

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE
THE SUPREME COURT
OF THE
UNITED STATES

CAPTION: INDOPCO, INC., Petitioner V. COMMISSIONER OF
INTERNAL REVENUE

CASE NO: 90-1278

PLACE: Washington, D.C.

DATE: November 12, 1991


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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 INDOPCO, INC., :

4 Petitioner :

5 v. : No. 90-1278

6 COMMISSIONER OF INTERNAL :

7 REVENUE :

8 - - - - -X

9 Washington, D.C.

10 Tuesday, November 12, 1991

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States at
13 10:03 a.m.

14 APPEARANCES:

15 RICHARD J. HIEGEL, ESQ., New York, New York, on behalf of
16 the Petitioner.

17 KENT L. JONES, ESQ., Assistant to the Solicitor General,
18 Department of Justice, Washington, D.C.

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1 PROCEEDINGS

2 (10:01 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument
4 first this morning in 90-1278, Indopco v. the Commissioner
5 of Internal Revenue. Mr. Hiegel, is it?

6 MR. HIEGEL: Yes, Your Honor.

7 CHIEF JUSTICE REHNQUIST: Mr. Hiegel, you may
8 proceed whenever you're ready.

9 ORAL ARGUMENT OF RICHARD J. HIEGEL

10 ON BEHALF OF THE PETITIONER

11 MR. HIEGEL: Mr. Chief Justice, and may it
12 please the Court:

13 The issue in this case is what test should be
14 applied to determine whether an expenditure is capital in
15 nature and therefore not currently deductible as an
16 ordinary business expense under section 162(a) of the
17 Internal Revenue Code.

18 This is a fundamental issue arising, as the
19 Commissioner says, in virtually every area of business
20 activity. We contend that the separate and distinct asset
21 test enunciated by this Court in the Lincoln Savings case
22 is controlling, and should have been applied to determine
23 that petitioner's payments are currently deductible.

24 The Commissioner, on the other hand, would not
25 have any general test and would instead make a

1 case-by-case determination of the test to be applied. In
2 this case, he would employ a nonrecurring future benefit
3 test to find that petitioner's payments were capital
4 expenditures, not deductible either currently or at any
5 time before petitioner's final liquidation.

6 The issue arises in the context of an
7 unsolicited offer by Unilever, a large, multinational
8 group of companies, to buy petitioner's stock, which was
9 publicly held. On advice of counsel, petitioner engaged
10 an investment banking firm to value the company so that
11 its board of directors could make recommendations to the
12 stockholders concerning the offer. Under Delaware law, it
13 was required to advise the stockholders, and it had to do
14 this whether or not the stockholders ultimately approved
15 the transaction. The board's recommendation turned out to
16 be favorable, the stockholders voted to approve the offer,
17 and they closed in August 1978.

18 Petitioner itself did not buy or sell any stock
19 or other assets. Only stockholders transferred their
20 stock to Unilever Corporation. This transfer was
21 accomplished in part by a merger of a transitory
22 subsidiary into petitioner. Before the transaction, the
23 Commissioner ruled that this merger should be disregarded
24 and the transaction should be treated as a direct purchase
25 and sale between the stockholders and the Unilever

1 Corporation.

2 After the stock purchase, petitioner carried on
3 its business essentially in the same way as before,
4 without any significant technological or other assistance
5 from Unilever. The investment banking and legal fees and
6 other expenses incurred by petitioner were reasonable in
7 amount and customarily incurred in transactions of this
8 kind.

9 QUESTION: Were the investment banking fees
10 contingent on successful completion of the transaction?

11 MR. HIEGEL: There was a partial contingency,
12 Your Honor. There was a \$500,000 amount that was to be
13 paid regardless of the completion of the transaction and
14 an additional \$1,700,000 in the event it was completed.

15 The tax court and the court of appeals held that
16 these payments were nondeductible capital expenditures
17 because they were incident to a transaction that, in their
18 view, conferred a long-term benefit on petitioner.

19 QUESTION: Counsel, in the return as filed, only
20 some of the fees and expenses were asserted.

21 MR. HIEGEL: That's correct, Your Honor.

22 QUESTION: Why weren't all of them?

23 MR. HIEGEL: I -- the record does not show why,
24 Your Honor. The legal fees were not deducted immediately.
25 I've been told that it was a mistake, but there is no

1 evidence in the record to tell us --

2 QUESTION: Does that indicate --

3 MR. HIEGEL: Why that happened.

4 QUESTION: Does that indicate the taxpayer felt
5 they were not deductible?

6 MR. HIEGEL: As I say, I've been told that it
7 was a mistake, and I do not -- I do not know any more than
8 that.

9 QUESTION: You said these expenses were
10 ordinarily incurred in a transaction like this.

11 MR. HIEGEL: Yes, Your Honor.

12 QUESTION: Do you think they would have been
13 generally across the country, or is it -- was it just
14 because of the requirements of Delaware law?

15 MR. HIEGEL: Well, in many -- most corporations
16 today, I think, are incorporated in Delaware, or States
17 that have similar laws, and I do not think that there
18 would be any difference in particular jurisdictions.

19 QUESTION: Actually, what -- do you think -- do
20 you think ordinarily if somebody who wants to acquire a
21 corporation makes an offer to its stockholder -- to
22 the -- to target stockholders that the corporation goes
23 through this?

24 MR. HIEGEL: Yes, ordinarily they do, Your
25 Honor.

1 QUESTION: And you think whether or not the law
2 requires it?

3 MR. HIEGEL: I think it's just basic -- part of
4 the basic fiduciary responsibility of the board of
5 directors to the shareholders, particularly in a public
6 company, to make a determination as to whether the offer
7 is a reasonable offer and represents a fair price to the
8 stockholders. That, I think, is quite common and
9 ordinary, and in fact there's a case in the
10 Delaware -- again in the Delaware courts that imposed
11 liability on a board if it -- because it did not seek
12 expert advice in this situation.

13 The long-term benefit that --

14 QUESTION: Counsel, may I ask, now, what about
15 the expenses of organizing a corporation to get started in
16 business?

17 MR. HIEGEL: Those expenses are capitalizable,
18 Your Honor.

19 QUESTION: Well, a special statute was passed,
20 was it, to --

21 MR. HIEGEL: A special statute --

22 QUESTION: To allow --

23 MR. HIEGEL: -- was passed to allow 5-year
24 amortization.

25 QUESTION: -- some deduction, and before the

1 passage of that statute, how were those expenses treated?

