but I simply don't know the reasons for their doing it. I don't know whether they rely on management or not.

Q. Well, if they don't rely on management, why does management really have to make a recommendation to them?

A. Because management has an obligation to do so.

Q. Why would that obligation be imposed?

A. Because the law imposes it, at least in Delaware. The obligation is on the board of directors to make decisions with respect to the management of Delaware companies.

Q. What would the rationale behind that rule be?

A. Well, one rationale behind that certainly is
(p. 110) that boards of directors are generally more informed and are better able to make judgments with respect to business affairs of the corporation than the body of stockholders are.

Q. Are you familiar with a merger structure known as a reverse subsidiary cash merger?

A. I've heard the merger in this case called that.

Q. Do I take that to be a yes?

THE COURT: I think he answered the question.

BY MR. MORMAN:

Q. In general, the purpose of structuring a merger this way is to make sure that the acquirer gets 100 percent control of the target stock, isn't it?

A. I can't answer that question. I don't know. There are many mergers in many different forms in which you acquire 100 percent of the other company's stock.

I can't say that that's unique to this or especially important to this form.

MR. MORMAN: No further questions, Your Honor.

THE COURT: Do you have any?

MR. WALKER: We have nothing further, Your Honor.

THE COURT: Thank you, Mr. Sutton.

(Witness excused.)

MR. WALKER: Your Honor, petitioner rests.

MR. SAPINSKI: We don't have anything further, Your Honor.

(Certificate of transcriber and proofreader omitted)

[Trial Exhibit—Pages 42-43 of Ruebhausen Deposition]

undertake?

MR. MURPHY: Can I ask a question?

Was it you who personally gave the assignment to Morgan Stanley?

A. From these notes, it appears that I was the spokesman.

Q. Sir —

MR. MURPHY: What did you say to them to give them the assignment?

THE WITNESS: I have no present independent recollection of what I said to them.

Q. Bearing that in mind, sir, you said your recollection had been refreshed —

A. I am referring to the notes, "OMR advised Baldwin that the Greenwall 15 percent holdings presented estates problems, but they have been managed. Yet they present, by overhanging the market, a" — question mark — "for National Starch Corporation for the future. And advice as to a range of protective steps was desired for National Starch, particularly since an opportunity —" and I can't read — "was not before National Starch —" "particular opportunity put before National Starch."

Q. Did you or the others who attended on behalf of National Starch at that meeting, do you recall whether you gave Mr. Baldwin an oral or a written description of the structure of the transaction?

[Trial Exhibit—Pages 42-43 of Ruebhausen Deposition]

A. I do not recall having given any description to Mr. Baldwin of the structure of the transaction.

Q. Do you recall any meeting with anyone else at Morgan Stanley, at that time or shortly thereafter, in which you or anyone in your presence, where the structure was described to them?

A. I do not recall ever describing the structuring myself to Morgan Stanley.

Q. Thank you, sir.

Do you know whether Morgan Stanley after — let's back up.

Did Morgan Stanley take the assignment to represent National Starch —

MR. WALKER: Could you just rephrase it, to say did Morgan Stanley take an assignment rather than "the," it makes it

UNITED STATES TAX COURT

NATIONAL STARCH AND CHEMICAL CORP., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 31669-84 Filed July 24, 1989.

CLAPP, *Judge:* Respondent determined a deficiency in petitioner's Federal income tax for the taxable year ended August 15, 1978, in the amount of $1,068,281. The only issue for our decision is whether petitioner, the acquired corporation in a friendly takeover, may deduct under section 162(a)[1] the expenditures it incurred incident to the takeover.

FINDINGS OF FACT

Most of the facts were stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by this reference. At the time the petition was filed, the principal office of National Starch & Chemical Corp. (petitioner) was located in Bridgewater, New Jersey.

Petitioner is a Delaware corporation which uses the accrual method of accounting for Federal income tax purposes. The tax year in issue was a short year that ran from January 1 to August 15, 1978. Petitioner manufactures and sells adhesives, starches, and specialty chemical products in the United States and certain foreign countries. Immediately prior to

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954 as amended and in effect for the year in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

August 15, 1978, petitioner's authorized capital stock consisted of 250,000 shares of preferred stock, none issued or outstanding, and 8 million shares of common stock, approximately 6,563,930 shares of which were issued and outstanding. Petitioner's common stock was publicly held by approximately 3,700 shareholders and was traded on the New York Stock Exchange. Petitioner's largest shareholder was Frank K. Greenwall (Greenwall) who, together with his wife, owned approximately 14½ percent of petitioner's outstanding common stock.

Unilever United States, Inc. (Unilever U.S.), is a Delaware corporation whose principal office is located in New York City. It is a holding company whose principal subsidiaries prior to August 15, 1978, were Lever Brothers Co. and Thomas J. Lipton, Inc. These corporations manufacture and sell foods, detergents, and other products. All of the outstanding stock of Unilever U.S. is owned by Unilever N.V., a publicly held Netherlands corporation. Unilever N.V. and Unilever PLC (a publicly held United Kingdom corporation), along with companies directly or indirectly owned or controlled by them, comprise the Unilever Group.

On October 7, 1977, representatives of the Unilever Group indicated an interest in making a tender offer for all of petitioner's stock. This interest was expressed at a meeting with the chairman of petitioner's board of directors and with Greenwall (who was chairman of the executive committee of the board of directors). In the course of the subsequent discussions, Greenwall (who was 81 years old and his wife 79 years old) indicated that for estate planning reasons he and his wife would voluntarily dispose of their stock only in a tax-free transaction that would be available to the other shareholders. The Unilever Group said that it would proceed with the tender offer only if both Greenwall and petitioner favored the acquisition of the stock.

The law firm of Cravath, Swaine & Moore, counsel to Unilever U.S., and Debevoise, Plimpton, Lyons & Gates (Debevoise, Plimpton), counsel to petitioner and to the Greenwalls, devised a structure that was designed to satisfy Greenwall's concerns. This structure involved the formation of two new companies. One was National Starch & Chemical Holding Corp. (Holding), a Delaware subsidiary of Unilever U.S. The other, which would have only a transitory existence, was a subsidiary of Holding named NSC Merger, Inc. Pursuant to an exchange offer, Holding would exchange one share of its nonvoting preferred stock for each share of petitioner's common stock that it received from petitioner's shareholders. This transaction was intended to be tax free under section 351. Pursuant to an Agreement and Plan of Merger (merger agreement), any common stock of petitioner that was not acquired by Holding pursuant to the exchange offer would be converted into cash in a merger of NSC Merger, Inc. into petitioner. The structure of the proposed transaction was discussed with Internal Revenue Service officials in the ruling branch of the national office on November 3, 1977.

