UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 49 | Number 2 Article 13

2-1-1971

Income Taxation -- Nondeductibility of Appraisal Litigation Expenses

E. Cader Howard

is in order, whether it be through judicial reconstruction of the removal statute with an eye toward policy considerations prominent in this day, or through act of Congress.

JOHN WOODWARD DEES

Income Taxation—Nondeductibility of Appraisal Litigation Expenses

In two recent decisions, the United States Supreme Court ruled that litigation expenses incurred by either individual stockholders[1] or a corporation[2] in a statutory appraisal proceeding to value shares of dissenting shareholders were not deductible as nonbusiness[3] or business[4] expenses. The holdings in *Woodward v. Commissioner*[5] and *United States v. Hilton Hotels Corp.*[6] resolved conflicting results reached earlier by the eighth[7] and seventh[8] circuits in essentially similar fact situations. The disallowance of the claimed deductions in these cases may have significant impact upon future corporate decisions regarding proposed alterations of their corporate structures when there is a substantial likelihood of appraisal proceedings being instituted. Moreover, the character of the appraisal remedy itself as a protective device for the interests of dissenting shareholders may be affected by the decisions.

In *Woodward*, taxpayers owning a majority of stock in a publishing firm voted to extend the corporation's finite charter. The minority stockholder voted against the extension and, pursuant to Iowa law,[9] majority taxpayers negotiated to purchase the minority's stock interest. Following

---

[1] Woodward v. Commissioner, 397 U.S. 572 (1970).

[2] United States v. Hilton Hotels Corp., 397 U.S. 580 (1970).

[3] INT. REV. CODE of 1954, § 212 [hereinafter cited as § 212] provides in general:

> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses . . . (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.

[4] INT. REV. CODE of 1954, § 162(a) [hereinafter cited as § 162] permits the deduction of all ordinary and necessary trade or business expenses.

[5] 397 U.S. 572 (1970).

[6] 397 U.S. 580 (1970).

[7] Woodward v. Commissioner, 410 F.2d 313 (8th Cir. 1969).

[8] Hilton Hotels Corp. v. United States, 410 F.2d 194 (7th Cir. 1969).

[9] IOWA CODE ANN. § 491.25 (1949), provides that the majority shareholders voting for renewal "shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal." Although the Iowa statute would characterize the action taken by the majority stockholders as a "renewal," in essence the action involved the creation of a perpetual corporation from a finite one.

unsuccessful efforts to value the stock, taxpayers initiated appraisal proceedings in state court. Eventually the stock was purchased by the majority at a price determined in the appraisal proceeding.[10]

When taxpayers sought to deduct over twenty-five thousand dollars paid to attorneys, accountants, and appraisers, the Commissioner of Internal Revenue characterized the amounts as capital expenditures that were "incurred in connection with the acquisition of capital stock of a corporation"[11] and disallowed the claimed deductions. The ruling was affirmed by the Tax Court[12] and the Eighth Circuit Court of Appeals.[13]

In *Hilton* the taxpayer corporation, owning approximately ninety per cent of the Hotel Waldorf-Astoria, voted to merge the corporations.[14] Prior to the vote, a minority of Waldorf shareholders filed their objections to the merger and demanded payment for their shares in accordance with New York Stock Corporation Law.[15] Hilton consummated the merger and made a cash offer to the dissenters. The offer was rejected by the dissenters who then began appraisal proceedings in state court, as provided for by section 91 of the New York Stock Corporation Law.[16] A settlement was agreed to by the parties and approved by the court.[17]

Hilton sought to deduct consulting fees, legal expenses, and expenditures for other professional services in connection with the appraisal proceeding. As in *Woodward*, the Commissioner disallowed the deductions, asserting that they were capital expenditures.[18] Following payment of the tax and filing of suit for refund by Hilton, the district court ruled that the

---

[10] 397 U.S. at 573.

[11] *Id.*

[12] Fred Woodward, 49 T.C. 377 (1968).

[13] Woodward v. Commissioner, 410 F.2d 313 (8th Cir. 1969).

[14] 397 U.S. at 582.

