

10-1919

Income Tax Department

John B. Niven

Follow this and additional works at: <https://egrove.olemiss.edu/jofa>



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

Niven, John B. (1919) "Income Tax Department," *Journal of Accountancy*. Vol. 28: Iss. 4, Article 7.
Available at: <https://egrove.olemiss.edu/jofa/vol28/iss4/7>

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

Income Tax Department

EDITED BY JOHN B. NIVEN

A conclusion, liberal in its interpretation, has been reached by the commissioner of internal revenue with regard to losses from depreciation or obsolescence of intangibles by distillers and liquor-dealers, as a consequence of the ratification of the prohibition amendment to the constitution. This conclusion is recorded in two letters published below, sanctioning the deduction of the demonstrable loss from this source of the value of assignable goodwill, trade-marks or trade brands. The amount of loss is determined by the value at March 1, 1913, or the cost of acquisition, depending on whether the intangibles were acquired or *established* prior to that date or acquired subsequently. Recognition that a deductible value may be proved for intangibles *developed* prior to March 1, 1913, establishes a precedent that might, conceivably, have far-reaching consequences. It contemplates the capitalizing of income and its relation to capital investment, and full statistical information on this point is required.

The time for deduction of the amount of loss is settled in the second letter, in which the period of obsolescence is finally made dependent on the constitutional amendment, instead of on the enactment of the war-prohibition measure. Because the series of state ratifications began in January, 1918, the period of amortization is set at the interval between January 31, 1918, and January 16, 1920, when the amendment becomes effective. The present value at January 31, 1918, of the income to be derived between these dates is said to be the value of the intangible assets at January 31, 1918,—although we presume the present value of the excess of that income over the normal return on capital is really meant—and this value is the loss to be pro-rated over the approximate period of two years. In addition, the excess of the full cost of the intangibles (or their value at March 1, 1913) over the value at January 31, 1918, may also be deducted in the first taxable year closed after January 31, 1918, as obsolescence actually accrued.

One new treasury decision (T. D. 2916) is published. It supplements, without superseding, the regulations on depletion deductions for timber. Value at March 1, 1913, must be determined in the light of conditions at that date, uninfluenced by such considerations as subsequent intensive developments in the industry, now enhancing the value; and the basis for depletion allowances must, as in other depleting assets, be unit cost. For this purpose the timber content must be calculated, if only by way of estimate, with the usual privilege of revising the calculation in the light of greater knowledge, and distributing the balance of the cost over the new aggregate quantity.

The Journal of Accountancy

TREASURY RULINGS

(T. D. 2916, September 5, 1919.)

Market value of timber.

Providing for the addition of two new articles, regulations 45, in regard to the determination of the fair market value and quantity of timber.

The final edition of regulations No. 45 is amended by the insertion of two new articles to be known as article 234 and article 235, as follows:

Art. 234. *Determination of fair market value of timber.*—Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the commissioner, by the owner of the property in the light of the most reliable and accurate information with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought should be that established, assuming a transfer between a willing seller and a willing buyer as of that particular date. No rule or method of determining the fair market value of timber property is prescribed, but the commissioner will give due weight and consideration to any and all facts and evidence having a bearing on the market value, such as cost, actual sales, and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purposes of the capital-stock tax, valuation for local or state taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods, and other factors. For depletion purposes the cost of the timber or its fair market value at a specified date shall not include any part of the cost or value of the land.

Art. 235. *Determination of quantity of timber.*—Each taxpayer claiming a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board measure, cords, or other units) of timber reasonably known or on good evidence believed to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. The taxpayer, according to his best knowledge and belief and in the light of the most accurate and reliable information, will estimate the number of units of timber actually present upon the specified date; this estimate will state the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 per cent. of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If, subsequently, during the ownership of the taxpayer making the return additional units of timber are found to be available for utilization as the result of the growth of the timber, of closer utilization of the timber, of the utilization of species of trees not formerly utilized, of underestimates of the quantity of timber available on the specified date, etc., which were not taken into account in estimating the number of units for purposes of depletion, or if it shall be found in the course of operation that timber included in the estimate is not merchantable as the result of deterioration through rot or otherwise, or that the original estimate was too great, a new estimate of the recoverable units of timber (but not of the cost or the fair market value at a specified date) shall be made and when made shall thereafter constitute a basis for depletion. In the selection of the unit or units of estimate the custom applicable to the given type of timber in the given region should be considered.