2 MR. HIEGEL: They were capitalized and no
3 deduction was allowed until final liquidation.

4 QUESTION: And no amortization?

5 MR. HIEGEL: And no amortization, because --

6 QUESTION: How about the expense --

7 MR. HIEGEL: Excuse me --

8 QUESTION: Yes.

9 MR. HIEGEL: Sorry, Your Honor. I would say, no
10 amortization in the case where the charter was perpetual.
11 Where the charter of the corporation had a limited period,
12 then amortization was allowed over that period.

13 QUESTION: I see; and how about expenses of
14 restructuring a corporation, a corporate reorganization?

15 MR. HIEGEL: Well, that depends, Your Honor, on
16 what you mean by restructuring. The term corporate
17 restructuring, or capital structure changes, has been used
18 a great deal in this cases, and it really is -- the cases
19 look at it in two ways, and involve several different
20 types of situations.

21 The first situation is the organizational
22 expenses, and then there's stock issuance expenses, and
23 changes to the characteristics of the stock such as
24 changing its par value, increasing the authorized shares.
25 Stock issuance expenses are looked at in two ways. One,

1 the courts say the expenses of doing that is an offset to
2 the amount of capital that is raised by issuing the stock,
3 therefore there's no deduction because you're just raising
4 that much less capital.

5 Other cases look at those -- those situations
6 and say, there's a creation of a capital asset, an
7 intangible capital asset, and it's not deductible for that
8 reason.

9 QUESTION: So your answer is that there is a
10 split of authority?

11 MR. HIEGEL: In -- there is a split of theory on
12 which those cases are based. In each -- in each case,
13 there's no deduction allowed at the outset. In the case
14 where it's held to be a capital -- intangible capital
15 asset, there is a deduction allowed at the end of the
16 corporation's life under section 165 of the code or its
17 predecessor, and in the case where it's treated as an
18 offset to the amount of capital raised, there would be
19 no -- logically no deduction allowed in that case.

20 QUESTION: What about expenses incurred in
21 connection with a hostile takeover?

22 MR. HIEGEL: Well, the -- there have been no
23 cases dealing with hostile takeovers. The Internal
24 Revenue Service, in certain private rulings, has changed
25 its position with respect to hostile takeovers.

1 Originally, they said that they were deductible,
2 and then they changed their view and said that they were
3 not deductible, and then again changed their -- their
4 view. The most recent view expressed by the Service has
5 just been about 2 weeks ago, in which they said
6 they -- those expenses can be capitalizable if the
7 transaction results in a future benefit to the
8 corporation.

9 In other words, if the hostile -- if the hostile
10 takeover succeeds, and the company is actually taken over,
11 those expenses can be capitalized.

12 QUESTION: And if it is not, if it does not
13 occur?

14 MR. HIEGEL: If it does not occur, then there's
15 no transaction to which that you -- no benefit, no
16 transaction occurs, and the expense is a -- is a
17 deductible loss.

18 Originally the theory of --

19 QUESTION: It is a deductible loss in the year
20 incurred?

21 MR. HIEGEL: If the transaction does not
22 incur -- does not occur. That might not necessarily be
23 the same year. If they're capitalized initially, Your
24 Honor, and the -- and the period of time over which it
25 takes to see whether the --

1 QUESTION: Here's the hostile takeover and
2 it -- and it comes and goes and is unsuccessful in one
3 year, and the company spends a lot of money opposing it --

4 MR. HIEGEL: That would be deductible.

5 QUESTION: As an -- as an ordinary and necessary
6 business expense?

7 MR. HIEGEL: Yes, Your Honor.

8 QUESTION: Is that clear? Does the Internal
9 Revenue Service agree with that, or do you know?

10 MR. HIEGEL: I believe so, yes. There are cases
11 that so hold, unless it's successful. Yes -- I think the
12 question was whether -- if it were unsuccessful, Your
13 Honor.

14 QUESTION: Mr. Hiegel, could I go back to
15 Justice Kennedy's question? Is it not true -- you said
16 \$500,000 was payable in all events. That's only if the
17 negotiations reached a certain stage in their proxy
18 solicitations, isn't that true? As I read --

19 MR. HIEGEL: That's correct. That's correct,
20 Your Honor.

21 QUESTION: In other words, if they had rendered
22 a negative opinion and the negotiations had fallen apart
23 almost immediately, you would have only paid about
24 \$100,000?

25 MR. HIEGEL: You're -- you're right. I think it

1 was \$200,000, but --

2 QUESTION: Well --

3 MR. HIEGEL: It was a lesser figure, that's
4 correct.

5 QUESTION: If the -- if the transaction didn't
6 occur, there would have been a deduction?

7 MR. HIEGEL: Yes. I see no reason why not, Your
8 Honor.

9 MR. HIEGEL: At any rate, to get back to the
10 last statement of the facts, the benefit that the courts
11 below, the reason why they capitalized the expenditures in
12 question, was because of the possibility that petitioner's
13 new parent might at some point in the future provide
14 technological or other assistance to petitioner in its
15 business operations.

16 We believe that the separate and distinct asset
17 test, rather than the future benefit test as followed by
18 the courts below, is controlling for two reasons. First,
19 the separate and distinct asset test is the only test for
20 capitalization that is consistent with the tax accounting
21 system set up by Congress in the code, and second, the
22 future benefit approach has three critical flaws.

23 First, it is not -- it is inconsistent with our
24 tax accounting system; secondly, it fails to provide any
25 principle or basis for distinguishing between admittedly

1 deductible expenses and expenditures that have to be
2 capitalized; and thirdly, it will generate unending
3 controversy because of its inherently subjective and
4 speculative nature.

5 Before addressing these points, I would like to
6 mention that the Commissioner would not necessarily apply
7 a future benefit test in every case, and indeed he does
8 not support the formulation of the future benefit test
9 that the court below indicated. However, we believe that
10 his position is even more at odds with the statute and
11 would further undermine predictable and evenhanded
12 administration of the tax law.

13 Let me now address those points in turn. In
14 Lincoln Savings, this Court held that the presence of an
15 ensuing benefit having some future aspect was not
16 controlling as to the capital nature of an expenditure.
17 What was important and controlling, it held, was that the
18 payment served to create or enhance a separate and
19 distinct asset. It also --

20 QUESTION: You -- you don't claim, do you, that
21 Lincoln requires your result in this case?

22 MR. HIEGEL: We believe that if you look at the
23 facts of the case and follow the process of reasoning of
24 the Court, that it would require the result in this case.
25 That position has been taken by the courts of appeals in

1 cases following Lincoln Savings, the Treasury Department
2 believed it, and it was a premise on which Congress
3 enacted section 195 of the code. However, if all of those
4 cases and the Treasury Department and the Congress were
5 wrong about that, and what -- what the Court meant to do
6 was only to say that it found an asset in that particular
7 case --

8 QUESTION: Sufficient condition, not necessary
9 condition.

10 MR. HIEGEL: That's correct. It -- certainly
11 it's a possibility, but it does not mean that that is not
12 the correct test. Certainly the Court did not reject in
13 that case separate and distinct asset as a general test,
14 and we think that it should adopt that test as a general
15 test for the reason I'm about to state, and the reason is
16 that, as I said, that this is the only test that's
17 consistent with the tax accounting system in the code.

