SUPREME COURT OF THE UNITED STATES

No. 91–1135

NEWARK MORNING LEDGER CO. AS SUCCESSOR TO THE HERALD COMPANY, PETITIONER *v.* UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[April 20, 1993]

JUSTICE BLACKMUN delivered the opinion of the Court.

This case presents the issue whether, under §167 of the Internal Revenue Code, 26 U. S. C. §167, the Internal Revenue Service (IRS) may treat as nondepreciable an intangible asset proved to have an ascertainable value and a limited useful life, the duration of which can be ascertained with reasonable accuracy, solely because the IRS considers the asset to be goodwill as a matter of law.[1]

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[1]Section 167 states:

"(a) GENERAL RULE.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

"(1) of property used in the trade or business, or

"(2) of property held for the production of income."

Treasury Regulations §1.167(a)-(3) interprets §167(a) and states:

"If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the

Petitioner Newark Morning Ledger Co., a New Jersey corporation, is a newspaper publisher. It is the successor to The Herald Company with which it merged in 1987. Eleven years earlier, in 1976, Herald had purchased substantially all the outstanding shares of Booth Newspapers, Inc., the publisher of daily and Sunday newspapers in eight Michigan communities.[2] Herald and Booth merged on May 31, 1977, and Herald continued to publish the eight papers under their old names. Tax code provisions in effect in 1977 required that Herald allocate its adjusted income tax basis in the Booth shares among the assets acquired in proportion to their respective fair market values at the time of the merger. See 26 U. S. C. §§332 and 334(b)(2) (1976 ed.).[3]

Prior to the merger, Herald's adjusted basis in the Booth shares was approximately $328 million. Herald allocated $234 million of this to various financial assets (cash, securities, accounts and notes receivable, the shares of its wholly owned subsidiary that published Parade Magazine, etc.) and tangible assets (land, buildings, inventories, production equipment, computer hardware, etc.). Herald also

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allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill." 26 CFR §1.167(a)-3 (1992).

[2]The eight Michigan papers were The Ann Arbor News, The Bay City Times, The Flint Journal, The Grand Rapids Press, The Jackson Citizen Patriot, Kalamazoo Gazette, The Muskegon Chronicle, and The Saginaw News.

[3]Section 334(b)(2) was repealed in 1982 and replaced by the somewhat different provisions of the present §338 of the Code.

allocated $67.8 million to an intangible asset denominated “paid subscribers.”[4] This consisted of 460,000 identified subscribers to the eight Booth newspapers as of May 31, 1977, the date of merger. These subscribers were customers each of whom had requested that the paper be delivered regularly to a specified address in return for payment of the subscription price. The $67.8 million figure was petitioner's estimate of future profits to be derived from these at-will subscribers, all or most of whom were expected to continue to subscribe after the Herald acquisition. The number of “paid subscribers” was apparently an important factor in Herald's decision to purchase Booth and in its determination of the appropriate purchase price for the Booth shares. See Brief for Petitioner 4–5. After these allocations, the approximately $26.2 million remaining was allocated to going-concern value and goodwill.

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[4]According to petitioner, the term “`paid subscribers' is intended to reflect the fact that the customers in question paid for their newspapers, rather than receiving them for free, and that they subscribed to the newspaper, requesting regular delivery, rather than purchasing it on a single copy basis.” Brief for Petitioner 4, n. 5. The term does not connote subscription payments in advance; indeed, the customer relationship was terminable at will.

On its federal income tax returns for the calendar years 1977–1980, inclusive, Herald claimed depreciation deductions on a straight-line basis for the $67.8 million allocated to "paid subscribers." The IRS disallowed these deductions on the ground that the concept of "paid subscribers" was indistinguishable from goodwill and, therefore, was nondepreciable under the applicable Regulations. Herald paid the resulting additional taxes. After the 1987 merger, petitioner filed timely claims for refund. The IRS took no action on the claims, and, upon the expiration of the prescribed 6–month period, see 26 U. S. C. §6532(a)(1), petitioner brought suit in the District of New Jersey to recover taxes and interest that it claimed had been assessed and collected erroneously.

The case was tried to the court. Petitioner presented financial and statistical experts who testified that, using generally accepted statistical techniques, they were able to estimate how long the average at-will subscriber of each Booth newspaper as of May 31, 1977, would continue to subscribe. The estimates ranged from 14.7 years for a daily subscriber to The Ann Arbor News to 23.4 years for a subscriber to the Sunday edition of The Bay City Times. This was so despite the fact that the total number of subscribers remained almost constant during the tax years in question. The experts based their estimates on actuarial factors such as death, relocation, changing tastes, and competition from other media. The experts also testified that the value of "paid subscribers" was appropriately calculated using the "income approach." Under this, petitioner's experts first calculated the present value of the gross-revenue stream that would be generated by these subscriptions over their estimated useful lives. From that amount they subtracted projected costs of collecting the subscription revenue. Petitioner contended that the resulting estimated net-revenue stream—calculated as $67,773,000 by one of its experts—was a reasonable estimate of the value of "paid subscribers."

