

Dear Meredith: More on Intangibles

by Robert W. Wood • San Francisco

Lately, there seems to be more and more authority of one sort or another dealing with the sometimes consuming topic of intangibles. The general business press is even coming round to the topic, with *Forbes ASAP* noting in the April 7, 1997 issue that the rules regarding capitalization of intangibles are in dire need of rewriting. See Lev, "The Old Rules No Long Apply: Accounting Needs New Standards for Capitalizing Intangibles," *Forbes ASAP*, April 7, 1997, p. 35. In any case, a recent Tax Court case, *Meredith Corp., et al. v. Commissioner*, 108 T.C. No. 7 (Feb. 27, 1997), is worthy of note.

More On Subscriber Lists

The *Meredith Corp.* case dealt with the tax treatment of contingent costs that became fixed in 1990 with respect to "subscriber relationships" (as they were denominated) purchased in 1986. The subscriber relationships were purchased by Meredith Corp. when it acquired the *Ladies' Home Journal* magazine, assuming some of the seller's obligations relating to the subscriber relationships intangible. As is so often the case in magazine or newspaper acquisitions, Meredith agreed to fulfill existing subscriptions by producing and delivering the *Ladies' Home Journal* to existing subscribers for the remainder of their subscription terms.

The fulfillment costs attributable to these obligations were contingent, in part because the costs of paper, printing, salaries of editorial personnel, and even delivery costs were variable. The other reason for the contingent nature of this obligation was because the subscribers to the *Ladies' Home Journal* could

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DEAR MEREDITH

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choose to request cash refunds from the prior publisher from which Meredith purchased the title. The useful life of the subscriber relationships was not in controversy. By the time the Tax Court case was heard, the IRS and Meredith had agreed that the subscriber relationships had a useful life of 42 months.

Actually, there had already been a Tax Court decision in *Meredith Corp.* In *Meredith Corp. v. Commissioner*, 102 T.C. 406 (1994), the Tax Court considered the costs assumed by Meredith as part of the purchase price, and concluded that these costs could not be included in Meredith's basis. The court's reason for that decision was that the costs involved were contingent. The Tax Court held that these costs had to be added to the basis of the asset in the years in which the costs were incurred.

The Tax Court allowed Meredith to amortize its 1986 and 1987 costs over what remained of its 42-month useful life for the subscriber relationships. And, Meredith and the Service resolved the same issue for fiscal years 1988-1989. However, when it came to 1990, Meredith claimed a \$1.5 million ordinary deduction relating to the acquisition of the subscriber relationships.

The reason? The useful life of this asset expired in 1989, Meredith claimed. Predictably, the IRS disallowed the deduction, arguing that Meredith was no longer entitled to annual recovery of the costs of subscriber relationships, and that those continuing costs had to be allocated to going concern value or goodwill (not the acquisition lawyer's favorite category!).

Good News

Now, though, the Tax Court has granted Meredith's motion for partial summary judgment, concluding that the IRS had misconstrued the earlier Meredith Corp. decision. Perhaps more ominously, the Tax Court now says that the IRS is disregarding general principles of tax law concerning the treatment of contingent asset acquisition costs incurred after an asset has exceeded its useful life. (Take that, IRS, sayeth the court.)

The Tax Court quotes its 1994 opinion (102 T.C.

406) that subscriber relationships are not treated as goodwill because they can be valued and have a limited useful life, which can be estimated with reasonable accuracy. Anyway, the Tax Court in its current *Meredith* decision says that it finds nothing in its prior opinion suggesting that Meredith is not entitled to an ordinary deduction for the additional contingent costs.

As a proverbial last nail in the IRS' coffin, the Tax Court cites the eminently citable *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952) (coincidentally, also one of the hallmark tax treatment of damage awards cases), noting that because Meredith Corp. would have been entitled to ordinary amortization deductions if the added basis had been included in the original acquisition cost, so also the company would now be entitled to an ordinary deduction in 1990 of the full amount of the contingent cost that became fixed in that year. The Tax Court flatly rejected the IRS' contention that a 1990 deduction for Meredith would result in "excessive cost recovery." ■

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