18 As the cases in this Court -- this Court and
19 other courts, and as the Commissioner agrees, the goal of
20 the system is not simply to disallow a current deduction
21 and thereby tax gross income. Rather, the intention is to
22 spread out the effect of a capital expenditure over its
23 revenue-producing life.

24 The system does this by providing for the
25 recovery of these capitalized costs through depreciation

1 or amortization, or by deduction from the proceeds
2 realized upon a sale, or upon another disposition, such as
3 by abandonment.

4 In each and every case, the code sections that
5 perform this function require that there be a property or
6 an asset with a basis, or else they just don't apply. For
7 example, section 167 allows depreciation for, quote,
8 property used in the trade of business, and determines the
9 amount of depreciation by reference to the basis of the
10 property, which is its cost.

11 The regulations under section 167 allow
12 amortization of an intangible asset. Section 1001
13 computes gain or loss by reference -- on a sale by
14 reference to the adjusted basis of the property.

15 Since costs are capitalized under the Lincoln
16 Savings test only where there's an asset or an item of
17 property, then the taxpayer has the means of recovering
18 his cost through those statutory provisions, and therefore
19 the test is entirely consistent with the statutory scheme.

20 QUESTION: But Mr. Hiegel, you've -- you've said
21 that -- why, you said that these costs in other instances,
22 for example, where they are the costs of restructuring a
23 corporation, are ultimately recoverable when the
24 corporation is dissolved. That's the point at which that
25 asset, if you want to consider it an asset, is finally

1 disposed of, when the whole corporation is dissolved. Why
2 doesn't that solve your incompatibility problem?

3 MR. HIEGEL: Well, in the first place, Your
4 Honor, on the facts of this case we don't have a corporate
5 restructuring. We do not have the kind of --

6 QUESTION: No, I understand, but you're making a
7 theoretical argument --

8 MR. HIEGEL: That's correct.

9 QUESTION: That unless you use a separate asset
10 theory you can never recover this money, but you can, when
11 the corporation is dissolved, as you do with respect to
12 restructuring expenses.

13 MR. HIEGEL: I think restructuring, Your Honor,
14 is an example that -- an exception, really, that proves
15 the rule. It's the one case -- it's really the one case
16 where there isn't an asset that can be depreciated or
17 amortized or where the cost can be recovered on sale or
18 abandonment.

19 QUESTION: Well, that must be wrong --

20 MR. HIEGEL: It's the -- it's --

21 QUESTION: That must be wrong, too, then?

22 MR. HIEGEL: Well, as I said before -- as I said
23 before, there are two ways of looking at those cases, Your
24 Honor. One is that the amounts expended to raise capital
25 are simply an offset to the amount of capital raised,

1 therefore it -- it really doesn't matter whether it's
2 considered an asset or not. You just have less capital.
3 You don't have a deductible expense or an intangible
4 asset, either.

5 But if you look at them as an intangible asset,
6 then it just -- it just happens to be the one case where
7 there is no recovery until final liquidation. That does
8 not mean that that's a good system, and in fact as I said
9 in response to Justice O'Connor's question, Congress
10 enacted section 248 of the code because it was not
11 satisfied with a situation where organizational
12 expenses -- expenses had to be capitalized and there was
13 no recovery of those costs. After all, we have a net
14 income tax system, not a gross income tax system.

15 The objective is not to tax gross income, it's
16 to recover costs in a rational way during the period that
17 they are producing revenue over the -- over the life of
18 those expenditures. Capital structure is just one case
19 where there is no definite life, and as I said before
20 also, if there were a definite life, it is amortizable, so
21 you do have a means of recovery in that case. It's only
22 where the charter is perpetual, which happens to be the
23 case with most corporations, but that's just the facts of
24 life. There is that one situation.

25 That does not mean, I think, that we should

1 adopt a rule that in the generality of cases every time
2 that you capitalize an expense without an asset to which
3 it can be assigned as a basis, you have no recovery
4 whatsoever. You have no way of recovering that cost under
5 the Internal Revenue Code.

6 QUESTION: Do we have to accept the finding of
7 fact of the district -- of the tax court that there was a
8 long-term future benefit?

9 MR. HIEGEL: That there was a -- I think what
10 the finding was, Your Honor, was that there was a
11 possibility of a future benefit. I think you do have to
12 accept that. We are not arguing that that is not a
13 correct finding, but that is not relevant to the ultimate
14 result in this case, in our view, because that is not the
15 appropriate test.

16 Future benefit is not the appropriate test, it's
17 the separate and distinct asset test that is the
18 appropriate test, and there was a finding by the courts
19 below, and a statement to that effect by the court of
20 appeals in particular, that there was no asset found,
21 there was no asset in this case, and I don't see how there
22 could be an asset in this case.

23 What the Court -- what this Court did in Lincoln
24 Savings, when it talked about a separate and distinct
25 asset, was to look at -- it said it was a recognized -- a

1 distinct and recognized property interest. In other
2 words, it read the words asset and property in the code in
3 their normal meaning, which is, of course, the paramount
4 rule of statutory construction, as this Court has said
5 many times, and it looked at the characteristics that a
6 property interest would normally have; transferability,
7 the ability to earn income, to be used to satisfy other
8 obligations or to be exchanged for cash, the fact that it
9 was accounted for as an asset for accounting purposes, and
10 presumably could not be misappropriated by anyone else in
11 that case.

12 QUESTION: I -- I must say I'm having trouble
13 with your argument that if it's not a separate and
14 distinct asset then it must follow that it's an ordinary
15 and necessary business expense. It just doesn't seem to
16 me that the -- that the conclusion follows, and that is
17 your argument, I take it?

18 MR. HIEGEL: It is my argument that if there are
19 other requirements in section 162(a), it has to be paid or
20 incurred in carrying on a trade or business, necessary in
21 the sense of being appropriate and helpful, so that the
22 only word that's in issue is the question of whether
23 it's -- it's an ordinary expense.