The Government did not contest petitioner's expert evidence at all. In fact, it stipulated to the estimates of the useful life of "paid subscribers" for each newspaper. Also, on valuation, the Government presented little or no evidence challenging petitioner's calculations. Instead, it argued that the only value attributable to the asset in question was the cost of generating 460,000 new subscribers through a subscription drive. Under this "cost approach," the Government estimated the value of the asset to be approximately $3 million.

The Government's principal argument throughout the litigation has been that "paid subscribers" represents an asset indistinguishable from the goodwill of the Booth newspapers. According to the Government, the future stream of revenue expected to be generated by the 460,000 "paid subscribers" represented the very essence of the goodwill value of the newspapers. It argued that because goodwill is nondepreciable, the value of "paid subscribers" cannot be depreciated but must be added to basis so that, when the business is disposed of, the cost of the asset will be deducted from the proceeds in computing capital gain or loss.

The District Court (Judge H. Lee Sarokin) ruled in petitioner's favor. 734 F. Supp. 176 (NJ 1990). It found as a fact that the "paid subscribers" asset was not self-regenerating—it had a limited useful life the duration of which could be calculated with reasonable accuracy. *Id.*, at 180. The court further found that the value of "paid subscribers" was properly calculated using the "income approach" and that the asset itself was separate and distinct from goodwill. "[O]ne must distinguish between a galaxy of customers who may or may not return, whose frequency is unknown, and whose quantity and future purchases cannot be predicted, against subscribers who can be predicted to purchase the same item, for the same price on a daily basis." *Id.*, at 176–177.

The Court of Appeals for the Third Circuit reversed. 945 F. 2d 555 (1991). It concluded that the District Court had erred in defining goodwill as that which remains after all assets with determinable useful lives and ascertainable values have been accounted for. *Id.*, at 568. The court concluded that goodwill has a substantive meaning—the expectancy that "`old customers will resort to the old place' of business," *id.*, at 567—and that "paid subscribers" is the essence of goodwill. Even though the "paid subscribers" asset may have a limited useful life that can be ascertained with reasonable accuracy, the court held that its value is not separate and distinct from goodwill. *Id.*, at 568.

The Court of Appeals denied petitioner's suggestion for rehearing in banc, with two judges dissenting. See App. to Pet. for Cert. 52a. In order to resolve an issue of substantial importance under the Internal Revenue Code and to settle a perceived conflict,[5] we granted certiorari, 503 U. S. ___ (1992).

Section 167(a) of the Code allows as a deduction for depreciation a reasonable allowance for the exhaustion and wear and tear, including obsolescence, of property used in a trade or business or of property held for the production of income. See n. 1, *supra*. This Court has held that "the primary purpose" of an annual depreciation deduction is "to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes." *Massey Motors, Inc.* v. *United States*, 364 U. S. 92, 104 (1960). The depreciation deduction has been a part of the federal tax system at least since 1909, when Congress recognized that a corporation should calculate its annual net income by deducting from gross income "all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any." Tariff of 1909, §38 Second, 36 Stat. 113. Nothing in the text of the 1909 statute or in the implementing Treasury Decision precluded a depreciation allowance for intangible property.[6] This

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[5]Compare the Third Circuit's ruling in the present case with *Donrey, Inc.* v. *United States*, 809 F. 2d 534 (CA8 1987). See also *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C. 463 (1988), aff'd, 919 F. 2d 1492 (CA11 1990).

[6]According to the Treasury Department, the depreciation deduction "should be the estimated amount of the loss, accrued during the year to which the return relates, in the value of the property in respect of which such deduction is claimed that arises

changed in 1914 with the promulgation of Treas. Regs. 33 (1914) issued under the 1913 Income Tax Law.[7]

The Revenue Act of 1918, §234(a)(7), authorized a "reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence." 40 Stat. 1078 (1919). Treas. Regs. 45 (1919), promulgated under the 1918 Act, explicitly recognized that intangible assets "may be the subject of a depreciation allowance." Art. 163. Thereafter, the Regulations governing the depreciation of intangible assets have remained essentially unchanged. The current version is set forth in n. 1, *supra*.

