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Date:
April 30, 2010

Attn:

EIN:

LEGEND

Taxpayer =

Group =

Member1 =

Member2 =

Date1 =

State =

$a =

b% =

Year1 =

Dear :

This ruling is in response to your letter dated (PLR request). You requested a private letter ruling concerning the federal income tax treatment of amounts paid to marketing agents under marketing and termination agreements.

FACTS

Taxpayer is the common parent of Group. Taxpayer files a consolidated U.S. federal income tax return on the basis of a fiscal year ending Date1. Group uses the accrual method of accounting.

Group is in the investment management business. Group earns fees by providing investment advisory and related services to investment funds registered under the Investment Company Act of 1940 and high net worth and institutional investors. Generally, the investment funds pool capital from many investors and hire an investment advisor to invest that capital on the investment fund's behalf in stocks, bonds, and other securities in accordance with the investment fund's objectives. None of the investment funds are members of Group.

The investment funds involved in this PLR request are closed-end funds, which generally offer shares at a single point in time and do not need to continually maintain liquid assets to meet redemption requests. None of the investment funds involved in this PLR request is an interval fund that periodically offers to repurchase its shares from its shareholders.

Member1 is a State business trust taxed as a corporation for U.S. federal income tax purposes. Member1 is a member of Group. Member1 serves as the investment advisor for most of the registered investment funds branded with the Taxpayer's name. Neither Member1 nor any member of Group has a relationship with an investment fund specified in § 267(b) of the Internal Revenue Code.

Member1 initially forms an investment fund by investing $a in return for shares in the investment fund. Planning begins for a public offering of the investment fund's shares to be issued to unrelated public investors. Member1's ownership in the investment fund represents an immaterial portion of the investment fund's total assets.

After the initial formation, independent trustees are appointed to govern the investment fund. The trustees have no direct or indirect interest in Member1 or any other member of Group.

The investment fund then enters into an investment advisory agreement with a professional investment manager, such as Member1. Under the investment advisory agreement for each investment fund, Member1 is responsible for making discretionary investment decisions for the investment fund and supervises any sub-advisors chosen by Member1 and approved by the independent trustees. Member1 is responsible for paying sub-advisor fees.

Member1 is paid a fee by the investment fund for its investment advisory services calculated as a percentage of the investment fund's net assets. This

percentage usually varies among investment funds depending on the funds' investment objectives, but in all cases, because the total amount of the fee is based on a percentage of net assets, it generally is to Member1's advantage for the investment fund to maximize its net assets.

The initial term of the investment advisory agreement is two years. A majority of the investment fund's independent trustees must review and approve the investment advisory agreement annually after the second year. At any time during the 2-year term, the trustees or Member1 may terminate the investment advisory agreement upon 60 days notice without penalty. The investment advisory agreement will automatically terminate in the event of its assignment. Although the investment advisory agreements are rarely terminated, there is no economic compulsion to prevent either party from doing so.

After the investment fund enters into an investment advisory agreement, the investment fund generally seeks to complete the process of registering its shares for sale to the public under §12(b) of the Securities Exchange Act of 1934. The investment fund bears all costs associated with the operation and issuance of its securities and treats the expenses as a cost of the capital it received in the stock issuance. Member1 has no contractual obligation to sell any of the investment fund's shares or to take possession or ownership of any of the investment fund's shares offered to the public.

The independent trustees choose underwriters for the offering of the investment fund's shares. A form of the underwriting agreement is attached to the preliminary prospectus that is filed with the Securities and Exchange Commission (SEC). Underwriters determine the level of interest in the investment fund's shares after the preliminary prospectus is filed and during the marketing period. The underwriters provide the investment fund with a firm commitment of the number of shares the underwriters will purchase (the pricing). The underwriters are paid a commission for each share sold. Member1 has no obligation, control, or involvement in handling the allocation of shares by the underwriters.

Member1 typically enters into service agreements with marketing agents to increase demand for investment in the investment fund. All of the marketing agents also are underwriters for the investment fund; however, not all of the underwriters are marketing agents. The investment fund itself is not a party to and has no obligation under the marketing agreements.