24 That word apparently has two meanings, according
25 to the decisions of this Court. One is that it's usual

1 and customary, and the other is that it's not a capital
2 expenditure, and yes, if it is not a capital expenditure,
3 and if it meets the other requirements of section 162(a),
4 then it should be allowed as a deduction. If it is not
5 allowed as a deduction, it will never be recovered.

6 As I said before, the Government -- and let me
7 just address that point for a second. The Government in
8 its brief says that we would get this deduction on -- we
9 would get a deduction on final liquidation.

10 That assertion rests on the cases that deal with capital
11 structure, where they held that it was an intangible asset
12 and the asset was lost on liquidation, but the section
13 under which that was allowed as a deduction was the
14 predecessor of section 165, and section 165 now, and did
15 then, requires that in order to have a deductible loss,
16 it's limited to the basis of property.

17 So if you don't have property, if you don't have
18 an asset, there is no deduction under those cases, and
19 therefore there's no deduction under the Commissioner's
20 position here, ever. If we don't have a change in capital
21 structure, then there -- there is -- no asset, even
22 arguably is no asset to which this cost can be assigned,
23 and we never get a deduction, and that would be true even
24 if it were known at the outset that the life of this
25 benefit -- let's assume that there was a future benefit,

1 an even more concrete one than was found by the courts
2 below, but it would only last for 10 years.

3 Let's assume that Unilever had to dispose of the
4 stock of the company in 10 years, for whatever reason, so
5 we knew it would only last for 10 years. You would think
6 that under a rational net income tax system you'd be able
7 to write off that cost over that 10-year period when you
8 were realizing the benefit, or at least that you'd get a
9 loss at the end of that period, a deductible loss under
10 165.

11 The answer is, you would not get a loss. There
12 is no provision in the code that would give you either the
13 write-off over the 10-year period, or the loss, because
14 there is no asset. Each of those provisions depends on
15 there being property or an asset with basis.

16 QUESTION: Mr. Hiegel, can I ask you a question?
17 I haven't really thought this through, but I'd like
18 you -- like you to comment on it.

19 It seems to me that arguably the investment
20 banker here was really representing the selling
21 shareholders, and that in one sense you could have set up
22 a transaction in which the costs of the -- of this
23 \$2 million could have been, in effect, charged to the
24 shareholders in some way and treated as a cost of sale and
25 therefore be recoverable as part of the -- you know, the

1 deduction, reduce the amount of the capital gain that
2 they'd have. Is that conceivable, or is that -- it seems
3 to me there's a little bit of uncertainty as suggests who
4 was being represented by the investment bankers, the
5 stockholders of the corporation. That's what's running
6 through my mind.

7 MR. HIEGEL: I think it's theoretically possible
8 that could be the situation. The facts in this case,
9 however, show that it was not the situation. The
10 investment banking firm was hired by the board to enable
11 it to decide whether Unilever's offer was a fair price.

12 QUESTION: But most of the fee went for
13 consummating the sale rather than for giving the advice.
14 Only about \$100,000 was for the advice, as I understand
15 it, which was noncontingent. The rest is a contingent fee
16 on completing the transaction.

17 MR. HIEGEL: I -- I don't -- well, the fact that
18 it was contingent on completing the transaction I don't
19 think indicates necessarily that they were acting for the
20 stockholders, Your Honor. It's just that their liability,
21 because they --

22 QUESTION: But the decision as to whether or not
23 to go forward with the transaction was governed by the
24 advice they got, which was available for
25 \$100,000, \$150,000.

1 MR. HIEGEL: That's correct, but
2 once -- once if --

3 QUESTION: That is clearly a corporate function
4 there, but when you go beyond that, aren't they in a sense
5 representing sellers rather than the ongoing corporation?

6 MR. HIEGEL: I don't -- I don't see on the facts
7 of this case, Your Honor, what they did to help the
8 sellers. They did not negotiate this transaction. In
9 fact, when Unilever originally made their offer of \$65 to
10 \$70, they reported back to the board that they thought
11 that was a fair price, and it was the board that didn't
12 think that it was a fair price, and asked them to go back
13 and tell them we want \$80 a share, and it ended up at
14 \$73.50 a share. So they really didn't act on behalf of
15 the corporation -- on behalf of the shareholders at all.

16 QUESTION: Well, that shows they had an interest
17 in having the sale go through, I guess.

18 MR. HIEGEL: They had an interest in having the
19 sale because their liability was greater. If their -- if
20 their opinion was in the proxy statement and was published
21 to the stockholders, then they would have much greater
22 liability because of giving that opinion than just
23 advising the board. They were then -- they were then
24 answerable to this whole group of public stockholders if
25 their opinion was negligent or didn't take into account

1 the proper factors, and that's why, typically, the
2 court -- the fees are much higher.

3 If the Court please, I would like to reserve my
4 remaining time for rebuttal.

5 CHIEF JUSTICE REHNQUIST: Very well, Mr. Hiegel.
6 Mr. Jones, we'll hear from you.

7 ORAL ARGUMENT OF KENT L. JONES

8 ON BEHALF OF THE RESPONDENT

9 MR. JONES: Mr. Chief Justice, and may it please
10 the Court:

11 This is a case where starting at the beginning
12 really will help us get to the end, so before I discuss
13 Lincoln Savings and the reorganization expense cases I'd
14 like to spend a few minutes talking about the fundamental
15 analytical issue that's present in every capital expense
16 case.

17 The distinction between capital and ordinary
18 expenses is rooted in the simple fact that the Federal
19 income tax is assessed and collected on an annual basis.
20 In order to reflect taxable income for each separate year,
21 it's necessary to match the income derived from each
22 year's activities with the expenses incurred to produce
23 that year's income.

24 The problem that is addressed in capital expense
25 cases arises when an expense incurred in one year assists

1 in producing income in more than a single year. For
2 example, 2 years of prepaid rent, if it's deducted
3 entirely in the current year it would understate present
4 income and overstate income in the following year, so the
5 function of capitalization is to achieve, as Judge Wisdom
6 said in the Ellis Banking case, an accurate measure of net
7 income by properly matching expenses with the income that
8 it benefits.

9 While capitalization is conceptually necessary
10 for all expenses that create a material future benefit,
11 the goal of achieving an accurate measure of net income is
12 a pragmatic one. Expenses of advertising and maintenance
13 create both present and future benefits, but
14 capitalization is not required as a practical matter even
15 though some future benefit results, because the current
16 benefit predominates and the expense is a regularly
17 recurring one, so you achieve essentially the same
18 statement of income whether you deduct the entire expense
19 in the current year or whether you amortize a portion that
20 relates to the future benefit each year. Since the
21 current deduction for those kinds of recurring expenses
22 would not materially misstate income, they are allowed.