Since 1927, the IRS consistently has taken the position that "goodwill" is nondepreciable.[8] One court

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from exhaustion, wear and tear, or obsolescence out of the uses to which the property is put . . . . This estimate should be formed upon the assumed life of the property, its cost value, and its use." Treas. Regs. 31, Art. 4, p. 11 (1909).

[7]Treas. Regs. 33 provided explicitly that the depreciation deduction should be "estimated on the cost of the *physical property* with respect to which such deduction is claimed, which loss results from wear and tear due to the use to which the property is put" (emphasis added). Art. 159. Furthermore, "[a]ssets of any character whatever which are not affected by use, wear and tear (except patents, copyrights, etc.) are not subject to the depreciation allowance authorized by this act." Art. 162.

[8]Between 1919 and 1927, the IRS recognized that the goodwill of distillers and dealers might be depreciable as a result of the passage of the Eighteenth Amendment prohibiting the manufacture, sale, or transportation of intoxicating liquors. See T.B.R. 44, 1 Cum. Bull. 133 (1919). But in 1926, the Eighth

has said specifically: "Indeed, this proposition is so well set-tled that the only question litigated in recent years regarding this area of the law is whether a particular asset is `goodwill.'" *Houston Chronicle Publishing Co.* v. *United States*, 481 F. 2d 1240, 1247 (CA5 1973), cert. denied, 414 U. S. 1129 (1974).

"Goodwill" is not defined in the Code or in any Treasury Department Regulations. There have been attempts, however, to devise workable definitions of the term. In *Metropolitan Bank* v. *St. Louis Dispatch Co.*, 149 U. S. 436 (1893), for example, this Court considered whether a newspaper's goodwill survived after it was purchased and ceased publishing under its old name. It ruled that the goodwill did not survive, relying on Justice Story's notable description of "goodwill" as

> "`the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives

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Circuit, in *Red Wing Malting Co.* v. *Willcuts*, 15 F. 2d 626, cert. denied, 273 U. S. 763 (1927), ruled that, under the plain language of the Revenue Act of 1918, goodwill could not be depreciated, for the depreciation provision "limits the allowance for obsolescence to such property as is susceptible to exhaustion, wear, and tear by use in the business, and good will is not such property." *Id.*, at 633. Following *Red Wing Malting*, the Treasury Department amended its Regulations to provide: "No deduction for depreciation, including obsolescence, is allowable in respect of good will." T.D. 4055, VI-2 Cum. Bull. 63 (1927). That has been the position of the IRS ever since.

> from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities, or prejudices.'" *Id.*, at 446, quoting J. Story, Partnerships §99 (1841).

In *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153 (1915), the Court described goodwill as "that element of value which inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business." *Id.*, at 165. See also *Los Angeles Co.* v. *Railroad Comm'n*, 289 U. S. 287, 313 (1933) (distinguishing "going concern" from "good will" when fixing rates for public utilities).

Although the definition of goodwill has taken different forms over the years, the short-hand description of goodwill as "the expectancy of continued patronage," *Boe* v. *Commissioner*, 307 F. 2d 339, 343 (CA9 1962), provides a useful label with which to identify the total of all the imponderable qualities that attract customers to the business. See *Houston Chronicle Publishing Co.* v. *United States*, 481 F. 2d, at 1248, n. 5. This definition, however, is of little assistance to a taxpayer trying to evaluate which of its intangible assets is subject to a depreciation allowance. The value of every intangible asset is related, to a greater or lesser degree, to the expectation that customers will continue their patronage.[9] But since 1918, at

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[9]We emphasize that while the "expectancy of continued patronage" is a serviceable description of what we generally mean when we describe an intangible asset that has no useful life and no ascertainable value, this shibboleth tells us nothing about whether the asset in question is depreciable. The dissent concedes that "[t]he law concerning the

least some intangible assets have been depreciable. Because intangible assets do not exhaust or waste away in the same manner as tangible assets, taxpayers must establish that public taste or other socioeconomic forces will cause the intangible asset to be retired from service, and they must estimate a reasonable date by which this event will occur. See B. Bittker & M. McMahon, Federal Income Taxation of Individuals ¶12.4, p. 12–10 (1988). Intangibles such as patents and copyrights are depreciable over their "legal lives," which are specified by statute. Covenants not to compete, leaseholds, and life estates, for example, are depreciable over their useful lives that are expressly limited by contract.

The category of intangibles that has given the IRS and the courts difficulty is that group of assets sometimes denominated "customer-based intangibles." This group includes customer lists, insurance expirations, subscriber lists, bank deposits, cleaning-service accounts, drugstore-prescription files, and any other identifiable asset the value of which obviously depends on the continued and voluntary patronage of customers. The question has been whether these intangibles can be depreciated notwithstanding their relationship to "the expectancy of continued patronage."

