Skaggs Cos. v. Commissioner, 59 T. C. 201 (1972)

Expenses incurred to facilitate a corporate restructuring by converting preferred stock to common stock are capital expenditures, not deductible as ordinary business expenses.

Summary

Skaggs Companies, Inc. attempted to restructure its capital by converting its preferred stock to common stock to avoid funding a sinking fund. To ensure the conversion, Skaggs entered into a 'Standby Agreement' with investment bankers, paying them $35,302. The court held that this payment was a non-deductible capital expenditure, not an ordinary and necessary business expense under section 162. The decision emphasized that expenses related to corporate restructuring are capital in nature and not amortizable due to the indeterminable life of the stock involved.

Facts

Skaggs Companies, Inc. issued preferred stock in 1965 with a redemption feature and a potential sinking fund obligation starting no later than 1975. In 1968, to restructure its capital and avoid the sinking fund, Skaggs devised a plan to convert its preferred stock to common stock. To mitigate the risk of having to redeem the preferred stock if the market price of its common stock fell, Skaggs entered into a 'Standby Agreement' with investment bankers, agreeing to pay them $35,302 to purchase the preferred stock at a price above the redemption value if necessary.

Procedural History

Skaggs deducted the $35,302 fee as an ordinary business expense on its 1969 tax return. The Commissioner of Internal Revenue disallowed the deduction, leading Skaggs to petition the U. S. Tax Court. The Tax Court upheld the Commissioner's decision, ruling the fee as a non-deductible capital expenditure.

Issue(s)

1. Whether the $35,302 payment to investment bankers to ensure the conversion of preferred stock to common stock is deductible as an ordinary and necessary business expense under section 162 or is a nondeductible capital expenditure under section 263.
2. If the payment is a capital expenditure, whether it is amortizable.

Holding

1. No, because the payment was integral to a corporate restructuring plan, making it a capital expenditure.
2. No, because the expenditure was related to raising capital through stock

issuance, which does not have a determinable useful life for amortization purposes.

Court's Reasoning

The court reasoned that the payment to the investment bankers was part of a broader plan to restructure the company's capital structure by converting preferred stock to common stock. The court cited established case law, such as Mills Estate v. Commissioner, stating that expenses related to reorganizations or recapitalizations are capital in nature. The court rejected Skaggs's argument that the payment was akin to insurance or a premium for retiring debt, as preferred stock is an equity item, not a debt instrument. The court also dismissed the argument for amortization, noting the indeterminable life of the preferred stock and that the expense was related to raising capital through stock issuance, which is not an amortizable asset.

Practical Implications

This decision impacts how corporations approach and account for expenses related to corporate restructuring, particularly when converting one type of stock to another. It clarifies that such expenses are capital expenditures and not deductible as ordinary business expenses. Corporations must consider the tax implications of restructuring their capital structure and cannot use such expenses to offset current income. The ruling also affects legal and financial advisors who must guide clients on the tax treatment of restructuring costs. Subsequent cases, such as General Bancshares Corporation v. United States, have followed this precedent, reinforcing the principle that corporate restructuring costs are capital expenditures.

