INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-113870-04, CC:ITA:3

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference:

LEGEND:

CP –
C –
D –
Target A –
Target B –
Subsidiary A –
Subsidiary B –
Acquisition Subsidiary A –
Acquisition Subsidiary B –
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
P =
Q =
Business X =
Y =
Z =
Group A =
Group B =

State X =
State Y =
V Years =
W Years =

ISSUE:

Are an acquired corporation's ("T") pre-acquisition transaction costs (investment banking, legal and accounting fees) that were previously capitalized under section 263 of the Internal Revenue Code by T deductible under section 165 as a result of T's subsequent state law dissolution where, just prior to such dissolution, T transfers all of its property to its parent corporation in a transaction to which sections 332 and 337 apply, and T's business and assets continue to be held and operated by the parent corporation?

CONCLUSION:

Pre-acquisition transaction costs (investment banking, legal and accounting fees) that were previously capitalized under section 263 by T do not become deductible under section 165 as a result of T's state law dissolution where just prior to such dissolution T transfers all of its property to its parent in a transaction to which sections 332 and 337 apply, and T's business and assets continue to be held and operated by its parent.

FACTS:

CP (Taxpayer) is a holding company and the common parent of a group of corporations filing a calendar year consolidated federal income tax return. CP is wholly-owned by C, and C is wholly-owned by D. D is engaged in Business X. D and its worldwide subsidiaries are leading providers of Y.

In the first transaction under consideration, from Date 1 to Date 2, Subsidiary A, a holding company and a wholly-owned Subsidiary of CP, formed Acquisition Subsidiary A, and acquired substantially all of the outstanding common stock of Target A, a State X corporation, in exchange for cash in a taxable transaction. In furtherance of this plan, on Date 3, Acquisition Subsidiary A merged with and into Target A. Target A was the surviving corporation in the merger, and the separate existence of Acquisition Subsidiary A ceased. As a result of the acquisition, Target A became a wholly-owned subsidiary of Subsidiary A. Subsidiary A is engaged in the business of providing Y. Target A is engaged in the business of providing Y to Group A. Prior to its acquisition by Subsidiary A, Target A was a publicly traded corporation. In connection with the acquisition, Target A incurred financial advisory and investment banking, legal and accounting fees for a total of P. These costs were capitalized under section 263 by Target A.

The financial services were for a valuation analysis, an analysis of the accounting treatment of the acquisition, and rendering a fairness opinion with respect to the

acquisition. The legal fees were for structuring the acquisition, and drafting acquisition documents. The accounting and other services generally included assistance with financial analysis and preparation of documents for Securities and Exchange Commission schedules. These capitalized costs were liabilities of Target A and were paid by Target A.

On or about Date 4, Target A transferred all of its assets and liabilities to Subsidiary A and was formally dissolved under State X law.[1] The period between the acquisition of Target A stock and the dissolution of Target A was approximately V Years. For federal income tax purposes, Taxpayer claims the transfer of property is a complete liquidation of Target A, qualifying under sections 332 and 337. After the liquidation of Target A, Subsidiary A adopted Target A's name (hereinafter "New Target A"). Subsequent to the distribution and state law dissolution of Target A, substantially all of its operations were conducted by New Target A. As a result of the state law dissolution of Target A, CP claimed P as a deduction under section 165 for the capitalized costs of Target A described above.

In the second transaction under consideration, on Date 5, Subsidiary B, a wholly-owned subsidiary of CP acquired all of the outstanding and issued stock of Target B in a taxable transaction. Target B is a State Y corporation. Prior to its acquisition by Subsidiary B, Target B was publicly traded. Subsidiary B formed a transitory corporation, Acquisition Subsidiary B. Acquisition Subsidiary B acquired the stock of Target B and, as part of the same transaction, Acquisition Subsidiary B merged with and into Target B. Target B was the surviving corporation in the merger, and the separate existence of Acquisition Subsidiary B ceased. As the result of the acquisition, Target B became a wholly-owned subsidiary of Subsidiary B. Subsidiary B is engaged in Business X. More particularly, it provides Z to Group B. Target B is also engaged in Business X, providing Z to Group B.