On November 7, 1977, petitioner's directors were told about the Unilever Group's interest in purchasing petitioner's stock and about the proposed structure of the transaction. At that meeting, Edward A. Perell, a partner at Debevoise, Plimpton, advised the directors that they had a fiduciary duty under Delaware law to ensure that the proposed transaction would be fair to the stockholders. In his judgment, the directors should retain an outside independent investment banking firm which would assist in the valuation of petitioner and would be available in the event that either the Unilever Group or a third party made a hostile or unsolicited tender offer. Perell told the directors that their failure to retain such a firm might be evidence that they did not carry out their fiduciary responsibilities.

On November 14, 1977, petitioner engaged the investment banking firm of Morgan Stanley & Co. Inc. (Morgan Stanley). Morgan Stanley was retained primarily to value the stock, to render a fairness opinion, and to stand ready to assist if there was a hostile tender offer.

The Unilever Group had originally proposed a price of $65 to $70 for each share of stock in petitioner and, after valuing petitioner, Morgan Stanley informed petitioner that such a price was fair. Subsequently, Morgan Stanley held discussions with the Unilever Group's representative and was offered a price of $70. The senior executives of petitioner felt that this price was too low and told the Morgan Stanley representative that they wanted $80. Morgan Stanley conveyed this information to the Unilever Group's representative and several days later Morgan Stanley reported that the Unilever Group had offered $73.50.

On December 11, 1977, a representative of Morgan Stanley submitted to petitioner's board of directors an oral report favorably evaluating the offer. On that same date, a letter of intent relating to the acquisition of petitioner's common stock was executed by petitioner and Unilever U.S.

On March 16, 1978, the board approved the execution of the merger agreement. Under the terms of that agreement, petitioner did not have to proceed with the transaction unless the Internal Revenue Service issued a favorable private letter ruling. Such a ruling letter was issued on June 28, 1978. This ruling letter held that the formation of Holding's subsidiary, NSC Merger, Inc., and the merger of that subsidiary into petitioner (a reverse subsidiary cash merger) would be disregarded for Federal tax purposes. The transaction would be a taxable sale to those shareholders who received cash and would be tax free under section 351 to shareholders who received Holding preferred stock. When the Internal Revenue Service issued the ruling letter, it did not know that petitioner would claim a deduction for its legal fees and for its Morgan Stanley fee.

On July 10, 1978, Morgan Stanley's written fairness opinion was delivered to the board. This opinion concluded that the terms of the proposed merger agreement and related exchange offer taken as a whole were fair and equitable to petitioner's shareholders from a financial point of view.

On August 15, 1978, a special meeting of petitioner's shareholders was held at which the merger agreement was approved. Later the same day, there was a closing of both parts of the transaction pursuant to the exchange offer and the merger agreement. In the transaction, 179 of petitioner's shareholders (holding approximately 21 percent of petitioner's common stock) voluntarily exchanged their stock on a share-for-share basis for 1,313,383 shares of Holding nonvoting preferred stock with a par value of $73.50 per share. The remaining shareholders exchanged their stock for $73.50 per share in cash. As a result of the transaction, Holding acquired all of petitioner's outstanding common stock in exchange for cash of $380,151,075 and Holding preferred stock with an aggregate par value of $96,533,650.

A Morgan Stanley report had said that petitioner's management believed that affiliation with Unilever would create the opportunity for "synergy," and petitioner's 1978 annual report had said that petitioner would benefit from the availability of the Unilever Group's enormous resources. However, petitioner's business continued as before following Holding's acquisition of its stock. Its directors and officers remained in office, and its key officers and employees executed employment contracts with it as required by the merger agreement. The Unilever Group did not make any changes in the operation of petitioner, nor did it provide petitioner with significant technological or financial assistance, nor with significant legal, administrative, or accounting services. Petitioner did not acquire any property or services from any member of the Unilever Group nor did petitioner dispose of any of its assets or property. There was no material increase in petitioner's sales to the Unilever Group. For purposes of administrative convenience and simplicity, petitioner's Certificate of Incorporation was amended to eliminate its previously authorized shares of preferred stock and to reduce the total number of its authorized shares of common stock to 1,000.

Morgan Stanley charged petitioner a fee of $2,200,000 for its services. This fee was reasonable in amount. Morgan Stanley also charged petitioner a fee of $7,586.23 for out-of-pocket expenses and $18,000 for the legal fees of its counsel. Debevoise, Plimpton charged petitioner $490,000 for the legal services rendered by it to petitioner and its board of directors, plus out-of-pocket expenses of $15,069. The services performed by Debevoise, Plimpton included advice given petitioner and its board of directors regarding their legal rights and obligations with respect to the transaction, preparation of the Internal Revenue Service ruling request, participation in negotiations, and preparation of documents. This fee was reasonable in amount. Petitioner also incurred other expenses totalling $150,962 in connection with the transaction. These expenses were reasonable in amount and were of a type customarily incurred in connection with similar transactions.

In the Federal income tax return for the year ending in 1978, petitioner deducted the Morgan Stanley fee but did not deduct the Debevoise, Plimpton fee or the other expenses. In his notice of deficiency, respondent disallowed the Morgan Stanley fee. In the petition, petitioner contested the deficiency determined by respondent and also claimed overpayment of taxes because the Debevoise, Plimpton fee and other expenses were not deducted.

OPINION

The only issue for decision is whether petitioner, the acquired firm in a friendly takeover, is entitled to deduct under section 162(a) the expenditures it incurred incident to the takeover. To our surprise, we find that this issue is one of first impression despite the prevalence of takeovers in the modern corporate world; however, we note that two highly respected commentators have stated, without citation of authority, that—

> The well-established rule in this area is that amounts incurred to effectuate a corporate "reorganization" (in the broad sense of a rearrangement resulting in a restructuring of the corporate entity or enterprise, even if not a technical "reorganization" as defined by section 368(a) * * * are not currently deductible as business expenses under section 162 by the person incurring such costs. [B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders, par. 5.06.2, p. 5-33 (5th ed. 1987).]

Petitioner argues that it is entitled to take the deductions because the expenditures were ordinary and necessary within the meaning of section 162(a). Respondent argues that the expenditures are nondeductible because they either were capital expenditures or were constructive distributions to the shareholders.