The material terms of the marketing agreements are generally agreed upon by Member1 and the marketing agents prior to the filing of the preliminary prospectus. Each marketing agreement is generally signed by the parties after or contemporaneously with the execution of the underwriting agreement. In practice, however, the marketing agreements are generally not executed and finalized until after the marketing period has closed because all payments are based upon services

performed by the marketing agents during the marketing period. Taxpayer represents that at no point was there an implicit or explicit understanding between Member1 and the independent trustees that any of the terms of the investment advisory agreement were conditioned on Member1's engagement of the marketing agents.

The marketing period begins after the investment fund files with the SEC the preliminary prospectus. During the marketing period, the marketing agents provide assistance and resources in marketing and promoting Member1's investment strategy with respect to the particular investment fund. For example, the marketing agents may host internal meetings and conference calls within their respective organizations and provide feedback to Member1 regarding the structure of the investment fund and the findings of the marketing agents' investment committees. These meetings provide Member1 with information on promoting and marketing its investment strategy with respect to the investment fund and on whether the structure of the proposed investment strategy should be modified. Member1 also gains access to each marketing agent's distribution network of brokers and investment advisors, who assist in advertising Member1's proposed investment strategy and general expertise as an investment advisor.

Member1 enters two types of marketing agreements with the marketing agents, differing primarily in how payments are made by Member1 to the marketing agent:

1. Structuring Fee Agreement: Under a Structuring Fee Agreement, Member1 pays a lump sum to the marketing agent. The lump sum is calculated by multiplying a certain percentage by the average assets generated by the efforts of the marketing agent during the marketing period. The Structuring Fee Agreement requires payment to be made promptly after execution of the agreement. The Structuring Fee Agreement terminates upon such payment.

2. Additional Compensation Agreement: Under an Additional Compensation Agreement, Member1 pays a fee on a quarterly basis in arrears that is based upon the investment fund's average daily gross assets attributable to the efforts of the marketing agents during the marketing period. There is a cap for the amounts payable under the Additional Compensation Agreements (Maximum ACA Fee), calculated as b% of the gross proceeds invested by the public shareholders reduced by the amounts paid to other marketing agents under the Structuring Fee Agreements. Once the Maximum ACA Fee is paid, no further payments are due by Member1 under the Additional Compensation Agreement and the marketing agent is under no further obligation to continue providing services under the Additional Compensation Agreement.

Member1 has the option to prepay the Maximum ACA Fee, but Member1 has no right to terminate the Additional Compensation Agreement for a lesser amount. Member1's obligation to make payments under the Additional

Compensation Agreement may cease if the investment advisory agreement is terminated and Member1 ceases to be the investment advisor to the investment fund.

The services provided under the Additional Compensation Agreements are primarily performed during the marketing period. In addition, the Additional Compensation Agreement may vary as follows: (1) the marketing agent does not provide any additional ongoing services after the investment fund's offering has closed; (2) the marketing agent provides research reports to Member1 while the Additional Compensation Agreement is in effect; or (3) the marketing agent may provide additional marketing–related services upon Member1's request after the closing of the investment fund offering. In each instance, however, Member1 determines the fee to be paid to the marketing agents on the basis of the marketing agent's efforts during the marketing period. In the case of the provision of services after the marketing period, Member1's payments are made only after the services are performed.

Taxpayer represents that no portion of the fees paid by Member1 under the marketing agreements was paid on behalf of any investment fund. Member1 pays the fees out of its own operational cash flow and is not reimbursed by Group or the associated investment fund. Taxpayer also represents that no portion of the expenses paid by Member1 under the marketing agreements related to an agreement providing an exclusive right to provide services to, or an exclusive right to receive services from, Member1.

During Member1's Year1 fiscal year, Member1 and certain marketing agents agreed to terminate their respective Additional Compensation Agreements and entered termination agreements. Separate termination agreements were needed because the parties negotiated the termination of the Additional Compensation Agreements through payment of an amount less than the Maximum ACA Fee. The payments under the termination agreements were for past services performed in satisfaction of the original Additional Compensation Agreement and were not an additional payment to terminate the agreement.