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depreciation of intangible assets related to goodwill has developed on a case-by-case basis," *post*, at 6 n. 4, yet, inexplicably, it suggests that "[s]uch matters are not at issue in this case, however, because the asset that Ledger seeks to depreciate is indistinguishable from goodwill," *post*, at 7, n. 4. As we demonstrate below, an intangible asset with an ascertainable value and a limited useful life, the duration of which can be ascertained with reasonable accuracy, is depreciable under §167 of the Code. The fact that it may also be described as the "expectancy of continued patronage" is entirely beside the point.

When considering whether a particular customer-based intangible asset may be depreciated, courts often have turned to a "mass asset" or "indivisible asset" rule. The rule provides that certain kinds of intangible assets are properly grouped and considered as a single entity; even though the individual components of the asset may expire or terminate over time, they are replaced by new components, thereby causing only minimal fluctuations and no measurable loss in the value of the whole. The following is the usually accepted description of a mass-asset:

> "[A] purchased terminable-at-will type of customer list is an indivisible business property with an indefinite, nondepreciable life, indistinguishable from—and the principal element of—goodwill, whose ultimate value lies in the expectancy of continued patronage through public acceptance. It is subject to temporary attrition as well as expansion through departure of some customers, acquisition of others, and increase or decrease in the requirements of individual customers. A normal turnover of customers represents merely the ebb and flow of a continuing property status in this species, and does not within ordinary limits give rise to the right to deduct for tax purposes the loss of individual customers. The whole is equal to the sum of its fluctuating parts at any given time, but each individual part enjoys no separate capital standing independent of the whole, for its disappearance affects but does not interrupt or destroy the continued existence of the whole." *Golden State Towel & Linen Service, Ltd.* v. *United States*, 179 Ct. Cl. 300, 310, 373 F. 2d 938, 944 (1967).

The mass-asset rule prohibits the depreciation of certain customer-based intangibles because they constitute self-regenerating assets that may change but never waste. Although there may have been some doubt prior to 1973 as to whether the mass-asset rule required that any asset related to the expectancy of continued patronage always be treated as nondepreciable goodwill as a matter of law, that doubt was put to rest by the Fifth Circuit in the *Houston Chronicle* case. The court there considered whether subscription lists, acquired as part of the taxpayer's purchase of The Houston Press, were depreciable. The taxpayer had no intention of continuing publication of the purchased paper, so there was no question of the lists' being self-regenerating; they had value only to the extent that they furnished names and addresses of prospective subscribers to the taxpayer's newspaper. After reviewing the history of the mass-asset rule, the court concluded that there was no *per se* rule that an intangible asset is nondepreciable whenever it is related to goodwill. On the contrary, the rule does not prevent taking a depreciation allowance "if the taxpayer properly carries his dual burden of proving that the intangible asset involved (1) has an ascertainable value separate and distinct from goodwill, and (2) has a limited useful life, the duration of which can be ascertained with reasonable accuracy." *Id.*, at 1250.

Following the decision in *Houston Chronicle*, the IRS issued a new ruling, modifying prior rulings "to remove any implication that customer and subscription lists, location contracts, insurance expirations, etc., are, as a matter of law, indistinguishable from goodwill possessing no determinable useful life." Rev. Rul. 74–456, 1974–2 Cum. Bull. 65, 66. The IRS continued to claim that customer-based intangibles generally are in the nature of goodwill, representing "the customer structure of a business, their value lasting until an indeterminate time in the future." Nonetheless, it acknowledged that, "in an unusual case," the taxpayer may prove that the "asset or a portion thereof does not possess the characteristics of goodwill, is susceptible of valuation, and is of use to the taxpayer in its trade or business for only a limited period of time." *Ibid.* Under these circumstances, the IRS recognized the possibility that the customer-based intangible asset could be depreciated over its useful life.