23 QUESTION: What about a hostile takeover, and
24 expenses incurred in connection with that?

25 MR. JONES: Well, the ordinary way to analyze

1 that, if you're the acquiring party, and you seek a
2 hostile takeover that doesn't succeed, your expenses are
3 deemed to be capital, but they're deducted as a loss in
4 the year that they're incurred -- I'm sorry, in the year
5 that the transaction falls apart, and that responds to
6 petitioner's suggestion that you have to have --

7 QUESTION: (inaudible)

8 MR. JONES: Well, not because an asset has
9 been --

10 QUESTION: Under the Government's theory.

11 MR. JONES: Under the Government's theory, they
12 are an expense that was incurred to create an asset that
13 was designed to have a future benefit, but when the asset
14 loses its value by the failure to conclude the
15 transaction, at that point in time we recognize the loss
16 that has occurred and allow it to be deducted under 165,
17 not under 162.

18 QUESTION: What about expenses of reorganization
19 or merger?

20 MR. JONES: Well, that -- that, of course, is
21 broadly speaking what this case is about. Reorganization
22 expenses, when incurred by a corporation to achieve future
23 benefits, which is the ordinary situation, are capitalized
24 under the structure of the business, and as counsel has
25 said, they remain in the capital structure until the

1 ultimate termination of the enterprise.

2 They have no determinable useful life. There's
3 no basis to amortize or depreciate, so they remain in the
4 current structure until an event of recognition occurs,
5 and the recognition event for those kinds of expenditures
6 is when the -- is when the asset is destroyed by the
7 termination of the enterprise.

8 QUESTION: But the initial corporate expenses
9 are treated differently to set up the corporation
10 initially?

11 MR. JONES: Well, prior to 1954, they were
12 treated the same. In 1954, Congress enacted section 248
13 that allows organizational expenses to be amortized. When
14 Congress did that, the legislative history at page A64 of
15 House Report 1337 shows that Congress knew that
16 reorganizational expenses were also capital in nature, but
17 expressly determined that only the organizational expenses
18 and not reorganizational expenses should be amortized.
19 That was a legislative determination made by Congress.

20 Functionally, it would be appropriate to
21 capitalize them both until the end of the enterprise,
22 because the benefit isn't exhaustive. The benefit of
23 organization or reorganization isn't exhausted in
24 60 months. Congress provided the privilege of a deduction
25 for organizational --

1 QUESTION: But what do you think the test is,
2 Mr. Jones, for knowing what must be capitalized and what
3 isn't? What is the taxpayer to apply as the test in
4 preparing a return?

5 MR. JONES: The test is a functional one of
6 properly matching expenses with the years they benefit
7 income, but it's a pragmatic test at the same time. It's
8 not pushed to extremes. We allow -- by regulation and
9 rules we allow advertising expenses to be deducted
10 currently, even though to some extent --

11 QUESTION: Well, is it possible to articulate
12 the test in any -- at any level of generality, and isn't
13 the tax law an area where it's desirable to have some kind
14 of clear standard?

15 MR. JONES: It is -- it is possible to, as I've
16 already tried to do, articulate the functional test.
17 Given the functional test, it is possible, and the courts
18 have articulated categorical rules, but the rules are
19 subject to exceptions. It is, for example, a categorical
20 rule that courts have consistently held that
21 reorganizational expenses should be capitalized. It is a
22 categorical rule that advertising expenses, on the other
23 hand, may be deducted currently, but we nonetheless
24 recognize exceptions.

25 For example, advertising that was designed

1 solely to promote a product not yet in production would be
2 capital in character, and they would be required to be
3 capitalized and either amortized -- and amortized over
4 some appropriate period.

5 This Court's --

6 QUESTION: Mr. Jones, what happens -- what
7 happens in this case if Unilever later disposes of this
8 company, so that the value that you think has been
9 acquired in this transaction, the value of the association
10 with Unilever, disappears. Can they take the deduction
11 then?

12 MR. JONES: Well, I'm not dodging the question,
13 I'll try to answer it, but I think it should be emphasized
14 that that isn't presented here, and the reason that should
15 be emphasized is because it depends -- it depends on
16 future events exactly how that transaction should be
17 characterized.

18 What courts have done in those situations -- the
19 McCrory case, the Vulcan Materials case -- they have said
20 that even though you dispose of the asset -- for example,
21 sell the assets that you acquired -- you nonetheless
22 retain in your corporation, the merged corporation, the
23 capital costs of the acquisition, because you obtain the
24 benefit of the joining of the corporate forces even if you
25 dispose of some of the assets later on.

1 So I think it's a factual inquiry, and different
2 facts could give different results, but the
3 ordinary -- the categorical rule on that situation is
4 well-established.

5 QUESTION: Well, if Unilever disposed of this
6 company, they would be selling the stock, I suppose.

7 MR. JONES: If Unilever --

8 QUESTION: And I thought the question was -- was
9 whether this is deductible by the subsidiary.

10 MR. JONES: I think you're absolutely right, and
11 I was trying to answer a different question.

12 QUESTION: Yes, you were answering a different
13 question.

14 MR. JONES: Right. You're absolutely right. If
15 Unilever simply sold the stock, then the basis -- the
16 basis that we're talking about, the capitalized expenses
17 we're talking about, are in National Starch --

18 QUESTION: Yes, but -- yes, but you say that --
19 you say that what they have acquired, that the long-term
20 asset they've acquired is the asset of the close
21 association with Unilever, which gives them all sorts
22 of -- all sorts of benefits. That's how --

23 MR. JONES: It does.

24 QUESTION: -- you describe it in your brief, so
25 I'm saying, what happens when Unilever says, get out, you

1 know, we're selling it to somebody else?

2 MR. JONES: There are three types of benefits
3 that are -- that are acquired by Indopco in this
4 reorganization. They acquired access to capital possessed
5 by Unilever. That's a --

6 QUESTION: Right.

7 MR. JONES: -- characteristic function of
8 reorganization.

9 QUESTION: Right, and that would disappear
10 when -- when Unilever disposed --

11 MR. JONES: But they would enjoy the benefit of
12 it during some period of time, and since there is no way,
13 a priori, to determine when that benefit is exhausted -- I
14 mean, they could have received the benefit by expansion.
15 The ordinary way that you benefit from access to capital
16 is by expansion. Theoretically they could expand. They
17 could become three times as big, and then they're sold.
18 They've already received and they possess the benefit of
19 that access to capital, so there would be no recognition
20 event that has occurred to provide for that to be
21 deducted.

