Ithaca Indus. v. Commissioner, 97 T. C. 253, 1991 U. S. Tax Ct. LEXIS 75, 97 T. C. No. 16 (T. C. 1991)

An assembled work force is not a separate intangible asset from goodwill or going-concern value and thus not amortizable, whereas certain contracts with limited useful lives may be amortized if they have a value separate from goodwill.

Summary

Ithaca Industries, Inc. purchased the stock of another corporation and allocated the purchase price among various assets, including an assembled work force and raw material contracts. The IRS challenged the allocations, asserting that the work force was part of goodwill or going-concern value and thus not amortizable, while the raw material contracts were amortizable over their 14-month life. The Tax Court held that the assembled work force was not a separate asset from goodwill or going-concern value and thus not subject to amortization. However, the court allowed amortization of the raw material contracts over their useful life, as they were separate from goodwill and had an ascertainable value and life.

Facts

Ithaca Industries, Inc. (New Ithaca) purchased all the common stock of Old Ithaca for $110 million in a leveraged buyout and subsequently liquidated Old Ithaca. New Ithaca allocated $7. 7 million of the purchase price to an assembled work force and $1. 76 million to raw material contracts. Old Ithaca had 17 manufacturing plants, a distribution facility, and an executive office, employing about 5,153 hourly and 212 other employees. The raw material contracts were for yarn supply with terms up to 14 months. The IRS disallowed amortization deductions claimed by Ithaca for both the work force and the contracts, arguing they were part of goodwill or going-concern value.

Procedural History

The IRS issued a notice of deficiency to Ithaca Industries for fiscal years ending February 3, 1984, and February 1, 1985, disallowing amortization deductions for the assembled work force and raw material contracts. Ithaca petitioned the U. S. Tax Court for a redetermination of the deficiencies. The Tax Court ruled that the assembled work force was not a separate asset from goodwill or going-concern value and thus not amortizable, but allowed amortization of the raw material contracts over their 14-month life.

Issue(s)

1. Whether an assembled work force is an intangible asset distinct from goodwill or going-concern value with an ascertainable useful life over which its value may be amortized.
2. Whether raw material supply contracts are assets distinct from goodwill or going-

concern value with an ascertainable useful life over which their value may be amortized.
3. If either the work force in place or the raw material contracts has a value apart from goodwill or going-concern value and an ascertainable useful life, what is the useful life and proper value allocable to each such asset?

Holding

1. No, because an assembled work force is not a wasting asset separate and distinct from goodwill or going-concern value and thus may not be amortized.
2. Yes, because the raw material contracts have a limited useful life of 14 months and an ascertainable value separate and distinct from goodwill or going-concern value, which value may be amortized over the useful life of the contracts pursuant to section 167.
3. The useful life of the raw material contracts is 14 months, and their value is to be determined by adjusting market prices by a 2. 5% discount, eliminating any contracts where no savings result.

Court's Reasoning

The court reasoned that an assembled work force is part of going-concern value, which does not have an ascertainable useful life and thus is not amortizable. The court cited prior cases where an assembled work force was necessary for uninterrupted business operation, indicating it was part of going-concern value. The court also determined that the work force was not a wasting asset, as its value did not diminish over time or through use. In contrast, the court found that the raw material contracts had a limited useful life of 14 months and a value separate from goodwill. The court rejected the IRS's arguments that the contracts' life was indefinite due to price fluctuations and potential renewals, emphasizing that the contracts themselves, not the favorable price spread, were the asset to be amortized. The court also determined the value of the contracts by adjusting market prices by a 2. 5% discount to reflect Ithaca's quantity purchases.

Practical Implications

This decision clarifies that an assembled work force is not a separate amortizable asset from goodwill or going-concern value, impacting how companies allocate purchase prices in acquisitions. It also establishes that contracts with limited useful lives and ascertainable values separate from goodwill can be amortized, guiding the treatment of such assets in future transactions. The ruling affects tax planning for mergers and acquisitions, particularly in determining the amortization of intangible assets. Subsequent cases have followed this precedent in distinguishing between goodwill and other intangible assets. Businesses must carefully assess the nature of their assets to determine proper tax treatment, and tax professionals should consider these principles when advising on the allocation of purchase prices and the amortization of intangible assets.