Section 162(a) allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." Five separate requirements must be satisfied before a deduction is allowed under this section. *Commissioner v. Lincoln Savings & Loan Association,* 403 U.S. 345 (1971). One requirement— that the expenditures be paid or incurred during the taxable year— clearly is satisfied. Respondent claims that none of the other requirements are satisfied. Those requirements are (1) that the expenditures were necessary, (2) that the expenditures were for the carrying on of a trade or business, (3) that the expenditures were ordinary, and (4) that the expenditures were current expenses, not capital expenditures.

Given our disposition of the case, we need consider only the last of these requirements.

The distinction between a deductible current expense and a nondeductible capital expenditure can, at times, be unclear. When making the distinction, it must be kept in mind that deductions are a matter of legislative grace. *New Colonial Ice Co. v. Helvering,* 292 U.S. 435 (1934). Deduction statutes must be strictly construed. *Mills Estate v. Commissioner,* 206 F.2d 244, 246 (2d Cir. 1953), revg. in part on other grounds 17 T.C. 910 (1951). The taxpayer bears the burden of showing the right to the claimed deduction. *Interstate Transit Lines v. Commissioner,* 319 U.S. 590 (1943). A deduction is not allowed just because an expenditure possesses "some characteristics different from the more commonly accepted capital expenditures * * *." *General Bancshares Corp. v. Commissioner,* 326 F.2d 712, 716 (8th Cir. 1964), affg. 39 T.C. 423 (1962), cert. denied 379 U.S. 832 (1964).

The courts have determined that a number of expenditures are capital and, thus, nondeductible. These expenditures include, among others, those incurred incident to a merger into a parent company, *Denver & Salt Lake Railway Co. v. Commissioner,* 24 T.C. 709 (1955), dismissed pursuant to stipulation 234 F.2d 663 (10th Cir. 1956); a distribution to shareholders of subscription warrants for a subsidiary's stock, *Missouri-Kansas Pipe Line Co. v. Commissioner,* 148 F.2d 460 (3d Cir. 1945), affg. a Memorandum Opinion of this Court; a distribution of stock dividends, *General Bancshares Corp. v. Commissioner, supra,* a recapitalization, *Mills Estate Inc. v. Commissioner, supra,* a corporate reorganization, *Gravois Planing Mill Co. v. Commissioner,* 299 F.2d

199, 206 (8th Cir. 1962), revg. on other grounds a Memorandum Opinion of this Court; a bankruptcy reorganization, *Bush Terminal Buildings Co. v. Commissioner,* 7 T.C. 793, 818-819 (1946); and an increase in capitalization, *Fishing Tackle Products Co. v. Commissioner,* 27 T.C. 638, 645(1957).

Relying on cases such as these, respondent argues that petitioner's expenditures are nondeductible because they were incurred incident to a recapitalization, merger, or reorganization. As evidence of a recapitalization, respondent points to the amendment of petitioner's Certificate of Incorporation that eliminated the previously authorized shares of preferred stock and reduced the total number of authorized shares of common stock to 1,000. We note, however, that this amendment was done merely for purposes of administrative convenience and simplicity. Accordingly, it is not relevant to the deductibility issue.

As evidence of a merger, respondent points to the merger of NSC Merger, Inc. into petitioner. This merger, however, was incidental to the transaction, as illustrated by the Internal Revenue Service ruling letter which stated that the merger would be disregarded. Accordingly, the merger will not cause the expenditures to be characterized as capital expenditures.

Finally, respondent argues that from the standpoint of the corporation the transaction was essentially a reorganization under section 368(a)(1)(B). Respondent acknowledges that from the standpoint of the shareholders the transaction differed significantly from a section 368(a)(1)(B) reorganization, but argues that this is unimportant since we are focusing on the tax consequences to the corporation. We agree that the various definitions of section 368(a)(1) can be helpful when deciding whether from the corporate viewpoint an expenditure was incurred incident to a reorganization. *Bilar Tool & Die Corp. v. Commissioner,* 530 F.2d 708, 713 (6th Cir. 1976), revg. on factual grounds 62 T.C. 213 (1974). We are unwilling to hold, however, that the instant transaction is sufficiently similar to a reorganization under section 368(a)(1)(B) to cause the expenditures to be capital in nature.

Although we reject these specific arguments, we hold that the expenditures at issue are not deductible under section 162(a). We base our holding upon our judgment that petitioner's directors determined that it would be in petitioner's long-term interest to shift ownership of the corporate stock to Unilever. The expenditures in issue were incurred incident to that shift in ownership and, accordingly, lead to a benefit "which could be expected to produce returns for many years in the future." *E.I. duPont de Nemours & Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970). An expenditure which results in such a benefit is capital in nature. *E.I. duPont de Nemours & Co. v. United States, supra* at 1059; *Falstaff Beer, Inc. v. Commissioner,* 322 F.2d 744, 745-746 (5th Cir. 1963), affg. 37 T.C. 451 (1961); *Clark Thread Co. v. Commissioner,* 100 F.2d 257, 258 (3d Cir. 1938), affg. 28 B.T.A. 1128 (1933); *McDonald v. Commissioner,* 139 F.2d 400, 401 (3d Cir. 1943), affd. 323 U.S. 57 (1944). The reason for the capitalization of such expenditures is "that the purpose for which the expenditure is made has to do with the corporation's operations and betterment, sometimes with a continuing capital asset, for the duration of its existence or for the indefinite future or for a time somewhat longer than the current taxable year, in contrast to being devoted to the income production or other needs of the more immediate present." *General Bancshares Corp. v. Commissioner, supra* at 715. "While the period of the benefits may not be controlling in all cases, it nonetheless remains a prominent, if not predominate, characteristic of a capital item." *Central Texas Savings & Loan Association v. United States,* 731 F.2d 1181, 1183 (5th Cir. 1984). Expenditures may be capital in nature even if they do not result in the acquisition or increase of a corporate asset. *General Bancshares v. Commissioner, supra* at 716. If no capital asset is acquired, it does not follow that an expenditure is deductible. *Baltimore & Ohio Railroad Co. v. Commissioner,* 29 B.T.A. 368, 372-373 (1933), affd. 78 F.2d 460 (4th Cir. 1935); *Holeproof Hosiery Co. v. Commissioner,* 11 B.T.A. 547, 556 (1928).

