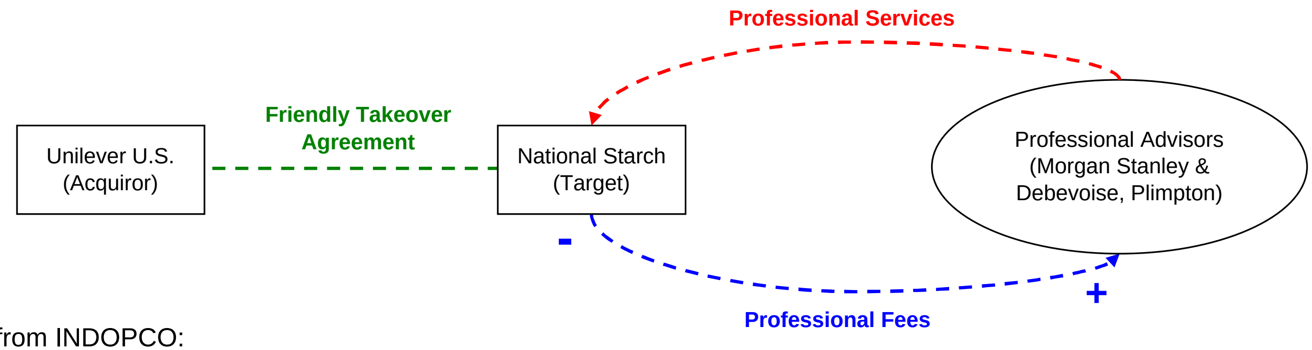
INDOPCO v. Commissioner
503 U.S. 79 (1992)

Deductibility of Takeover Expenses



The following is an excerpt from INDOPCO:

In this case we must decide whether certain professional expenses incurred by a target corporation in the course of a friendly takeover are deductible by that corporation as "ordinary and necessary" business expenses under §162(a) . . . .

Section 162(a) . . . allows the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." . . . [T]he 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. . . .

. . . [T]his Court has noted the "familiar rule" that "an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." . . . [D]eductions are strictly construed and allowed only "as there is a clear provision therefor." . . .

. . . [I]n Lincoln Savings, we determined that, to qualify for deduction under §162(a) , "an item must (1) be 'paid or incurred during the taxable year,' (2) be for 'carrying on any trade or business,' (3) be an 'expense,' (4) be a 'necessary' expense, and (5) be an 'ordinary' expense." . . . [T]he term "necessary" imposes "only the minimal requirement that the expense be 'appropriate and helpful' for 'the development of the [taxpayer's] business,' . . . [T]o qualify as "ordinary," the expense must relate to a transaction "of common or frequent occurrence in the type of business involved". The Court has recognized, however, that the "decisive distinctions" between current expenses and capital expenditures "are those of degree and not of kind," . . . and that because each case "turns on its special facts," . . . the cases sometimes appear difficult to harmonize. . . .

Lincoln Savings stands for the simple proposition that a taxpayer's expenditure that "serves to create or enhance . . . a separate and distinct" asset should be capitalized under §263. It by no means follows, however, that only expenditures that create or enhance separate and distinct assets are to be capitalized under §263. . . .

. . . Although the mere presence of an incidental future benefit . . . may not warrant capitalization, a taxpayer's realization of benefits beyond the year in which the expenditure is incurred is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization.

In applying the foregoing principles to the specific expenditures at issue in this case, we conclude that National Starch has not demonstrated that the investment banking, legal, and other costs it incurred in connection with Unilever's acquisition of its shares are deductible as ordinary and necessary business expenses under §162(a) .

For a chart of the mechanics of the acquisition see the **chart of Rev. Rul. 84-71**