INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 26, 2004

Third Party Contact: none

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Director of Field Operations - East
Natural Resources and Construction
LMSB:NRC

Taxpayer's Name:
Taxpayer's Address:

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

LEGEND:

Taxpayer	=
Business E	=
Business F	=
Target 1	=
Target 2	=
State B	=
State C	=
State D	=
Year 2	=
Year 3	=
Year 4	=
Date T	=
Date U	=
Date W	=
Date X	=
g	=
h	=

$mm =
$pp =
$qq =

ISSUE(S):

(1) Are stock issuance costs netted against stock proceeds, or do stock issuance costs create a separate intangible asset?

(2) If stock issuance costs are not netted against stock proceeds, may a target corporation deduct, under §165 of the Internal Revenue Code, the target's previously incurred stock issuance costs when the target is acquired in a statutory merger that qualifies as a tax-free reorganization under § 368(a)(1)(A)?

CONCLUSION(S):

(1) Stock issuance costs are netted against stock proceeds.

(2) Because we have determined that the stock issuance costs should be netted against stock proceeds, we need not reach the second issue.

FACTS:

Taxpayer is a Business E holding company organized as a Subchapter C corporation for federal income tax purposes and is an accrual basis taxpayer. Taxpayer's subsidiaries provide various Business F services.

Target 1

Prior to Date X, Target 1 was a Business E holding company organized under the laws of State C. In Year 2, Target 1 had raised additional capital by issuing shares of its common stock to the public. Proceeds from the sale were to be used for general corporate purposes. In connection with the issuance of the stock, Target 1 incurred $mm of issuance costs. The stock issuance costs were reflected in the equity section of Target 1's financial statements and were not deducted on its income tax return.

Subsequently on Date X, Target 1 merged into Taxpayer. The facts state that the merger of Target 1 into Taxpayer qualified as a reorganization under § 368(a)(1)(A). Under the Agreement and Plan of Merger, dated as of Date T, each outstanding share of the common stock of Target 1 was converted into g shares of Taxpayer.

Target 2

Prior to Date W, Target 2 was a Business E holding company organized under the laws of State D. In Year 2, Target 2 had raised additional capital by issuing shares of its common stock to the public. In connection with the issuance of its common stock, Target 2 incurred $pp of stock issuance and regulatory costs.

Subsequently on Date W, Target 2 merged into Taxpayer. Under the Agreement and Plan of Merger, dated as of Date U, each outstanding share of the common stock of Target 2 was to be converted into h shares of Taxpayer common stock. Each share of Target 2 Class B Preferred Stock was to be converted into one share of Taxpayer Class B Preferred Stock. The facts state that the merger qualified under § 368(a)(1)(A).

Taxpayer's Claim

Taxpayer timely filed a consolidated income tax return for Year 3. In Year 4, Taxpayer filed a Form 1120X, Amended U.S. Corporation Income Tax Return for Year 3, claiming increased deductions of $qq (equal to $mm plus $pp), and claimed a refund. The additional deductions were taken for "transaction costs that no longer provide future benefit."

LAW AND ANALYSIS:

Established precedent holds that when a taxpayer sells its own stock, the costs incident to the sale are netted against the proceeds of the sale and are never recoverable. See McCrory Corp. v. United States, 651 F.2d 828 (2d Cir. 1981); Barbour Coal Co. v. Commissioner, 74 F.2d 163 (10th Cir. 1934); Affiliated Capital Corp. v. Commissioner, 88 T.C. 1157 (1987); Pacific Coast Biscuit Co. v. Commissioner, 32 B.T.A. 39 (1935), acq. in part, 1935-1 C.B. 15, nonacq. in part, 1935-1 C.B. 35, acq. 1954-1 C.B. 6; Van Keuren v. Commissioner, 28 B.T.A. 480 (1933); Simmons Co. v. Commissioner, 8 B.T.A. 631 (1927), acq., 1928-2 C.B. 3, aff'd, 33 F.2d 75 (1st Cir. 1929); Appeal of Emerson Electric Manufacturing Co., 3 B.T.A. 932 (1926).

Taxpayer argues that costs of stock issuance should no longer be netted against proceeds after INDOPCO, Inc. v. Commissioner, 503 U.S. 79 (1992), which held that certain expenditures incurred in a friendly takeover of the taxpayer should be capitalized. INDOPCO clarified that Commissioner v. Lincoln Savings & Loan, 403 U.S. 345 (1971), did not mean "that *only* expenditures that create or enhance separate and distinct assets are to be capitalized under § 263." 403 U.S. at 86 (emphasis in original). Some of the cases that form the established precedent rely upon the argument that the costs of stock issuance did not result in the acquisition of a capital asset. See, e.g., Pacific Coast, 32 B.T.A. at 42. Therefore, Taxpayer argues they are overturned by INDOPCO.

However, the rationale of these cases is not directed at whether the expenditure is ordinary or capital but whether the taxpayer has incurred a cost that could result in a loss. See Pacific Coast, 32 B.T.A. at 41-42. The cases reason that the taxpayer receives less capital investment, because of the expenditures. Barbour Coal, 74 F.2d at 164; Simmons, 8 B.T.A. at 646; Emerson Electric, 3 B.T.A. at 935. Because the expenditures at issue simply reduced the amount of capital the taxpayer received for the sale of the stock, there is no potential loss for the taxpayer. Pacific Coast, 32 B.T.A. at 42.

The cases that form the established precedent thus distinguish cases, such as Hershey Mfg. Co. v. Commissioner, 43 F.2d 298 (10th Cir. 1930), where the expenditure at issue results in the acquisition of an asset and the asset could potentially be the basis for a loss. See Barbour Coal, 74 F.2d at 164; Simmons, 8 B.T.A. at 646. For the same reason, the cases explicitly distinguish cases, such as Malta Temple Assn. v. Commissioner, 16 B.T.A. 409 (1929), acq. in result, 1930 C.B.70, involving organizational expenses, which would likewise result in an asset that could be the basis for a loss. See Van Keuren, 28 B.T.A at 485; Pacific Coast, 32 B.T.A. at 42. Although INDOPCO holds that the acquisition of an asset is not a prerequisite for capitalization, INDOPCO does not hold that all capitalized costs are recoverable. As a result, INDOPCO does not change prior precedent that no loss is ever allowed for costs of a stock issuance.

Taxpayer also argues that prior precedent is changed by the recent publication of § 1.263(a)-5(a)(8) of the Income Tax Regulations, which requires that a taxpayer capitalize amounts paid to facilitate a stock issuance. Section 1.263(a)-5(a) lists what expenditures must be capitalized as opposed to being currently deducted. Stock issuance costs are listed to assure they are not construed to be currently deductible. Taxpayer also cites Notice 2004-18, 2004-11 I.R.B. 605, which solicits comments on the possible treatment of capitalized costs, including stock issuance costs, in future regulations. The Notice, however, does not change past precedent in regard to their treatment.

CAVEAT(S):

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