Internal Revenue Service

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April 11, 2008

Legend

Company =

Acquisition Co. =

Parent =

Intermediate HoldCo =

The Sponsors =

Investor Group =

Financial Advisor A =

Financial Advisor B =

Financial Advisor C =

Legal Counsel =

Other Service Providers =

Financial Service Providers =

Debt Financing Fees =

State X =

Shareholder A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter is in reply to your authorized representative's letter dated Date 5, requesting rulings regarding Federal income tax consequences of certain transaction costs incurred in completed transactions. The information submitted for consideration is summarized below.

SUMMARY OF FACTS

Company, a State A corporation, was acquired on Date 1 through a merger transaction. The acquisition was accomplished through the merger of Acquisition Co. with and into Company, with Company being the surviving company (the "Transaction"). As more fully described herein, the exchanging shareholders of Company received cash in the Transaction.

Prior to the Transaction, pursuant to a merger agreement dated and accepted by the Company's Board of Directors on Date 2 (a date prior to Date 1), the Sponsors (a group of private equity funds that coordinated to effectuate the Transaction) created Parent, Intermediate HoldCo, and Acquisition Co.. As a preliminary step in the Transaction, Shareholder A and certain members of the Company management team contributed a portion of their shares in Company and/or cash in a section 351 transaction in exchange for Parent's stock. Following the initial section 351 transaction, Parent was owned by the Sponsors, Shareholder A, and certain members of Company management (collectively referred to as the "Investor Group"). In addition, Acquisition Co. was a subsidiary of Intermediate HoldCo, which in turn is a subsidiary of Parent. As a result of the merger of Acquisition Co. with and into Company, Company became a wholly owned subsidiary of Intermediate HoldCo.

On Date 1, as part of the Transaction, Acquisition Co. (prior to its merger into Company), entered into a secured credit agreement with a group of lenders. Company is required to pay interest under the terms of the senior secured credit agreement, and also paid commitment fees to the lenders. Pursuant to the plan of merger, Company, using funds borrowed by Acquisition Co., paid its old shareholders (except for the transaction involving Shareholder A and certain management) cash in exchange for their interest in Company.

DESCRIPTION OF TYPES OF TRANSACTION COSTS AND SERVICE PROVIDERS

Financing

Following the Company Board of Director's approval of the Transaction on Date 2, Company began, with its advisors, to consider several distinct financing mechanisms. One source of financing was a whole business securitization approach under which the Company's assets would have been used for financing the Transaction, referred to as the "securitization financing plan." The plan was considered through Date 3, and then

ultimately abandoned when it was determined that the plan would be unduly burdensome to administer. Costs incurred for the securitization financing plan include a portion of Legal Counsel's and of Other Service Providers' fees.

When the securitization plan was abandoned, more traditional forms of financing were pursued. On Date 4, and on several dates after, the Company announced that, in connection with the Transaction, it was commencing certain financing transactions. These transactions consisted of borrowing new senior secured and unsecured indebtedness, the repayment of certain debts, and several other financing vehicles. Under each of these vehicles, Company is required to pay the associated interest, principle, and fees. These fees include all of the Debt Financing Fees, all of the Financial Service Providers' fees, and based upon a detailed review of the relevant documentation, an allocated portion of both Financial Advisor C's and Legal Counsel's fees.

Financial Advice

To maintain its market share, protect against the threat of takeover and maximize competitive opportunity, Company has historically monitored and considered corporate development growth strategies and opportunities, consulting frequently with third-party financial advisors for modeling on alternatives, identification of market trends, obtaining recommendations for future strategic alternatives, access to capital markets, etc. Prior to Date 2, Company had significant discussions and meetings with Financial Advisor A on all of these strategic issues. In addition, a Special Committee also retained Financial Advisor B to provide services related to its role.