Our judgment that petitioner's directors determined that it would be in petitioner's long-term interest to shift ownership of the corporate stock to Unilever is based upon several factors. First, "when a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interest of the corporation and its shareholders." *Unocal Corp. v. Mesa Petroleum Corp.,* 493 A.2d 946, 954 (Del. 1985). Because petitioner's directors approved the takeover, they must have determined that it was in the best interest of petitioner and its shareholders. Second, petitioner's 1978 annual report said that petitioner would benefit from the availability of the Unilever Group's enormous resources, and Morgan Stanley said that petitioner's affiliation with Unilever would create the opportunity for "synergy." There is no evidence of an immediate benefit from the affiliation, but we believe that this is immaterial. The lack of benefits in the short term does not imply their absence in the long term, especially given the time it takes to plan and implement significant changes in a corporation's operations. Besides, expenditures "made with the contemplation that they will result in the creation of a capital asset cannot be deducted as ordinary and necessary business expenses even though that expectation is subsequently frustrated or defeated * * *." *Union Mut. Life Ins. Co. v. United States,* 570 F.2d 382, 392 (1st Cir. 1978), *cert. denied* 439 U.S. 821 (1978); *Radio Station WBIR, Inc. v. Commissioner,* 31 T.C. 803, 813-814 (1959). Third, the very availability of the resources of Unilever was an immediate, as well as a long-term, benefit because it broadened petitioner's opportunities.

Petitioner argues for several reasons, however, that the expenditures in issue are deductible. First, it cites *Commissioner v. Lincoln Savings and Loan Association, supra* at 354, where it was said that "the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year. What is important and controlling, we feel, is that the * * * payment serves to create or enhance for [the taxpayer] what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature * * *." Petitioner accordingly argues that its expenditures are deductible because the expenditures did not create or enhance a separate and distinct additional asset. In *Lincoln Savings,* however, the Court did not address the deductibility of expenditures which do not create or enhance a separate and distinct asset. Thus, *Lincoln Savings* does not support petitioner's argument.

Petitioner next refers to several Court of Appeals cases that have cited *Lincoln Savings: Iowa-Des Moines Nat. Bank v. Commissioner,* 592 F.2d 433 (8th Cir. 1979), affg. 68 T.C. 872 (1977); *NCNB Corp. v. United States,* 684 F.2d 285 (4th Cir. 1982); *Colorado Springs National Bank v. United States,* 505 F.2d 1185 (10th Cir. 1974); and *Briarcliff Candy Corp. v. Commissioner,* 475 F.2d 775 (2d Cir. 1973). *Iowa-Des Moines Nat. Bank* merely cites *Lincoln Savings* for the proposition that a benefit with a future aspect is not controlling. The remaining cases each dealt with the narrow factual situation where a firm increased its business by, respectively, expanding a branch banking system, participating in a credit card system, and soliciting agents for the sale of candies. The court in each case held that the expenditures were ordinary and necessary expenses of doing daily business rather than capital expenditures. Each case depended on its facts, and we do not find them controlling here.

Petitioner also refers to several cases in which the "dominant aspect" of a transaction determined the deductibility of expenditures incurred incident to the transaction. These cases involved transactions with some of the characteristics of a partial liquidation and some of the characteristics of a reorganization, merger, or recapitalization. In the cases in which the partial liquidation was the "dominant aspect" of the transaction, the expenditures were held to be deductible current expenses. *Gravois Planing Mill Co. v. Commissioner,* 299 F.2d 199, 209 (8th Cir. 1962), revg. a Memorandum Opinion of this Court; *United States v. General Bancshares Corp.,* 388 F.2d 184 (8th Cir. 1968); *United States v. Transamerica Corp.,* 392 F.2d 522 (9th Cir. 1968); and *El Paso Co. v. United States,* 694 F.2d 703 (Fed. Cir. 1982). In the cases in which the reorganization, merger, or recapitalization was the "dominant aspect," the expenditures were capital expenditures. *Mills Estate Inc. v. Commissioner,* 206 F.2d 244 (2d Cir. 1953), revg. in part on other grounds 17 T.C. 910 (1951). In one case, this Court determined that the dominant aspect was a partial liquidation and, thus, the expenditure was a deductible current expense, but the Court of Appeals held that the dominant aspect was a reorganization and, thus, the expenditure was a capital expenditure. *Bilar Tool & Die Co. v. Commissioner,* 62 T.C. 213 (1974), revd. on factual grounds 530 F.2d 708 (6th Cir. 1976).

Petitioner argues that the dominant aspect of its expenditures was the fiduciary duty its directors owed to its shareholders and, accordingly, that its expenditures are deductible because they were incurred incident to that fiduciary duty. The dominant aspect of the transaction was not the fiduciary duty. Instead, the dominant aspect was the transfer of petitioner's stock for the benefit of petitioner and its shareholders. We would let the tail wag the dog if we were to view the stock transfer as the incidental aspect and the fiduciary duty that arose from the stock transfer as the dominant aspect.

We conclude that the expenditures in issue were related more to petitioner's permanent betterment, and hence capital in nature, than to the carrying on of daily business and production of income. Thus they were not ordinary and necessary within the meaning of section 162(a) and, accordingly, they are not deductible. We need not reach respondent's alternative argument that petitioner's expenditures were constructive distributions to its shareholders.

Decision will be entered for the respondent.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 89-1923

NATIONAL STARCH AND CHEMICAL CORPORATION,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

Argued March 16, 1990

Decided November 13, 1990

As Amended November 28, 1990

Before: SLOVITER, BECKER, and STAPLETON,
Circuit Judges

OPINION OF THE COURT

SLOVITER, Circuit Judge.

This is an appeal by National Starch and Chemical Corporation (National Starch) from a decision of the Tax Court affirming the disallowance by the Internal Revenue Service (IRS) of the investment banking fee, legal fees and related expenses incurred by National Starch's Board of Directors in deciding whether to acquiesce in a takeover by Unilever United States, Inc.

National Starch contends that these were ordinary and necessary business expenses deductible under section 162(a) of the Internal Revenue Code. The Tax Court agreed with the Commissioner of Internal Revenue that all of the fees were nondeductible capital expenditures. This appeal presents, as far as we can tell, an issue of first impression.

I. *Facts and Procedural History*

The facts are largely undisputed and are in the record as a result of a stipulation between the parties.