22 The second benefit that they got from the
23 reorganization was the synergy between working
24 with -- combining their assets and abilities with
25 Unilever's business needs. There again, that synergy can

1 create benefits for them that would exist even after the
2 entities had separated.

3 For example, the trial testimony in the tax
4 court from the Indopco officers describes new ventures
5 that they've begun to supply specialized raw materials for
6 Unilever. That kind of expansion of the corporation is
7 the sort of thing that was made possible by this
8 reorganization. It is a long-term benefit which is
9 received by the corporation. It does not terminate
10 predictably, and that's really all we have to talk about
11 at that point, is can we predict now when it will
12 terminate? No, we can't.

13 Your question about whether, if it was sold
14 later on how we would treat it, is quite honestly a
15 difficult question that would depend upon a different
16 factual record and that would require a very -- a
17 difficult analysis. I can't categorically dispose of the
18 possibility that it would be a recognition event as you
19 suggested, but I can categorically say it might not be,
20 and that's -- that's really --

21 QUESTION: May I vary Justice Scalia's question?
22 You haven't gotten to your third benefit. I would guess
23 some -- maybe you ought to tell us, what is --

24 MR. JONES: Well, the third --

25 QUESTION: You said, access to wealth and

1 synergy. What -- what --

2 MR. JONES: The third benefit was -- was a
3 permanent one. It resolved the persistent problem that
4 they had of retiring the shares of a major shareholder in
5 a way that did not interrupt their ongoing business, and
6 if I might say before --

7 QUESTION: Well, let me give you my other
8 question --

9 MR. JONES: Okay.

10 QUESTION: -- because you may want to cover it
11 at the same time. Supposing none of these three features
12 had been present. Supposing they sold to a totally
13 unrelated company that was no larger in wealth than the
14 existing shareholders. As I read the Government's brief,
15 you'd take the same position in that case?

16 MR. JONES: Yes, we would, and that gets --

17 QUESTION: So we really shouldn't rely on these
18 factors?

19 MR. JONES: Well, I think you should rely on
20 them. I think they're important, but there are two
21 separate tests that courts have looked at in the
22 reorganization expense area.

23 The first, the older test, is the Motion Picture
24 Capital Corporation test, where the court -- the Second
25 Circuit emphasized that reorganization expenses don't

1 provide any current benefit to the corporation. They do
2 not assist in the production of current income, they do
3 not -- they are not incurred in the ordinary course of
4 producing income, certainly none of the expenses incurred
5 by Indopco have anything to do with generating income for
6 the corporation in 1978, the year they were incurred.

7 It is the second test, as exemplified by Justice
8 Blackmun's opinion in General Bancshares for the Eighth
9 Circuit, where the court stressed that reorganization
10 expenses do provide a long-term benefit for the
11 corporation and are not devoted to current income
12 production or other immediate needs of the corporation, so
13 those -- this is an area where pragmatic balancing of
14 objectives is the functional necessity of -- of the study.

15 When the future benefit is predominant and the
16 current benefit is nonexistent, clearly that is an
17 appropriate occasion for capitalization. I'm not -- I'm
18 not saying --

19 QUESTION: What's the answer when there's no
20 benefit -- when there's no benefit?

21 MR. JONES: Well --

22 QUESTION: Justice Stevens' question -- no
23 discernible benefit.

24 MR. JONES: If there's no discernible benefit
25 from an expense to the business, period, then the question

1 may -- I have to ask, I would have to ask in what context
2 that is made.

3 If you're talking about in a reorganizational
4 context, then the answer is that it is not deductible
5 because it has nothing to do with generating income in the
6 year that it's made. It is an expense incurred to achieve
7 something that will last into the future, a reorganizing
8 of the corporation, and that kind of organizational or
9 reorganizational expense is the most characteristic type
10 of capital expenditure.

11 Well, this Court has struggled for over 60 years
12 and has itself held that there is no verbal formula that
13 supplies a ready touchstone.

14 QUESTION: Assume --

15 QUESTION: What about the situation where a
16 company unsuccessfully opposes a hostile takeover,
17 claiming that this couldn't possibly benefit this company,
18 all it could do is benefit the -- these raiders, and that
19 they spent a lot of money and they -- and it's -- and they
20 get taken over anyway? What about those expenses?

21 MR. JONES: We recognize two possible outcomes
22 in that situation.

23 QUESTION: Because that may be a case where
24 there's no benefit.

25 MR. JONES: There may be no benefit, there may

1 be no appropriate deduction, but there may also be a
2 future benefit. I mean, when a -- it is common in these
3 commercial situations, when someone proposes a takeover,
4 for them to be resisted, and whether the degree of
5 resistance is called hostile or not hostile is a --

6 QUESTION: Yes.

7 MR. JONES: -- is a difficult --

8 QUESTION: But in any event, you say that in
9 this example there would be no current deduction?

10 MR. JONES: In -- in the --

11 QUESTION: In the example I just --

12 MR. JONES: Opposing, hostile --

13 QUESTION: The unsuccessful opposition to a
14 hostile takeover.

15 MR. JONES: That is correct. There may be --

16 QUESTION: No current -- no current deduction.

17 MR. JONES: There may be a capital -- it may
18 properly be capitalized --

19 QUESTION: It may be, but not currently.

20 MR. JONES: But there's no current deduction,
21 because it doesn't benefit current income, but
22 in -- sorry.

23 QUESTION: By the compulsory -- by the
24 compulsory nature of this expense, let's assume -- and you
25 might quarrel with it on the facts, but let's assume that

1 the company, the petitioner is correct, that they were
2 required as a matter of corporate policy, as a matter of
3 fiduciary responsibility, to incur these expenses, it
4 seems to me that the compulsory aspect of the case somehow
5 weighs in favor of the taxpayer, although I can't quite
6 fit it into a formulation as to why that should be.

7 MR. JONES: Well, the -- I think the answer to
8 that was -- is in the Woodward v. Commissioner case, where
9 the court emphasized that you look to the origin of the
10 expense, not its classification as a fiduciary expense, or
11 whatever.

12 As the tax court said in this case, it would let
13 the tail wag the dog to say that these expenses were
14 incurred out of fiduciary duty. In fact, they were
15 incurred to facilitate the reorganization. The origin of
16 the expense was the reorganization, not the fiduciary
17 duty. That argument would be like saying that attorney's
18 fees incurred in registering stock are simply designed to
19 satisfy legal requirements of the SEC, and so they're
20 current. That's not the way the court has looked at it.
21 They've looked at what is the function of --

22 QUESTION: Yes, but when you register stock, you
23 have the option to engage in the transaction or not.
24 Here, at least at the outset, they had -- they had no
25 option but to incur the expense, or to make the payment.