Financial Advisor C rendered Services to Acquisition Co. while the Transaction was being considered. All of these financial advisory firms became involved with the Transaction prior to Date 2 and began investigatory due diligence for the Transaction. As the Transaction progressed, Financial Advisor C assisted in the preparation, review and negotiation of the terms and conditions of the debt used to finance the Transaction. As the Transaction proceeded to closing, Financial Advisor C both directly and through various advisors, become involved with negotiating, structuring, and reviewing the merger agreement. Financial Advisor C also assisted with routine business activities, including preparing a post-Transaction business plan for Company.

Legal Advice

Company, Parent, Acquisition Co., and others employed Legal Counsel to perform various services over the course of planning, modeling, investigating, pursuing, and completing the Transaction, including the financing portions of the Transaction.

Accountants, Rating Agencies, Banks, and Others

Company, Parent, Acquisition Co., and others employed other service providers to perform various services over the course of planning, modeling, investigating, pursuing, and completing the Transaction, including all the activities necessary to put into place the financing portions of the Transaction.

RULINGS

Based solely on the information submitted, we hold as follows:

ALLOCATION OF TRANSACTION COSTS

Company requests a ruling that the transaction costs may be allocated to either Company or Acquisition Co. based on the entity to whom the services were rendered and/or on whose behalf the services were provided.

Parent arranged a number of transaction services. Each service provider was directly engaged by Company and the services were directly provided to Company.

Acquisition Co. also incurred a variety of transaction costs. These costs included fees for financial advice, legal services, due diligence services, insurance due diligence, and other miscellaneous transaction related services.

During the transaction, expenses were incurred for arranging the debt financing for the transaction. These expenses included rating fees, lender's out of pocket expenditures, and advisory fees. Although these providers may not have been directly engaged by Company, the fees were paid to secure the debt financing.

The Investor Group arranged for the underwriting services for the transaction. Although arranged by the Investor Group, these services were provided on behalf of Company as part of obtaining the debt. Similarly, the Investor Group engaged certain service providers on behalf of Acquisition Co.. These services directly benefited Acquisition Co..

Section 162(a) allows a deduction for ordinary and necessary expenses paid or incurred by the taxpayer in carrying on a trade or business. Whether an expense is deductible under section 162 is ultimately a question of fact. See Commissioner v. Heininger, 320 U.S. 467 (1943).

Section 1.263(a)-4 provides, in part, that except as otherwise provided in this section, a taxpayer must capitalize an amount paid to acquire an intangible or an amount paid to facilitate the acquisition of an intangible, whether the taxpayer is the acquirer or the target.

Section 1.263(a)-5 provides, in part, that a taxpayer must capitalize an amount paid to facilitate the acquisition of a trade or business. Similarly, that section provides that the taxpayer must capitalize the costs of a borrowing. Further, section 1.263(a)-5(k) provides that for these purposes, an amount paid to or by a party include an amount paid on behalf of the party.

Company requests permission to allocate the transaction costs incurred based on the entity to whom the services were rendered and/or on whose behalf the services were provided. Company's position is that this treatment is appropriate because these entities directly and proximately benefited from the services and incurred the economic burden of these services. Company essentially argues that the proper party to be charged with costs incurred in the Transaction may not be readily identifiable because of the structure of the transaction and the many parties involved.

It is well established that where a taxpayer undertakes to pay the obligations of another taxpayer, such payments are not deductible as ordinary or necessary business expenses incurred in the taxpayer's trade or business. See Interstate Transit Lines v. Commissioner, 319 U.S. 590 (1943); Deputy v. du Pont, 308 U.S. 488 (1940). This is true even where the cost would have been deductible had the taxpayer incurred it. The determination of the appropriate taxpayer is often a question of fact. See Crosby v. United States, 496 F.2d 1384 (5th Cir. 1974).

We conclude Company may allocate transaction costs to either Company or Acquisition Co. based upon the entity to which the services were rendered and/or on whose behalf the services were provided.

ALLOCATION OF LUMP SUM FEES

Company requests a ruling that Acquisition Co. and Company may allocate lump-sum service provider fees between deductible, amortizable, and capitalizable categories based on scope of service provided.

