National Starch & Chemical Corp. v. Commissioner, 93 T. C. 67 (1989)

Expenses incurred by an acquired company in a friendly takeover are capital expenditures, not deductible as current expenses under IRC § 162(a).

Summary

National Starch & Chemical Corp. sought to deduct expenses related to its acquisition by Unilever, including legal and investment banking fees. The Tax Court held that these expenses were capital in nature because they were incurred to facilitate a long-term shift in corporate ownership, expected to benefit the company over many future years. This ruling emphasized that the dominant aspect of the expenditures was the takeover itself, not the incidental fiduciary duties of the directors. The decision clarified that such expenses do not qualify as ordinary and necessary under IRC § 162(a), impacting how similar corporate transactions are treated for tax purposes.

Facts

National Starch & Chemical Corp. (National Starch) was acquired by Unilever United States, Inc. (Unilever U. S.) in a friendly takeover. In the transaction, National Starch's shareholders either exchanged their stock for cash or for nonvoting preferred stock in a newly formed Unilever subsidiary. National Starch incurred significant expenses, including legal fees from Debevoise, Plimpton, Lyons & Gates and investment banking fees from Morgan Stanley & Co. Inc. These fees were incurred to structure the transaction, obtain a fairness opinion, and ensure compliance with fiduciary duties to shareholders. National Starch attempted to deduct these expenses as ordinary and necessary business expenses under IRC § 162(a).

Procedural History

The Commissioner of Internal Revenue disallowed the deduction of these expenses, leading National Starch to petition the U. S. Tax Court. The Tax Court considered whether the expenses were deductible under IRC § 162(a) or if they should be treated as non-deductible capital expenditures.

Issue(s)

1. Whether the expenses incurred by National Starch incident to its acquisition by Unilever are deductible as ordinary and necessary business expenses under IRC § 162(a).

Holding

1. No, because the expenses were capital in nature, incurred to effect a long-term shift in corporate ownership that was expected to produce future benefits for the

company.

Court's Reasoning

The Tax Court applied the principle that expenditures leading to benefits that extend beyond the current tax year are capital in nature. The court found that the expenses incurred by National Starch were related to a significant shift in corporate ownership, which was deemed to be in the long-term interest of the company. The court rejected the argument that these expenses were deductible because they did not result in the creation or enhancement of a separate asset, emphasizing instead that the dominant aspect of the transaction was the takeover itself. The court cited several cases to support its view that expenditures related to corporate reorganizations, mergers, or shifts in ownership are capital expenditures, even if they do not result in the acquisition of a tangible asset. The court also noted that the expectation of future benefits, even if not immediately realized, was sufficient to classify the expenses as capital.

Practical Implications

This decision has significant implications for how companies should treat expenses related to corporate acquisitions. It establishes that expenses incurred by an acquired company in facilitating a takeover are not deductible as ordinary business expenses but must be capitalized. This ruling affects tax planning for corporate transactions, requiring companies to account for such expenses as part of their capital structure rather than as immediate deductions. The decision also impacts how legal and financial advisors structure and advise on corporate takeovers, emphasizing the need to consider the long-term benefits of the transaction when determining the tax treatment of related expenses. Subsequent cases have followed this precedent, further solidifying the principle that takeover expenses by the acquired entity are capital in nature.