In 1977, Unilever approached National Starch, one of Unilever's suppliers, to gauge its interest in being the target of a friendly takeover. All of the stock of Unilever United States, Inc. is owned by Unilever N.V. (jointly referred to as Unilever), a publicly held Netherlands Corporation.[1] Unilever was interested in increasing its United States revenues relative to its overall revenues.

Unilever expressed its interest in National Starch to, *inter alia,* Frank Greenwall, a member of National Starch's Board of Directors, who along with his wife was the largest stockholder, holding approximately 14 ½ percent of the stock. The Greenwalls decided to sell their shares to Unilever if the transaction could be arranged to be tax-free to them so that they could defer capital gains for estate planning purposes. Unilever, which was interested only in a friendly takeover,

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[1] Unilever United States, Inc. is a holding company whose principal subsidiaries in 1977 were Lever Brothers Co. and Thomas J. Lipton, Inc., both of which manufacture and sell primarily foods and detergents.

would proceed only if the Greenwalls were willing to sell their shares.

To satisfy the Greenwalls, the merger was arranged as a "reverse subsidiary cash merger" under which Unilever created a subsidiary, National Starch and Chemical Holding (Holding),[2] which offered to either purchase the shares of National Starch's shareholders with money contributed by Unilever or exchange them for preferred stock of Holding. Subsequently, this arrangement received the desired ruling from the Internal Revenue Service that shareholders who exchanged National Starch stock for Holding stock could do so without adverse tax consequences.

When the plan was presented to National Starch's Board of Directors for consideration, the corporation's legal counsel advised the directors that they had a duty to ensure that the transaction "would be fair to the shareholders and that that would involve valuations of the company." App. at 91. Counsel suggested "as a practical matter that it would be extremely useful for the board to have a firm of outside independent investment bankers . . . to assist in the valuations of the company to ensure fairness of any transaction," *id.*, and that it was also wise from a legal standpoint in carrying out the Board's fiduciary duties. App. at 92. When it appeared likely that a favorable ruling would be forthcoming from the IRS, National Starch

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[2] Holding then created a subsidiary, NSC Merger (Merger), which was immediately merged into National Starch. The government concedes that this merger was "an incidental aspect of the transaction that should be disregarded." Brief for Appellee at 18 n.7.

asserting that it had overpaid its 1978 taxes in the amount of $706,079 because it had not deducted, and was entitled to deduct, ancillary expenses which included its attorneys' fees, costs associated with the proxies, and the SEC fees which it incurred with respect to the merger plan.[3] The Tax Court upheld the disallowance by the IRS. 93 T.C. 67 (1989).

The Tax Court rejected the IRS' contention that the expenditures were nondeductible because they were incurred incident to a recapitalization, merger, or reorganization, concluding essentially that the form and structure of the transaction was selected primarily for administrative convenience. On the other hand, the Tax Court concluded that these were nondeductible capital expenditures because National Starch's directors determined that it would be in National Starch's "long-term interest to shift ownership of the corporate stock to Unilever" and "[t]he expenditures in issue were incurred incident to that shift in ownership. . . ." *Id.* at 75. Accordingly, it believed those expenditures "lead to a benefit 'which could be expected to produce returns for many years in the future.'" *Id.* (quoting *E. I. du Pont de Nemours and Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970)). Such a benefit is "capital in nature" because its purpose has to do with the corporation's betterment for the indefinite future. *Id.* The court noted that National Starch's 1978 annual report stated that it would benefit from the availability of Unilever's enormous resources, and that Morgan Stanley's report stated that National Starch's affiliation with Unilever would create the opportunity for synergy. *Id.* at 76.

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[3] A refund in excess of $257,444 is barred by the statute of limitations.

The Tax Court rejected National Starch's argument that the Supreme Court's decision in *Commissioner v. Lincoln Savings & Loan Ass'n,* 403 U.S. 345, 91 S.Ct. 1893, 29 L.Ed.2d 519 (1971), created a new test to determine deductibility under section 162(a) that looks to whether a separate and distinct additional asset is created, rather than the length of the period of the benefits. 93 T.C. at 77. It also rejected National Starch's contention that the dominant aspect of the transaction was the fiduciary duty the Board of Directors owed to the shareholders and not the transfer of the stock, finding instead that "the dominant aspect was the transfer of petitioner's stock for the benefit of [National Starch] and its shareholders." *Id.* at 78.

National Starch has appealed from the Tax Court's decision. We have jurisdiction pursuant to 26 U.S.C. § 7482. Our review of the Tax Court's construction of the Code is plenary; we review its factual findings and inferences for clear error. *Pleasant Summit Land Corp. v. Commissioner,* 863 F.2d 263, 268 (3d Cir. 1988).

II. *Ordinary and Necessary Business Expenses*

A. *Effect of Lincoln Savings*

The issue before us is whether National Starch's expenditures for investment banking and legal fees can be deducted under section 162(a) of the Internal Revenue Code as ordinary and necessary business expenses or whether they must be capitalized under section 263. Section 162 provides: "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." 26 U.S.C. § 162(a) (1988). This provision must be interpreted in tandem with section 263, which prohibits deductions for "[a]ny amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." 26 U.S.C. § 263(a)(1) (1988).

The Supreme Court has enumerated five separate requirements for deductibility under section 162(a). The item must (1) be paid or incurred during the taxable year (2) for carrying on any trade or business, and (3) be an expense (4) that is "necessary" and (5) "ordinary." *Commissioner v. Lincoln Savings & Loan Ass'n,* 403 U.S. at 352, 91 S.Ct. at 1898. Only the "ordinary expense" requirement is in dispute here. The Court has stated, in somewhat circular fashion, that the principal function of the term "ordinary" is to distinguish between expenses currently deductible and capital expenditures which, if deductible at all, must be amortized over the useful life of the asset. *See Commissioner v. Tellier,* 383 U.S. 687, 689-90, 86 S.Ct. 1118, 1119-20, 16 L.Ed. 2d 185 (1966).

Tax deductions are a matter of legislative grace. *See Interstate Transit Lines v. Commissioner,* 319 U.S. 590, 593, 63 S.Ct. 1279, 1281, 87 L.Ed. 1607 (1943). Thus, the burden is on the taxpayer to show that the expenses are deductible. *See E. I. du Pont de Nemours and Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970).