Despite the suggestion by the Court of Appeals in this case that the mass-asset rule is "now outdated," 945 F. 2d, at 561, it continues to guide the decisions of the Tax Court with respect to certain intangible assets. In *Ithaca Industries, Inc.* v. *Commissioner*, 97 T.C. 253 (1991), for example, the Tax Court recently considered whether a taxpayer could depreciate the value allocated to the trained work force of a purchased going concern over the length of time each employee remained with the purchasing company. The court acknowledged that "whether the assembled work force is an intangible asset with an ascertainable value and a limited useful life separate from goodwill or going-concern value is a question of fact." *Id.*, at 263–264. After reviewing the record, it concluded that the mass-asset rule applied to prohibit the depreciation of the cost of acquiring the assembled work force:

> "Although the assembled work force is used to produce income, this record fails to show that its value diminishes as a result of the passing of time or through use. As an employee terminated his or her employment, another would be hired and trained to take his or her place. While the assembled work force might be subject to temporary attrition as well as expansion through departure of some employees and the hiring of others, it would not be depleted due to the passage of time or as a result of use. The turnover rate of employees represents merely the

> ebb and flow of a continuing work force. An employee's leaving does not interrupt or destroy the continued existence of the whole." *Id.*, at 267.

As a factual matter, the Tax Court found that the taxpayer hired a new worker only so he could replace a worker "who resigned, retired, or was fired." *Id.*, at 268. The court found that the "assembled work force" was a nondiminishing asset; new employees were trained in order to keep the "assembled work force" unchanged, and the cost of the training was a deductible expense. *Id.*, at 271.

Since 1973, when *Houston Chronicle* clarified that the availability of the depreciation allowance was primarily a question of fact, taxpayers have sought to depreciate a wide variety of customer-based intangibles. The courts that have found these assets depreciable have based their conclusions on carefully developed factual records. In *Richard S. Miller & Sons, Inc.* v. *United States*, 210 Ct. Cl. 431, 537 F. 2d 446 (1976), for example, the court considered whether a taxpayer was entitled to a depreciation deduction for 1,383 insurance expirations that it had purchased from another insurer.[10] The court concluded that the taxpayer had carried its heavy burden of proving that the expirations had an ascertainable value separate and distinct from goodwill and had a limited useful life, the duration of

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[10] An "expiration" is a copy of the face of an insurance policy made when the policy is issued. It shows the name of the insured, the type of insurance, the premium, the covered property, and the expiration date. "Its principal value in the insurance business is its indication of the most advantageous time to solicit a renewal." *Richard S. Miller & Sons, Inc.* v. *United States*, 210 Ct. Cl., at 436, 537 F. 2d, at 450.

which could be ascertained with reasonable accuracy. The court acknowledged that the insurance expirations constituted a "mass asset" the useful life of which had to be "determined from facts relative to the whole, and not from experience with any particular policy or account involved." *Id.*, at 443, 537 F. 2d, at 454. The court also noted, however, that the mass-asset rule does not prevent a depreciation deduction "where the expirations as a single asset can be valued separately and the requisite showing made that the useful life of the information contained in the intangible asset as a whole is of limited duration." *Id.*, at 439, 537 F. 2d, at 452. All the policies were scheduled to expire within three years, but their continuing value lay in their being renewable. Based on statistics gathered over a 5-year period, the taxpayer was able to estimate that the mass asset had a useful life of not more than 10 years from the date of purchase. Any renewals after that time would be attributable to the skill, integrity, and reputation of the taxpayer rather than to the value of the original expirations. "The package of expirations demonstrably was a wasting asset." *Id.*, at 444, 537 F. 2d, at 455. The court ruled that the taxpayer could depreciate the cost of the collection of insurance expirations over the useful life of the mass asset.

In *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C. 463 (1988), aff'd, 919 F. 2d 1492 (CA11 1990), the taxpayer argued that it was entitled to depreciate the bank-deposit base acquired in the purchase of nine separate banks.[11] The taxpayer sought to

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[11]The term "deposit base" describes "the intangible asset that arises in a purchase transaction representing the present value of the future stream of income to be derived from employing the purchased core deposits of a bank." *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C., at 465. The value of the

depreciate the present value of the income it expected to derive from the use of the balances of deposit accounts existing at the time of the bank purchases. The Commissioner argued that the value of the core deposits was inextricably related to the value of the overall customer relationship, that is, to goodwill. The Commissioner also argued that the deposit base consisted of purchased, terminable-at-will customer relationships that are equivalent to goodwill as a matter of law. The Tax Court rejected the Commissioner's position, concluding that the taxpayer had demonstrated with sufficient evidence that the economic value attributable to the opportunity to invest the core deposits could be (and, indeed, was) valued and that the fact that new accounts were opened as old accounts closed did not make the original purchased deposit base self-regenerating. *Id.*, at 499.

The court also concluded that, based on "lifing studies" estimating the percentage of accounts that would close over a given period of time, the taxpayer established that the deposit base had a limited useful life, the duration of which could be ascertained with reasonable accuracy. The taxpayer had established the value of the intangible asset using the cost-savings method, entitling it to depreciate that portion of the purchase price attributable to the present value of the difference between the ongoing costs associated with maintaining the core deposits and the cost of the market alternative for funding its loans and other investments. *Id.*, at 510.

