***Pacolet Industries, Inc. v. Commissioner*, T.C. Memo. 1972-206 (1972)**

Costs incurred by a corporation in appraisal proceedings initiated by dissenting shareholders of consolidating corporations are not considered 'organizational expenditures' amortizable under Section 248 of the Internal Revenue Code, as they are not directly incident to the creation of the corporation.

Summary

Pacolet Industries, Inc., formed through the consolidation of five corporations, sought to amortize legal and appraisal fees incurred in proceedings brought by dissenting shareholders as 'organizational expenditures' under Section 248 of the Internal Revenue Code. The Tax Court denied the amortization, holding that these expenses, while related to the consolidation that created Pacolet, were not 'incident to the creation' of the corporation itself. The court reasoned that the appraisal costs originated from the necessity of acquiring the dissenting shareholders' interests due to the consolidation agreement, not from the act of incorporating Pacolet. Thus, they were capital expenditures not qualifying for amortization as organizational costs.

Facts

Pacolet Industries, Inc. was formed through the consolidation of five existing South Carolina corporations. Some shareholders of the consolidating corporations dissented from the consolidation and did not receive Pacolet stock. South Carolina law required Pacolet to pay these dissenting shareholders the appraised value of their stock. Dissenting shareholders initiated appraisal proceedings against Pacolet. Pacolet incurred significant legal fees, appraiser fees, and other costs in defending against these proceedings. Pacolet elected to amortize organizational expenditures under Section 248 and included these appraisal proceeding costs in its amortization.

Procedural History

Pacolet Industries, Inc. deducted the appraisal proceeding costs as organizational expenditures on its federal income tax returns. The Commissioner of Internal Revenue determined that these costs were not deductible as current expenses and did not qualify for amortization as organizational expenditures. Pacolet petitioned the Tax Court, conceding the costs were not currently deductible but arguing they were amortizable organizational expenditures.

Issue(s)

1. Whether the legal fees, appraiser fees, and other costs incurred by Pacolet Industries, Inc. in appraisal proceedings initiated by dissenting shareholders are 'organizational expenditures' within the meaning of Section 248(b) of the Internal Revenue Code, and thus amortizable as deferred expenses.

Holding

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1. No. The Tax Court held that the costs incurred in the appraisal proceedings are not ‘organizational expenditures’ because they are not ‘incident to the creation of the corporation.’ These costs originated from the consolidation agreement and the subsequent necessity to acquire the stock of dissenting shareholders, rather than from the act of creating the corporate entity itself.

Court’s Reasoning

The court applied the ‘origin of the claim’ test, citing *United States v. Gilmore*, 372 U.S. 39 (1963), and *Woodward v. Commissioner*, 397 U.S. 572 (1970). The court reasoned that while Pacolet’s creation was a ‘but for’ condition for the appraisal litigation, the origin of the claim was the consolidation agreement and the rights of dissenting shareholders arising from it. The court stated, “It is clear to us that the costs of the appraisal proceedings were not made to bring Pacolet into being. It can not be said that the consolidation would not have taken place ‘but for’ the creation of Pacolet. On the contrary, ‘but for’ the decision to consolidate, Pacolet would not have been created. Thus, as in *Woodward* and *Hilton Hotels*, the appraisal expenditures involved herein originated in that decision and the consequent necessity of acquiring the interests of the dissenters.” The court emphasized that under South Carolina law, Pacolet’s corporate existence began regardless of dissenting shareholder actions. The appraisal process was triggered by dissent, not by the incorporation itself. Therefore, these costs were not ‘directly incident to the creation of a corporation’ as required by Section 248 and related regulations.

Practical Implications

This case clarifies that the scope of ‘organizational expenditures’ under Section 248 is limited to costs directly related to the act of incorporation itself. Expenses that arise from related transactions, such as mergers or consolidations, even if they occur concurrently with or shortly after incorporation, are not automatically considered organizational expenditures. Specifically, costs associated with resolving dissenting shareholder claims in corporate reorganizations are treated as capital expenditures related to the acquisition of stock, not the creation of the corporation. This decision highlights the importance of distinguishing between the costs of forming a corporate entity and the costs of related transactions when seeking to amortize organizational expenditures for tax purposes. Legal professionals should advise clients that appraisal costs in consolidations, while necessary for the overall transaction, are unlikely to qualify for amortization under Section 248.

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