Before 1971, this court held that when an expenditure resulted in a benefit to the taxpayer "which could be expected to produce returns for many years in the future," the expenditure was deemed capital and therefore nondeductible. *Id.* at 1059 (legal expense in devising plan to satisfy antitrust decree which involved restructuring of the enterprise not deductible);

see also McDonald v. Commissioner, 139 F.2d 400, 401 (3d Cir. 1943) (campaign expenses not deductible as ordinary expenses because benefit sought to be derived putatively spread over ten-year term), *aff'd,* 323 U.S. 57, 65 S.Ct. 96, 89 L.Ed. 68 (1944).

National Starch argues that the legal standard employed by the Tax Court in this case, which looked to the presence of a future benefit to determine that the expenditures were ordinary and necessary business expenses, was specifically rejected by the Supreme Court in *Commissioner v. Lincoln Savings & Loan Ass'n.* It argues that *Lincoln Savings* established a new and exclusive test for distinguishing between deductible expenses and nondeductible capital expenditures under which expenses are not to be capitalized unless they result in the creation or enhancement of a separate and distinct asset.

The issue before the Supreme Court in *Lincoln Savings* was whether an additional premium required by federal statute to be paid by a savings and loan association to the Federal Savings and Loan Insurance Corporation (FSLIC) was deductible as an ordinary and necessary business expense under section 162(a). The Court accepted the distinction made by the IRS between premiums paid by Lincoln for the FSLIC's Primary Reserve, the general reserve for the expenses and insurance losses in which the insured institutions had no property interest, and its Secondary Reserve, on which those institutions were credited a return and in which they owned a pro rata share to be refunded upon termination of their insured status. Premiums paid for the Primary Reserve were deductible as ordinary and necessary expenses, but the Court held that payments to the Secondary Reserve were nondeductible capital expenditures. The Court stated:

> [w]hat is important and controlling . . . is that the . . . payment serves to create or enhance for Lincoln what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature and not an expense, let alone an ordinary expense, deductible under § 162(a) in the absence of other factors not established here.

403 U.S. at 354, 91 S.Ct. at 1899.

In the course of determining that the expenses were capital, the Court stated that "the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year." *Id.* National Starch relies on this language to support its argument that expenditures which do not create or enhance a separate and distinct asset are to be treated as deductible ordinary expenditures.

We do not read *Lincoln Savings* as broadly as does National Starch. The language upon which National Starch relies does not create a new bright-line test. Although the opinion clearly holds that a payment that creates or enhances a separate asset is capital in nature, *see id.*, it does not necessarily follow that if no asset is created the expenditure is not capital in nature. The government aptly describes this argument as concluding that "because something made out of glass is fragile, all things fragile must be made out of glass." Brief for Appellee at 28 n. 13.

There is nothing in the *Lincoln Savings* opinion that announces a new test for the lower courts to apply or suggests that the Court intended to create a new standard applicable irrespective of the factual context. Although it is clear that the Court viewed the creation or enhancement of a separate and distinct asset as "important and controlling" in requiring the expense to be capitalized, the absence of such an asset is not addressed in the opinion. Further, although an incidental future benefit would plainly not be controlling, the Court does not suggest that the presence of a significant future benefit is not a legitimate factor to consider in determining deductibility.

If National Starch's interpretation were correct, the Court would have implicitly overruled without discussion its earlier precedent in which it held that expenses should be capitalized even though no separate asset was created or enhanced. *See, e.g., Deputy v. du Pont,* 308 U.S. 488, 60 S.Ct. 363, 84 L.Ed. 416 (1940) (holding nondeductible carrying charges on short sales of stock to corporation's executives made by shareholder to assist the corporation in preserving his investment). In fact, in *Lincoln Savings*, 403 U.S. at 353, 91 S.Ct. at 1898, the Court cited with approval *Welch v. Helvering*, 290 U.S. 111, 54 S.Ct. 8, 78 L.Ed. 212 (1933), a case holding that payments by a former officer of the corporation's discharged debts to strengthen his own credit and professional standing were capital outlays, even though there was no separate and distinct asset involved. Thus, the *Lincoln Savings* opinion itself undermines National Starch's interpretation.

Finally, in cases decided after *Lincoln Savings,* the Court has used tests other than the separate and distinct asset test to determine whether expenditures should be capitalized. For example, in *United States v. Mississippi Chemical Co.*, 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed. 2d 217 (1972), decided the year after *Lincoln Savings,* the Court held that expenses associated with the acquisition of stock of the Bank of Cooperatives established by the Farm Credit Act of 1933 should be capitalized without making reference to any so-called *Lincoln Savings* test. Had it viewed *Lincoln Savings* as representing a radical shift and a new bright-line test for capitalization, it is unlikely that it would have ignored such a test the following year. Instead, the Court cited the *Lincoln Savings* precedent as support for its conclusion that "[s]ince the security is of value in more than one taxable year, it is a capital asset . . . and its cost is nondeductible." *Id.* 405 U.S. at 310, 92 S.Ct. at 915.

National Starch contends that every Court of Appeals that has faced this issue in the last eighteen years has held that where the expenses did not create or enhance a separate and distinct asset, the expenses were allowed as deductible under Section 162(a). Some Courts of Appeals have indeed construed *Lincoln Savings* to have created a new standard such as that proffered by National Starch. *See, e.g., Briarcliff Candy Corp. v. Commissioner,* 475 F.2d 775, 782 (2d Cir. 1973) (*Lincoln Savings* "brought about a radical shift in emphasis" and directs the inquiry to whether the expenditures created or enhanced what was essentially a separate and distinct asset); *see also NCNB Corp. v. United States,* 684 F.2d 285 (4th Cir. 1982) (en banc) (where expenditures of bank and its parent for metro studies, feasibility studies, and application to the Comptroller of the Currency do not create or enhance separate and identifiable assets but instead are used by parent to continually evaluate its market position, expenditures are ordinary and necessary.).

Of course, the determination whether an expenditure is ordinary or capital is fact-specific. 6 Mertens, Law of Federal Income Taxation § 25.27 (1988). Analytically inapposite are those cases which, while reading *Lincoln Savings* differently than we do, found that there was in fact a separate asset which required the capitalization of expenditures. *See, e.g., Central Texas Savings & Loan Ass'n v. United States,* 731 F.2d 1181 (5th Cir. 1984). Moreover, the cases cited by National Starch that involved the treatment of start-up costs for expansion projects of banks, *see, e.g., Colorado Springs Nat'l Bank v. United States,* 505 F.2d 1185 (10th Cir. 1974) (initial costs for computers, credit checks, and promotional activities in connection with participation in credit card system), are distinguishable. Banks, the *NCNB* court noted, are "unique" because a substantial portion of their assets must be readily available as cash to meet depositors' claims, and their books must accurately reflect their liquidity position. 684 F.2d at 293. Therefore, it found that the requirement by the Comptroller of the Currency that national banks treat such start-up costs as current expenses was presumptively controlling, but noted that the conservative accounting policy applicable to banks differed from that applicable to certain other federally regulated industries. *Id.* at 292.