1 MR. JONES: I'm not sure that I would agree that
2 they had no option but to incur a \$2 million expense. I
3 think that --

4 QUESTION: Well, let's assume that there was a
5 finding to that effect.

6 MR. JONES: Well, even if they had no option, if
7 the result of the -- that's like saying that you have no
8 option but to pay other expenses that are capital in
9 nature, and there are examples of that.

10 If the reason that the expense has to be
11 incurred is to facilitate a reorganization, as it was
12 here, then whether it's an optional expenditure -- you
13 have to have legal title opinions, you have to do other
14 things to reorganize a company, but that doesn't mean it's
15 not a capital expenditure.

16 QUESTION: And what -- what happens -- can you
17 give other instances of expenditures that you don't know
18 whether they're capital or current expenditures until you
19 wait and see whether the -- whether the thing is
20 successful or not? I mean, I find that very strange, you
21 know.

22 MR. JONES: I'm not --

23 QUESTION: The client comes to me and says, do I
24 deduct this this year, or not, and you say well, you know,
25 have to wait and see. If it's a successful takeover, no;

1 if it is unsuccessful, it's an ordinary expense.

2 MR. JONES: Well, it's -- it's like any other
3 loss, Justice Scalia. You don't know when it's going to
4 happen, but when it happens it's then deductible.

5 QUESTION: Oh, I see, you're allowing it to be
6 deducted as a loss when it happens, not as a -- I've got
7 you.

8 MR. JONES: I'd like to discuss the suggestion
9 of petitioner that in Lincoln Savings the Court adopted
10 the separate and distinct asset test as a panacea for all
11 capitalization questions.

12 In a literal sense, the fact that an expense
13 creates an asset that is separate and distinct is neither
14 necessary nor sufficient for capitalization. Prepaid rent
15 expense for 6 months is a distinct capital asset, but it's
16 fully deductible if it's fully consumed in the current
17 year. A ballpoint pen is an asset, and it may well
18 provide benefits beyond a single year, but it's fully
19 deductible as a regularly recurring ordinary business
20 expense.

21 Goodwill purchased in connection with the
22 business is defined by regulations as a capital asset, but
23 in no real sense is it a separate and distinct asset,
24 because it only exists in combination with the other
25 assets of the corporation. It has no independent value.

1 There is a semantic circularity in this problem.
2 From an accounting standpoint, any capitalized expense
3 would be called an asset. To say that an expense that
4 creates an asset should be capitalized is a
5 chicken-and-egg kind of problem.

6 In Lincoln Savings, the Court therefore
7 emphasized that the asset created by the premium expenses
8 that were involved in that case provided value to the
9 corporation that was more permanent than temporary. The
10 premium expense was capital in nature because it provides
11 a benefit, quote, not only in the current year, but in the
12 future, and as Justice Blackmun concluded in the General
13 Bancshares case in the Eighth Circuit, whether an expense
14 is characterized as an asset or not is not itself
15 critical.

16 If the expense affords meaningful long-term
17 benefits for the corporation, it is capital in nature
18 because the contribution it makes to the corporation is
19 not fully consumed and therefore not properly matched
20 against income in the current period.

21 QUESTION: Do you think that General Bancshares
22 and Lincoln Savings are in tension?

23 MR. JONES: Are -- are what?

24 QUESTION: Are in tension, there's any
25 inconsistency?

1 MR. JONES: I don't think there's any logical
2 tension whatever between them. I think that the Court in
3 both cases addressed the issues that were necessary to
4 decide the case. There was a -- it is a characteristic
5 result in capital expense cases for courts to focus upon
6 the existence of assets, for exactly the reason that
7 petitioners would focus on that.

8 There are -- when especially a tangible asset is
9 seen to exist, a financial asset is seen to exist, it is
10 easier to focus on the capital character of that, but in
11 the General Bancshares the Court emphasized that whether
12 there's a tangible or intangible asset, what is relevant
13 is that the expense provides long-term benefits for the
14 corporation, that it would mismatch income to deduct all
15 of that expense in the current period.

16 QUESTION: I think the -- the older case was
17 cited in Lincoln Savings, anyway, for what that's worth.

18 MR. JONES: Well, I think it was -- well, since
19 you wrote both, you could best explain, but I believe it
20 was --

21 (Laughter.)

22 MR. JONES: I believe that rather than being in
23 tension, these cases are perfectly consistent.

24 QUESTION: Maybe I've been around too long, you
25 see. Meet myself coming back on these cases.

1 (Laughter.)

2 MR. JONES: Well, at least in our view, Your
3 Honor, you were right both times, and we think if you put
4 those two together the Government's right in this case.

5 QUESTION: Mr. Jones, let me -- let me ask you
6 about the situation again in which the company is now
7 owned by one large corporation, the stock is acquired by
8 another one. There is no conceivable benefit to the
9 company at all, it is solely a benefit to the
10 stockholders, the company is not acquiring any new
11 connections, or any access to capital that it didn't have.
12 On what possible theory can you say that this has to be
13 treated as a capital expenditure?

14 MR. JONES: Well, I think I said that in the no
15 possible benefit situation it was not a current expense.
16 I don't think I went on to say that it's therefore a
17 capital expense.

18 QUESTION: I see.

19 MR. JONES: And if I may answer --

20 QUESTION: All right.

21 MR. JONES: I can explain that.

22 QUESTION: All right.

23 MR. JONES: In the tax court we argued that this
24 expense was either a capital expense or a dividend,
25 constructive dividend to the shareholders. It would be a

1 constructive dividend to the shareholders if it was
2 primarily for the shareholders' benefit and not for the
3 benefit of the corporation. It would be a --

4 QUESTION: Even -- even if the corporation was
5 obliged in law to make these expenditures?

6 MR. JONES: If the obligation was one they owed
7 to the shareholders, which is, I believe, the situation
8 you have in mind here, yes, that would not change the
9 case.

10 Our position was that if it benefits the
11 corporation, then it's capital. If it benefited the
12 shareholders, it was a constructive dividend. The court
13 of appeals didn't address that, the tax court didn't
14 address it, we're not asking this court to address it, but
15 we do think that the findings of the tax court support
16 capitalization and do not support dividend treatment.

17 The findings of the tax court were that this
18 created several long-term benefits for the corporation.
19 We think that's sufficient in this case to remove the
20 issue of constructive dividend treatment.

21 We also agree with petitioner it would be very
22 hard to sell to the shareholders that they -- they
23 received any benefit from this \$2.25 million fee, because
24 all that Morgan Stanley recommended was a purchase -- was
25 that the sale go forward at \$70. It was management that

1 insisted upon and obtained a higher price.

