Computing & Software, Inc. v. Commissioner, 65 T. C. 1153 (1976)

The basis of a depreciable asset must be reduced by the full amount of depreciation deductions allowed, even if based on an erroneous allocation, to the extent that the deductions resulted in a tax benefit.

Summary

Computing & Software, Inc. purchased a credit information business and allocated the purchase price between a credit file and goodwill. The company claimed a depreciation deduction for the credit file in 1965, which resulted in a tax benefit. The Tax Court held that the basis of the credit file must be reduced by the full amount of the depreciation deduction allowed in 1965, despite the erroneous allocation of the purchase price, because the deduction was only claimed for the credit file and not for goodwill. This decision underscores that adjustments to basis under section 1016(a)(2)(B) are to be made based on the deductions actually allowed and resulting in tax benefits, regardless of errors in asset allocation.

Facts

In December 1964, Consumer Credit Clearance, Inc. (CCC) purchased a credit information business from Hughes Dynamics, Inc. for $2,050,000, allocating $1,715,000 to a credit information file and $173,982. 51 to goodwill. In 1965, CCC claimed a depreciation deduction of $423,850 for the credit file, which resulted in a tax benefit of $276,768. The Tax Court later reallocated the purchase price, assigning $1,000,000 to the credit file and $715,000 to goodwill, and determined the allowable annual depreciation for the file to be $166,666.

Procedural History

The original Tax Court opinion was issued on May 15, 1975, with a supplemental opinion filed on March 22, 1976, addressing the basis adjustment issue for the credit file. The court’s decisions were based on the application of section 1016(a)(2)(B) to the facts of the case.

Issue(s)

1. Whether the basis of the credit file should be reduced by the full amount of the depreciation deduction allowed in 1965 ($276,768) or by the amount allowable under the court’s reallocation ($166,666).

Holding

1. Yes, because the full amount of the depreciation deduction claimed in 1965 was allowed with respect to the credit file, and no part of it was allowed with respect to goodwill. Therefore, the basis of the credit file must be reduced by the full $276,768, which resulted in a tax benefit.

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Court’s Reasoning

The court applied section 1016(a)(2)(B), which requires basis adjustments for depreciation deductions allowed or allowable, whichever is greater. The court found that the depreciation deduction was claimed and allowed solely for the credit file, not for goodwill. The error was in the allocation of the purchase price, not in allowing depreciation for a non-depreciable asset like goodwill. The court rejected the petitioner’s argument to allocate the deduction between the file and goodwill, stating that the deduction was allowed for the file as reported on the tax return. The court distinguished prior cases like Hoboken Land & Improvement Co. and Pittsburgh Brewing Co. , noting that those involved different factual scenarios regarding the allowance of depreciation for non-depreciable assets or separate classes of depreciable assets. The court emphasized that the adjustment must reflect the actual tax benefit received from the allowed deduction.

Practical Implications

This decision impacts how tax practitioners should handle basis adjustments for depreciation deductions. It clarifies that basis must be reduced by the full amount of deductions allowed, even if based on an erroneous allocation, as long as they resulted in a tax benefit. This ruling affects how businesses allocate purchase prices among assets and how they claim depreciation deductions. It also informs future cases involving basis adjustments, emphasizing the importance of the actual tax benefit derived from deductions in determining basis reductions. Practitioners must ensure accurate asset allocations and understand that adjustments to basis are tied to the deductions as allowed on tax returns, not merely to what might have been allowable under a different allocation.

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