[15] Section 91 enabled a stockholder who voted against consolidation to demand an appraisal to determine the fair market value of his shares and to have the shares paid for pursuant to section 21. Ch. 359, § 7 [1937] N.Y. Sess. L. 936, now embodied in N.Y. BUS. CORP. LAW § 623(c) (McKinney 1963). Section 21 of the New York Stock Corporation Law provided:

> (6) Any stockholder demanding payment for his shares shall have no right to receive any dividends or distributions payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights of a shareholder of the corporation in respect to such stock, except the right to receive payment for the value thereof.

Ch. 647, § 6 [1950] N.Y. Sess. L. 1504, now embodied in N.Y. BUS. CORP. LAW 623(e) (McKinney 1963).

[16] Ch. 359, § 7 [1937] N.Y. Sess. L. 936.

[17] 397 U.S. at 582.

[18] *Id.*

appraisal litigation expenses were deductible.[19] Its decision was affirmed by the Seventh Circuit Court of Appeals.[20]

Four factual differences can be discerned in the two cases. First, the type of underlying transaction in *Woodward* was an extension of a finite charter to a perpetual one; *Hilton* involved a statutory merger. Second, the laws of the two situs states differed with regard to the time when title to the dissenters' stock is deemed to have passed. Under Iowa law, title of the stock did not pass until after the price had been determined by the parties or in the appraisal proceeding.[21] New York law, however, provides that title passes as soon as the minority registers its dissent, at which point the dissenters become creditors of the acquiring company for the fair value of their stock.[22] Third, in *Woodward* the individual majority stockholders were required to purchase the dissenter's interest,[23] whereas in *Hilton* the corporation acquired the minority's shares.[24] Finally, deductions in the two cases were sought under different sections of the Internal Revenue Code. Individual taxpayers in *Woodward* sought to deduct appraisal expenses as nontrade or nonbusiness expenses under section 212. The Hilton corporation claimed deduction of its appraisal litigation expenses as ordinary and necessary business expenses under section 162.

Upon review, the Supreme Court disallowed the claimed deductions in both cases. The principal holding was delivered in *Woodward* in which Mr. Justice Marshall began by noting that capital expenditures were not deductible under either section 212 or section 162,[25] sections of the Internal Revenue Code that had been judicially declared to be *in pari materia*.[26]

[19] Hilton Hotels v. United States, 285 F. Supp. 617 (N.D. Ill. 1968).
[20] 410 F.2d 194 (7th Cir. 1969).
[21] *See* note 9 *supra*.
[22] *See* note 15 *supra*; *see also* 397 U.S. at 583.
[23] IOWA CODE ANN. § 491.25 (1949).
[24] *See* note 16 *supra*.
[25] 397 U.S. at 574; INT. REV. CODE of 1954, § 263(a) [hereinafter cited as § 263], provides generally that no deduction will be allowed for capital expenditures. TREAS. REG. § 1.263(a)-(b) (1958), defines capital expenditures as "amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer, such as plant or equipment, or (2) to adapt property to a new or different use."
[26] 397 U.S. at 575, n.3; *cf.* Bingham v. Commissioner, 325 U.S. 365, 373 (1944). The significance of this statement is that the fact of deduction being sought in one case under section 162 and in the other under section 212 is of no consequence since Congress provided the nonbusiness deduction in 1941 to afford individual taxpayers the same opportunities to deduct certain expenses from gross income that had been available to corporate taxpayers. *Id.* at 373-74, *citing* H.R. REP. No. 2333, 77th

He then proceeded to state that any costs incurred in the acquisition or disposition of a capital asset were capital in nature, including such ancillary expenses as legal and accounting fees.[27] Mr. Justice Marshall rejected the "primary purpose" test as a standard for determining whether the costs were to be considered as "incurred in the acquisition or disposition of a capital asset."[28] This test had been adopted by the seventh circuit in *Hilton*[29] and two lower courts in other cases involving deductions for appraisal litigation expenses.[30] Instead of asking whether the

---

Cong., 2d Sess. 46, 74-76 (1944); S. Rep. No. 1631, 77th Cong., 2d Sess. 87-88 (1944).

[27] 397 U.S. at 575-76; *see also* Spangler v. Commissioner, 323 F.2d 913 (9th Cir. 1963) (taxpayer's litigation expenses in recovering property sold upon fraudulent inducement held to be capital expenditures); United States v. St. Joe Paper Co., 284 F.2d 430 (5th Cir. 1960) (taxpayer's legal expenses following acquisition of stock in company about to reorganize held to be part of stock's cost and capital in nature). *See generally* 4A J. Mertens, Law of Federal Income Taxation §§ 25.25, 25.26, 25.40, 25A.15 [hereinafter cited as Mertens].