Income Tax Department

Allowance for obsolescence of goodwill, trade-marks, and trade brands in the case of distillers, dealers in liquors, etc.—Receipt is acknowledged of your letter of March 12, 1919, in which you request a ruling to the effect that distillers and dealers in liquors may for the year 1918 take a reasonable amount for obsolescence of goodwill, trade-marks, and trade brands, the value of which has been impaired or destroyed by prohibition legislation. In reply you are advised that a reasonable allowance for obsolescence of such assets may be taken by distillers and dealers in liquors against earnings between November 21, 1918, the date upon which the agricultural appropriation act, providing for war-time prohibition was enacted, and July 1, 1919, the date upon which the war-time prohibition is to become effective. To sustain a claim for a deduction for obsolescence in respect of goodwill, trade-marks, or trade brands, the taxpayer must show that the value of the property in question has been destroyed or will be destroyed not later than June 30, 1919, and that the taxpayer is not continuing in any similar trade or business. An allowance will be made only in respect of such assets as are assignable as distinguished from those attaching to the individuals owning or conducting the business or to the premises at which it is being or has been conducted. No allowance for obsolescence will be made in any case where, in connection with the operation of his previous business, the taxpayer has developed a goodwill, trade-mark, or trade brand, that will be valuable in continuing a lawful business after June 30, 1919.

The values will be based on those as at March 1, 1913, if the goodwill, trade-marks, or trade brands were acquired or established prior to that date, or at the actual cost thereof, if acquired subsequent to February 28, 1913.

Information helpful in establishing the values would be of the following general character:

A. Where the goodwill, trade-marks, or trade brands were acquired prior to March 1, 1913:

1. The nature of business (whether distillers, wholesalers, or retailers, or a combination thereof).

2. Date of foundation of business and whether organized as an individual, partnership, or corporation. Also date and particulars of each change in the ownership or form of organization of the business, such as the admission or retirement of a partner or partners; the incorporation of a company and of each reorganization thereof.

3. In respect to the trade-marks or trade brands for which a deduction is claimed:

(a) The date established and by whom.

(b) The date of acquisition by the present owners.

(c) The price paid therefor and whether paid in cash or stock; if the latter, state the basis of the valuation on which the purchase price was determined.

(d) For each year from 1900 or the date of the establishment of the trade-mark or trade brand, if subsequent to that year to 1919 inclusive:

(I) Annual sales (quantity and amount).

(II) The gross profit on sales (i. e., the difference between the selling price and the cost price of the merchandise sold).

(III) The total expenses and losses of the business which, when deducted from the gross profit on sales, will produce—

(IV) The net income.

Where the records permit, the sales and gross profit on sales should be submitted for each class of merchandise sold and, if possible, for each trade-mark or trade brand in respect of which a deduction is claimed.

The Journal of Accountancy

(V) The amount of capital invested in the business (i. e., capital or capital stock and paid-in or earned surplus and undivided profits) as at the beginning of each year.

(VI) The amount included in the invested capital at the beginning of the period in respect of goodwill, trade-marks, or trade brands and the date and amount of each subsequent addition to the goodwill, trade-marks, or trade brands.

(e) Full details of each offer to purchase any of the trade-marks or trade brands, setting forth in particular the date of each offer, by whom and on whose behalf made: the amount of each offer, and whether payable in cash or stock; and the date or dates on which the purchase price was proposed to be paid, and the amounts to be paid on each such date.

4. Where a deduction is claimed in respect of goodwill, as distinct from trade-marks or trade brands, the following information should be submitted:

(a) The date of acquisition, and from whom acquired.

(b) The amount paid therefor and whether paid in cash or in stock. If the latter, state the basis of the valuation on which the purchase price was arrived at.

(c) For each year from 1900 or the date of acquisition, if subsequent to that year, to 1919, inclusive.

(I) The annual sales of the business (quantity and amount) classified, if possible, as to the various kinds of merchandise sold.

(II) Gross profit on each class of merchandise sold, or if the records do not disclose the information, the gross profit of the business as a whole.

(III) Total yearly expenses and losses of the business which, when deducted from the gross profit on sales, will produce—

(IV) The net income from the business.

(V) The amount of capital invested in the business (i. e., capital or capital stock and paid-in or earned surplus and undivided profits), as at the beginning of each year.