In connection with the acquisition, Target B incurred financial advisory and investment banking, legal and accounting fees for a total of Q. These costs were capitalized under section 263 by Target B.

The financial services were for a valuation analysis, an analysis of the accounting treatment of the acquisition, and rendering a fairness opinion with respect to the acquisition. The legal fees were for drafting acquisition documents. The accounting services included assistance with respect to actuarial services, services in connection with Target B's Board of Director meetings, information agent fees and preparation of documents to be filed with the Federal Trade Commission. These costs were liabilities of Target B and were paid by Target B.

[1] Target A's transfer of all of its assets to Subsidiary A did not qualify as a state law merger.

On Date 6, Target B transferred all of its assets and liabilities to Subsidiary B and was dissolved under State Y law[2]. The period between Subsidiary B's acquisition of all of Target B's stock and Target B's dissolution was approximately W Years. For federal income tax purposes, Taxpayer claims the transfer of property is a complete liquidation of Target B, qualifying under sections 332 and 337.

Subsequent to the state law dissolution of Target B, substantially all of the former operations of Target B were conducted by Subsidiary B. As a result of the state law dissolution of Target B, CP claimed Q as a deduction under section 165 for capitalized costs of Target B described above.

LAW AND ANALYSIS:

Section 165(a) states that "there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." Section 165(b) states that "for purposes of subsection (a), the basis for determining the amount of the deduction or any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property."

Section 1.165-1(b) states that "To be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and … actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss."

Similarly, section 1.165-1(d)(1) regarding the year of deduction states, "A loss shall be allowed as a deduction under section 165(a) only for the taxable year in which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year."

In Rev. Rul. 2004-58, 2004-24 I.R.B. 1043, the Service considered whether a taxpayer could deduct the cost of acquiring and developing creative property as a loss under section 165 under certain circumstances . The ruling recognized that the taxpayer may claim a deduction under section 165(a) either for abandonment or worthlessness of the property. However, in either case, the requirements of section 1.165(b) and (d)(1) must be satisfied. The ruling states, section 165(a) losses "have been referred to as abandonment losses to reflect that some act is required which evidences an intent to discard or discontinue use permanently." Rev. Rul. 2004-58, citing Gulf Oil Corp. v. Commissioner., 914 F.2d 396, 402 (3d Cir. 1990). The ruling notes that a deduction is not allowable if a taxpayer intends to hold and preserve property for possible future use or to realize potential future value from the property. Rev. Rul. 2004-58, citing AJ Indus. Inc. v. United States, 503 F.2d 660, 670 (9th Cir. 1974). The identifiable event required by section 1.165-1(b) and (d)(1) "must be

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[2] Target B's transfer of all of its assets to Subsidiary B did not qualify as a state law merger.

observable to outsiders and constitute 'some step which irrevocably cuts ties to the asset'," Rev. Rul. 2004-58. Courts have permitted a deduction under section 165(a) on the grounds of worthlessness. Echols v. Commissioner, 935 F.2d 703, reh'g denied, 950 F.2d 209 (5th Cir. 1991), Proesel v. Commissioner, 77 T.C. 992 (1981). Rev. Rul. 2004-58 confirms that a deduction for worthlessness under section 165 is allowable only if there is a closed and completed transaction fixed by identifiable events establishing that the property is worthless in the taxable year the deduction is claimed, citing section 1.165-1(b) and (d)(1).

Taxpayer argues that the previously capitalized expenditures are deductible as a loss under section 165(a) upon dissolution of the state law legal entity. The examining agent disallowed the deduction on the grounds that the dissolution of the state law legal entity does not represent an identifiable event establishing a loss under section 165(a) because the expenditures continue to provide a benefit to Taxpayer. For the reasons set forth below, we conclude that a loss under section 165(a) for the previously capitalized expenditures is not permitted in this instance on dissolution of the state law legal entity.

No case directly addresses whether a state law dissolution of the corporate entity permits a section 165(a) deduction of previously capitalized investment banking, legal, accounting and other expenditures incurred by a target corporation in order to facilitate the acquisition of its stock. However, both Taxpayer and the examining agent rely upon inferences drawn from Indopco v. United States, 503 U.S. 79 (1992), to support their positions.