[28] 397 U.S. at 577. The "primary purpose" test was first developed with reference to Treas. Reg. § 1.263(a)-2(c) (1958), which requires expenditures incurred in "defending or perfecting title to property" to be capitalized. Strictly construed, this regulation would require the capitalization of any litigation expenses since title may be conceivably affected in virtually any suit against a taxpayer. Convinced that Congress did not intend such a fate for all legal expenses, the courts determined that such expenses be capitalized under the regulation only when the taxpayer's "primary purpose" in the litigation was to defend or perfect title to property. *See* Rassenfoss v. Commissioner, 158 F.2d 764 (7th Cir. 1946).

[29] 410 F.2d at 196.

[30] Vermont Bank & Trust Co. v. United States, 296 F. Supp. 682 (D. Vt. 1969); Smith Hotel Enterprises, Inc. v. Nelson, 236 F. Supp. 303 (E.D. Wis. 1964). *But see* Boulder Bldg. Corp. v. United States, 125 F. Supp. 512 (W.D. Okla. 1954). If the "primary purpose" test were applied to *Woodward* and *Hilton*, the expenditures would probably be deductible. The "primary purpose" tests asks simply what *chiefly motivated* or *prompted* the taxpayer to incur the expenditure in question. If the expenditure was not incurred in order to effect the acquisition of a capital asset, the expenses would be deductible. Here both underlying transactions had been completed prior to the initiation of appraisal proceedings. Taxpayers arguably incurred the appraisal litigation expenses and acquired the dissenters' shares only because of statutory requirements. Indeed, the appraisal proceedings could have been avoided if dissenters and the taxpayers in each case had been successful in negotiating the value of the former's shares. Thus, it could not be argued that the appraisal proceedings were necessary to complete either the renewal in *Woodward* or the merger in *Hilton*. The appraisal remedy aims at the establishment of a fair value for dissenters' shares. *See* note 56 *infra*. Accordingly, taxpayers in *Woodward* and *Hilton* should be able to argue successfully that the "primary purpose" of incurring the appraisal expenses was not to complete a capital transaction or to acquire a capital asset, but only to establish the "fair value" of dissenters' stock, which under Iowa and New York law the majorities and acquiring corporation were required respectively to purchase. The expenditures would then be deductible. *See*, Comment, *Deductibility of Appraisal Litigation Expenses*, 70 Colum. L. Rev. 538, 548-50 (1970).

primary purpose of the expenditure was to acquire a capital asset, the Court held that the proper inquiry looked to the "origin and character of the claim."[31] If the expenses in question originated in the process of acquiring or disposing of a capital asset, the expenses must be capitalized. The Court reasoned that since the establishment of the purchase price, herein accomplished by the appraisal court, was clearly part of the process of acquisition, it followed that the appraisal litigation expenses were part of the stock's cost and had to be capitalized.[32]

The Court in *Hilton* primarily relied upon *Woodward* to rule that the appraisal expenses were nondeductible. The taxpayer had argued that the expenses could not be regarded as part of the process of acquisition since, under New York law, unlike the Iowa law governing the parties in *Woodward,* title had already passed to the acquired corporation before appraisal proceedings commenced. The Court in *Hilton* rejected this argument, saying that the "functional nature of the appraisal remedy as a forced purchase of the dissenters' stock is the same, whether title passes before or after the price is determined."[33]

The Supreme Court's disallowance of appraisal litigation cost deduction in *Woodward* and *Hilton* regrettably leaves many questions unanswered. The Court correctly noted in *Woodward* that expenses incurred in connection with the acquisition or disposition of a capital asset had to be capitalized.[34] What the Court was really called upon to decide is how sufficiently related to a capital acquisition or disposition an expense must be before it is deemed to be incurred *in connection with* the acquisition or disposition and is therefore required to be capitalized. Will deduction problems of this nature be resolved by determining if the expenditure in question was incurred in order to effect the acquisition or disposition of a capital asset, *i.e.,* if such an objective was the taxpayer's "primary purpose?"[35] Or will a more indirect causal relationship between the expense and capital acquisition or disposition require the capitalization of the former? The Court in *Woodward* adopted the latter approach.

