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Indopco, Inc. v. Commissioner: Will the IRS Use a Nebulous Supreme Court Decision to Capitalize on Unsuspecting Taxpayers?

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Indopco, Inc. v. Commissioner:
Will the IRS Use a Nebulous Supreme Court Decision to Capitalize on Unsuspecting Taxpayers?

INTRODUCTION

The Internal Revenue Service ("IRS") has long been at odds with taxpayers over the characterization of expenditures as either currently deductible, ordinary and necessary business expenditures, or as capital expenditures that must be amortized, if at all, over the useful life of the asset. Just when it seemed the courts had fashioned a bright line test to settle these disputes,¹ the United States Supreme Court, in Indopco, Inc. v. Commissioner,² fashioned a new, more nebulous test that focuses on future benefits and the taxpayer's purpose for making the expenditures.³ In Indopco, the Court used this test to find that acquisition fees incurred by a target corporation to facilitate a friendly merger were nondeductible capital expenditures because they created future benefits for the corporation.

This Note provides an analysis of the rationale behind the Indopco decision and the potential impact the decision will have on various corporate transactions. Part I describes the background of Internal Revenue Code sections 162 and 263.⁴ Part II provides the history of Indopco from the original transaction through decisions in the Tax Court and the Third Circuit Court of Appeals.⁵ Part III focuses on the Supreme Court’s reason for granting certiorari in Indopco, the rejection of the "separate and distinct asset" test, and the formulation of a new "future benefits and purpose of expenditures" test.⁶ Part IV analyzes the potential

¹ See infra notes 95-103 and accompanying text (discussing the "separate and distinct asset" test).
³ See infra notes 102-08 and accompanying text (analyzing Indopco and the formulation of the new "future benefits and purpose of expenditures" test).
⁵ See infra notes 37-73 and accompanying text.
⁶ See infra notes 74-108 and accompanying text.
impact of Indopco on business transactions such as acquisitions, business expansion expenditures, and advertising.\(^7\) Based on rulings issued since the Indopco decision, Part V presents the IRS's position concerning the deductibility of certain expenditures.\(^8\) This Note concludes that, even limiting the Indopco decision to its own facts, the Indopco test may result in the capitalization of expenditures where the taxpayer is unprepared to satisfy the burden of proving the nonexistence of future benefits from such expenditures.

I. BACKGROUND ON I.R.C. SECTIONS 162 AND 263

A. Internal Revenue Code Section 162

Before delving into a full-blown discussion of Indopco and its impact on deductions, capital expenditures, and business expenses, a brief explanation of the relevant Internal Revenue Code sections on which Indopco is based is necessary. Section 162(a) of the Internal Revenue Code "allow[s] as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."\(^9\) For any business expense to qualify as a section 162(a) deduction, the expenditure must satisfy five requirements. The expenditure must: (1) be "paid or incurred during the taxable year," (2) be an "expense," (3) be an "ordinary" expense, (4) be a "necessary" expense, and (5) be incurred "in carrying on any trade or business."\(^10\)

The Supreme Court has clearly defined these factors. The Court has held that to be an "ordinary" expense for purposes of section 162(a), the

\(^7\) Other types of business expenditures reach beyond the scope of this Note and include location of white knights, hostile takeovers followed by a negotiated transaction, abandoned efforts or plans, and stock redemptions. See infra note 141 and accompanying text. For more background on hostile takeovers followed by a negotiated transaction, see Victory Markets, Inc. v. Commissioner, 99 T.C. 34 (1992); Phillip Adams & J. Dean Hinderliter, Indopco, Inc. v. Commissioner: Impact Beyond Friendly Takeovers, 55 TAX NOTES 93, 99 (1992); see also United States v. Kroy (Europe) Ltd., No. 91-909, 1992 Bankr. LEXIS 1249 (Bankr. D. Ariz. Feb. 14, 1992) (applying an "origin of the transaction" test to determine whether loan fees incurred in a leveraged buyout were deductible); McGee Grigsby & Cabell Chunnis, Jr., Indopco v. Commissioner: The Supreme Court Takes National Starch to the Cleaners, 44 TAX EXECUTIVE 85, 92 (1992) (providing additional analysis of expenditures for abandoned efforts or plans); Adams & Hinderliter, supra, at 100-01 (presenting further information on stock redemption transactions); infra notes 109-40 and accompanying text.

\(^8\) See infra notes 141-55 and accompanying text.

\(^9\) 26 U.S.C. § 162(a) (1988). Section 162(a) generally allows the deduction of all ordinary and necessary business expenses and in later subsections specifically delineates certain deductible expenditures.

\(^10\) See Commissioner v. Lincoln Sav. & Loan Ass'n, 403 U.S. 345, 352 (1971) (holding that an additional premium payment made pursuant to the National Housing Act did not meet the requirements of a deductible expense).
expense must be the common method of dealing with the perceived need.\textsuperscript{11} In other words, "[t]he situation giving rise to the expenditure may be unique with respect to the particular business affected, but not uncommon in the industry or business community as a whole."\textsuperscript{12} "The principal function of the term 'ordinary' in section 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset."\textsuperscript{13}

In defining "necessary" expenses, the Supreme Court has held that those expenditures that are appropriate and helpful for the taxpayer's business are "necessary" expenses.\textsuperscript{14} Thus, the "necessary" requirement is not one of absolute need, but rather a requirement that the expense be of normal measure to ensure the effective and efficient operation of the taxpayer's business.\textsuperscript{15} To determine whether an expenditure meets the "in carrying on any trade or business" requirement, the Court has held that "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal'."\textsuperscript{16}

The remaining factors are capable of literal interpretation and the Court has not found the need to judicially expound on their meaning. "Paid or incurred in the taxable year" merely requires that funds be expended or legal obligations created during the year for which the return is filed. That the expenditure be an "expense" simply means that the value of the asset or service, or a portion thereof, has been exhausted in the production of income.\textsuperscript{17}

\textbf{B. Internal Revenue Code Section 263}

Section 263(a)(1) states that no deduction shall be allowed for any amount paid "for permanent improvements or betterments made to increase

\textsuperscript{11} See Welch v. Helvering, 290 U.S. 111, 114 (1933) (refusing to classify as ordinary and necessary payments of a bankrupt corporation made by a former corporate officer in order to strengthen the officer's business standing).


\textsuperscript{13} Commissioner v. Tellier, 383 U.S. 687, 689-90 (1965) (admitting that attorney's fees paid to defend a securities fraud prosecution are "ordinary and necessary" expenses and finding that deductibility does not offend public policy).

