You are the tax accountant for Oh Gnome You Didn’t, Inc. (“Gnome”), a C-corporation that designs and creates unique gnome gardens for its clients. On May 25th, 2018, Gnome acquired substantially all the business assets of You Better Duck, Inc. (“Duck”). Duck is a C-corporation that bathed and groomed pet ducks prior to the asset sale. It is well-known that 75% of duck aficionados own a gnome garden because ducks love to quack up at the funny-looking gnomes, so this was a very strategic business decision for Gnome. The transition was seamless, and no duck was forced to stay unkempt for a moment.

Gnome paid $1,725,000 to acquire Duck’s assets, of which $690,000 was allocated to the tangible property used to bathe and groom Duck’s feathery clientele. The remaining $1,035,000 of the purchase price related to Duck’s intangible assets. Millie, Gnome’s CFO, is familiar with how to allocate the cost of the acquired intangible assets under GAAP, and has provided the following table for you to reference:

|  |  |  |  |
| --- | --- | --- | --- |
| **Type of Intangible** | **Adjusted Basis** | **Cost Allocation Method – GAAP** | **2018 GAAP Amortization Expense** |
| 3-year exclusive agreement with Ducks ‘R Us, a reputable supplier of duck cleaning products | $93,000 | Amortize over 36 months, beginning with June 2018 | $93,000/36 months \* 7 months in 2018 = **18,083** |
| Patent for the Clean “Bill” of Health bathing process invented by Donald, Duck’s founder (expires in 16 years) | 25,000 | Amortize over 192 months, beginning with June 2018 | $25,000/192 months \* 7 months in 2018 = **911** |
| 2-year Employment Agreement with the #1 duck whisperer in the known universe | 260,000 | Amortize over 24 months, beginning with June 2018 | $260,000/24 months \* 7 months in 2018 = **75,833** |
| Goodwill | 657,000 | Not amortizable | **Not Applicable** |
| **Summary** | **$1,035,000** |  | **$94,827** |

Millie has asked you to complete a similar table of information from an income tax perspective, and has provided an incomplete version as seen below. She is certain Gnome’s tax return is likely to be audited by the IRS, so she wants to make sure you provide proper citations that substantiate your conclusions in the cost allocation method column.

|  |  |  |  |
| --- | --- | --- | --- |
| **Type of Intangible** | **Adjusted Basis** | **Cost Allocation Method – Income Tax** | **2018 Income Tax Amortization Expense** |
| 3-year exclusive agreement with Ducks ‘R Us, a reputable supplier of duck cleaning products | $93,000 |  |  |
| Patent for the Clean “Bill” of Health bathing process invented by Donald, Duck’s founder (expires in 16 years) | 25,000 |  |  |
| 2-year Employment Agreement with the #1 duck whisperer in the known universe | 260,000 |  |  |
| Goodwill | 657,000 |  |  |
| **Summary** | **$1,035,000** |  |  |