Section 1.263(a)-4(c)(3)(i) provides that a purchaser must capitalize amounts paid to acquire an ownership interest in a corporation. Section 1.263(a)-5 provides rules for the treatment of costs associated with the acquisition of a trade or business. Generally, costs that facilitate the acquisition must be capitalized. Other costs would typically be deductible.

Section 1.263(a)-5(b) provides in part that an amount is paid to facilitate a transaction if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigation or otherwise pursuing the transaction is determined based on all of the facts and circumstances. Section 1.263(a)-5(e) provides, in part, that except for certain facilitative costs listed in

section (e)(2), an amount paid by the taxpayer in the process of investigating or otherwise pursuing a covered transaction facilitates the transaction only if it relates to activities performed on or after the earlier of the date a letter of intent or similar communication is executed or the date on which the material terms of the transaction are authorized or approved by the taxpayer's board of directors. Section 1.263(a)-5(e)(2) provides a list of costs that are inherently facilitative, which are facilitative regardless of when performed.

Section 1.263(a)-5(f) provides detailed rules concerning the supporting documentation necessary to establish the portion of any amount paid that is contingent on the successful closing of a covered transaction that is allocable to activities that do not facilitate the transaction. In general, this documentation must consist of supporting records (for example, time records, itemized invoices, or other records) that identify the activities performed, the fee allocable to those activities, the date of performance, and the service provider. This documentation must be completed on or before the due date for the taxpayer's timely filed return (including extensions).

Company cites several cases for the proposition that allocation of transaction costs among various categories of expense is appropriate in the context of an acquisition. Specifically, the taxpayer states that McCrory v United States, 651 F.2d 828 (2d Cir. 1981); A.E. Staley Manufacturing Co. v. Commissioner, 119 F.3d 482 (7th Cir. 1997); and Wells Fargo & Co. v. Commissioner, 224 F.2d 874 (8th Cir. 2000) all found that costs are not automatically treated as incident to an acquisition merely because a merger occurred. Instead, these courts have permitted taxpayers to allocate lump-sum fees among various categories of services provided. These allocations are grounded in the origin of the claim doctrine, under which the "origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense is deductible or not." U.S. v. Gilmore, 372 U.S. 39, 49 (1963).

With respect to fees that are not contingent upon the successful closing of the transaction, the example provided by Company demonstrates that the proposed allocation is based upon contemporaneous records that memorialize the activity performed, time spent, and the average rate of the party performing the activity. With respect to fees that are contingent upon the successful closing of the transaction, Company states that detailed billing records are not available.

Although section 1.263(a)-5(f) provides detailed rules concerning the necessary documentation, that section does not require time records. Other records may be used to establish an appropriate allocation. A determination as to whether records establish such an allocation is a question to be determined upon examination.

We conclude that Company and Acquisition Co. may allocate lump-sum provider service costs to the services provided.

INVESTIGATORY COSTS

Company has requested a ruling that Company may treat its investigatory due diligence costs as deductible expenses under section 162 and that Acquisition Co. may treat its business advice and investigatory costs associated with the Transaction as amortizable start-up expenditures under section 195.

The costs at issue arise from due diligence and other investigatory services provided Company by several providers, including Financial Advisor A and Financial Advisor B, certain Legal Counsel, and Other Service Providers and provided Acquisition Co. by Financial Advisor C and certain Legal Counsel.

Section 162(a) allows a deduction for ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business. As described above, under section 1.263(a)-5, a taxpayer must capitalize an amount paid to facilitate a transaction. Thus, ordinary and necessary business expenses associated with a covered transaction that are not facilitative are generally deductible.

A taxpayer is permitted to take a deduction where the taxpayer is expanding its active trade or business. Briarcliff Candy Corp v. Commissioner, 475 F.2d 775, 787 (2d Cir. 1973); NCNB Corp v. United States, 684 F.2d 285 (4th Cir. 1982). In addition, pre-decisional investigatory costs incurred in a business expansion context are deductible under section 162. Wells Fargo & Co. v. Commissioner, 224 F.3d 874 (8th Cir. 2000).