\textsuperscript{14} \textit{Welch}, 290 U.S. at 113.

\textsuperscript{15} Id.

\textsuperscript{16} United States v. Gilmore, 372 U.S. 39, 49 (1963) (holding that none of the expenses incurred in defending a divorce action were deductible).

\textsuperscript{17} See Jack's Cookie Co. v. United States, 597 F.2d 395, 402 (4th Cir. 1979).
the value of any property or estate." The "priority ordering directive of [sections] 161" and 261 requires that section 263 take precedence over section 162. Section 263(a)(1) also includes several specific exceptions to the general rule of nondeductibility, among them an exception for expenses incurred in research, development, conservation, and statutorily mandated expenditures. None of these exceptions, however, is applicable to the issue discussed in this Note.

The debate over classification as deduction or capital expenditure has yielded no set formula. Instead, decisions are based on an "appraisal of all the surrounding facts and circumstances, including, but not limited to, the purpose, nature, extent, and value" of the expenditure. The United States Court of Appeals for the Ninth Circuit held that "[e]xpenses incurred for the purpose of the benefit of future operations are not ordinary and necessary business expenses," and are, therefore, capital expenditures.

The nature of expenditures as recurring or nonrecurring has been held to provide a

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19 See Commissioner v. Idaho Power Co., 418 U.S. 1, 17 (1974) (declaring depreciation of construction equipment owned by the taxpayer and used to erect capital improvements is not deductible). The language of sections 161 and 261 when read together clearly mandates the precedence of section 263 over section 162. Section 161 states:
   In computing taxable income under section 63, there shall be allowed as deductions items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).
21 Section 261 provides:
   In computing taxable income no deduction shall in any case be allowed in respect of the items specified in this part.
23 Section 263 does not apply to:
   (A) expenditures for the development of mines or deposits deductible under section 616,
   (B) research and experimental expenditures deductible under section 174,
   (C) soil and water conservation expenditures deductible under section 175,
   (D) expenditures by farmers for fertilizer, etc., deductible under section 180,
   (E) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190,
   (F) expenditures for tertiary injectants with respect to which a deduction is allowed under section 193, or
   (G) expenditures for which a deduction is allowed under section 179.
25 See Fall River Gas Appliance Co. v. Commissioner, 349 F.2d 515, 516 (1st Cir. 1965) (discussing various factors for determining deductibility as delineated in prior cases).
26 United States v. Wehrli, 400 F.2d 686, 690 (10th Cir. 1968).
27 Farmers Union Corp. v. Commissioner, 300 F.2d 197, 200 (9th Cir.), cert. denied, 371 U.S. 861 (1962).
crude but serviceable demarcation between business expenditures and capital expenditures.\textsuperscript{24} The duration of the expenditure's benefit is given some weight in determining whether an expense qualifies as a deduction or as a capital expenditure. The United States Court of Appeals for the Tenth Circuit has held that generally an expenditure should be capitalized if it brings about the acquisition of an asset or an advantage to the taxpayer with a useful life in excess of one year.\textsuperscript{25} Other courts have held, however, that this general rule is a mere guidepost and not an absolute that requires capitalization of every expenditure providing a benefit of more than one year.\textsuperscript{26} Furthermore, courts have recognized that "many expenses [that are] concededly deductible have prospective effect beyond the taxable year."\textsuperscript{27} These holdings generally imply that if the expenditure creates a benefit lasting more than one year that is substantial or is coupled with other factors, the expenditure must be capitalized.

Although expenditures sometimes increase asset value, it is not necessary for an expenditure to do so in order for the court to classify the expense as a capital expenditure. However, if the value of an asset is increased for a period in excess of one year, the related expenditure will more likely than not be considered a capital expenditure.\textsuperscript{28}

\textbf{C. The Rationale Behind I.R.C. Sections 162 and 263}

The rationale for distinguishing between business expenditures and capital expenditures is to diminish the taxpayer's ability to manipulate the computation of taxable income. By segregating expenditures into these two categories, Congress has attempted to create a more consistent and

\textsuperscript{24} See Encyclopaedia Britannica, Inc. v. Commissioner, 685 F.2d 212, 217 (7th Cir. 1982) (holding that, contrary to the Supreme Court's statement in Welch v. Helvering, 290 U.S. 111 (1933), currently deductible expenses do not have to be normal or habitual); see also supra note 11 and accompanying text.

\textsuperscript{25} See Hotel Kingkade v. Commissioner, 180 F.2d 310, 312 (10th Cir. 1950) (holding that expenses incurred to repair a hotel were capital in nature, not "ordinary and necessary").

\textsuperscript{26} Wehrli, 400 F.2d at 689.

\textsuperscript{27} Commissioner v. Lincoln Sav. & Loan Ass'n, 403 U.S. 345, 354 (1971); see Southland Royalty Co. v. United States, 582 F.2d 604, 611 (Cl. Ct. 1978) (affirming lower court's finding that litigation expenses incurred to collect royalties and costs to prepare a study of oil reserves were currently deductible but legal fees to settle a dispute over a leasehold were not), cert. denied, 441 U.S. 905 (1979); Southern Natural Gas Co. v. United States, 412 F.2d 1222, 1263 (Cl. Ct. 1969) (analyzing the deductibility of itemized expenses incurred while acquiring the assets of the plaintiff's bankruptcy predecessor), rev'd, Commissioner v. Idaho Power Co., 418 U.S. 1 (1974).

\textsuperscript{28} See Geator Corp. v. United States, 485 F.2d 283, 285 (4th Cir. 1973) (finding that expenses incurred resisting cancellation of a company's trademark registration would likely, if successful, result in benefits extending beyond the tax period).
accurate method of matching expenditures with the periods in which revenues from such expenditures arise. A business expenditure, due to its nature as ordinary and necessary to the taxpayer’s business, provides benefits and generates income only in the year in which the expense was incurred. A capital expenditure, on the other hand, provides benefits or generates income in years beyond that of the expenditure. If both types of expenditures were currently deductible, the taxpayer would have the power to shift income by strategically planning asset purchases.

To curb this power and to reflect more consistently and accurately the taxpayer’s net income for the year, Congress enacted sections 162 and 263, which (1) allow a deduction from the current year’s income for the entire amount of business expenditures and (2) require capital expenditures to be capitalized and properly matched with the benefits and income they generate through amortization or depreciation over their estimated useful lives. Capital expenditures for assets without determinable useful lives, such as goodwill, cannot be deducted through depreciation or amortization.