In Indopco, the Supreme Court determined that investment banking, legal, and other expenses incurred in a partially taxable transaction by the acquired corporation were required to be capitalized. The expenses at issue in Indopco are similar to the expenses at issue in this case. Factual similarities include that the target corporations in both Indopco and this case were publicly held corporations, the acquiring corporations operated in similar industries to the acquired corporation, and the acquiring corporations were part of a large multi-national group. Taxpayer and the examining agent agree that the previously capitalized expenditures in this case were properly capitalized by each of the target corporations up to the time of the dissolution of each of the target corporations. In each case, the target corporation's pre-acquisition expenditures were essentially identical to the expenditures required to be capitalized in Indopco.

In Indopco, a target corporation, National Starch, incurred investment banking and legal fees to facilitate the acquisition of its stock. The Tax Court and the Third Circuit determined that such expenses must be capitalized because long-term benefits accrued to the acquired corporation from the acquisition ("both Unilever's enormous resources and the possibility of synergy arising from the transaction served the long-term betterment of National Starch.") National Starch & Chemical Corp. v. Commissioner, 918 F.2d 426, 432-433 (3rd Cir. 1990). National Starch argued that the

expenses were deductible because they did not create a separate and distinct asset, citing Lincoln Savings v. Commissioner , 403 U.S. 345 (1971). The Court rejected the argument that Lincoln Savings created an exclusive test for identifying a capital expenditure, requiring creation or enhancement of an asset. The Court determined that National Starch had failed to demonstrate that the expenditures incurred were deductible as ordinary and necessary business expenses. Indopco at 88. It also found that "the [lower courts'] findings that the transaction produced significant benefits to National Starch that extended beyond the tax year in question are amply supported by the record." Indopco at 88.

The Court first discussed what it termed "resource related benefits." It noted that National Starch, as the acquired corporation, would benefit from the availability of the acquirer's resources, and from synergy that may exist with the acquiring corporation. The Court then discussed the benefits obtained by the acquired corporation "through its transformation from a publicly held, freestanding corporation into a wholly owned subsidiary," for example, by reducing its number of shareholders, shareholder-relations expenses and the total number of preferred and common shares. Indopco at 88-89. Finally, the Court notes that the rationale behind cases that require capitalization of professional expenditures involved in changing corporate structure "applies equally to the professional charges at issue in this case." Indopco at 90, citing a number of those cases.

Taxpayer here argues that the Indopco opinion controls the tax treatment of the costs at issue. Taxpayer first argues that Indopco supports the idea that the costs are required to be capitalized because they effect a change in the corporate entity, similar to organization and reorganization expenses. Therefore, Taxpayer argues that the costs should be viewed as solely allocable to the corporate charter, or the state law legal entity. Taxpayer claims that the issue in Indopco was how to account for costs that were not associated with any particular asset, and Taxpayer therefore asserts the costs must instead be associated with the corporate charter. The taxpayer argues that the costs should not be associated with the corporation's operations or business assets. In addition, Taxpayer, referencing the paragraph of Indopco that discusses corporate restructuring expenses, argues that Indopco supports allocation of the expenditures to the corporate charter because the Court "treats the expenses as reorganization expenses."

We reject Taxpayer's suggestion that Indopco supports or requires allocation of the costs solely to the state law legal entity. While the Court does not associate a target's acquisition costs with any particular asset, tangible or intangible, it does not follow that the costs must therefore be associated with the corporate charter. On the contrary, the opinion stands for the proposition that if an expenditure gives rise to a significant future benefit, it is capitalizable.

Indopco bases the requirement of capitalization on benefits resulting from the transaction, including synergy and resource benefits. The Court's opinion focuses on

the future benefits that result from the expenditures, benefits that do not relate solely to the corporate charter. The opinion contains a substantial discussion of synergy and resource benefits. Indopco at 88-89. Taxpayer suggests that Indopco's discussion of resource and synergy benefits should be disregarded and be viewed as irrelevant to the Court's determination that the expenses should be capitalized. Taxpayer's position would essentially make this discussion unnecessary.

