



## Tax Reduction Letter

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### Revenue Ruling 73-580

Section 263. Capital Expenditures

July 1973

Capital expenditures; corporate salaries in connection with mergers and acquisitions. The portion of the compensation paid by a corporation to its employees attributable to services performed in connection with corporate mergers and acquisitions must be capitalized; however, such amounts paid with respect to abandoned plans for mergers or acquisitions are deductible as losses in the year of abandonment.

Advice has been requested whether, under the circumstances described below, the taxpayer must capitalize compensation paid to its employees for services performed with respect to corporate mergers and acquisitions.

The taxpayer, a domestic corporation engaged in manufacturing, diversified its operations in 1971 and added new lines of products through internal growth and by acquisitions of other entities. In that year, the taxpayer completed mergers and acquisitions in which it acquired the stock or assets of other corporations in exchange for its own stock. During the year, some of the taxpayer's employees, including employees of its legal department, accounting department, and internal audit staff, spent a substantial amount of their time on mergers and acquisitions.

Section 162 (a) of the Internal Revenue Code of 1954 provides that there 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, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 263 of the Code provides generally that no deduction shall be allowed for capital expenditures. Expenses incurred in completing mergers, recapitalizations, consolidations, and other reorganizations are capital expenditures and, as such, are not deductible as ordinary and necessary business expenses under section 162 of the Code. See *Skenandoa Rayon Corporation v. Commissioner*, 122 F.2d 268 (2d Cir. 1941), cert. denied, 314 U.S. 696 (1941).

Expenditures directly relating to a reorganization, when performed by other than a taxpayer's own employees, must be capitalized as part of the cost of the reorganization. Rev. Rul. 67-125, 1967-1 C.B. 31, holds that legal fees incurred by a corporation for advice on the tax consequences prior to the consummation of a merger with another corporation are expenditures that are capital in nature and are not deductible as ordinary and necessary business expenses.

Compensation paid for services performed by employees relating to the acquisition of other corporations is not distinguishable from fees paid for similar services performed by outsiders. Thus, in *Ernest DuPont*, 34 B.T.A. 1059 (1936), aff'd sub nom 96 F.2d 642 (9th Cir. 1938), the corporation's president received stock worth \$36,765 as a commission for consummating the

contract of a reorganization. The United States Board of Tax Appeals, citing *Odorono Co.*, 26 B.T.A. 1355 (1932), in which reorganization expenses were held to be capital expenditures, held that the fair market value of the stock could not be deducted as an ordinary and necessary business expense. Thus, capitalization of an expenditure is not prevented simply because the payment is made to an employee. See *General Spring Corporation*, 22 P-H Tax Ct. Mem. 770 (1953).

If the plan of reorganization is abandoned, the expenditures related to the proposed plan are deductible in the year it is abandoned. See *Sibley, Lindsay & Curr Co.*, 15 T.C. 106 (1950), acq., 1951-1 C.B. 3.

Accordingly, in the instant case, the taxpayer must capitalize that portion of the compensation paid to its employees during 1971 that is reasonably attributable to services performed in connection with corporate mergers and acquisitions. However, amounts paid to employees with respect to "abandoned" plans for mergers or acquisitions are deductible as losses under section 165 (a) of the Code in the year of the abandonment.