Section 1.263(a)-5 requires taxpayers to capitalize amounts paid to facilitate an acquisition of a trade or business. Section 1.263(a)-5(e)(1) provides a bright-line rule to determine whether amounts paid in certain covered transaction are facilitative. Section 1.263(a)-5(e)(i) provides that an amount, which is not inherently facilitative, facilitates a transaction only if the amount relates to activities performed on or after the earlier of (i) the date of which a letter of intent, exclusivity agreement, or similar written communication (other than a confidentiality agreement) is executed by representatives of the acquirer and the target; or (ii) the date on which the material terms of the transaction (as tentatively agreed to by the representatives of the acquirer and the target) are authorized or approved by the taxpayer's board of directors (or committee of the board of directors). In addition, section 1.263(a)-5(e)(2) provides that an amount paid in the process of investigating or otherwise pursuing a covered transaction facilitates that transaction if the amount is inherently facilitative, regardless of whether the amount is paid for activities performed prior to the date determined under paragraph (e)(1) of this section.

Section 195(a) provides that, except as otherwise provided in section 195, no deduction is allowed for start-up expenditures.

Section 195(c)(1) defines “start-up expenditure,” in part, as any amount (A) paid or incurred in connection with investigating the creation or acquisition of an active trade or business, and (B) which, if paid or incurred in connection with the operation of an existing active trade or business (in the same field as the trade or business referred to in subparagraph (A)), would be allowable as a deduction for the taxable year in which paid or incurred.

Rev. Rul. 99-23, 1991-1 C.B 998, generally provides that expenditures paid or incurred in order to determine whether to enter a new business and which business to enter are investigatory costs that are start-up expenditures under section 195. Conversely, costs incurred in the attempt to acquire a specific business are capital in nature and thus, are not start-up expenditures under section 195.

Company states that the costs at issue were not facilitative costs under section 1.263-5 because they were incurred in the process of investigating or otherwise pursuing a covered transaction before the earlier of the date a letter of intent or similar communication was executed or the date on which the material terms of the transaction were authorized or approved and were not inherently facilitative costs. Further, Company anticipates the transaction will speed the domestic and international growth of Company’s business. Company will continue to take Acquisition Co.’s investigatory costs into account under section 195.

We conclude that Company may deduct, under section 162, the investigatory expenses incurred in investigating the growth of its business that are non facilitative under section 1.263-5. Acquisition Co. may treat similar expenses as investigatory costs that are start-up expenditures under section 195.

COVERED TRANSACTION

Company requests a ruling that the Transaction is a “covered transaction” under section 1.263(a)-5(e)(3).

Company argues that the Transaction is a covered transaction because it is an acquisition that results in Company being a wholly owned subsidiary of Intermediate HoldCo, which is wholly owned by Parent. Thus, Parent, Intermediate HoldCo, and Company are related under section 267(b).

Section 1.263(a)-5 provides, in part, that costs that facilitate a “covered transaction” must be capitalized.

Section 1.263(a)-5(e)(3) provides, in part, that a covered transaction is (i) a taxable acquisition by the taxpayer of assets that constitute a trade or business, (ii) a taxable acquisition of an ownership interest in a business entity if immediately after the transaction, the acquirer and target are related within the meaning of section 267(b) or

707(b), or (iii) a reorganization described in section 368(a)(1)(A), (B), or (C) or certain reorganizations described in section 368(a)(1)(D). Corporations that are members of the same controlled group are considered related for purposes of section 267(b) of the Code.

Section 3.01 of Rev. Proc. 2008-3, 2008-1 I.R.B. 110 (Jan. 7, 2008) provides that the Service will not issue a ruling concerning most corporate reorganizations.

We conclude that the Transaction is a covered transaction within the meaning of section 1.263(a)-5(e)(3).

AMORTIZATION OF COSTS TO FINANCE BORROWING COSTS

Company requests a ruling that the costs incurred to finance the Transaction are eligible for amortization in accordance with section 1.446-5. These costs include a portion of the fees of Financial Advisor C, Legal Counsel, Other Service Providers and Financing Service Providers, as well as Debt Financing Fees.

Section 1.446-5 provides rules for allocating debt issuance costs over the term of the debt for which the costs were incurred. The term debt issuance costs means those transaction costs incurred by an issuer of debt (that is, a borrower) that are required to be capitalized under section 1.263(a)-5. If these costs are otherwise deductible, they are deductible by the issuer over the term of the debt as determined under section 1.446-5(b).

Under section 1.446-5(b), solely for the purposes of determining the amount of the debt issuance costs that may be deducted in any period, debt issuance costs are treated as if they adjusted the yield of the debt. To effect this adjustment, the issuer treats the costs as if they decreased the issue price of the debt. See section 1.1273-2 to determine the issue price of the debt instrument. Thus, debt issuance costs increase or create original issue discount and decrease or eliminate bond issuance premium.

Under section 1.446-5(b)(2), any resulting original issue discount is taken into account by the issuer under the rules of section 1.163-7, which generally require the use of a constant yield method (as described in section 1.1272-1) to compute how much original issue discount is deductible for a period. However, see section 1.163-7(b) for special rules that apply in the total original issue discount on the debt is the de minimis.

Under section 1.446-5(b)(3), any remaining bond issuance premium is taken into account by the issuer under the rules of section 1.163-13, which generally require the use of a constant yield method for purposes of allocating bond issuance premium to accrual periods.

We conclude that Company may take into account the properly allocable costs incurred to finance the Transaction in accordance the provisions of section 1.446-5.

LOSS FOR COSTS OF ABANDONED SECURITIZATION PLAN

Company requests a ruling that its costs related to the securitization financing plan are eligible for an abandonment loss in accordance with section 165.

Section 1.263(a)-5(a) requires, in part, the capitalization of costs that facilitate a stock issuance or borrowing.

Section 165 allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 1.165(a)-1(b) provides that to be allowed as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Further, only a bona fide loss may be deducted. Substance and not form governs in determining a loss.

Section 1.165-2(a) provides that a loss is deductible under section 165(a) if it is incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein. For example, in Rev. Rul. 73-580, 1973-2 C.B. 86, the taxpayer was permitted a deductible loss under section 165 for otherwise capitalizable merger and acquisition costs when the transaction was abandoned.

If a taxpayer engages in multiple separate and distinct transactions, costs properly allocated to abandoned transactions may be deductible even if other transactions are completed. Sibley, Lindsay & Curr Co. v. Commissioner, 15 T.C. 106 (1950), acq. 1951-1 C.B. 3. By contrast, if the proposals are alternatives, only one of which can be completed, no abandonment loss is proper unless the entire transaction is abandoned. The cost of pursuing any alternatives not consummated must be capitalized as part of the cost of the completed transaction. United Dairy Farmers, Inc. v. United States, 267 F.3d 510 (6th Cir. 2001); Nicolazzi v. Commissioner, 79 T.C. 109 (1982).

Company argues that it is entitled to a loss under section 165 because the securitization financing was a separately investigated plan that was never implemented. As a result, Company received no benefit from the plan. In support, Company has represented that the financing plans were not mutually exclusive and that it received no further benefit from the securitization plan financing when the final financing plan was adopted.

The costs at issue are clearly identified and no further benefit was received after adoption of the final financing plan.

We conclude that the costs related to the securitization financing plan are eligible for an abandonment loss in accordance with section 165.

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.

Company submitted voluminous materials concerning the costs at issue. While this office reviewed the materials submitted, we are not ruling on any particular item allocated or the amount of any of allocation addressed above, which are appropriately determinations subject to examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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.

Sincerely,

Robert M. Casey
Senior Technical Reviewer, Branch 3
(Income Tax & Accounting)