In addition, the Supreme Court discussion of the lower courts' findings on the benefits of the transaction supports our position. The Court states, "the [lower courts'] findings that the transaction produced significant benefits to National Starch that extended beyond the tax year in question are amply supported by the record." Indopco at 88. The Third Circuit opinion, in particular, explicitly rejected resting its determination that the expenditures had to be capitalized merely on change in corporate structure, without regard to other synergy and resource benefits.[3] We would not infer that the Court had adopted a position that was explicitly rejected the by the Third Circuit in the absence of any discussion regarding the Third Circuit's rationale.

Taxpayer argues that in determining the benefits of the expenditures, the origin of the claim doctrine, discussed in U.S. v. Gilmore, 372 U.S. 39 (1963), is applicable. In evaluating the benefits relating to the expenditures, Taxpayer argues that the benefits of the specific expenditure should govern the determination, and not the benefit of the transaction as a whole. For example, the investment banking expenditure resulted in valuing the stock for purposes of a fairness opinion. That stock valuation, they assert, has no benefit after the acquisition is completed other than the altered capital structure of the acquired corporation. Also, in applying the origin of the claim doctrine, Taxpayer suggests a comparison between the acquired corporation's costs and the acquiring corporation costs. The acquiring corporation's costs are added to the basis of the acquired corporation's stock, and are not allocable to an intangible asset or future benefit associated with the synergy of the transaction. Taxpayer suggests that if the acquiring corporation's costs are not associated with the synergy of the transaction, it is not appropriate to associate the acquired corporation's costs with the synergy of the transaction.

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[3]The court stated, " 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. … 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."

We disagree with Taxpayer that the origin of the claim doctrine supports allocation of the expenditures to the corporate charter. In Indopco, the Court indicates that it is the transaction as a whole that created the benefit ("the transaction produced significant benefits to National Starch that extended beyond the tax year in question") Indopco at 88. Taxpayer's argument is similar to an argument rejected by the Tax Court, and not subsequently raised by the Third Circuit or Supreme Court , i.e., that the expenditures should be deductible because "the dominant aspect of its expenditures was the fiduciary duty its directors owed to its shareholders." Rather, the Tax Court found that "the dominant aspect was the transfer of petitioner's stock for the benefit of petitioner and its shareholders." National Starch and Chemical Corp. v Commissioner, 93 T.C. 67 (1989). Similarly, we reject Taxpayer's suggestion that because an acquiring corporation's acquisition related expenses are allocable to the stock acquired and not to future synergy benefits, the similar expenses paid by the target corporation costs cannot be viewed as allocable to future synergy benefits. Case law is clear that expenditures incurred in connection with the purchase of an asset are allocable to the assets. Woodward v. Commissioner, 397 U.S. 572 (1970). Such a result should not prevent expenditures for future synergy benefits from being capitalized when no tangible asset is created by the expenditures. Nor should such result require that these costs be capitalized to a corporate charter, as Taxpayer implies.

In addition, Taxpayer relies on certain portions of the Indopco opinion that discuss recovery of capital costs to support their argument that the capitalized costs may be deducted on dissolution of the corporate charter. The Court states, "While business expenses are currently deductible, a capital expenditure usually is amortized and depreciated over the life of the relevant asset, or where no specific asset or useful life can be ascertained, is deducted upon dissolution of the enterprise." Indopco at 84. Taxpayer apparently believes that the costs benefited only the corporate charter, or the state law legal entity, as it asserts that the phrase "dissolution of the enterprise" refers to a dissolution of the state law legal entity. In addition, Taxpayer relies upon the Court's reference to certain corporate reorganization expenditures having a benefit "for the duration of its existence", Indopco at 90[4], to support its claim that the expenditures may be deducted on dissolution of the state law legal entity.