Taxpayer represents that expenses paid by Member1 under the marketing agreements and termination agreements were incurred in the ordinary course of its investment management business and were a common or frequent occurrence in operating its investment management business.

RULING REQUESTED

Taxpayer requests a ruling that Member1's payments of service fees to the marketing agents under the marketing agreements and termination agreements are ordinary and necessary business expenses allowable as deductions under § 162.

CONCLUSION

Member1's payments to marketing agents under the marketing agreements and termination agreements are not required to be capitalized under § 263 and the regulations thereunder, and such payments are allowable as deductions under § 162.

LAW & ANALYSIS

Section 162(a) provides generally that there is allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162-1(a) of the Income Tax Regulations provides that deductible business expenses include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. Under § 161, if a cost is a capital expenditure, the capitalization rules of § 263 take precedence over the deduction rules of § 162. Commissioner v. Idaho Power Company, 418 U.S. 1, 17 (1974). Therefore, a capital expenditure cannot be deducted under § 162, regardless of whether the expenditure is ordinary and necessary in carrying on a trade or business.

Section 263(a) provides generally 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 or any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made. See also §1.263(a)-1(a).

Section 1.263(a)-4 provides rules for applying § 263 to amounts paid to acquire or create intangibles. In relevant part, § 1.263(a)-4(b)(1) provides that a taxpayer must capitalize an amount paid to create (or facilitate the creation of) an intangible, or to create or enhance (or facilitate the creation or enhancement of) a separate and distinct intangible asset. These rules raise the issue of whether the marketing agreements or the investment advisory agreements are intangibles for which payments under the marketing agreements should be capitalized. These rules are also relevant in determining whether the amounts paid to terminate certain marketing agreements should be capitalized.

Section 1.263(a)-5(a) provides rules for applying § 263 to amounts paid that facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions. Under § 1.263(a)-5(a), a taxpayer must capitalize an amount paid to facilitate certain transactions, including a stock issuance, without regard to whether the transaction is comprised of a single step or a series of steps carried out as part of a single plan and without regard to whether gain or loss is recognized in the transaction.

Separate and Distinct Intangible Asset

As an initial matter, we address whether Member1's payments to marketing agents under the marketing agreements and termination agreements are required to be capitalized as costs to create or enhance (or facilitate the creation or enhancement of) a separate and distinct intangible asset. The term "separate and distinct intangible asset" is defined as a property interest of ascertainable and measurable value in money's worth that is subject to protection under applicable state, federal or foreign law and the possession and control of which is intrinsically capable of being sold, transferred or pledged (ignoring any restrictions imposed on assignability) separate and apart from a trade or business. Section 1.263(a)-4(b)(3)(i). However, § 1.263(a)-4(b)(3)(ii) provides that amounts paid to another party to create, originate, enter into, renew or renegotiate an agreement with that party that produces rights or benefits for the taxpayer (and amounts paid to facilitate the creation, origination, enhancement, renewal or renegotiation of such an agreement) are treated as amounts that do not create (or facilitate the creation of) a separate and distinct intangible asset.

The marketing agreements are agreements that produce rights or benefits for the taxpayer and, therefore, cannot be separate and distinct intangible assets under § 1.263(a)-4(b)(3). Further, even if the agreements were separate and distinct intangible assets, the amounts paid by Member1 to the marketing agents were not paid to create or enhance (or facilitate the creation or enhancement of) the marketing agreements. Instead, the amounts paid under the marketing agreements were for the services themselves. Therefore, payments to the marketing agents for services under the marketing agreements are not required to be capitalized under § 1.263(a)-4(b)(1).

Even applying this analysis to the investment advisory agreements, the payments under the marketing agreements are not required to be capitalized as amounts that create or enhance (or facilitate the creation or enhancement of) a separate and distinct asset. Section 1.263(a)-4(b)(3)(iii) provides that amounts paid in performing services under an agreement are treated as amounts that do not create a separate and distinct intangible asset, regardless of whether the amounts result in the creation of an income stream under the agreement. The amounts paid to the marketing agents by Member1 are paid in performing services under the investment advisory agreements and, therefore, are treated as amounts that do not create a separate and distinct intangible asset. Although the amounts paid under the marketing agreements are intended to maximize the revenue of Member1's investment management business, they are not required to be capitalized under § 1.263(a)-4(b)(1).