If the taxpayer is eventually allowed a deduction for both ordinary expenditures and capital expenditures, why have so many disputes arisen between the IRS and taxpayers over the classification of expenditures? The short answer is that, practically speaking, a currently deductible expenditure is more valuable to a taxpayer than an expenditure that must be capitalized and deducted over a period of time. Moreover,

30 See supra notes 9-16 and accompanying text for a discussion of business expenditures.
31 See supra notes 18-28 and accompanying text for a discussion of capital expenditures.
32 See Quinn, supra note 12, at 169 n.14, explaining the difference between amortization and depreciation as follows:
   Amortization describes loss in value due to the passage of time
   Depreciation refers to the gradual reduction in value of property because of physical deterioration through use
   A taxpayer generally amortizes intangible assets and deprecitates tangible assets
   For example, the taxpayer amortizes the cost of prepaid expense payments, such as advance rental payments, over the useful life of the payments
   In the case of tangible assets the taxpayer depreciates the cost over the useful life of the asset.
   Id. (citations omitted).
34 Id. No deductions are allowed for either ordinary or capital expenditures without a determinable useful life.
35 This is the "time value of money" principle. Generally applied, the principle demonstrates that the more rapidly expenditures can be deducted, the longer taxes can be deferred. The longer taxes are deferred, the more money the taxpayer has with which to earn a return to pay off the deferred taxes. Thus, if the taxpayer can defer taxes for eight years and earn a rate of return on its money sufficient to allow it to double its money in eight years, the taxpayer will have paid no tax. See Note, Fairness and Tax Avoidance in the Taxation of Installment Sales, 100 Harv. L. Rev. 403, 403 n.5 (1986).
if the assets are business acquisitions, and the acquisition costs are
deemed to be capital expenditures, they may not have tax value because
they will probably not have a determinable useful life. Consequently, no
deduction for depreciation or amortization will be allowed. 35

II. BACKGROUND OF THE INDOPCO DECISION

A. The Indopco/Unilever Merger

On October 7, 1977, Unilever United States, Inc. ("Unilever")
indicated an interest in acquiring all of Indopco’s stock in a friendly
merger. 37 Unilever’s board of directors first expressed interest at a
meeting with the chairman of Indopco’s board of directors and Frank
Greenwall, owner of the largest outstanding interest in Indopco’s stock. 38
Unilever indicated it would proceed with the tender offer only if
Indopco’s board approved it and Greenwall agreed to sell his shares to
Unilever. 39

Greenwall indicated that he and his wife would dispose of their stock
in Indopco only if a tax free merger could be arranged. 40 In an attempt
to satisfy Greenwall’s desire, outside law firms for Unilever and Indopco
devised a merger plan that involved the creation of two new enti-
ties—National Starch & Chemical Holding Corporation ("Holding"), a
subsidiary of Unilever, and NSC Merger, Inc. ("NSC"), a subsidiary of
Holding. 41 Indopco shareholders who wished to have a tax free exchange
would exchange shares of Indopco for shares of Holding. 42 Any Indopco
stock not exchanged would be converted into cash in a merger of NSC
into Indopco. 43 The merger agreement was contingent upon the IRS
issuing a favorable private letter ruling. 44 The IRS issued the favorable

34 The taxpayer can, however, include the nondepreciable/nonamortizable capital expenditure in
the basis of the company to determine gain or loss on the sale of the company. Nevertheless, even
this provides only a limited tax value because the sale of the company may not happen for decades,
if ever.
36 See id. at 69. Frank Greenwall, along with his wife, beneficially owned approximately 14.5%
of Indopco’s outstanding common stock.
37 Id.
38 Id. Frank Greenwall was the founder of Indopco. Greenwall and his wife were 81 and 79 years
old, respectively, and wanted a tax-free merger because of their low basis in the stock.
39 Id.
40 Id.
41 Id.
42 Id.
43 Id. at 70.
letter ruling and held that the merger would be a taxable sale to shareholders who received cash for Indopco stock and tax free to shareholders who received Holding stock for Indopco stock. The merger agreement, therefore, satisfied Greenwall's request for a tax free transaction.

While Unilever was preparing the merger agreement, the proposed merger was brought before a meeting of Indopco's board of directors. At that meeting, Indopco's legal counsel advised the directors that they had a fiduciary duty under Delaware law to ensure that the proposed merger was fair to the corporation's stockholders. Indopco, therefore, retained the investment banking firm of Morgan Stanley & Co., Inc. ("Morgan Stanley") to value the stock and issue a fairness opinion. On July 10, 1978, Morgan Stanley delivered a favorable fairness opinion letter to Indopco's directors. The merger agreement was approved by Indopco's shareholders on August 15, 1978, and the transaction was completed later that day.

In connection with its work on the transaction, Morgan Stanley charged Indopco approximately $2.2 million. In addition, Indopco's outside counsel charged $490,000 for legal services related to the merger transaction and $15,069 for out-of-pocket expenses. Indopco itself incurred other expenses in excess of $150,000 related to the merger. On its 1978 Federal income tax return, Indopco deducted, as ordinary business expenses, the fees associated with the merger transaction. After auditing Indopco's 1978 return, the IRS denied the deduction of the merger transaction fees and assessed a deficiency against Indopco.

B. The Tax Court Decision

Before the Tax Court, Indopco argued that the merger fees were deductible under the principles enunciated in Commissioner v. Lincoln Savings & Loan Ass'n because they did not "create or enhance for [the
taxpayer] what is essentially a separate and distinct additional asset

The Tax Court ruled that Lincoln Savings did not support Indopco's argument because "the [Lincoln Savings] Court did not address the deductibility of expenditures which do not create or enhance a separate and distinct asset." Indopco also argued that the "dominant aspect" of the transaction determined the deductibility of expenditures incurred as a result of the transaction. Indopco asserted that the fiduciary duty owed to the shareholders was the dominant aspect of the transaction, and that the expenditures were deductible because they were incurred as a result of that fiduciary duty. The Tax Court focused on the primary purpose of the merger in determining the dominant aspect and found that "the dominant aspect was the transfer of [Indopco's] stock for the benefit of [Indopco] and its shareholders." The Tax Court noted that a Morgan Stanley report had concluded that Indopco would benefit from the merger with Unilever because it would create the opportunity for synergy, as well as access to Unilever's enormous resources. The Tax Court also determined that Indopco benefited from the administrative convenience of fewer authorized shares and fewer public reporting requirements.