Rejecting as we do Taxpayer's argument that the expenditures are allocable solely to the corporate charter, we also reject its conclusion that the Court's discussion of the dissolution of the enterprise refers to a dissolution of the corporate charter. Since we view the benefits requiring capitalization as including resource and synergy benefits, we cannot conclude that a dissolution of the charter terminates such benefits. Such benefits are not necessarily affected by a state law dissolution of a subsidiary's

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[4] The Court stated, "… courts more frequently have characterized an expenditure as capital in nature because " 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 times somewhat longer than the current taxable year." … The rationale behind these decisions applies equally to the professional charges at issue in this case. …" Indopco at 90 (citations omitted).

corporate shell where the subsidiary transfers its business enterprises to its parent who continues those enterprises. The resource and synergy benefits between the acquired company's business enterprise and the acquiring corporation's business enterprise continue to exist. While we do not dispute that certain corporate organization and reorganization expenses may give rise to a benefit for the duration of the corporation's existence, and are appropriately deducted on its dissolution, we believe that the determination of whether dissolution is an appropriate time to deduct the expenditures depends upon a determination of whether the benefits relating to that expenditure terminate upon the state law dissolution of the corporation. Therefore, we decline to accept Taxpayer's argument that the Court's reference to a dissolution of the enterprise refers to a dissolution of the state law legal entity when that dissolution involves the acquired corporation's transfer of its entire business operation to its parent in the context of a section 332 liquidation. Instead, we would interpret the phrase "dissolution of the enterprise" to also encompass the discontinuation of the acquired corporation's operations and activities, as being the more consistent point in time at which the benefits identified by the Court as arising from these expenditures cease to exist. Further, this meaning and application of the term enterprise is consistent with common usage. According to Black's Law Dictionary, an "enterprise" is a business venture or undertaking. Black's Law Dictionary 367 6th ed. (1991). The existence of, and benefits arising from, a venture or enterprise are not dependent on the existence of a separate corporate legal entity.

We find Taxpayer's position that there is a dissolution of the business enterprises of Target A and Target B as a result of their state law dissolutions incompatible with the federal tax treatment of liquidations to which sections 332 and 337 apply. In a section 332 liquidation, the subsidiary's tax attributes are carried over to and survive in the parent corporation. For the purpose of determining whether a parent corporation may distribute a business enterprise of its subsidiary in partial liquidation, the parent is treated as if it conducted the subsidiary's business for the entire time it was conducted by the subsidiary. See Rev. Rul. 75-223, 1975-2 C.B. 109, and Rev. Rul. 77-376, 1977-2 C.B. 107 (a subsidiary's 5-year business enterprise is attributed to its parent for purposes of former section 346 (determination of partial liquidation) where the subsidiary liquidates into the parent (even where the subsidiary sells its 5-year business prior to the liquidation)). Accordingly, to the extent that Target A liquidated into Subsidiary A under section 332, Subsidiary A succeeded to Target A's tax attributes and business enterprise. Likewise, Subsidiary B succeeded to Target B's tax attributes and business enterprise. The policies of Rev. Rul. 75-223 and Rev. Rul. 77-376 weigh heavily in favor of concluding that a state law dissolution of a corporate charter does not equate to a "dissolution of the business enterprise."

Taxpayer concedes its position that a "dissolution of the corporate enterprise" refers solely to a state law dissolution of the corporate charter should not apply in all situations. Specifically, Taxpayer concedes that its position is inappropriate where the state law dissolution takes place in the context of a section 368(a)(1)(F) reorganization ("F" reorganization). For example, "AcqCo" acquires all the stock of "Oldco," a State 1

corporation, and Oldco properly capitalized costs incurred in the acquisition of its stock. In an unrelated transaction, Oldco transfers all of its assets and liabilities to "Newco", in exchange for Newco stock, Oldco transfers the Newco stock to its shareholder and then dissolves under State 1 law in a transaction qualifying under section 368(a)(1)(F). Taxpayer believes Oldco's dissolution should not result in its taking a loss for its previously capitalized stock acquisition costs because, for federal tax purposes, Oldco and Newco are treated as the same corporation. [5] However, Taxpayer contends a state law dissolution in the context of any other section 381 transaction, including a section 332 transaction, should trigger the deduction of previously capitalized costs. Taxpayer's stated reason for distinguishing between F reorganizations and other section 381 transactions is that F reorganizations receive special treatment under section 381 with regard to net operating loss (NOL) carrybacks and the closing of the tax year.

