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Tax Valuation E-Flash

The Charles Schwab Corporation and Subsidiaries 122 T.C. No. 10, March 9, 2004

Charles Schwab purchased a local brokerage, Rose & Co. Investment Brokers, Inc. (Rose) and performed a purchase price allocation that assigned a considerable amount of the purchase price to identifiable intangible assets. The IRS attacked the amount assigned to identifiable intangible assets and claimed that Rose customer accounts were not amortizable.

The IRS contended that the discount brokerage customer accounts purchased by Schwab were not amortizable because of differences from the customers/subscribers for which the U.S. Supreme Court permitted amortization in *NEWARK MORNING LEDGER CO. V. UNITED STATES*, 507 U.S. 546, 566 (1993). The IRS also claimed the customer accounts had been overvalued.

Schwab paid \$37 million for Rose including \$3 million for a non-compete agreement. Rose's current assets totaled about \$165 million and its total liabilities were \$146 million. Schwab's appraiser used a Multi-Period Excess Earnings Approach and began by first identifying the designated categories of customer accounts used by Schwab and Rose. He next analyzed Rose's

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annual income for each of its categories and determined the useful lives of the acquired accounts using an actuarial study and developing a survival curve reflecting the rate of retirement and the age of the assets. Importantly, he used Schwab's data because Rose's data was not available and claimed (and the court accepted) that Schwab's data would be a more accurate measure of useful life since the Rose customers were to be integrated into Schwab's business environment. The appraiser determined that cash and margin customer accounts had useful lives of 4 and 6 years, respectively.

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Schwab's appraiser used a 12% revenue growth factor, a 34% tax rate, and a 16% discount rate and established "the fair market values of Rose's cash and margin customer accounts... to be \$4,130,000 and \$6,711,000, respectively." Total allocations were approximately \$14,500,000.

The Court held, "Considering the parties' experts' approaches, we conclude and hold that petitioner has shown sufficient similarity to use its own useful life data and categorization to determine the useful lives of the acquired Rose accounts." The court held that Rose's discount brokerage customer accounts may be amortized and are not necessarily distinguishable from the subscriber accounts considered in *NEWARK MORNING LEDGER CO.* The court also agreed with Schwab's claim as to the amount and useful life of the acquired customer accounts.

This E-Flash was written by Mike Mard, ABV, ASA, Managing Director in the Tampa office