Deering Milliken, Inc. v. Commissioner, 59 T. C. 469 (1972)

Costs incurred in appraisal proceedings to determine the value of dissenting shareholders' stock are not organizational expenditures under Section 248 of the Internal Revenue Code.

Summary

In Deering Milliken, Inc. v. Commissioner, the Tax Court ruled that legal fees and related costs incurred by Pacolet Industries, Inc. , in an appraisal proceeding brought by dissenting shareholders after a corporate consolidation could not be amortized as organizational expenditures under Section 248 of the Internal Revenue Code. The court applied the 'origin of the claim' test, determining that these costs stemmed from the decision to consolidate rather than from the creation of the new corporation. This decision clarified that only costs directly incident to the corporation's creation qualify as organizational expenditures, impacting how similar corporate reorganization expenses are treated for tax purposes.

Facts

Pacolet Industries, Inc. , was formed in December 1962 through the consolidation of five South Carolina corporations. Some shareholders dissented from the consolidation, leading to an appraisal proceeding to determine the value of their shares in the consolidating corporations. Pacolet incurred significant legal and appraisal fees in connection with this proceeding. Pacolet sought to amortize these costs as organizational expenditures under Section 248 of the Internal Revenue Code, but the Commissioner of Internal Revenue challenged this treatment.

Procedural History

The Commissioner determined a deficiency in Pacolet's income tax, disallowing the amortization of the appraisal proceeding costs as organizational expenditures. Pacolet conceded that these costs could not be deducted currently but argued they should be amortized under Section 248. The case was heard in the United States Tax Court, where the court ruled in favor of the Commissioner, holding that the costs did not qualify as organizational expenditures.

Issue(s)

1. Whether the costs incurred by Pacolet in the appraisal proceeding brought by dissenting shareholders qualify as organizational expenditures under Section 248 of the Internal Revenue Code.

Holding

1. No, because the costs of the appraisal proceeding originated from the decision to consolidate rather than from the creation of Pacolet itself.

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Court’s Reasoning

The Tax Court applied the ‘origin of the claim’ test from United States v. Gilmore, determining that the appraisal proceeding costs were not ‘incident to the creation of the corporation’ as required by Section 248(b)(1). The court reasoned that the consolidation would have occurred regardless of the appraisal proceeding, and the costs were incurred to determine the value of dissenting shareholders’ stock, not to establish the new corporation. The court emphasized that the consolidation decision, not the corporation’s creation, was the critical factor leading to the appraisal proceedings. The court also noted that the costs were not ‘directly incident to the creation of the corporation’ as defined in the regulations and committee reports related to Section 248.

Practical Implications

This decision clarifies that only costs directly related to a corporation’s formation can be treated as organizational expenditures under Section 248. For legal practitioners, this means that costs associated with post-formation activities, such as resolving shareholder disputes or determining stock value, cannot be amortized as organizational expenditures. Businesses undergoing consolidation or reorganization must carefully distinguish between costs of formation and those related to subsequent activities. This ruling may influence how companies structure their reorganizations to minimize tax liabilities and has been cited in subsequent cases dealing with the treatment of reorganization expenses.

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