The Tax Court reached the same result in *Colorado National Bankshares, Inc.* v. *Commissioner*, 60 TCM 771 (1990), aff'd, ___ F. 2d ___ (CA10 1993). The Tax

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deposit base rests upon the "ascertainable probability that inertia will cause depositors to leave their funds on deposit for predictable periods of time." *Id.*, at 500.

Court concluded that

> "the value of the deposit base does not depend upon a vague hope that customers will patronize the bank for some unspecified length of time in the future. The value of the deposit base rests upon the ascertainable probability that inertia will cause depositors to leave their funds on deposit for predictable periods of time." *Id.*, at 789.

The court specifically found that the deposit accounts could be identified; that they had limited lives that could be estimated with reasonable accuracy; and that they could be valued with a fair degree of accuracy. They were also not self-regenerating. "It is these characteristics which separate them from general goodwill and permits separate valuation." *Ibid.* See also *IT&S of Iowa, Inc.* v. *Commissioner*, 97 T.C. 496, 509 (1991); *Northern Natural Gas Co.* v. *O'Malley*, 277 F. 2d 128, 139 (CA8 1960) (concurring opinion).

The Eighth Circuit has considered a factual situation nearly identical to the case now before us. In *Donrey, Inc.* v. *United States*, 809 F. 2d 534 (1987), the taxpayer sought to depreciate the subscription list of a newspaper it had purchased as a going concern. The taxpayer asserted that the subscription list was not simply a list of customers but "a machine to generate advertising revenue." *Id.*, at 536. There was expert testimony that the value of the subscription list was "the present value of the difference in advertising revenues generated by the subscription list as compared to the revenues of an equivalent paper without a subscription list." *Ibid.* A jury found that the list had a limited useful life, the duration of which could be ascertained with reasonable accuracy; that the useful life was 23 years; and that it had an ascertainable value of $559,406 separate and distinct from goodwill. The District Court denied a motion for judgment notwithstanding the verdict after concluding that, although reasonable minds could have differed as to the correct result, there was evidence from which the jury could properly find for the taxpayer. The Court of Appeals implicitly rejected the Government's argument that the subscription list was necessarily inseparable from the value of goodwill when it deferred to the jury's finding that the subscription list was depreciable because it had a determinable useful life and an ascertainable value.

Although acknowledging the "analytic force" of cases such as those discussed above, the Court of Appeals in the present case characterized them as "no more than a minority strand amid the phalanx of cases" that have adopted the Government's position on the meaning of goodwill. 945 F. 2d, at 565.[12] "In any case, consistent with the prevailing case law, we believe that the IRS is correct in asserting that, for tax purposes, there are some intangible assets that, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and

[12]At least one commentator has taken issue with the Court of Appeals' characterization of the recent cases as nothing but a "minority strand." See Avi-Yonah, Newark Morning Ledger: A Threat to the Amortizability of Acquired Intangibles, 55 Tax Notes 981, 984 (1992) (of the 14 cases cited by the Third Circuit that were decided after *Houston Chronicle* in 1973, the IRS has prevailed in only 6 of them; "hardly an `overwhelming weight of authority' in the IRS' favor, especially given that two of the IRS victories, but none of the taxpayers,' were only at the district court level"). Regardless of whether the cases discussed in Part IV, *supra*, are characterized as a "minority strand" or as a "modern trend," we find their reasoning and approach persuasive.

nondepreciable." *Id.*, at 568. The Court of Appeals concluded further that in "the context of the sale of a going concern, it is simply often too difficult for the taxpayer and the court to separate the value of the list *qua* list from the goodwill value of the customer relationships/structure." *Ibid.* We agree with that general observation. It is often too difficult for taxpayers to separate depreciable intangible assets from goodwill. But sometimes they manage to do it. And whether or not they have been successful in any particular case is a question of fact.

The Government concedes: "The premise of the regula-tory prohibition against the depreciation of goodwill is that, like stock in a corporation, a work of art, or raw land, goodwill has no determinate useful life of specific duration." Brief for United States 13. See also *Richard S. Miller & Sons, Inc.* v. *United States*, 210 Ct. Cl., at 437, 537 F. 2d, at 450 ("Goodwill is a concept that embraces many intangible elements and is presumed to have a useful life of indefinite duration"). The entire justification for refusing to permit the depreciation of goodwill evaporates, however, when the taxpayer demonstrates that the asset in question wastes over an ascertainable period of time. It is more faithful to the purposes of the Code to allow the depreciation deduction under these circum-stances, for "the Code endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes," *INDOPCO, Inc.* v. *Commissioner*, 503 U. S. ___, ___ (1992) (slip op. 5).[13]