Finally, amounts paid to another party to terminate (or facilitate the termination of) an agreement with that party are treated as amounts that do not create a separate and distinct intangible asset. Section 1.263(a)-4(b)(3)(ii). Therefore, amounts paid by Member1 to the marketing agents to terminate the Additional Compensation

Agreements are not amounts that create a separate and distinct intangible asset, and are not required to be capitalized under § 1.263(a)-4(b)(1).

Created Intangible

Second, we address whether Member1's payments to marketing agents under the marketing agreements and termination agreements are required to be capitalized as costs to create an intangible. Section 1.263(a)-4(b)(1)(ii) provides that a taxpayer must capitalize an amount paid to create an intangible as described in § 1.263(a)-4(d). The relevant sections of paragraph (d) are discussed below.

Section 1.263(a)-4(d)(3) provides that a taxpayer must capitalize prepaid expenses. Member1's payments to the marketing agents under the Structuring Fee Agreements are not prepaid expenses because the payments were made after the marketing agents performed the services. Member1's payments to the marketing agents under the Additional Compensation Agreements are made on a quarterly basis until the Maximum ACA Fee amount is reached. Some types of Additional Compensation Agreements also contemplate some additional minor services to be provided by the marketing agent. However, all of the services for which the fees are paid to the marketing agents are for those services performed in the marketing period. For any additional services provided after the marketing period, Member1's payments are made only after the services are performed. Accordingly, Member1 is not required to capitalize the amounts paid to marketing agents as prepaid expenses.

Section 1.263(a)-4(d)(6)(i)(B) provides that a taxpayer must capitalize amounts paid to another party to create, originate, enter into, renew, or renegotiate with that party an agreement providing the taxpayer the right to provide or to receive services (or the right to be compensated for services regardless of whether the taxpayer provides such services). Member1 entered into investment advisory agreements with the investment funds providing Member1 the right to provide, and be compensated for, services. However, the amounts at issue were paid to the marketing agents, not the investment funds. Therefore, the amounts paid under the marketing agreements did not serve to create the investment advisory agreements. Also, the amounts paid by Member1 to the marketing agents were under agreements with the marketing agents for Member1's right to receive services from the marketing agents. However, the amounts were not paid to create, originate, enter into, renew, or renegotiate those agreements. Instead, the amounts paid under the marketing agreements were for the services themselves.

Further, Member1 is not required under § 1.263(a)-4(d)(6)(i)(B) to capitalize amounts paid to the marketing agents to terminate certain marketing agreements. The termination payments were not paid to renew or renegotiate the marketing agreements with the marketing agents because the termination agreements did not lead to a renegotiation of another contract with Member1 and the marketing agents. See §1.263(a)-4(d)(6)(iii) (the taxpayer is renegotiating an agreement if the taxpayer enters

into a new agreement with the same party to a terminated agreement, the taxpayer could not cancel the terminated agreement without the consent of the other party, and the other party would not have consented to the cancellation unless the taxpayer entered into the new agreement).

Section 1.263(a)-4(d)(7) provides that a taxpayer must capitalize amounts paid to another party to terminate certain agreements: (i) a lease of real or tangible personal property between taxpayer and that party; (ii) an agreement that grants that party the exclusive right to acquire or use the taxpayer's property or services to conduct the taxpayer's business; or (iii) an agreement that prohibits the taxpayer from competing with that party or from acquiring property or services from a competitor of that party. Member1 is not required to capitalize payments made to terminate the marketing agreements under this subparagraph because the parties did not terminate an agreement that is listed under § 1.263(a)-4(d)(7).

Accordingly, we conclude that Member1 is not required to capitalize payments made to marketing agents under the marketing agreements as amounts paid to create an intangible pursuant to § 1.263(a)-4(d).

Facilitate Creation of an Intangible

Section 1.263(a)-4(b)(1)(v) provides that a taxpayer must capitalize an amount paid to facilitate the creation of an intangible. In general, an amount is paid to facilitate the creation on an intangible if the amount is paid in the process of investigating or otherwise pursuing the transaction. Section 1.263(a)-4(e)(1)(i). The term "transaction" means all of the factual elements comprising an acquisition or creation of an intangible and includes a series of steps carried out as part of a single plan. Section 1.263(a)-4(e)(3).

