner as precedent for allowing depreciation when a limited useful life can be established.

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