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[13]The dissent suggests that we are usurping the proper role of Congress by seeking to "modify the *per se* ban on depreciating goodwill," *post*, at 13, n. 10. But we are doing nothing of the kind. We simply have determined that, in light of the factual record in this case, the "paid subscribers" asset is depreciable. The

In the case that first established the principle that goodwill was not depreciable, the Eighth Circuit recognized that the reason for treating goodwill differently was simple and direct: "`As good will does not suffer wear and tear, does not become obsolescent, is not used up in the operation of the business, depreciation, as such, cannot be charged against it.'" *Red Wing Malting Co.* v. *Willcuts*, 15 F. 2d 626, 633 (1926) (citation omitted), cert. denied, 273 U. S. 763 (1927). See also 5 J. Mertens, The Law of Federal Income Taxation §23A.01, p. 7 (1992) ("Goodwill is not amortizable intangible property *because* its useful life cannot be ascertained with reasonable accuracy" (emphasis added)). It must follow that if a taxpayer can prove with reasonable accuracy that an asset used in the trade or business or held for the production of income has a value that wastes over an ascertainable period of time, that asset is depreciable under §167, regardless of the fact that its value is related to the expectancy of continued patronage. The significant question for purposes of depreciation is not whether the asset falls "within the core of the concept of goodwill," Brief for United States 19, but whether the asset is capable

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dissent's mistake is to assume that because the "paid subscribers" asset looks and smells like the "expectancy of continued patronage," it is, *ipso facto*, nondepreciable. In our view, however, whether or not an asset is depreciable is not a question to be settled by definition. "Goodwill" remains nondepreciable under applicable regulations, and we do not purport to change that fact. In interpreting those regulations, however, we have concluded that because the "paid subscribers" is an asset found to have a limited useful life and an ascertainable value which may be determined with reasonable accuracy, it is depreciable. By definition, therefore, it is not "goodwill."

of being valued and whether that value diminishes over time. In a different context, the IRS itself succinctly articulated the relevant principle: "Whether or not an intangible asset, or a tangible asset, is depreciable for Federal income tax purposes depends upon the determination that the asset is actually exhausting, and that such exhaustion is susceptible of measurement." Rev. Rul. 68–483, 1968–2 Cum. Bull. 91–92.

Although we now hold that a taxpayer able to prove that a particular asset can be valued and that it has a limited useful life may depreciate its value over its useful life regardless of how much the asset appears to reflect the expectancy of continued patronage, we do not mean to imply that the taxpayer's burden of proof is insignificant. On the contrary, that burden often will prove too great to bear. See, *e.g.*, Brief for Coopers & Lybrand as *Amicus Curiae* 11 ("For example, customer relationships arising from newsstand sales *cannot* be specifically identified. In [our] experience, customers were identified but their purchases were too sporadic and unpredictable to reasonably ascertain either the duration of the relationships or the value of the relationships (based on their net income stream)" (emphasis in original)).

Petitioner's burden in this case was made significantly lighter by virtue of the Government's litigation strategy:

> "[B]ecause of the stipulation reached by the parties, Morning Ledger need not prove either the specific useful lives of the paid subscribers of the Booth newspapers as of May 31, 1977, or that Dr. Glasser [its statistical expert] has correctly estimated those lives. In light of the stipulation, [the Government's] argument with regard to Dr. Glasser's estimation of the specific useful lives of the Booth subscribers is wholly irrelevant.

> Instead, Dr. Glasser's testimony establishes that qualified experts could estimate with reasonable accuracy the remaining useful lives of the paid subscribers of the Booth newspapers as of May 31, 1977." 734 F. Supp., at 181.

Petitioner also proved to the satisfaction of the District Court that the "paid subscribers" asset was not self-regenerating, thereby distinguishing it for purposes of applying the mass-asset rule:

> "[T]here is no automatic replacement for a subscriber who terminates his or her subscription. Although the total number of subscribers may have or has remained relatively constant, the individual subscribers will not and have not remained the same, and those that may or have discontinued their subscriptions can be or have been replaced only through the substantial efforts of the Booth newspapers." *Id.*, at 180.