The Tax Court concluded that the benefits arising from the merger were "related more to [Indopco's] permanent betterment, and hence capital in nature". The court, therefore, classified the expenses as non-deductible capital expenditures.

C. The Court of Appeals Decision

The United States Court of Appeals for the Third Circuit affirmed the Tax Court's decision. Indopco again proffered the argument that Lincoln

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56 Id. at 77 (citing Commissioner v. Lincoln Sav. & Loan Ass'n, 403 U.S. 345, 354 (1971)).
57 Id.
58 Id. at 77-78; see also El Paso Co. v. United States, 694 F.2d 703 (Fed. Cir. 1982) (finding expenditures for divestiture of corporate property were deductible); United States v. Transamerica Corp., 392 F.2d 522 (9th Cir. 1968) (creating a separate company that results in a "spin-off" or "D" reorganization will result in capital expenses, not deductions); General Bancshares Corp. v. Commissioner, 326 F.2d 712 (8th Cir. 1964) (holding that costs of issuing non-taxable stock dividends were capital rather than deductible expenses); Mill's Estate, Inc. v. Commissioner, 206 F.2d 244 (2d Cir. 1953) (determining a partial liquidation was in essence a reorganization and expenses therefrom were capital expenditures).
59 See National Starch, 93 T.C. at 78.
60 Id.
61 Id. at 71.
62 Id. at 72. The Tax Court noted that subsequent to the merger, Indopco's certificate of incorporation was amended to eliminate preferred shares of stock and to reduce the number of authorized shares to 1000.
63 Id. at 78.
64 National Starch v. Commissioner, 918 F.2d 426 (3d Cir. 1990), cert. granted sub nom.
Savings established a new test for distinguishing between deductible expenditures and nondeductible capital expenditures. Under the new test, expenditures would not be capitalized unless they create or enhance a separate and distinct asset. The court of appeals, like the Tax Court, found that Lincoln Savings did not support Indopco's position.

Rejecting Indopco's primary argument, the court of appeals also determined the proper treatment of Indopco's merger expenditures. The court noted that "the sine qua non of capitalization, is the presence of a not insignificant future benefit that is more than merely incidental." Thus, according to the court of appeals, "capitalization is appropriate where an expense produces a future benefit, that benefit is significant, and that benefit is a purpose, rather than an incidental by-product, of the expenditure." Whether the factors that determine capitalization are present can be established only through a factual inquiry. Because the Tax Court had already performed the factual inquiry and had determined that Indopco's expenditures were capital expenditures, the court of appeals could not overturn the Tax Court's factual findings unless they were found to be clearly erroneous. After concluding that adequate evidence supported the Tax Court's findings that Unilever's enormous resources and the possibility of synergy arising from the merger created future benefits for Indopco, the court of appeals affirmed the Tax Court's decision that Indopco's merger fees were not deductible.

In its opinion, the court of appeals noted that section 263 required the merger fees to be capitalized even though the lack of an ascertainable useful life meant the fees were not susceptible to depreciation or amortization. Furthermore, the court held that expenditures meeting the requirements for classification as capital expenditures must be capitalized despite the fact that such expenses were required by law.

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64 Id. at 429.
65 Id. at 431.
66 Id. (finding that the case presented a particularly difficult inquiry because, as the court noted, the expenditures in question "resulted in neither a tangible asset nor a readily identifiable intangible asset"), see Ellis Banking Corp. v. Commissioner, 688 F.2d 1376, 1379 n.7 (11th Cir. 1982) (finding that expenses for investigation of a company's financial position for the purpose of stock acquisition are capital expenditures), reh'g denied, 698 F.2d 1238 (11th Cir. 1983), cert. denied, 463 U.S. 1207 (1983).
67 National Starch, 918 F.2d at 431.
68 Adams and Hinderliter, supra note 7, at 94.
69 National Starch, 918 F.2d at 432.
70 Id. at 432-33.
71 Id. at 434.
72 Id., see Commissioner v. Lincoln Sav. & Loan Ass'n, 403 U.S. 345, 359 (1971); E.I. duPont de Nemours and Co. v. United States, 432 F.2d 1052, 1059 (3d Cir. 1970) (holding that order from court to terminate interest in a company does not relieve taxpayer from requirement to capitalize the
III. ANALYSIS OF UNITED STATES SUPREME COURT OPINION

A. Reason for Granting Certiorari

The United States Supreme Court granted certiorari "to resolve a perceived conflict among the Courts of Appeals." The Court noted that decisions from the Courts of Appeals for the Second, Fourth and Fifth Circuits had consistently applied the Supreme Court's decision in Commissioner v. Lincoln Savings & Loan Ass'n quite differently than the Third Circuit had in Indopco.

In Briarcliff Candy Corp. v. Commissioner, the Second Circuit was asked to determine whether expenditures to maintain a company's market share by realigning its distribution system were ordinary and necessary business expenses and thus deductible under section 162(a). In holding that such expenditures were deductible, the court noted that Lincoln Savings caused a "radical shift in emphasis" that established the inquiry as whether the expenditures created or enhanced a separate and distinct asset.

In NCNB Corp. v. United States, the Fourth Circuit considered whether bank expenditures for expansion plans, feasibility studies, and regulatory applications could be classified as currently deductible business expenditures. Citing Lincoln Savings, the court determined that the expenditures were currently deductible as "necessary and ordinary" business expenditures because they did not create or enhance separate and identifiable assets. Likewise, in Central Texas Savings & Loan Ass'n v. United States, the Fifth Circuit was asked to determine whether

expenses of the termination); Woolrich Woolen Mills v. United States, 289 F.2d 444, 448 (3d Cir. 1961) (holding that costs of mandatory filtration were not deductible simply because required by law).


See Central Texas Sav. & Loan Ass'n v. United States, 731 F.2d 1181 (5th Cir. 1984) (expenses for starting new branch of bank); NCNB Corp. v. United States, 684 F.2d 285 (4th Cir. 1982) (branch offices are expansions of new businesses, not separate assets); Briarcliff Candy Corp. v. Commissioner, 475 F.2d 775 (2d Cir. 1973) (franchises are not separate assets).

400 U.S. 345 (1971); see supra note 57 and accompanying text (explaining Indopco's inability to use Lincoln Sav. & Loan Ass'n as support for its argument).