As previously stated, the Court concluded in *Woodward* that an "origin and character" test should be used to determine the deductibility

[31] 397 U.S. at 578. The Court relied on United States v. Gilmore, 372 U.S. 39 (1963).
[32] 397 U.S. at 579.
[33] *Id.*
[34] *Id.* at 575.
[35] *See* note 28 *supra.*

tion of a capital asset.[36] Such a test looks to the "origin and character" of the expenditure, rather to its "primary purpose." Rejecting the "primary purpose" test as too uncertain for such tax problems, the Court preferred the "simpler inquiry whether the origin of the claim litigated is in the process of acquisiton itself."[37] The Court relied upon *United States v. Gilmore*,[38] in which expenses of defending a divorce suit were disallowed because the claim stemmed from the marital relationship and not from the conservation of income-producing assets.[39]

The genesis of the "origin and character" type of analysis for tax problems may be found in *Lykes v. United States*,[40] in which a taxpayer was not allowed to deduct litigation expenses incurred in contesting the amount of his federal gift tax under section 212 because the expense was attributable to the gifts and not to the conservation of his income-producing assets.[41] The Court in *Lykes* reasoned that since the litigation expenses would not have arisen but for the gift and those expenses could be traced to the gift for their origin, the expenses were of a personal nature and could not be deducted.[42] Applying the type of causal analysis employed in *Lykes* to *Woodward* and *Hilton*, the appraisal litigation expenses would be regarded as *originating* in the process of acquiring the dissenters' shares, and since such acquisition is of a capital *character*, the expenses would not be deductible.[43]

The problem with an "origin and character" type of analysis was suggested by Mr. Justice Jackson in his dissent in *Lykes*:

> A majority of my brethren think they can escape this conclusion by going further back in the chain of causation. They can say the cause of this legal expense was the gift. Of course one can reason, as my brethren do, that if there had been no gift there would have been no tax, if there had been no tax, there would have been no deficiency, if there were no deficiency there would have been no contest, if there were no contest there would have been no expense. And so the gifts caused

[36] 397 U.S. at 577.
[37] *Id.*
[38] 372 U.S. 39 (1963).
[39] *Id.* at 51.
[40] 343 U.S. 118 (1952).
[41] *Id.* at 125.
[42] The specific holding of *Lykes* was overruled by Congress through an amendment of section 212 in the Internal Revenue Code of 1954, but the causal analysis employed by the majority in that decision has survived. Snyder, *The Impact of Supreme Court Decisions of the Deduction of Legal Fees*, 23 TAX LAW. 339, 342 (1970).
[43] *See* 397 U.S. at 577.

> the expense. The fallacy of such logic is that it would be just as possible to employ it to prove that the lawyer's fees were caused by having children. If there had been no children, there would have been no gift . . . . If this reasoning were presented by a taxpayer, what would we say of it?[44]

Accordingly, it can be seen that the "origin and character" test of necessity involves a highly subjective causal exploration in tax situations where the issue is whether litigation expenses arose from personal activities of the taxpayer. Prior to *Woodward* and *Hilton,* this test had not been extended to cover tax problems involving expenses allegedly incurred in the process of acquiring or disposing of a capital asset.

It would appear that the same problems of unpredictable causal explorations and likelihood of inconsistent results that were pointed to by Mr. Justice Jackson in *Lykes* will likely surround the extended application of the "origin and character" test to tax questions similar to those presented in *Woodward* and *Hilton.* For example, it is well-established that expenses of a complete liquidation, including legal and accounting fees, are deductible as ordinary and necessary business expenses.[45] But suppose that the *Lykes-Gilmore* type of analysis (now that of *Woodward* and *Hilton*) is applied to determine the deductibility of liquidation expenses. If the origin of the corporation's decision to liquidate can be traced to a personal dispute between two principal shareholders or to some other personal reason, the "origin and character" test would disallow deduction of hitherto unquestionably deductible expenses. Courts have permitted the deduction of liquidation expenses on the theory that no capital asset was being created or continued,[46] although liquidation does involve a disposition of capital assets. But if the "origin and character" type of analysis is valid for tax questions such as those raised in *Lykes-Gilmore* and now *Woodward-Hilton,* there is no reason not to apply it to liquidation and other tax problems. Such application would require tax courts to make a subjective search for the origin of any transaction giving rise to expenses of questionable deductibility. It would appear then that the Court's adoption of the "origin and character" test for the problems posed in *Woodward* and *Hilton* portends increasing uncertainty for the taxpayer and increasing tax litigation for the courts. The Court in *Woodward*

[44] 343 U.S. at 128.

