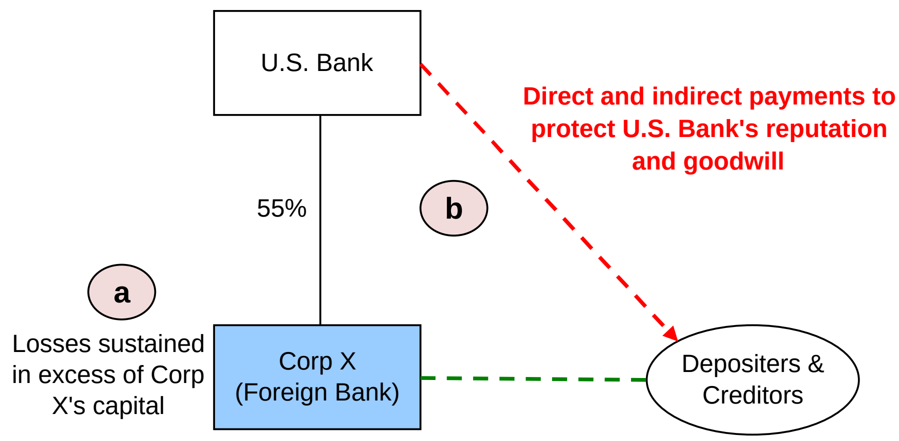
Revenue Ruling 73-226

Payments to Protect Business Reputation & Goodwill

In 1969 U.S. Bank, a domestic corporation engaged in the commercial banking business, acquired capital stock representing 55 percent of the equity and voting power of X corporation, a commercial bank that was incorporated in foreign country M. In January 1971, the U.S. Bank learned that X had sustained losses, in excess of its capital, from improper and unauthorized investments for X's own account. Many of the customers of X were also customers of the U.S. Bank. At this time U.S. Bank's X corporation capital stock was worthless. In order to protect its business reputation and goodwill, U.S. Bank's board of directors determined that it was necessary to make such payments as were required to prevent the depositors and creditors of X from suffering losses as a result of X's insolvency. The payments would not be made by the taxpayer to acquire additional goodwill, but solely to prevent damage to the U.S. Bank's already existing goodwill. These payments would be made through a moratorium proceeding supervised by the courts of country M.



Section 162 provides for the deduction of ordinary and necessary expenses paid or incurred in carrying on a trade or business. In general, the existence of separate corporate entities must be strictly observed for Federal income tax purposes. The debts and expenses of one company are not those of another. However, if the primary motive of the payer of another company's debts is to preserve its own good will and credit rating, rather than to help the debtor company continue in business, the payments are currently deductible. Payments made "to avoid extended controversy and the expense of litigation" and "to avoid unfavorable publicity and injury to [U.S. Bank's] business reputation' are currently deductible. This is the rule even though there is serious doubt as to the taxpayer's legal liability. Section 165(g) provides, in effect, that if capital stock representing less than 80 percent of the voting power of all classes of stock in a corporation becomes worthless during the taxable year, the loss resulting therefrom shall be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset. Amounts paid by U.S. Bank directly or indirectly to depositors and other creditors of X are deductible by U.S. Bank in the year or years in which paid as ordinary and necessary business expenses under section 162(a) to the extent such amounts exceed the value of assets acquired by the U.S. Bank under the Plan. U.S. Bank's total investment in X's stock is deductible as a long-term capital loss in 1971 under the provisions of section 165(g).