See supra notes 64-73 and accompanying text.

475 F.2d 775 (2d Cir. 1973).

Id. at 782.

684 F.2d 284 (4th Cir. 1982).

Id. at 294.

731 F.2d 1181 (5th Cir. 1984).
expenditures to acquire a permit to build additional branch banks were deductible as "necessary and ordinary" business expenses. The court, again citing Lincoln Savings, stated that the "question, therefore, is whether the establishment of a new branch office creates a separate and distinct additional asset."84

Contrary to the opinions of the Second, Fourth, and Fifth Circuits, the Third Circuit, in Indopco, denied the applicability of the Lincoln Savings "separate and distinct asset" test and focused instead on the purpose of the expenditure and the significance of future benefits arising therefrom.85 Through its decision in Indopco, the Court intended to clarify its decision in Lincoln Savings and to provide commentary to aid the courts of appeals in reaching consistent decisions regarding the classification of expenditures as either "necessary and ordinary" or capital.

B. The Supreme Court's Analysis of I.R.C. Sections 162 and 263

The Supreme Court's opinion began with a discussion of the relevant portions of Internal Revenue Code sections 16286 and 263,87 addressing well-established interpretations of the revenue statutes.88 The Court, discussing the relationship between deductible business expenditures and capital expenditures, reiterated that "an income tax deduction is a matter of legislative grace and the burden of clearly showing the right to the claimed deduction is on the taxpayer."89

The Court noted that capitalization is the rule and deduction the exception: "Deductions are specifically enumerated in the Code and are subject to disallowance in favor of capitalization."90 On the other hand, capital expenditures are not "exhaustively enumerated," and § 263 serves only as a method of distinguishing capital expenditures from deductible business expenditures.91 The Court, therefore, reaffirmed that "deductions are strictly construed and allowed only 'as there is a clear provision therefor.'"92

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84 Id. at 1184 (finding, on facts similar to NCNB Corp., that expenditures to establish branch banks did create a "separate and distinct asset").
85 See supra notes 64-73 and accompanying text.
89 Id.
90 Id.
91 Id.
The Court also delineated the five requirements for an expenditure to qualify as a deduction and noted "that the 'decisive distinctions' between current expenses and capital expenditures 'are those of degree and not of kind.'" With this narrow characterization of deductions, the Court made the circumstances under which the five requirements for deductibility might be satisfied more difficult to achieve but made its own decision considerably easier.

C. The "Distinct and Separate Asset" Test

To support its contention that the merger fees were deductible as ordinary and necessary business expenditures, Indopco maintained that the fees did not satisfy the "separate and distinct asset" test established in Lincoln Savings. Indopco argued that deductibility under section 162(a) is the rule and capitalization the exception; this exception, according to Lincoln Savings, applies only if the expenditure creates or enhances a "separate and distinct asset." The Supreme Court disagreed with Indopco and accepted the lower court decisions, stating that Indopco had "overread" Lincoln Savings.

In Lincoln Savings, the Court was asked to determine whether insurance premiums paid to a Federal Savings and Loan Insurance Corporation ("FSLIC") reserve fund were deductible as ordinary and necessary business expenditures. Because each insured institution maintained a property interest in the reserve fund, the Court held that the payments were capital expenditures that served to "create or enhance for Lincoln what [was] essentially a separate and distinct additional asset.

Indopco cited numerous courts that had taken this language to mean that only expenditures that created or enhanced separate and distinct assets were capital expenditures. The Supreme Court commented that Lincoln Savings stood only for the proposition that expenditures creating or enhancing a separate and distinct asset should be capitalized under section 263. The Court stated, however, that although the creation of

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"See Indopco, 112 S. Ct. at 1043-44; see also supra notes 9-17 and accompanying text.
"Id. at 1044 (quoting Welch v. Helvering, 290 U.S. 111, 114 (1933)).
"Id.
"Indopco, 112 S. Ct. at 1044.
"Indopco, 112 S. Ct. at 1043 n.5.
"See id. at 1044.
a separate and distinct asset may be sufficient to require capitalization of an expenditure, it is not a necessary condition to capitalization. The Court's holding thus sounded the death knell of the "separate and distinct asset" test as the litmus test for distinguishing capital expenditures from deductible business expenditures.

D. Formulation of the "Future Benefits and Purpose of Expenditures" Test

The Court's rejection of Indopco's primary argument—that the "separate and distinct asset" test controlled—required the Court to fashion a rule for determining the nature of Indopco's merger fees. The Court developed a two-pronged inquiry: (1) whether the expenditures created future benefits and (2) whether the future benefit was a purpose, rather than an incidental by-product, of the expenditure. Neither prong is wholly determinative.

According to the Court, its previous statement in *Lincoln Savings* that "the presence of an ensuing benefit that may have some future aspect is not controlling" did not prevent using future benefits to distinguish between ordinary business expenses and capital expenditures. The *Lincoln Savings* statement meant only that capitalization may not be justified where a taxpayer realizes merely an incidental future benefit. Applying the "future benefits" prong of its analysis to the facts in *Indopco*, the Court held that "the Tax Court's and the Court of Appeals' findings that the transaction produced significant benefits to [Indopco] that extended beyond the tax year in question are amply supported by the record."

The Court provided only a cursory discussion of the "purpose" prong of its analysis. The Court supported this prong in its statement that "the mere presence of an incidental future benefit may not warrant

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101 See id. (citing General Bancshares Corp. v. Commissioner, 326 F.2d 712, 716 (8th Cir.), cert. denied, 379 U.S. 832 (1964) for the proposition that "although expenditures may not 'result[ ] in the acquisition or increase of a corporate asset... these expenditures are not, because of that fact, deductible as ordinary and necessary business expenses').

102 See id. at 1044-45.

103 See *Indopco*, 112 S. Ct. at 1044 (quoting *Lincoln Sav. & Loan Ass'n*, 403 U.S. at 354).

104 See id. (noting, however, that the creation of benefits that extend beyond one year are undeniably important in the analysis of capital expenditures versus ordinary business expenditures); see also United States v. Mississippi Chemical Corp., 405 U.S. 298, 310 (1972) (determining the benefit derived from purchase of stock requires capitalization of the expense); Central Texas Sav. and Loan Ass'n v. United States, 731 F.2d 1181, 1183 (5th Cir. 1984) (requiring capitalization of expenses incurred in starting new branches).