[45] Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965); Gravois Planing Mill Co. v. Commissioner, 299 F.2d 199 (8th Cir. 1962).

[46] Gravois Planing Mill Co. v. Commissioner, 299 F.2d 199, 206 (8th Cir. 1962), *citing* 4 MERTENS § 25.35.

fails to justify its rejection of the alternative "primary purpose" test. The Court's approach is especially questionable in view of the fact that there have been a number of cases involving expenditures connected with the acquisition or disposition of a capital asset that have been resolved by analysis that focuses on the purpose of the expenditure rather than its "origin and character."[47]

Another question emerging in the wake of the decisions concerns the possibility of an argument by the taxpayer in the *Woodward* fact situation that the appraisal litigation expenses are deductible as organizational expenditures under section 248 of the Internal Revenue Code.[48] Applying the "origin and character" test adopted by the Court, the expenses of the appraisal proceeding could be said to lie in the extension of the corporate charter by the majority shareholders. Since that transaction essentially resulted in the creation of a perpetual corporation from a finite one, the ensuing appraisal expenses should arguably be deductible as organizational expenses under section 248.[49]

---

[47] *See, e.g.*, Kennecott Copper Corp. v. United States, 347 F.2d 275, 305 (Ct. Cl. 1965); Gravois Planing Mill Co. v. Commissioner, 299 F.2d 199 (8th Cir. 1962); *see especially* Campbell v. Fields, 229 F.2d 197, 203 (5th Cir. 1956), in which the taxpayer incurring litigation and surveying charges incident to the establishment of unitization, pooling, and operating agreements between himself and other gas and oil lessees, was allowed to deduct such expenses because they had not been for the purpose of acquiring a capital asset but to satisfy a requirement of a state regulatory commission. This case would appear to support an argument that if the "primary purpose" test were applied to the facts in *Woodward* and *Hilton*, the appraisal expenses would be deductible, in view of the fact that the proceeding was required by state law. *See*, Comment, *Deductibility of Appraisal Litigation Expenses*, 70 COLUM. L. REV. 538, 550 (1970). *See also* Straub v. Granger, 143 F. Supp. 250 (W.D. Pa. 1956) (legal expenses paid for advice given on ways to preserve taxpayer's interest in a closely held corporation held deductible, even though a majority of the corporation's stock was acquired pursuant to such advice). The district court in *Straub* noted that the legal expenses were "regarded properly in relation to the purpose for which taxpayers obtained counsel rather than to the increased ownership which resulted." *Id.* at 254. "Primary purpose" was held to be the governing test there and "the fact that the taxpayers' ownership in the corporation was increased partly through the services of counsel does not establish that counsel was paid for acquiring stock." *Id.* at 255.

[48] INT. REV. CODE of 1954, § 248(a) provides that organizational expenditures of a corporation may be treated as deferred expenses and deducted ratably from gross income. Section 248(b) defines an organizational expenditure as one which "(1) is incident to the creation of the corporation (2) is chargeable to capital account; and (3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life." TREAS. REG. § 248-1(b)(2) (1956), adds that "legal services incident to the organization of the corporation" are organizational expenditures.

[49] Such an argument would not be available to the taxpayer in *Hilton* since the original transaction was a reorganization which clearly requires capital treatment.