We agree with Taxpayer's conclusion that previously capitalized reorganization costs should not be recovered at the time of an "F" reorganization. We also conclude, however, that a state law dissolution that occurs in the context of a section 332 transaction does not trigger the deduction of previously capitalized costs where the acquiring corporation succeeds to the target corporation's business and tax attributes, as is the case here. As pointed out by Taxpayer, the two primary characteristics that generally distinguish an "F" reorganization from other section 381 transactions are: (1) NOLs acquired in an "F" reorganization may be carried back as well as forward, and (2) the target corporation's tax year does not close.

With respect to NOL carrybacks, in the instant case, there is little difference between Taxpayer's section 332 transaction and an F reorganization. NOLs are calculated for the group on a consolidated basis (consolidated net operating loss, hereinafter "CNOL"). Section 1.1502-21 and 1.1502-21T.[6] Section 1.1502-21(b) governs the extent to which losses that are taken into account in determining the CNOL for a taxable year may be carried to other taxable years (whether consolidated or separate). As a general matter, a loss incurred by one member of the group may offset the income of another member of the group. Moreover, a CNOL may be carried back to offset the group's consolidated income.

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[5] In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of section 368(a)(1)), the acquiring corporation shall be treated (for purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. Thus, the taxable year of the transferor corporation shall not end on the date of transfer merely because of the transfer; a net operating loss of the acquiring corporation for any taxable year ending after the date of transfer shall be carried back in accordance with section 172(b) in computing the taxable income of the transferor corporation for a taxable year ending before the date of transfer, and the tax attributes of the transferor corporation enumerated in section 381(c) shall be taken into account by the acquiring as if there had been no reorganization. Section 1.381(b)-1(a)(2).

[6] Section 1.1502-21(b) is generally applicable to tax years for which the due date (without extensions) of the consolidated return is after June 25, 1999. Former Section 1.1502-21T(b) applies to consolidated return years beginning on or after January 1, 1997.

For example, X is the common parent of a consolidated group of corporations. Y and Z are X's wholly-owned subsidiaries. In year 1, the group has taxable income that is solely attributable to Y. In year 2, Y liquidates into X in a transaction to which sections 332 and 337 apply, and the group has a net loss attributable to X. Such loss may be carried back to offset the group's income in year 1 even though such income was attributable to Y. Under the facts at issue, Target A and Target B each liquidated into its respective parent. As a general matter, the CNOLs of the post-liquidation CP consolidated group could have similarly been carried back to offset income that Target A and/or Target B earned as members of the CP group, prior to their liquidations.

Moreover, the consolidated regulations have a special rule for intragroup section 381 transactions with respect to short taxable years. If a corporation that does not join in the filing of a consolidated return engages in a section 381(a) transaction, the transaction may give rise to a short taxable year and this short year is usually considered a full year in determining the number of years remaining in a loss carryover. Section 1.381(c)(1)-1(e)(3). The CNOL regulations provide an exception to this rule for certain intragroup reorganizations. If during a consolidated return year, a member of the group transfers its assets to another corporation that is a member of the group immediately after the transaction, and section 381(a) applies, the transaction does not cause the target or distributing corporation to have a short taxable year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net operating loss may be carried. Section 1.1502-21(b)(3)(iii).

Taxpayer's dependence on state law, equating the Indopco Court's use of the word "dissolution" in the context of the phrase "dissolution of the enterprise" with a state law dissolution, does not withstand scrutiny in the context of an F reorganization where, for federal income tax purposes, the state law event is not determinative. As noted, Taxpayer agrees with this result. Thus, we find Taxpayer's dependence on state law equally unpersuasive in the context of a section 332 transaction, where for federal tax purposes, the acquiring corporation succeeds to the target's property and tax attributes, and the state law event is not determinative. See section 1.332-2(d).

