



Code particularly in light of *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992).

BACKGROUND

Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 263 generally prohibits deductions for capital expenditures. Section 263(a)(1) provides that no deduction is allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. Under § 263(a)(2), no deduction is allowed for any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made in the form of a deduction for depreciation, amortization, or depletion.

In *INDOPCO*, the Supreme Court of the United States concluded that certain legal and professional fees incurred by a corporation to facilitate a friendly acquisition of the corporation created significant long-term benefits for the taxpayer and, therefore, were capital expenditures. In reaching this decision, the Court specifically rejected the argument that its decision in *Commissioner v. Lincoln Savings & Loan Association*, 403 U.S. 345 (1971), should be read as holding “that *only* expenditures that create or enhance separate and distinct assets are to be capitalized under § 263.” *INDOPCO* at 86–87 (emphasis in original). The Court further stated that “[a]lthough the mere presence of an incidental future benefit—‘*some* future aspect’—may not warrant capitalization, a taxpayer’s realization of benefits beyond the year in which the expenditure is incurred is undeniably important in determining whether the appropriate tax treatment is immediate deduction or capitalization.” *INDOPCO* at 87 (emphasis in original).

The Service believes that the *INDOPCO* decision did not change the fundamental legal principles for determining whether a particular expenditure may be deducted or must be capitalized. Since the decision in *INDOPCO*, the Service has issued a variety of revenue rulings applying §§ 162(a) and 263(a) to specific expenditures. For

example, the Service ruled that the *INDOPCO* decision did not change the treatment of advertising costs (Rev. Rul. 92–80, 1992–2 C.B. 57), incidental repair costs (Rev. Rul. 94–12, 1994–1 C.B. 36), or severance payments (Rev. Rul. 94–77, 1994–2 C.B. 19), all of which are generally deductible under § 162.

REQUEST FOR PUBLIC COMMENT

The Service continues to receive numerous informal inquiries regarding issues of capitalization. Taxpayers should be aware that, in appropriate circumstances, they can receive private letter rulings on the deductibility or capitalization of specific expenditures. The Service welcomes comments on possible changes to the private letter ruling process that would facilitate advance resolution of these issues. In addition, the Service requests comments concerning: (1) whether general guidance clarifying the fundamental principles of capitalization would aid in resolving capitalization issues; (2) what specific approaches, principles, or issues such guidance should address; and (3) whether safe-harbor amortization periods should be provided for certain capitalizable expenditures and what data would support any suggested periods.

Written comments should be submitted by May 6, 1996. Written comments should be sent to: Internal Revenue Service, Attn: CC:DOM:CORP:R (IA-Branch 5), Room 5228, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. All materials submitted will be available for public inspection and copying. During its review of the comments, the Service will continue to process private letter rulings and continue to resolve issues under §§ 162 and 263(a) raised in examinations.

DRAFTING INFORMATION

The principal author of this notice is John Moriarty of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Moriarty on (202) 622-4950 (not a toll-free call).

Request for Comments on Further Capitalization Guidance

Notice 96–7

This notice invites public comment on approaches the Service should consider to address issues raised under §§ 162 and 263 of the Internal Revenue