Unfortunately the opinions in *Woodward* and *Hilton* do not discuss the tax consequences of the holdings for the corporate taxpayer. The Court in *Woodward* does note that capital expenditures "are added to the basis of the capital asset with respect to which they are incurred, and are taken into account for tax purposes either through depreciation or by reducing the capital gain (or increasing the loss) when the asset is sold."[50] For the taxpayer in the *Hilton* situation, it would appear that the appraisal expenses may never be taken into account for tax purposes. Any stock is nondepreciable, for it is an intangible asset with an unlimited life.[51] Following the merger, Hilton can either put the costs of the appraisal proceeding as an addition to good will or attempt to apply the costs to adjust the basis of tangible assets it acquired from Waldorf-Astoria. The Commissioner would be certain to insist that these capital expenditures be accorded the former treatment, arguing that the acquiring Hilton corporation increased the intangible benefits flowing to it from the Waldorf corporation by increasing its own percentage of stock holdings as a consequence of the appraisal proceeding. Even if the taxpayer were able to argue successfully for the application of appraisal costs to an adjustment of the basis of tangible assets it acquired from the Waldorf entity, a highly complicated allocation problem would remain. With either treatment, the taxpayer is unlikely to realize any tax benefit from the capital expenditures. The Hilton corporation will be able to recover the costs of the appraisal proceeding only upon liquidation, making it probable that any tax advantage of an adjusted basis will never be realized.

Another problem concerns the Court's rejection of Hilton's argument that the appraisal costs should be regarded as obligations of the acquired Waldorf corporation which the acquiring Hilton corporation assumed and satisfied as ordinary and necessary expenses. The Court briefly noted that since Hilton had conceded that the purchase price of the dissenters' shares was a capital outlay, it could not successfully argue that the appraisal costs belonged to the Waldorf corporation.[52] The Court's arbitrary dismissal of taxpayer's argument is clearly unsatisfactory. If the "origin and character" test is applied to Hilton, the appraisal costs may be seen to have originated as a consequence of Waldorf's statutory obligation to pay the dissenting shareholders the fair value of their shares, *i.e.*, the appraisal expenses arose in connection with an obligation of the

[50] 397 U.S. at 574-75; *see also* TREAS. REG. § 1.1001-1(a) (1957).
[51] TREAS. REG. § 1.167(a)-3 (1956).
[52] 397 U.S. at 584-85.

disappearing corporation. Hilton, as the acquiring corporation, assumed the obligations of paying the purchase price of the dissenters' shares and paying the accompanying costs of the appraisal proceeding. The latter expenses may be regarded as closely analogous to clearly deductible liquidation expenses.[53] As is the case with a liquidating corporation, Waldorf will cease to exist as a corporate entity following the merger. What the acquiring Hilton corporation is doing in paying the costs of the appraisal proceeding (which initially arose as a part of Waldorf's statutory obligation to pay the dissenters for their shares)[54] is essentially the same process involved when a liquidating corporation pays or satisfies its debts and obligations. Here the obligation has merely been transferred to the Hilton corporation in the course of the merger. There would appear to be little reason for according transactions having essentially the same juridical effect differing tax treatment.

In *Woodward* it is uncertain whether the capital asset with respect to which the expenditures in question were incurred is only the stock acquired from the dissenters or is all of the taxpayers' stock in the corporation. The issue then is which stock will receive an adjustment in basis. The Court reasoned that the appraisal expenses arose as part of the process of acquisition and had to be capitalized. Since majority stockholders in *Woodward* incurred the expenses of the appraisal proceeding in the course of a transaction which undoubtedly affected the "character" of their pre-extension stock interests, could not such expenses be regarded as incurred with respect to all of the stock in the corporation and not just that acquired from the dissenters? In this event, the taxpayers in *Woodward* would be entitled to a basis boost on all their stock in the corporation. The decision in *Woodward* affords little guidance to this problem of basis adjustment. The only tax consequence that is clear is that whatever stock is benefited by the increase in adjusted basis, the benefit will be realizable only upon an inter vivos disposition of the shares. As an intangible asset with an unlimited life, the stock is nondepreciable, and there is no other asset to which a basis boost can be applied.

Woodward and *Hilton* could well result in a change in the availability of the appraisal remedy itself as a protective device for the interest of the

---

[53] *See* note 45 *supra*.