Furthermore, at least three circuits continue to look to whether an ensuing benefit was created to determine whether the expense was ordinary and necessary. *See Central Texas Savings,* 731 F.2d 1181

(5th Cir. 1984); *Iowa-Des Moines Nat'l Bank v. Commissioner,* 592 F.2d 433 (8th Cir. 1979); *Colorado Springs Nat'l Bank,* 505 F.2d 1185 (10th Cir. 1974).

In any event, our reading of the Supreme Court cases leads us to conclude that no one factor alone can control this complex decision. *See Colorado Springs Nat'l Bank,* 505 F.2d at 1192 ("[w]e find no statutory, regulatory, or decisional test which is dispositive. The issue [of the treatment of the challenged items] must be determined on the facts presented in the novel situation before us."). As Justice Cardozo noted in his oft-quoted statement about the ordinary and necessary determination:

> [h]ere . . . the decisive distinctions are those of degree and not kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.

Welch, 290 U.S. at 114-15, 54 S.Ct. at 9, quoted in *Lincoln Savings,* 403 U.S. at 353, 91 S.Ct. at 1898.

We conclude that although the presence of a separate and distinct asset is sufficient to treat an expenditure creating or enhancing that asset as capital, the lack of such an asset alone does not necessarily mean that an expenditure is ordinary and necessary under section 162(a). We turn, therefore, to consider the appropriate treatment of National Starch's payments, a particularly difficult inquiry here because the expenditures at issue resulted in neither a tangible asset nor a readily identifiable intangible asset. *See Ellis Banking Corp. v. Commissioner,* 688 F.2d 1376, 1379 n.7 (11th Cir. 1982), *cert. denied,* 463 U.S. 1207, 103 S.Ct. 3537, 77 L.Ed. 2d 1388 (1983).

B. *Treatment of National Starch's Expenses*

Notwithstanding National Starch's protestations to the contrary, the common characteristic of expenses that have been found to be capital, in fact the *sine qua non* of capitalization, is the presence of a not insignificant future benefit that is more than merely incidental. The Court of Appeals' decision reversed in *Lincoln Savings* had failed to recognize that such a benefit always ensues when the expenses are used to create or enhance a capital asset. However, even post-*Lincoln Savings* cases acknowledge that the period of the benefit produced by the expenditure "remains a prominent, if not predominate, characteristic of a capital item." *Central Texas Savings,* 731 F.2d at 1183. As stated in *Ellis Banking,* "[t]he courts have uniformly interpreted [section 263] as denying a deduction for the cost of any long-lived asset." 688 F.2d at 1379 n.5. Moreover, as we previously noted, the Supreme Court itself considered the length of time a security would be of value to the taxpayer in concluding that its acquisition costs were not deductible. *Mississippi Chemical,* 405 U.S. at 310, 92 S.Ct. at 915.

In this case, the Tax Court held that the expenditures were not deductible in light of its determination that National Starch's directors concluded that it would be in the corporation's "long-term interest to shift ownership of the corporate stock to Unilever." 93 T.C. at 75. The Tax Court found that the transaction provided at least two inherently permanent benefits to National Starch: (1) the availability of Unilever's enormous resources, and (2) the opportunity for synergy created by Unilever's affiliation with National Starch. *Id.* at 76. These are factual findings of the Tax Court which we may not overturn unless clearly erroneous. *See Pleasant Summit Land Corp.*, 863 F.2d at 268.

In its discussion of the long-term benefits to National Starch as a result of the affiliation with Unilever, the Tax Court stated that "the very availability of the resources of Unilever was an immediate, as well as a long-term, benefit because it broadened [National Starch's] opportunities." 93 T.C. at 76-77. There is ample support in the record for this finding. National Starch had assets in 1976, the year before Unilever's approach, which were in excess of $241 million, App. at 373, and its operating income was $48 million. App. at 372. Unilever was gargantuan in comparison. It had combined assets in 1976 worth close to five and a half billion dollars, App. at 667, and its operating profit was in excess of one billion dollars. App. at 665

National Starch recognized that Unilever's sheer wealth provided it with a significant benefit. National Starch's 1978 Annual Progress Report stated that, "We will benefit greatly from the availability of Unilever's enormous resources, especially in the area of basic technology." App. at 391. Although this was written after the takeover, there is no reason why it did not equally represent the view of the Board of Directors in agreeing to the takeover.

Of additional significance to the finding of long-term benefit was the Tax Court's subsidiary finding that even though there is no evidence of an immediate benefit from the affiliation, it created the opportunity for synergy. 93 T.C. at 76. National Starch primarily produces specialty starches, adhesives and related chemical products sold to a large number of industrial users for use in manufacturing a wide variety of consumer products and product packaging. App. at 608-14. Unilever describes itself as "one of the dozen largest businesses in the world by turnover — and the largest in consumer goods." App. at 415. The larger part of Unilever is in branded and packaged consumer goods: mainly foods, detergents, and toilet preparations. Significantly, Unilever listed other "important" activities as including chemicals, paper, plastics and packaging. *Id.*

It was undisputed that prior to the affiliation National Starch sold its products to Unilever and has continued to do so thereafter. App. at 142. National Starch emphasizes that there has been no material increase in the volume of such sales, but the Tax Court noted that "[t]he lack of benefits in the short term does not imply their absence in the long term, especially given the time it takes to plan and implement significant changes in a corporation's operations." 93 T.C. at 76.

Although Ned Bandler, Unilever's senior vice-president, testified there was no synergy "in the classic sense," App. at 70, this self-interested testimony may be discounted because it was in his company's interest to minimize the tax liabilities of National Starch. *See Riley v. General Mills, Inc.*, 346 F.2d 68, 72 (3d Cir. 1965). Moreover, Bandler admitted in the very same sentence that National Starch "was not a business that was alien to Unilever's activities." App. at 70.

