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July 25, 2002

The Honorable Pamela F. Olson
Acting Assistant Secretary (Tax Policy)
Department of the Treasury
Room 1334 MT
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Charles O. Rossotti
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Ms. Olson and Mr. Rossotti:

I am pleased to enclose the New York State Bar Association Tax Section Report No. 1017 on the treatment of expenditures made in connection with acquiring, creating or enhancing intangible assets. Our report responds to a request for comments set forth in the advance notice of proposed rulemaking (the "Notice") issued January 17, 2002, 67 Fed. Reg. 3461-02. We commend Treasury on undertaking this important project to provide guidance on the treatment of such expenditures, which we expect will bring clarity to an area of significant controversy and uncertainty.

Part I of the report sets forth a summary of our significant comments. Part II provides a summary of current law regarding the treatment of expenditures made in connection with intangibles, focusing on its development since the Supreme Court's decision in INDOPCO, Inc. v. Commissioner, 503 U.S. 79 (1992). Part III provides a summary of the Notice. Part IV addresses areas about which the Notice requests comments.

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We endorse the general approach adopted by the Notice of identifying specific categories of expenditures that must be capitalized. We believe this approach is necessary to avoid reliance on general rules and principles (the application of which would be determined on a case by case basis) if the new rules are to achieve their objectives of reducing uncertainty, controversy and compliance costs. Although the potential limits of the approach are not fully developed, at the very least the Notice presents a presumption that expenditures not described in the Notice will be deductible currently. We recognize that Treasury and the IRS are seeking to reduce uncertainty and controversy through the issuance of the Notice and, ultimately, regulations. Nonetheless, in our view it would be impossible to identify every category of expenditure that should be required to be capitalized. Further, if capitalization treatment were limited to enumerated categories, some taxpayers might attempt to characterize their expenditures so as to avoid having them fall within one of the categories, even when such expenditures were of a type that should be capitalized under Section 263. For these reasons, and because we believe that a presumption of deductibility would be inconsistent with the general rules of capitalization applied in the case law, we recommend that the IRS include in the regulations a general rule requiring capitalization of certain expenditures that do not fall within one of the categories laid out in the Notice.

We believe that the IRS should be guided by several principles in creating a rule that requires capitalization of such expenditures. Specifically, capitalization should be required only where capitalization is necessary to reflect income clearly, particularly, although not exclusively, where expenditures are not regular and recurring, and the expenditures create a significant future benefit beyond the period described in the "12-Month Rule" set out in the Notice. Only expenditures that are not deductible under other existing authority should be subject to this rule. We believe that the IRS also should continue to follow the approach adopted in the Notice by identifying, as the IRS becomes aware of them, additional specific categories of expenditures that should be required to be capitalized or deducted.

We concur with the Notice's recognition that employee compensation almost always is an ordinary and necessary expense of a business and, therefore, should be subject to current deduction. We agree that it is appropriate to require the capitalization of bonuses or commissions paid in connection with the acquisition of intangible assets, but do not express a view if the bonus is paid in connection with the acquisition of such assets as a regular and recurring part of the taxpayer's business.

Very truly yours,

A handwritten signature in black ink, appearing to read "S. J. Dimon", with a long horizontal flourish extending to the right.

Samuel J. Dimon
Chair

cc: Eric Solomon
Robert P. Hanson
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