[54] The Court itself noted that establishment of the purchase price of a capital asset was part of the process of acquisition. *See* text preceding note 32 *supra*. It would follow from this that the appraisal expenses were part of Waldorf's obligation to pay to the dissenters the fair value of their shares.

dissenting minority shareholder upon future corporate alterations. The appraisal remedy may be regarded as the "*quid pro quo* for statutes giving the majority [stockholders] the right to override the veto which previously the holder of even one share could exercise against mergers, sales of all assets, and other basic corporate changes."[55] The appraisal proceeding is designed to protect the investment of the minority shareholder by assuring that he receives a "fair value" for his interest in the corporation.[56]

In order to determine such "fair value," parties are usually required to make considerable expenditures in paying for legal, accounting, and consulting services. Since legislatures and courts generally have failed to provide for an apportionment of appraisal costs,[57] the average investor, "faced with outlays disproportionate to the value of his holdings,"[58] is often handicapped in asserting his appraisal rights. *Woodward* and *Hilton* would appear to impose an additional burden on the dissenting seller by requiring his share of the appraisal costs, like those of the purchasing majority, to be capitalized and not deducted. Although neither opinion so states explicitly, the early Tax Court decision of *Heller v. Commissioner*,[59] allowing the seller to deduct his appraisal costs, is overruled by implication. Such a tax consequence could well revert the dissenter to his unfortunate position before the enactment of appraisal statutes when "the minority was pretty well stuck with the new investment if the required statutory majority approved the deal."[60]

Following *Woodward* and *Hilton*, a significant possibility exists that corporations contemplating merger may opt to forego such a reorganization when faced with the nondeductibility of appraisal costs and the likelihood of appraisal proceedings being instituted by a minority of its own shareholders or by a minority of the newly-acquired corporation. Instead, corporations faced with such a prospect may elect to effect a tax-free acquisition of assets, in which the acquiring corporation exchanges its own

---

[55] Vorenburg, *Exclusiveness of the Dissenting Shareholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1194 (1964).

[56] Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1456 (1966).

[57] N.C. GEN. STAT. § 55-113(e) (1965), provides: "The court shall assess the cost of said proceedings as it shall deem equitable."

[58] Note, *Appraisal of Corporate Dissenters' Shares: Apportioning the Proceeding's Financial Burdens*, 60 YALE L.J. 337, 341 (1951).

[59] Joseph Heller, 2 T.C. 371 (1943), *aff'd*, 147 F.2d 376 (9th Cir. 1945).

[60] Doar, *Protection of Minority Shareholders' Rights: Consolidation, Merger, and Sale of Assets*, 33 WIS. BAR BULL. 29, 34 (Aug., 1960).

stock or securities for all or part of another corporation's assets.[61] With the latter type of reorganization, the shareholders of the acquiring corporation have no recourse to the appraisal remedy under the law of most jurisdictions; and, in one-quarter of the states, even the shareholders of the acquired corporation cannot invoke the appraisal remedy.[62] Thus it appears that *Woodward* and *Hilton* could seriously impair the effectiveness of statutory appraisal remedies as protective devices for the interests of the minority shareholder.

E. CADER HOWARD

Labor Law—Issuance of Injunction to End Strike in Breach of Arbitration Agreement

Since the turn of this century, Congress and the United States Supreme Court have endeavored to balance the respective powers of labor and management. Whenever the scales tipped more favorably towards one group than the other, the reaction has been to establish equilibrium either legislatively or judicially. *Boys Markets, Inc. v. Retail Clerks Local 770*[1] is a striking example of this balancing process. The Supreme Court held that a federal district court could enjoin a strike in breach of a collective bargaining agreement despite section four of the Norris-LaGuardia Act, which prohibits the granting of federal injunctions in labor-management disputes. Significantly, the Court reversed *Sinclair Refining Co. v. Atkinson*,[2] in which it had held to the contrary. *Boys Markets* points up the unfortunate situation produced by the interaction of the Norris-LaGuardia[3] and Taft-Hartley Acts.[4]

Norris-LaGuardia was occasioned by the massive intervention of the judiciary into labor-management relations.[5] Prior to its enactment, a strike seemingly was labor's most potent weapon; however, management

[61] INT. REV. CODE of 1954, § 354(a)(1) provides: "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

[62] 13A B. FOX & E. FOX, BUSINESS ORGANIZATIONS: CORPORATE ACQUISITIONS AND MERGERS § 2501[2] (1970).

[1] 398 U.S. 235 (1970).

[2] 370 U.S. 195 (1962).

[3] 29 U.S.C. §§ 101-15 (1964).

[4] 29 U.S.C. §§ 141-97 (1964).

[5] *See generally* F. FRANKFURTER & N. GREENE, THE LABOR INJUNCTION (1932).