105 *Indopco*, 112 S. Ct. at 1045; see supra notes 60-63, 68-71 and accompanying text.
The Court noted, however, that Indopco’s merger fees were “‘incurred for the purpose of changing the corporate structure for the benefit of future operations,’” and such expenditures had long been viewed as capital expenditures.\(^\text{107}\)

Explaining the relationship between the “future benefits” and “purpose” prongs of its test, the Supreme Court stated that expenditures are characterized as capital in nature when “‘the purpose for which the expenditure is made has to do with the corporation’s operations and betterment for the duration of its existence or for the indefinite future or for a time somewhat longer than the current taxable year’”\(^\text{108}\) It thus appears that the Court will look at the combination of future benefits and the taxpayer’s purpose for the expenditure to determine whether the expenditure may be deducted immediately or must be capitalized.

**IV THE IMPACT OF INDOPCO ON ACQUISITIONS AND OTHER CORPORATE TRANSACTIONS**

While the *Indopco* decision was specifically addressed to acquisition fees in a friendly corporate merger, it potentially has much greater implications. The decision suggests that the IRS may be able to argue successfully the nondeductibility of other business expenditures such as hostile corporate acquisition fees, business expansion fees, proxy contest expenses and advertising expenses. The analysis of the potential effect of the *Indopco* decision on these various business expenditures requires application and historical analysis of *Indopco*, prior U.S. Supreme Court tax cases, and various sections of the Internal Revenue Code. Although the analysis may become complex at times, the basic principle is that the Supreme Court, by fashioning a nebulous test to distinguish between capital expenditures and ordinary and necessary business expenses, has created uncertainty in the characterization of what were traditionally deductible business expenditures.

**A. Acquisitions**

1. **Friendly Acquisitions**

Justice Blackmun indicated that the scope of *Indopco* was limited and that each case involving capitalization versus deductibility “‘turns on its

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\(^{106}\) *Indopco*, 112 S. Ct. at 1044.

\(^{107}\) Id. at 1045 (quoting General Bancshares Corp. v. Commissioner, 326 F.2d 712, 715 (8th Cir. 1964) (quoting Farmers Union Corp. v. Commissioner, 300 F.2d 197, 200 (9th Cir.), cert. denied, 371 U.S. 861 (1962))).

\(^{108}\) *Indopco*, 112 S. Ct. at 1046 (emphasis added) (quoting General Bancshares, 326 F.2d at 715).
special facts.’’\textsuperscript{109} Thus limiting language suggests that \textit{Indopco} will not prevent the deductibility of acquisition expenses in all friendly mergers. The Court’s language also provides taxpayers with a means to avoid capitalization.

Justice Blackmun indicated that \textit{Indopco} may involve a burden of proof issue. Blackmun first invoked 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.’”\textsuperscript{110} Later, Blackmun noted that \textit{Indopco} had failed to prove that its merger fees were deductible as ordinary and necessary business expenditures under section 162.\textsuperscript{111}

Thus, if a target corporation can meet its burden of proof, as \textit{Indopco} failed to do, it might be successful in defeating the IRS’s requirement that acquisition fees are not deductible. A target corporation must gather substantial objective data to support its claim that any future benefits were insignificant or incidental to the acquisition. If the target corporation can provide such data, it will meet its burden of proof and may deduct the acquisition expenses as “ordinary and necessary” business expenditures. To prove the nonexistence of significant future benefits, the target corporation should focus on the categories of future benefits the Court recognized in \textit{Indopco}. Those categories were characterized as: (1) resource-related benefits and (2) administrative benefits.\textsuperscript{112} The resource-related benefits in \textit{Indopco} consisted mainly of the acquiring company’s enormous resources and the potential for synergy arising from combining the two companies. The administrative benefits consisted of reduced shareholder relations expenses, reduced reporting and disclosure requirements, and a reduced number of authorized shares—from eight million to one thousand.\textsuperscript{113} To escape capitalization of acquisition expenses, a target corporation must prove that resource-related and administrative benefits such as those that the Court found existed in \textit{Indopco} were either nonexistent or minimal in the acquisition in question.

Some acquisitions are instituted by acquiring entities that have no significant resources, and thus produce no resource-related benefits to the target entity. Typical of such transactions are leveraged buyouts, which

\textsuperscript{109} Id. at 1044 (quoting Deputy v. Du Pont, 308 U.S. 481, 496 (1940)).


\textsuperscript{111} \textit{Indopco}, 112 S. Ct. at 1046; \textit{see also} Grigsby & Chinnis, \textit{supra} note 7, at 85-94 (examining \textit{Indopco} in detail and describing circumstances under which the decision is applicable).

\textsuperscript{112} Grigsby & Chinnis, \textit{supra} note 7, at 85-94.

\textsuperscript{113} \textit{See id.}, \textit{see also} Adams and Hinderliter, \textit{supra} note 7, at 97.
are often financed with debt by entities that have little or no resources. Likewise, the acquisition of a target corporation by an entity in an unrelated industry will provide no resource-related benefits because the resources are so dissimilar. Administrative benefits also are not always inherent in mergers. Many leveraged buyouts, for instance, require the issuance of "junk" bonds, which incur as many administrative expenses as do publicly traded securities. Furthermore, privately owned companies or wholly owned subsidiaries acquired in a takeover will not experience the significant administrative benefits that result when a public company is taken private. Expenditures for these types of acquisitions should be deductible under Indopco.

2. Hostile Acquisitions

In Indopco, the Supreme Court did not address the deductibility of expenses incurred defending against a hostile takeover. Although the Court provides no specific guidance, the argument for deductibility of such expenses is stronger than the argument for deductibility of friendly merger expenditures.

Analyzed under the "future benefits and purpose of expenditures" test the Court used in Indopco, successful hostile takeover defense expenses do not rise to a level requiring capitalization. In Indopco, the two major categories of future benefits were resource-related and administrative. If a hostile takeover defense succeeds, no resource-related benefits result because the companies do not combine to yield new resources or potential synergy. Likewise, no administrative benefits are gained because the intended target corporation does not experience the reduction in shareholder relations expenses or reporting and disclosure requirements that the acquired corporation in a successful merger experiences when taken off the public trading block.

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114 This possibility for avoiding capitalization hinges on a court's definition of resources. Courts may, for instance, consider the management experience an acquiring entity brings to the targeted corporation to be a significant resource. It is also true that leveraged buyouts, where the acquiring entity has no tangible resources, are uncommon in the current business community so that such acquisitions will typically provide the target corporation with new resources. The argument suggested here, however, may be one of the few ways to avoid the potentially broad capitalization net Indopco casts.