The 460,000 "paid subscribers" constituted a finite set of subscriptions, existing on a particular date—May 31, 1977. The asset was not composed of constantly fluctuating components; rather, it consisted of identifiable subscriptions each of which had a limited useful life that could be estimated with reasonable accuracy according to generally accepted statistical principles. Petitioner proved as a matter of fact that the value of the "paid subscribers" diminished over an ascertainable period of time.[14]

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[14]The dissent spends a substantial amount of time worrying about the sufficiency of petitioner's evidence. See *post*, at 7–13. The problem with petitioner's expert, according to the dissent, is that he predicted only how long a subscriber is likely to subscribe, and this "tells us nothing about how long date-of-sale subscriber habit or inertia will remain a cause of predicted subscriber faithfulness." *Post*, at 12. The dissent concludes that "Ledger's expert on his own terms has not even claimed to make the

Petitioner estimated the fair market value of the "paid subscribers" at approximately $67.8 million. This figure was found by computing the present value of the after-tax subscription revenues to be derived from the "paid subscribers," less the cost of collecting those revenues, and adding the present value of the tax savings resulting from the depreciation of the "paid subscribers." As the District Court explained, the taxpayer's experts "utilized this method because they each independently concluded that this method best determined the additional value of the Booth newspapers attributable to the existence of the paid subscribers as of May 31, 1977, and, thus, the fair market value of those subscribers." *Id.*, at 183. The Government presented no evidence challenging the accuracy of this methodology. It took the view that the only value attributable to the "paid subscribers" was equivalent to the cost of generating a similar list of new subscribers, and it estimated that cost to be approximately $3 million. The Court of Appeals agreed with the Government that this "cost approach" was the only appropriate method for valuing the list of subscribers. "The fact is that, when employed in the context of the sale of an ongoing

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showing of definite duration necessary to depreciate an asset under §167(a)." *Post*, at 12. We have little doubt that had the Government presented credible evidence challenging the relevance of this testimony, the District Court would have had a more difficult time deciding this case. As it happened, however, petitioner's evidence of the useful life of the "paid subscribers" was the only evidence the District Court had before it. The dissent skillfully demonstrates certain vulnerabilities in petitioner's proof, but the Government chose, rather, to rest its entire case on a legal argument that we now reject. This case was lost at trial.

concern, the income approach to valuing a list of customers inherently includes much or all of the value of the expectancy that those customers will continue their patronage—*i.e.*, the goodwill of the acquired concern." 945 F. 2d, at 568.

Both the Government and the Court of Appeals mischaracterized the asset at issue as a mere list of names and addresses. The uncontroverted evidence presented at trial revealed that the "paid subscribers" had substantial value over and above that of a mere list of customers. App. 67 (Price Waterhouse's Fair Market Value Study of Paid Newspaper Subscribers to Booth Newspapers as of May 31, 1977); *id.*, at 108–111 (testimony of Roger J. Grabowski, Principal and National Director, Price Waterhouse Valuation Services). These subscribers were "seasoned"; they had subscribed to the paper for lengthy periods of time and represented a reliable and measurable source of revenue. In contrast to new subscribers, who have no subscription history and who might not last beyond the expiration of some promotional incentive, the "paid subscribers" at issue here provided a regular and predictable source of income over an estimable period of time. The cost of generating a list of *new* subscribers is irrelevant, for it represents the value of an entirely different asset. We agree with the District Court when it concluded:

> "Although it was possible to estimate the direct cost of soliciting additional subscribers to the Booth newspapers, those subscribers if obtained were not and would not have been comparable, in terms of life characteristics or value, to the paid subscribers of the Booth newspapers as of May 31, 1977. . . . The cost of generating such marginal subscribers would not reflect the fair market value of the existing subscribers of the Booth newspapers as of May 31, 1977." 734 F. Supp., at 181.

Because it continued to insist that petitioner had used the wrong valuation methodology, the Government failed to offer any evidence to challenge the accuracy of petitioner's application of the “income approach.” The District Court found that the aggregate fair market value of the “paid subscribers” of the Booth newspapers as of May 31, 1977—*i.e.*, “the price at which the asset would change hands between a hypothetical willing buyer and willing seller, neither being under any compulsion to buy or sell, both parties having reasonable knowledge of relevant facts,” *id.*, at 185—was $67,773,000, with a corresponding adjusted income tax basis of $71,201,395. Petitioner was entitled to depreciate this adjusted basis using a straight-line method over the stipulated useful lives.

Petitioner has borne successfully its substantial burden of proving that “paid subscribers” constitutes an intangible asset with an ascertainable value and a limited useful life, the duration of which can be ascertained with reasonable accuracy. It has proved that the asset is not self-regenerating but rather wastes as the finite number of component subscriptions are canceled over a reasonably predictable period of time. The relationship this asset may have to the expectancy of continued patronage is irrelevant, for it satisfies all the necessary conditions to qualify for the depreciation allowance under §167 of the Code.

The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.