Arthur G. Rudd, Petitioner v. Commissioner of Internal Revenue, Respondent, 79 T. C. 225 (1982)

A partner may claim a loss deduction for the abandonment of a partnership name if it is a clearly identifiable and severable asset contributing to the partnership's goodwill.

Summary

Arthur Rudd, a partner in Maihofer, Moore & DeLong, claimed a loss deduction after the partnership dissolved in 1971 and its name was abandoned. The U. S. Tax Court ruled that Rudd was entitled to a deduction for the portion of goodwill attributable to the partnership's name, which was a distinct asset. The court determined that 20% of the partnership's goodwill was embodied in its name, and thus, Rudd could deduct 20% of his adjusted basis in the goodwill upon its abandonment. The decision underscores that a partnership's name can be a valuable, separate component of goodwill, affecting the deductibility of losses upon abandonment.

Facts

Maihofer, Moore & DeLong, a well-established public accounting firm in Muskegon, Michigan, dissolved in 1971. Upon dissolution, the rights to the firm's name were distributed to five partners, including Arthur Rudd, who then abandoned its use. Rudd had purchased interests in the partnership from 1958 to 1971, paying premiums for goodwill, part of which was attributed to the firm's name. The firm's name was well-recognized and contributed to client attraction and retention. After dissolution, Rudd and others joined Alexander Grant & Co. , a national accounting firm, without using the old firm's name.

Procedural History

Rudd filed a petition with the U. S. Tax Court contesting a deficiency determination by the Commissioner of Internal Revenue for 1971, claiming a loss deduction for the abandonment of the partnership's name. The Tax Court reviewed the case, considering whether the partnership's name was a severable asset contributing to goodwill, and if so, the amount of Rudd's allowable deduction.

Issue(s)

1. Whether the partnership's name was a clearly identifiable and severable asset for which Rudd could claim a loss deduction upon its abandonment.
2. Whether the partnership's goodwill was entirely embodied in its name.
3. Whether Rudd's loss deduction, if allowable, should be treated as an ordinary or capital loss.

Holding

1. Yes, because the partnership's name was a valuable, distinct asset that contributed to the partnership's goodwill, and its abandonment entitled Rudd to a loss deduction.
2. No, because the partnership's goodwill also included client relationships and other intangibles not abandoned upon dissolution.
3. The loss was an ordinary loss because it arose from abandonment, not a sale or exchange.

Court's Reasoning

The court found that the partnership's name was a significant component of its goodwill, contributing to client attraction and retention. The name's value was evidenced by its long-standing use, recognition in the community, and the partnership's refusal to change it. The court applied Section 165(a) of the Internal Revenue Code, allowing a deduction for losses from the abandonment of nondepreciable property. The court determined that 20% of the partnership's goodwill was embodied in its name, based on the firm's history and the importance of the name in the accounting industry. The court rejected the Commissioner's argument that no deduction should be allowed because the precise amount was unprovable, stating that some deduction was necessary. The court also clarified that Section 731(a)(2) did not apply because Rudd's loss arose from the abandonment after distribution, not the distribution itself. Finally, the court held that the loss was ordinary because it stemmed from abandonment, not a sale or exchange.

Practical Implications

This decision allows partners to claim loss deductions for the abandonment of partnership names, provided they can establish the name as a distinct asset contributing to goodwill. It highlights the need to allocate goodwill among its components, such as a firm's name, client relationships, and other intangibles. Practitioners must carefully assess the value of a partnership's name in relation to its total goodwill when advising clients on tax planning or dissolution. The ruling also clarifies that abandonment losses are ordinary, not capital, losses, which can impact tax strategies. Subsequent cases have cited Rudd when dealing with the valuation and deductibility of intangibles like business names.