115 See generally Adams & Hinderliter, supra note 7; Grigsby & Chinnis, supra note 7.

116 The exception to this rule may be expenditures made to find white knights. See Adams and Hinderliter, supra note 7.

117 See supra notes 112-13 and accompanying text.

118 But see infra notes 141-47 and accompanying text (regarding the IRS position on the deductibility of hostile takeover defense expenditures). For a court opinion subsequent to Indopco
If the hostile takeover defense is unsuccessful, however, the argument is not as strong. Once the acquisition succeeds, the IRS may be able to establish the existence of future benefits such as those that it proved in *Indopco*. In this situation, the target corporation must resort to the same defensive tactics discussed in the context of friendly acquisitions. The target corporation should, however, be able to successfully argue that the "purpose" prong of the *Indopco* test was not satisfied because the expenditures were not made for the purpose of changing corporate structure for the benefit of future operations. It should be reiterated, however, that the *Indopco* Court did not require that the expenditures satisfy both prongs of the "future benefits and purpose of expenditures" test.

Moreover, authority indicates that the *Indopco* Court may allow expenses incurred in an unsuccessful hostile takeover defense to be currently deducted. Under one argument, expenses may be deducted if the nexus between the expenditures and the future benefits is too tenuous. Although future benefits may have resulted from the acquisition, the benefits were not derived from the target corporation's expenditures.

### B. Business Expansion

Corporations often make expansion expenditures to diversify in a sluggish economy, to maintain market share in a highly competitive industry, or to service a growing industry. Prior to *Indopco*, courts generally held that such expenditures were deductible if not associated

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19 See *supra* notes 109-15 and accompanying text.


21 For further analysis of the "nexus" argument, see Grigsby & Chnnus, *supra* note 7, at 89-91.

22 See *In re Federated Dep't Stores*, Inc., 135 Bankr. 950 (Bankr. S.D. Ohio 1992) (explaining the deductibility of fees associated with an unsuccessful hostile takeover defense). The case involved the Campeau Corporation's hostile takeover of Federated Department Stores, Inc., and Allied Stores Corporation. Judge Aug held that the hostile defense expenditures were deductible under § 162(a) because "the decision to engage in a 'white knight' defense was an established, common and accepted defensive move, and thus would be considered 'ordinary' in the context of a hostile takeover battle." *Id.* at 961. Judge Aug also held that *Indopco* did not apply because it dealt with expenses incurred in a successful friendly takeover. The Allied and Federated "mergers never materialized, and thus conferred no benefit, and the Campeau mergers resulted in the very antithesis of long-term future benefit." *Id.* at 961-62.

23 See generally Grigsby & Chnnus, *supra* note 7, at 85-91 (discussing the relevancy and practical effect of the *Indopco* decision).
with the creation of a separate and distinct asset. With the Supreme Court's decision in Indopco, the deductibility of business expansion expenditures may be severely limited, if not altogether prohibited.

In Briarcliff Candy Corp. v. Commissioner, the court found that expenditures made to develop new sales territories were not capital expenditures where the company was already a going concern and the products sold remained the same. The Briarcliff decision was heavily based, however, on an interpretation of Commissioner v. Lincoln Savings & Loan Ass'n as creating a new "separate and distinct asset" test for capitalization. Thus, the Briarcliff court reasoned that if the expenditures did not create separate and distinct assets, they were not capital expenditures. The Indopco Court's clarification of Lincoln Savings obviously renders the precedential value of Briarcliff suspect.

NCNB Corp. v. United States involved the same interpretation of Lincoln Savings. The court in NCNB Corp. found that expenditures for feasibility studies and regulatory applications associated with opening new branch banks were an ordinary practice of NCNB's regular operations. Since the studies and applications did not create or enhance separate and distinct assets, they were currently deductible expenditures.

With the change Indopco has instigated, courts faced with the scenarios of Briarcliff and NCNB Corp. may find that the only support for those decisions was the erroneous application of Lincoln Savings. The result will probably be required capitalization of business expansion expenditures. On the other hand, courts might look beyond the invalidated Lincoln Savings interpretation to find another argument to support the continued classification of business expansion expenditures as currently deductible. The remaining argument for deductibility is grounded in an interpretation of legislative intent behind the enactment of Internal Revenue Code section 195.

Section 195 addresses the deductibility of corporate start-up expenditures. Historically, taxpayers were forced to capitalize such expendi-

124 See supra notes 74-84 and accompanying text.
125 475 F.2d 775 (2d Cir. 1973).
126 Id. at 781-82.
127 Id.
128 See supra notes 95-101 and accompanying text.
129 684 F.2d 285 (4th Cir. 1982).
130 Id. at 292.
131 Id. The court in NCNB noted that the expenditures for construction of buildings, purchase of real estate and other tangible capital assets had been properly capitalized in the start-up of branch banks.
133 Section 195 allows the taxpayer to elect treatment of start-up expenditures as deferred
tures because section 162 did not apply until the trade or business began.\textsuperscript{134} Since the expenditures were incurred in the creation of the trade or business, they yielded future benefits for an indefinite period and were not deductible until the business was sold or abandoned.\textsuperscript{135} Section 195 allows taxpayers to amortize start-up expenditures over a sixty-month period only if the expense would have been deductible if paid or incurred "in connection with the expansion of an existing trade or business."\textsuperscript{136} The language of section 195 evinces a legislative intent to make business expansion expenditures currently deductible. If this were not the case, section 195 would be useless because no start-up expenditure could satisfy the "otherwise deductible as a business expansion expenditure" requirement.\textsuperscript{137} Because Congress manifested an intent that business expansion expenditures be deductible, the courts should not obviate that intent, through application of \textit{Indopco}, absent a more definitive legislative directive.

\textbf{C. Miscellaneous Expenditures}

Given the vague language of \textit{Indopco}, the IRS conceivably could try to attack the deductibility of many types of business expenditures. The two most prevalent expenditures at risk are advertising expenses and proxy contest expenses.

