***7 T.C. 48 (1946)***

Expenditures for business development, such as salaries, travel, rent and advertising, are generally deductible as current expenses; however, when such expenditures result in the acquisition of goodwill, they are not subject to amortization or depreciation.

**Summary**

X-Pando Corporation sought to deduct amortization expenses related to a “Business Development Account,” which included expenditures for salaries, travel, rent, and advertising intended to expand its business through distributors. The Tax Court disallowed the deduction, finding that these expenditures, even if capital in nature, primarily resulted in the acquisition of goodwill. Goodwill is not subject to amortization or depreciation under the Internal Revenue Code. The court emphasized that deductions are a matter of legislative grace and must have a statutory basis, which was absent in this case.

**Facts**

X-Pando Corporation, a manufacturer of cement and waterproofing compounds, underwent a change in ownership and management in 1937. The new management invested heavily in developing its business by establishing a distribution network. These expenditures included officers’ and employees’ salaries, travel expenses, rent, and advertising. The company allocated portions of these expenses to current business expenses and the remainder to a “Business Development Account.” In 1941, X-Pando began amortizing this account at a 20% annual rate, deducting $5,282 from its gross income.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in X-Pando’s income and declared value excess profits tax for 1941, disallowing the claimed amortization deduction. X-Pando petitioned the Tax Court, challenging the Commissioner’s determination.

**Issue(s)**

Whether X-Pando Corporation can deduct amortization expenses related to its “Business Development Account,” which included expenditures for salaries, travel, rent, and advertising, when such expenditures primarily resulted in the acquisition of goodwill.

**Holding**

No, because the expenditures resulted in the acquisition of goodwill, which is not subject to amortization or depreciation under the Internal Revenue Code.

 

## Court’s Reasoning

The Tax Court reasoned that while expenditures like salaries, travel, rent, and advertising are typically deductible as current business expenses under Section 23(a) of the Internal Revenue Code, the key question was whether these expenditures resulted in the acquisition of a capital asset that could be depreciated. The court acknowledged that X-Pando had allocated a portion of these expenses to a “Business Development Account” because they anticipated future benefits from these investments. However, the court determined that the primary asset resulting from these expenditures was goodwill, which is not depreciable. The court stated, “No deduction for depreciation, including obsolescence, is allowable in respect of good will.” Since the company continued to benefit from the established distribution network, the expenditures did not diminish in value, further negating the basis for amortization.

## Practical Implications

This case reinforces the principle that expenditures creating goodwill are not depreciable or amortizable for tax purposes. It clarifies that even if a company can demonstrate that certain expenses are capital in nature, they must also establish that the resulting asset is depreciable under the Internal Revenue Code. The decision underscores the importance of properly categorizing business expenses and understanding the tax treatment of different types of assets. Taxpayers must distinguish between expenditures that create immediate deductions and those that create long-term, non-depreciable assets like goodwill. Later cases cite X-Pando to deny amortization deductions claimed for expenses that, in substance, create or enhance goodwill.