Frontier Chevrolet Co. v. Commissioner of Internal Revenue, 116 T. C. 289 (United States Tax Court 2001)

The U. S. Tax Court ruled in Frontier Chevrolet Co. v. Commissioner that covenants not to compete entered into in connection with an acquisition of an interest in a trade or business must be amortized over 15 years as per I. R. C. § 197. This decision impacts how businesses can deduct payments for noncompetition agreements, establishing a uniform amortization period and clarifying that even a stock redemption by a company counts as an acquisition under the statute, thus affecting tax planning strategies related to such agreements.

Parties

Frontier Chevrolet Co. was the petitioner at the trial level and on appeal. The Commissioner of Internal Revenue was the respondent throughout the litigation.

Facts

Frontier Chevrolet Co. , a corporation engaged in selling and servicing new and used vehicles, entered into a stock sale agreement with Roundtree Automotive Group, Inc. (Roundtree), effective August 1, 1994. Under the agreement, Frontier redeemed all of Roundtree's 75% ownership in Frontier's stock for $3. 5 million. Concurrently, Frontier entered into a noncompetition agreement with Roundtree and Frank Stinson, an executive involved in Roundtree's operations. The noncompetition agreement prohibited Roundtree and Stinson from competing with Frontier within Yellowstone County for five years, in exchange for monthly payments of $22,000 for 60 months. Frontier claimed to amortize these payments over the 60-month term of the agreement, but the IRS contended that a 15-year amortization period was required under I. R. C. § 197.

Procedural History

The Commissioner determined deficiencies in Frontier's federal income taxes for the years 1994, 1995, and 1996. Frontier filed a petition with the United States Tax Court, contesting the deficiencies and asserting that the noncompetition agreement payments should be amortized over 60 months. The parties stipulated the facts, and the case was submitted to the Tax Court for a decision on the legal issue of the appropriate amortization period. The court applied a de novo standard of review to the legal questions presented.

Issue(s)

Whether a covenant not to compete entered into in connection with a corporation's redemption of its own stock constitutes an acquisition of an interest in a trade or business under I. R. C. § 197, thereby requiring the amortization of payments over 15 years?

© 2025 SCOTUSreports.com. All rights reserved.

Rule(s) of Law

I. R. C. § 197 provides that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable § 197 intangible, which includes a covenant not to compete entered into in connection with a direct or indirect acquisition of an interest in a trade or business. The deduction is determined by amortizing the adjusted basis of the intangible ratably over a 15-year period beginning with the month in which the intangible was acquired. See I. R. C. § 197(a), (c)(1), and (d)(1)(E).

Holding

The Tax Court held that Frontier's redemption of its stock from Roundtree was an acquisition of an interest in a trade or business within the meaning of I. R. C. § 197. Consequently, the noncompetition agreement entered into in connection with this acquisition was subject to the 15-year amortization period mandated by § 197.

Reasoning

The court's reasoning was based on the plain language of I. R. C. § 197 and its legislative history. The court interpreted the term "acquisition" to include the redemption of stock, as it involved Frontier regaining possession and control over its stock. The legislative history of § 197 supported this interpretation by including stock in a corporation engaged in a trade or business as an interest in a trade or business. The court rejected Frontier's argument that only an acquisition of a new trade or business would trigger § 197, finding no such limitation in the statute or its legislative history. The court also dismissed Frontier's contention that the acquisition was made by a shareholder, not the company, as the agreements clearly identified Frontier as a party. The court further noted that while not applicable to this case, subsequent regulations under § 197 explicitly included stock redemptions within the term "acquisition," reinforcing the court's interpretation.

Disposition

The Tax Court affirmed the Commissioner's position and held that Frontier must amortize the noncompetition agreement payments over 15 years pursuant to I. R. C. § 197. The decision was to be entered under Rule 155 of the Tax Court Rules of Practice and Procedure.

Significance/Impact

The decision in Frontier Chevrolet Co. v. Commissioner clarified the scope of I. R. C. § 197 by establishing that a corporation's redemption of its own stock constitutes an acquisition of an interest in a trade or business, thereby subjecting related covenants not to compete to the 15-year amortization period. This ruling has significant implications for tax planning, as it affects the timing and amount of deductions businesses can claim for noncompetition agreements. The case has been

© 2025 SCOTUSreports.com. All rights reserved.

cited in subsequent tax court decisions and IRS guidance, solidifying its doctrinal importance in the area of tax amortization of intangibles. It also underscores the importance of considering the broad reach of I. R. C. § 197 when structuring corporate transactions involving noncompetition agreements.

© 2025 SCOTUSreports.com. All rights reserved.