Often, advertising campaigns produce benefits to the company for more than one year in the form of product or company goodwill. While courts and the IRS have long recognized advertising expenditures to be currently deductible,\textsuperscript{138} the "future benefits" analysis of \textit{Indopco} may lead to capitalization in the future.\textsuperscript{139}
The expense of proxy contests also could be changing from a currently deductible expense to a capital expenditure. Proxy contests involve battles among shareholders for control of the corporation. The most promising case for the IRS is a proxy contest that results in a change of corporate control. If corporate control changes, the IRS could argue that new and improved management policies create future benefits, as in *Indopco*. Such an argument would be subject to the taxpayer’s claim that, as with successful takeover defenses, the expenditures were incurred to maintain the status quo and no future benefits inured to the corporation. Despite the Court’s prior acceptance of the deductibility of advertising expenses and proxy contest expenses, both now may be in jeopardy of capital expenditure treatment.\(^{140}\)

To date, the IRS has not attempted an aggressive application of *Indopco* to either advertising expenses or proxy contest expenses. Nonetheless, the reasoning of the Court in *Indopco* has put every taxpayer on notice that a whole new classification of expenditures may be fair game for capitalization.

V  WHERE THE IRS STANDS FOLLOWING *INDOPCO*

During the adjudication of *Indopco* and subsequent thereto, the IRS issued or revised some technical advice memoranda and revenue rulings to clarify many of the concerns raised since the *Indopco* opinion. The most active area for change has been business acquisitions.

In March of 1989, the IRS issued technical advice memorandum ("TAM") 89-27-005.\(^{141}\) This TAM, issued just four months before *Indopco*'s complaint was filed in the Tax Court, involved a target corporation’s expenditures to oppose a hostile takeover attempt by locating a white knight.\(^{142}\) The IRS ruled that such expenditures were still deductible under *Indopco*).


\(^{142}\) A white knight is a third party, typically a corporation, that agrees to acquire a target corporation, usually at the target corporation’s request, as an alternative to a hostile takeover by another bidder. Target corporations seek out white knights because the merger generally offers terms more favorable to the target corporation’s management and a higher price per share to stockholders. In exchange for becoming a white knight, however, most corporations require concessions from the target corporation such as indemnification for potential lawsuits arising from the transaction and reimbursement of transaction fees. See Frank S. Hamblett, Note, *The Impact of Schreiber on the SEC*
not made in order to change the corporate structure, but to maintain profitability and fulfill the directors' fiduciary duty to the shareholders. The expenditures, therefore, were deductible as ordinary and necessary business expenses. Immediately following the *Indopco* decision by the Tax Court, the IRS issued TAM 89-45-003, revoking TAM 89-27-005 as inconsistent with the *Indopco* decision. The IRS noted that the fulfillment of the fiduciary duty was not controlling and that the expenses incurred resulted in a long-term benefit.

The IRS refined its position on deductibility of corporate expenses with TAM 90-43-003 and 90-43-004. In both memoranda, the IRS determined that expenditures relating directly to resistance of unfriendly takeover bids were deductible under section 162(a), but expenditures to find a white knight and to facilitate the acquisition of the target company stock were required to be capitalized. Following the Third Circuit's affirmation of the Tax Court's decision, the IRS issued TAM 91-44-042, which represents the Service's current position on the characterization of expenditures incurred in business acquisitions. The memorandum requires allocation of expenditures based on the services performed, and the expenses must be capitalized if the service is performed in connection with a transaction that produces a long-term benefit.

The IRS also has issued other advisory memoranda since the Supreme Court's decision in *Indopco*. In TAM 92-37-006, the IRS held that expenditures for a prudency audit conducted by an electrical utility for rate-making purposes were currently deductible. The Service found that *Indopco* was not controlling in this case because the prudency audit produced no long-term benefit. A significant factor in the decision was that the utility regularly incurred substantial expenses in performing audits to establish new rates. The IRS found that the "future benefit" of increased rates was a result of expenditures for new plant and equipment that had been properly capitalized.

In TAM 92-40-004, the IRS held that expenditures to replace asbestos insulation in manufacturing equipment are one-time expenditures

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144 Id.


146 See supra note 142 and accompanying text.


148 Id.


150 Id.

151 Id.

that result in significant change to the property and must be capitalized. The Service's rationale was that the expenditures produced future benefits including safer working conditions for employees, reduced risk of liability for the corporation, and increased marketability of the equipment.  

Finally, in Revenue Ruling 92-80,\footnote{Rev. Rul. 92-80, 1992-39 I.R.B. 8.} the IRS stated that the \textit{Indopco} decision does not affect the treatment of advertising costs as business expenses that generally are deductible under section 162 of the Internal Revenue Code. The exception to this general rule is in cases where the advertising is aimed at obtaining future benefits significantly beyond those associated with ordinary advertising.\footnote{See, e.g., Cleveland Elec. Illuminating Co. v. United States, 7 Cl. Ct. 220, 231-34 (1975) (if advertising predominantly contributes to acquisition of capital assets, cost is not deductible for the taxable year but must be amortized over its expected period).}

Although they provide the taxpayer with some guidance, the IRS rulings are merely interpretations of the Internal Revenue Code. As the \textit{Indopco} case illustrated, courts have the power to overrule these interpretations if they find them to be incorrect. The wary taxpayer, therefore, should be prepared in all areas of business transactions to defend against an IRS challenge and a broad definition of "future benefit."

\textbf{CONCLUSION}

The Supreme Court's decision in \textit{Indopco} ended the conflict among the circuits over the proper interpretation of \textit{Commissioner v. Lincoln Savings \\& Loan Ass'n.}\footnote{See supra notes 74-108 and accompanying text.} As is often the case in tax decisions, however, the Court's decision may have created more uncertainty than it resolved.

By casually placing on the taxpayer the burden of proving the nonexistence of future benefits, the Court suggests that \textit{Indopco} may have hinged on a taxpayer's failure to meet its burden of proof. Moreover, the Court's rejection of \textit{Bnarcliff Candy Corp. v. Commissioner}\footnote{See supra notes 125-28 and accompanying text.} and \textit{NCNB Corp. v. United States}\footnote{See supra notes 129-31 and accompanying text.} calls into question the deductibility of business expansion expenditures and other traditionally deductible business expenditures.

In an effort to hedge the opinion against future attack, the Supreme Court instructed that the scope of \textit{Indopco} should be limited due to the highly factual nature of the inquiry. Such qualified decision making by
the Supreme Court has perpetuated the fog of uncertainty surrounding the expenditure characterization dilemma. As a result, *Indopco*’s only guidance to taxpayers is that courts will now employ a nebulous “future benefits and purposes of expenditure” test, and the taxpayer must be prepared to prove the nonexistence of future benefits, or lose the tax benefits of potential deductions.

_Bryan Mattingly_