2 I wanted to return, if I could, to the third
3 benefit that Indopco received from its reorganization,
4 because it is in its own sense extremely important. By
5 retiring the shares of the major stockholder, Indopco
6 removed what they called the overhang on the market, of
7 the existence of that position.

8 The only way this overhang could be removed was
9 through a reorganization that changed the common stock of
10 the Greenwalls to fixed value preferred stock, and the
11 fixed value preferred stock was secured by a \$100 million
12 capital infusion from Unilever to Holding. That's
13 described at page 76 in the joint appendix. It is
14 described in somewhat murky detail in the exchange
15 agreement, which is at page 500 of the court of appeals'
16 record.

17 That substantial capital infusion solved a
18 long-term problem for the corporation. There was an
19 additional \$2 million capital infusion from Unilever to
20 Holding to Starch, or Indopco, which was used for the
21 purpose of retiring the employee's rights in the stock.
22 They didn't hold stock, they held rights to stock. That
23 \$2 million retired those rights, which is clearly a
24 long-term benefit for the corporation. Now, that's
25 described at page 564 in the court of appeals' record.

1 These long-term benefits for the corporation
2 bring this case squarely within the rule described by
3 Bittker and Eustice that the reorganizational expenses of
4 an acquired corporation are not deductible currently but
5 should be capitalized.

6 Unless there are further questions, I have
7 completed.

8 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Jones.
9 Mr. Hiegel, you have 5 minutes remaining.

10 REBUTTAL ARGUMENT OF RICHARD J. HIEGEL

11 ON BEHALF OF THE PETITIONER

12 MR. HIEGEL: I'd like to return to a point that
13 Mr. Jones -- an answer to Justice Scalia's question
14 concerning hostile takeovers. You asked him, Justice
15 Scalia, what would happen, what kind of deduction would be
16 allowed if there were a hostile takeover that turned out
17 to be unsuccessful, and counsel answered that there would
18 be a, sort of a suspension of the costs, and then when it
19 turned out -- it proved out that the transaction was
20 unsuccessful, the takeover was unsuccessful, the company
21 had successfully resisted it, that there would be a loss,
22 a deductible loss.

23 Now, the only provision in the code that allows
24 a deductible loss is section 165, and the amount of the
25 deduction that is allowed by that section is limited to

1 the basis of the property. It says, for the purposes of
2 subsection (a), which is the subsection that allows the
3 loss, the basis for determining the amount of the
4 deduction for any loss shall be the adjusted basis for
5 determining the loss from the sale or other disposition of
6 property.

7 So there's no loss unless you have property with
8 a basis. Now, where is the property in the case of the
9 hostile takeover? There is no property. The company
10 itself has no property. The company that's trying to do
11 the takeover is trying to acquire stock --

12 QUESTION: You would allow that loss if they
13 allowed it, I suppose.

14 MR. HIEGEL: No, we would not, Your Honor, but I
15 think it illuminates the flaw in their theory. Their
16 theory is, any time you have a future benefit you have to
17 capitalize it.

18 QUESTION: Well, you may have trouble
19 identifying the property, but you wouldn't have any
20 trouble at all in finding out what it cost.

21 MR. HIEGEL: That's correct, whatever it is,
22 whatever it is, Your Honor.

23 QUESTION: Well, but do you claim it's an
24 ordinary and necessary business expense under 1627

25 MR. HIEGEL: Yes. Yes, we do, Your Honor, and

1 that's -- and that's what we claim with respect to these
2 expenses. These expenses did not produce any property,
3 and I disagree with counsel's answer to the question about
4 current benefit. There was no -- these expenses did not
5 produce revenue, but they did help the board discharge its
6 fiduciary obligations.

7 Now, a lot of expenses a corporation incurs that
8 don't produce any benefit, particularly a publicly-held
9 company -- you have to send reports to the SEC, you have
10 to send reports to stockholders, you have to comply with
11 safety regulations, you have environmental laws, things
12 that would actually hinder your revenue-producing
13 capacity. Nevertheless, there's no question that these
14 are deductible.

15 These are things that a company has to do in
16 order to carry on business as a company, and just because
17 they don't produce a current income doesn't mean they're
18 not deductible as ordinary and necessary business expenses
19 under 162(a), and I think you have to look at the origin
20 of these costs.

21 Counsel mentioned the Woodward case. The
22 Woodward case held that the costs were capitalizable
23 because they adhered in the process of acquisition. The
24 taxpayer before the court in that case was the -- was the
25 company that was making the acquisition. This company

1 here is the target. It is not making any acquisition.
2 The origin of its expenses was the fiduciary duty that the
3 board had to the stockholders, not any process of
4 acquisition by the company itself.

5 The other point that -- that I think reveals a
6 flaw in the Government's position about future benefit, it
7 just doesn't account for a whole host of expenses that
8 everyone would agree are deductible. Advertising the
9 courts recognize, and there can be no doubt that
10 advertising has a future benefit. Strategic planning,
11 companies have whole departments devoted to strategic
12 planning for the future -- nothing but the future.

13 Those deductions are -- those expenses are
14 clearly deductible. Companies could not carry on business
15 without doing things that -- that affect their future
16 revenue, and for long periods of time in the future, and
17 yet they -- they are deductible. There's no question.

18 QUESTION: Well -- well, isn't there a separate
19 section for research and development?

20 MR. HIEGEL: Research and development is a
21 separate section, that's correct, because there you would
22 have an asset. You are, in research and development --

23 QUESTION: Well, you might or might not,
24 depending on how the research comes out.

25 MR. HIEGEL: That's -- that's correct. That's

1 correct. That is a special section in the code designed
2 to encourage research and development. It is -- it does
3 not -- it does not indicate any question of principle of
4 capitalization. It is acknowledged to be a special
5 benefit, like depletion allowance, for example, that -- to
6 give benefits to the oil, to encourage the oil and gas
7 exploration.

8 QUESTION: Well, I'm not sure how to distinguish
9 that between your strategic planning, from your strategic
10 planning example.

11 MR. HIEGEL: My strategic planning -- it is
12 deductible without regard to any special section of the
13 code, without regard to any such section as section 174,
14 because there is no asset created.

15 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Hiegel.

16 MR. HIEGEL: Thank you, Your Honor.

17 CHIEF JUSTICE REHNQUIST: The case is submitted.

18 (Whereupon, at 10:59 a.m., the case in the
19 above-entitled matter was submitted.)
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CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

901-1278 IDOPCO, INC., Petitioner V. COMMISSIONER
OF INTERNAL REVENUE

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BY alan friedman
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