(VI) The amount included in invested capital at the beginning of the period in respect of goodwill and the date and amount of each subsequent addition to goodwill, trade-marks, and trade brands.

(d) Full details of each offer to purchase the goodwill, setting forth in particular the date of each offer; by whom and in whose behalf made; the amount of each offer and whether payable in cash or in stock, and the date or dates on which the purchase price was proposed to be paid, and if on more than one date, the amount payable on each such date.

B. Where goodwill, trade-marks, or trade brands were acquired subsequent to February 28, 1913:

(1) Dates of acquisition of goodwill or of each trade-mark or trade brand.

(2) From whom acquired.

(3) Purchase price of goodwill or of each trade-mark or trade brand.

(4) Whether purchased for cash or stock; if the latter, state the basis of the valuation on which the purchase price was arrived at.

Similar information to that suggested in A—3d and 3e, and in A—4 should also be furnished for each of the five years prior to the date of acquisition, and for each year thereafter up to and including the year 1919.

C. In the case of goodwill, trade-marks, and trade brands acquired prior to March 1, 1913, a statement should be submitted showing the development of prohibition and local option laws within the territory of the taxpayer during the five years preceding March 1, 1913. Such statement should show each prohibition or local option law enacted by any State or other governmental unit within the business territory of the tax-

Income Tax Department

payer, and should also state the unsuccessful efforts at such legislation during such period. (Letter to Mr. Levi Cooke, Washington, D. C., signed by Commissioner Daniel C. Roper, and dated June 21, 1919.)

Allowance for obsolescence of goodwill, trade-marks, and trade brands in the case of distillers, dealers in liquors, etc.—This department has considered the request contained in your letter of June 23 last for a modification of the ruling relative to obsolescence of goodwill, trade-marks and trade brands, of distillers and dealers in liquors, the value of which has been impaired or destroyed by prohibition legislation, contained in this department's letter to you of June 21. The particular modification you desire is an extension of the period set forth in the ruling above referred to against the earnings of which the obsolescence may be taken as a deduction.

In reply you are advised (1) that distillers and dealers in liquors are entitled to make a deduction (based upon actual cost or fair market value as of March 1, 1913) from gross income, on account of depreciation or obsolescence of their intangibles, such as goodwill, trade-marks, trade brands, etc., such deduction being limited to assignable assets, the value of which has been destroyed by prohibition legislation, and (2) that in arriving at the taxable income for the first taxable year ending on or after January 31, 1918, the obsolescence fully accrued on that date is to be allowed as a deduction in computing the income subject to taxation under the Revenue Act of 1918, plus a further deduction of such proportion of the remaining value of the intangible assets as the interval between January 31, 1918, and the end of the taxable year bears to the total interval between January 31, 1918, and January 16, 1920, (unless at an earlier date the taxpayer discontinues his business, in which case such earlier date shall mark the close of the period), and (3) that for any taxable year following the taxable year just referred to a deduction in respect of the value of such intangible assets on January 31, 1918, based upon a ratable distribution will be permissible.

It is the opinion of the department that the ratification of the 18th amendment in the month of January, 1918, by the States of Massachusetts, Maryland, and Kentucky, was the first definite indication that the prohibition amendment would be ratified by the requisite number of State Legislatures, and therefore that on January 31, 1918, a computable portion of the costs of goodwill, trade-marks, trade brands, or the value thereof, on March 1, 1913, if acquired prior thereto (excluding any intangibles acquired since that date, the expenditures of which were deductible and had been deducted in computing income for tax purposes) had become obsolescent. On January 31, 1918, the intangible assets had an actual value, viz.: the then present value of the income to be derived therefrom between that date and January 16, 1920, or at an earlier date should the taxpayer discontinue his business prior thereto. This value as stated above should be distributed ratably over the period from January 31, 1918, to January 16, 1920, (unless at an earlier date the taxpayer discontinues his business, in which case such earlier date shall mark the close of the period). The excess of the cost of the intangibles or the value thereof, on March 1, 1913, if acquired prior thereto (subject to the exclusions mentioned above), over the value thereof, as of January 31, 1918, determined as outlined above, will represent the amount of obsolescence that was fully accrued on January 31, 1918. (Letter to Mr. Levi Cooke, Washington, D. C., signed by Acting Commissioner J. H. Callan, and dated August 19, 1919.)