Fed. Home Loan Mortg. Corp. v. Commissioner, 121 T. C. 129 (U. S. Tax Ct. 2003)

The U. S. Tax Court ruled that the Federal Home Loan Mortgage Corporation (Freddie Mac) could use the higher of its regular adjusted cost basis or the fair market value as of January 1, 1985, to amortize its intangible assets. This decision, stemming from the Deficit Reduction Act of 1984, ensures that pre-1985 asset value changes are not taxed, aligning with Congress's intent to neutralize tax impacts from Freddie Mac's shift to taxable status.

Parties

The petitioner was Federal Home Loan Mortgage Corporation (Freddie Mac), represented at trial and on appeal by Robert A. Rudnick, Stephen J. Marzen, James F. Warren, and Neil H. Koslowe. The respondent was the Commissioner of Internal Revenue, represented by Gary D. Kallevang.

Facts

Freddie Mac was chartered by Congress in 1970 and was originally exempt from federal income taxation. The Deficit Reduction Act of 1984 (DEFRA) subjected Freddie Mac to federal income taxes starting January 1, 1985. For the taxable years 1985 through 1990, Freddie Mac sought to amortize certain intangibles using their fair market values as of January 1, 1985. These intangibles included information systems, favorable leaseholds, a seller/servicer list, favorable financing, and customer relations. The Commissioner of Internal Revenue determined that the regular adjusted cost basis should be used instead.

Procedural History

Freddie Mac filed petitions in the U. S. Tax Court challenging deficiencies assessed by the Commissioner for the tax years 1985 through 1990. Both parties filed cross-motions for partial summary judgment concerning the appropriate basis for amortizing Freddie Mac's intangible assets as of January 1, 1985. The Tax Court granted summary judgment in favor of Freddie Mac, holding that the higher of the regular adjusted cost basis or the fair market value as of January 1, 1985, should be used.

Issue(s)

Whether, for the purpose of computing a deduction for amortization, the adjusted basis of any amortizable intangible assets that Freddie Mac held on January 1, 1985, is the regular adjusted cost basis provided in section 1011 of the Internal Revenue Code or the higher of the regular adjusted cost basis or fair market value of such assets on January 1, 1985, as provided in the Deficit Reduction Act of 1984?

Rule(s) of Law

Section 167(g) of the Internal Revenue Code states that “The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property. ” DEFRA section 177(d)(2)(A)(ii) provides that for purposes of determining any gain on the sale or other disposition of property held by Freddie Mac on January 1, 1985, the adjusted basis shall be equal to the higher of the regular adjusted cost basis or the fair market value of such asset as of January 1, 1985.

Holding

The U. S. Tax Court held that Freddie Mac’s adjusted basis for purposes of amortizing intangible assets under section 167(g) is the higher of regular adjusted cost basis or fair market value as of January 1, 1985, as provided by DEFRA section 177(d)(2)(A)(ii).

Reasoning

The court’s reasoning was based on the statutory language and legislative history of DEFRA. The court noted that DEFRA section 177(d)(2)(A)(ii) specifically applies to Freddie Mac and provides a dual-basis rule for determining gain, which is the higher of the regular adjusted cost basis or fair market value as of January 1, 1985. Section 167(g) of the Internal Revenue Code mandates that the basis for amortization is the same as that used for determining gain. The court rejected the Commissioner’s argument that DEFRA section 177(d)(2) was only for determining gain and loss, not amortization, by pointing out that Congress explicitly provided a different rule for tangible depreciable property but not for intangibles, indicating an intent to apply the dual-basis rule to intangibles for amortization purposes. The court also drew analogies to the historical basis rules applied to property held before March 1, 1913, where a similar dual-basis rule was used for depreciation and amortization. The court further dismissed the Commissioner’s concerns about the magnitude of the potential deductions and their impact on revenue estimates, stating that these concerns were irrelevant to the statutory interpretation.

Disposition

The U. S. Tax Court granted Freddie Mac’s motion for partial summary judgment, holding that the adjusted basis for amortizing Freddie Mac’s intangible assets is the higher of the regular adjusted cost basis or fair market value as of January 1, 1985.

Significance/Impact

This decision is significant because it clarifies the application of special basis rules for entities transitioning from tax-exempt to taxable status, specifically in the context of Freddie Mac. It establishes a precedent for using a dual-basis rule for amortization of intangible assets, which could affect other similar entities. The ruling aligns with the legislative intent to prevent the taxation of pre-1985 appreciation or depreciation of assets upon the imposition of taxes on Freddie Mac. The decision may influence future interpretations of tax legislation affecting government-sponsored enterprises and their accounting for intangible assets.