Finally, as emphasized by the Tax Court, Morgan Stanley reported that the National Starch "[m]anagement also feels that some synergy may exist with the

Unilever organization given a) the nature of the Unilever chemical, paper, plastics and packaging operations . . . and b) the strong consumer products orientation of Unilever United States, Inc." App. at 624-25. National Starch's managers reported this view to Morgan Stanley before the tax consequence of the transaction was at issue. There is thus adequate evidence to support the Tax Court's findings that both Unilever's enormous resources and the possibility of synergy arising from the transaction served the long-term betterment of National Starch, and they are not clearly erroneous.

As an additional reason for nondeductibility, the Commissioner proposes that we adopt the rule that "[*a*]*ny* transaction in which a corporate taxpayer is transformed from a publicly-held corporation to a one-shareholder corporation involves an effective change in the taxpayer's corporate structure that will benefit future operations," and therefore expenses incurred with respect to such an ownership shift are capital expenditures. Appellee's Brief at 21-22 (emphasis in original). The Tax Court did not reach this issue. There is some plausibility in the Commissioner's argument that the elimination of the risk of proxy fights and shareholders' derivative suits, as well as of the costs of annual filings with the SEC and the solicitation of proxies, are long-term benefits arising from the radical change in the corporate enterprise which will last for the indefinite future. However, we need not decide whether to accept the absolute rule sought by the Commissioner. In this case, more than a mere change in corporate ownership was effected. Because the transaction entailed the affiliation of National Starch with Unilever which, as we have held above, sufficed to create the requisite long-term benefit, we will leave for another case consideration whether the benefits of restructuring ownership alone would be sufficient to require capitalization of the fees pertinent thereto.

On the other hand, it is important to note that the Board of Directors was motivated, at least in part, by concern for the future development of National Starch in the event of the death of the Greenwalls, the company's largest stockholders, who were ages 79 and 81 at that time. Oscar M. Reubhausen, Chairman of the Board of National Starch at the time of this litigation, testified that he told Morgan Stanley that the "estates problems" concerning the Greenwalls were "overhanging the market" and represented a "question mark — 'for National Starch Corporation for the future.'" App. at 203. He thus viewed the Unilever offer as a "particular opportunity put before National Starch." App. at 203-04.

Indeed, Morgan Stanley referred to that very concern in a letter to the Board summarizing its assignment. It stated that, "We understand that National Starch is interested in having Morgan Stanley review its strategic alternatives within the context both of the longer term situation of a 15% equity ownership in National Starch which at some point will be transferred from its present individual 'founding' owners and of an evaluation of an immediate proposed business combination involving Unilever." App. at 597. It is thus evident from the record that the National Starch directors viewed the Unilever offer as a transaction that would promote the long-term betterment of the corporation.

In addition, the fact that the Tax Court rejected the Commissioner's argument that the transaction was essentially a reorganization under section 368(a)(1)(F), for which expenditures must be capitalized, does not preclude consideration of the general rationale behind requiring capitalization of expenses for restructuring. As explained by Justice Blackmun, writing as a circuit judge (who, coincidentally, also authored *Lincoln Savings*), reorganization expenses are treated as capital because they relate to the corporation's operations and betterment into the indefinite future, as distinguished from income production or other current needs. *See General Bancshares Corp. v. Commissioner,* 326 F.2d 712, 715 (8th Cir. 1964); *see also El Paso Co. v. United States,* 694 F.2d 703, 709 (Fed. Cir. 1982) (expenses of "conception and implementation" involved in "a statutory reorganization . . . are generally to be capitalized on the theory that the altered capital structure will provide a future business benefit of intermediate duration"); *McCrory Corp. v. United States,* 651 F.2d 828, 832 (2d Cir. 1981) (reorganization expenditures, like organization expenditures, contribute to the creation of an intangible long-term asset — a change in the corporate structure for the benefit of future operations).

If capital expenditures were immediately deductible, the taxpayer's income would be distorted both in the current year and in later years when the benefits are in fact received. This policy is reflected in section 263 which expressly precludes deductions for permanent "betterments" made to increase the value of any property. In line with this analysis, the court in *Ellis Banking* held that expenses made in connection with the decision to acquire stock of another corporation were not immediately deductible because to do so would understate current net income. 688 F.2d at

1379 (function of capitalization rules is to achieve accurate measure of net income by avoiding the understatement of current income associated with immediate deductibility); *see also States Steamship Co. v. Internal Revenue Serv.*, 683 F.2d 1282, 1284 (9th Cir. 1982) (disallowing "substantial tax windfall" taxpayer sought "by bunching all the excess depreciation of three years into one year").

Although National Starch notes correctly that the fees and expenses at issue are not susceptible to depreciation or amortization because the benefit to the company has no ascertainable useful life, other courts have also concluded that section 263 requires denial of immediate deductibility in comparable situations. *See, e.g., Mills Estate v. Commissioner,* 206 F.2d 244, 246 (2d Cir. 1953) (costs of corporate reorganization not deductible even though intangible asset of "altered corporate structure" was not depreciable). In this respect, the expenses are analogous to the treatment of goodwill which is neither deductible nor depreciable until the business is sold, even though the benefits (increased profits) are obtained throughout the life of the business. *See* 5 Mertens, Law of Federal Income Taxation § 23A.141 (1985); *see also Thrifticheck Services Corp. v. Commissioner,* 287 F.2d 1 (2d Cir. 1961).

Finally, we consider whether the expenditures are deductible merely because they may have been necessary under Delaware law for the Board members to satisfy their fiduciary obligation to the shareholders. Precedent suggests otherwise. The Court in *Lincoln Savings* held that additional premium payments must be capitalized even though the governing statute required their payment by the taxpayer. 403 U.S. at 359, 91 S.Ct. at 1901. Similarly, in *du Pont,* 432 F.2d at 1059, we stated that "[t]he fact that the expenditures were involuntary . . . does not negative a requirement that they be capitalized, if they were in fact capital expenditures." *See also Woolrich Woolen Mills v. United States,* 289 F.2d 444, 448 (3d Cir. 1961) ("The involuntary nature of the expenditure . . . does not render deductible as expense an item which would otherwise be non-deductible as capital.").

In sum, we conclude that the Tax Court's finding that the opportunities that arose from the friendly takeover by Unilever created a long-term benefit to National Starch was not clearly erroneous. Its conclusion that the Morgan Stanley consulting fee, legal fees, and other related expenses incurred by National Starch are not deductible under section 162(a) of the Code is consistent with the general principles usually applied by courts in analyzing the deductibility or capitalization of corporate expenses.

III. *Conclusion*

For the reasons set forth above, we will affirm the decision of the Tax Court.