Taxpayer cites various other court decisions in support of its position that Target A and Target B may each deduct costs relating to each company's original acquisition under section 165 at the time of each company's section 332 liquidation. Taxpayer cites Koppers Co., Inc. v. United States, 278 F.2d 946, 949 (Ct. Cl. 1960) and Wayne Coal Mining, Co., Inc. v. Commissioner, 12 T.C.M. 345 (1953) for the proposition that when a reorganized corporation ceases to exist, the benefits that are associated with the organization come to an end, without regard to whether the business continues following a dissolution. However, we find these decisions inapposite to the present case. In Koppers Co., Inc. and Wayne Coal Mining Co., Inc., corporations paid fees to the state of Pennsylvania for the privilege of engaging in certain activities. The corporations subsequently liquidated in section 332 liquidations, and the parent

corporations were then required to pay the fees again to continue these activities, with no credit being allowed for the previous fees paid by the former subsidiaries. Such an expenditure is distinguishable from the reorganization expenditures at issue here. The benefits relating to the liquidated corporations' Pennsylvania licenses were clearly terminated when the corporations were liquidated, and it was therefore appropriate to deduct the loss at that time. That the benefit terminated is evident because the parent corporations were required to pay the fee again for the same privilege. In the present case, the resource and synergy benefits relating to the acquisitions continue without regard to the liquidations of the subsidiaries.

Taxpayer also cites decisions relating to the capitalization and recovery of corporate organization expenditures, including Malta Temple Association v. Commissioner, 16 B.T.A. 409 (1929), Pacific Coast Biscuit Co. v. Commissioner, 32 B.T.A 39 (1935); Bryant Heater Co. v. Commissioner, 231 F.2d, 938 (6th Cir. 1956) and Kingsford Co. v. Commissioner, 41 T.C. 646 (1964). These cases permit a corporation to deduct organizational expenditures in the event of a liquidation, including a section 332 liquidation. However, the benefits created by organizational expenditures are different than the benefits created by the type of reorganizational expenditures at issue here. The benefits of organizational expenditures relate to formation of the corporate shell and include limited liability and a separate entity in which to conduct business. Benefits of reorganizational expenditures may enhance the original benefits associated with the corporation's original organization as noted by Taxpayer, but they also create benefits relating to the synergies and combined resources of the two corporations, which are not present in organizational expenditures alone. The resource and synergy benefits were noted in Indopco as significant benefits that supported the capitalization of the expenditures.

In Indopco, the Court emphasized certain benefits that are also present in this case, specifically noting resource, synergy and corporate structural benefits. Corporate acquisitions of the type described in Indopco and this case generally may be expected to provide benefits such as combined financial resources, cross-utilization of operating assets, complementary product or service lines, economies of scale, decreased shareholder expenses and reduction in competition. While the issue in Indopco related solely to the requirement to capitalize the expenditures, the principles discussed in Indopco, as well as general principles relating to tax accounting and capitalization of expenditures such as matching of expenses and income indicate that the expenditures should remain capitalized until the dissolution of the enterprise. Therefore, in determining whether the dissolution of the corporate charter and section 332 liquidation of Target A and Target B is an appropriate time to deduct the expenses, we should determine if the benefits arising from the previously capitalized expenses continue or are terminated.

The resource related and synergy benefits noted by the Court are not terminated by the dissolution of the state law entities of Target A and Target B. Under section 165 a deduction is not allowable if a taxpayer intends to hold and preserve property for

possible future use or to realize potential future value from the property. Rev. Rul. 2004-48, 2004-24 I.R.B. 1043, quoting AJ Indus. Inc. v. United States, 503 F.2d 660, 670 (9th Cir. 1974). The identifiable event required by section 1.165-1(b) and (d)(1) constitute 'some step which irrevocably cuts ties to the asset'. Rev. Rul. 2004-48, quoting United Dairy Farmers, Inc. v. U.S., 267 F.3d 510, 522 (6th Cir. 2001) (quoting Corra Resources, Ltd. v. Commissioner, 945 F.2d 224, 226 (7th Cir. 1991)). Indopco states that a deduction is a matter of legislative grace and the burden of showing the right to the deduction is on Taxpayer. Indopco at 84. Taxpayer here has not demonstrated that the dissolution of the corporate structure is the identifiable event that determines that the future benefits of its capitalized expenditures have been terminated. The dissolution of the corporate charter is not an appropriate identifiable event under section 165 because the dissolution does not terminate the potential future value of the benefits created by the capitalized expenditures. Since these continuing resource related benefits are significant, it is not appropriate to permit Taxpayer to deduct the capitalized reorganization expenses as a loss under section 165 at the time of the dissolution of the corporate charters of Target A and Target B under sections 332 and 337.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.