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## Section 1060 Asset Value Used in Later Sale

by Robert W. Wood • San Francisco

**S**ection 1060 requires the parties to most asset sales to agree on a value for the various assets acquired. While some transactions are excepted from the reach of Section 1060, most are not. Its allocation scheme is essentially the same as that in Section 338. A recent Tax Court case confirms (presumably, whether Section 1060 has applied to the initial transaction or not) that Section 1060 values will be used in evaluating the consequences of subsequent sales.

### Discount Truck Sales

In *East Ford Inc.*, TC Memo 1994-261, a Ford dealership ("East") also operated a truck leasing business, Action Leasing and Rental Inc. ("Action"). East sold the truck leasing operation to Thomas Truck Lease Inc. ("Thomas"). At the outset, East offered to sell Action to Thomas for \$1.6 million, as East had obligations outstanding on the trucks totaling \$1.4 million.

Thomas countered at \$1.33 million. East accepted, and the transaction was closed with Thomas borrowing the entire purchase price,

secured only by the purchased trucks. As part of the deal, East agreed not to compete with Action for five years. In exchange for \$20,000, East's shareholders also agreed not to compete with Action for five years.

### Subsequent Sale

Within twelve months of the purchase, Thomas sold nearly one-third of the trucks. The total sales proceeds amounted to \$107,000 less than the value of the trucks that had been assigned by Thomas. This loss did not take into account any reduction in the value of the trucks while they were held by Thomas, nor the fact that many of the trucks were resold at internally negotiated prices to a dealer that was affiliated with Thomas.

The original sales agreement between East and Thomas did not contain an allocation of the purchase price to the trucks. When East and Thomas later filed income tax returns, they reported conflicting allocations of the purchase price between tangible and intangible assets. East reported a capital gain of \$345,500 attributable to the sale of goodwill on its 1986 return.

Thomas, on the other hand, allocated the entire purchase price to the trucks. Then, on its 1987 return, Thomas claimed depreciation deductions on the trucks using a tax basis of \$1.33 million.

### Section 1060 Residual Value

The Tax Court determined that Thomas' valuation figures should be used to assign values to the trucks. Under the residual method prescribed by the Section 1060 regulations, the purchase price would have to be allocated between Class III and Class IV assets. Class III assets include everything that is not a Class I, Class II or Class IV asset.

Class I assets include cash, demand deposits, and similar accounts in banks and savings and

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loan associations. Class II assets include certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency. Class IV assets include intangible assets in the nature of goodwill and going-concern value.

The \$20,000 that was paid by Thomas for the covenant not to compete was a Class III asset. The remaining \$1.33 million was allocated by the court to the trucks (which also constituted Class III assets) to the extent of their fair market value. Any excess over fair market value, according to the court, would have to constitute goodwill, a Class IV asset.

**Related-Party Sales**

The court did not adjust the value of the trucks based on the subsequent sales made by Thomas, since many of the trucks were resold at internally negotiated prices to a related entity. Moreover, as both Thomas and East failed to present any evidence of the value of the leases, and failed to establish that the leases were a separately bargained-for element of the sale, the court concluded that no part of the purchase price should be allocated to them. ■

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