We conclude that Member1's payments to the marketing agents are not amounts paid to facilitate the creation of an intangible, namely, the creation of the investment advisory agreement. Taxpayer represented that although Member1 provided the trustees of the investment fund with forms of the marketing agreements and explained the general process of marketing the fund, there was no implicit or explicit understanding between the parties that the terms of the investment advisory agreement were conditioned on Member1's engagement of the marketing agents. In fact, the marketing agreements generally were not executed and finalized until after the marketing period had closed. Also, Member1's payments did not facilitate the creation of an intangible because the creation of the investment advisory agreement is not the creation of an intangible under § 1.263(a)-4(d), as explained above, because Member1's payments were to the marketing agents and not to the investment funds.

Section 1.263(a)-4(e)(1)(ii) provides that an amount paid to terminate (or facilitate the termination of) an existing agreement does not facilitate the creation of another

agreement under this section. Therefore, amounts paid by Member1 to terminate the marketing agreements did not facilitate the creation of the investment advisory agreements. Accordingly, we conclude that the amounts paid by Member1 to the marketing agents under the marketing and termination agreements are not amounts paid to facilitate the creation of an intangible.

Facilitate a Stock Issuance

Section 1.263(a)-5(a) provides that a taxpayer must capitalize an amount paid to facilitate certain transactions, including a taxpayer's restructuring, recapitalization, or reorganization of a business entity, a transaction involving the acquisition of capital, or a stock issuance. In the case of transaction costs that facilitate a stock issuance or recapitalization, such capital expenditures offset the proceeds of the stock issuance. See, e.g., Affiliated Capital Corp. v. Commissioner, 88 T.C. 1157, 1166 (1987). The marketing expenses paid by Member1 did not affect a change in Member1's capital structure because the shares issued were the shares of the investment fund, not Member1, and neither Member1 nor any member of Group had a relationship with an investment fund specified in § 267(b). It was the investment fund that bore all costs associated with the operation and issuance of the investment fund's securities, such as compensation to the underwriters, and treated these expenses as a cost of capital it received in the stock issuance. Member1 did not make any payments to the marketing agents in this regard.

Rev. Rul. 73-463, 1973-2 C.B. 34, amplified by Rev. Rul. 94-70, 1994-2 C.B. 17, lists the types of expenses considered stock issuance expenses. Such expenses are nondeductible capital expenditures that are charged to paid-in capital: legal and accounting fees incurred in preparation of a registration statement, SEC filing fees, "Blue Sky" filing and registration fees, costs of distributing and printing prospectuses, costs of printing stock certificates, costs of printing and processing periodic investment and dividend reinvestment plans, costs of processing applications for redemption, costs of processing stock certificates, costs of maintaining stockholder share accounts, and costs of issuing checks for the proceeds of redeemed shares. Each listed expense is directly incurred in the registration, issuance, and redemption of stock. Member1's payments to the marketing agents under the marketing agreements are not a type of expense that is directly incurred in the registration, issuance, or redemption of the investment fund's shares and are not capital expenditures in this regard. See Affiliated Capital Corp., 88 T.C. at 1169 (stockholder relations expenses, such as annual reports, proxy solicitations, and maintaining a listing of a stock on an exchange, are deductible corporate expenses). Therefore, we conclude that Member1's payments to the marketing agents under the marketing agreements are not required to be capitalized as amounts paid to facilitate transactions pursuant to § 1.263(a)-5.

Further, on the basis of the representations made by Taxpayer, the amounts paid by Member1 under the marketing agreements to the marketing agents constitute

ordinary and necessary business expenses. See § 1.162-1(a) (advertising and selling expenses are deductible business expenses); Capitol Indemnity Insurance Co. v. Commissioner, 237 F.2d 901 (7th Cir. 1956) (payments made by taxpayer to certain stockholders, pursuant to the terms of a cancellation agreement, were deductible as an ordinary and necessary business expense).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Kimberly L. Koch
Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

cc: