

**Office of Chief Counsel
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memorandum**

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to: Anthony J. Kim
Senior Counsel (San Francisco, Group 1)
(Large Business & International)

from: Lewis K. Brickates
Branch Chief, Branch 1
(Income Tax & Accounting)

subject: Applicability of Treasury Regulation section 1.263(a)-5(e) to Targets in Asset Acquisitions

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

When an acquired taxpayer elects to treat a stock sale as an asset sale under section 338(h)(10) of the Internal Revenue Code ("I.R.C. §"), can the acquired taxpayer elect to allocate success-based fees paid in conjunction with the acquisition pursuant to Revenue Procedure 2011-29, 2011-18 I.R.B. 746?

CONCLUSION

No. The safe harbor election under Rev. Proc. 2011-29 only applies to "covered transactions" under Treas. Reg. § 1.263(a)-5(e)(3). With regard to an acquired taxpayer in an asset acquisition, the transaction is not a "covered transaction" under Treas. Reg. § 1.263(a)-5(e)(3).

FACTS

On December 31, 2012, the shareholders of Target Corporation (Target), an S Corporation, sold all of their outstanding stock to Acquirer Corporation (Acquirer) for \$X

("Transaction"). Target and Acquirer jointly elected to treat the Transaction as a taxable asset acquisition under I.R.C. § 338(h)(10).

Target incurred success-based and non-success based costs leading up to the Transaction, including:

1. Success-based costs. Target incurred these costs to create financial models and prepare buyer lists. These costs were paid to an investment bank.
2. Non-success based costs. Target incurred these costs in the general marketing to potential buyers. The costs include the costs of drafting information memoranda, reviewing contracts, and preparing letters of intent.

On its timely filed original 2012 Form 1120-S, U.S. Income Tax Return for an S Corporation, Target attached a statement electing the safe-harbor allocation under Rev. Proc. 2011-29. In the statement, Target identified the Transaction, and stated that it was capitalizing 30% of its success-based costs. Target claimed a transaction cost deduction, including 70% of its success-based costs under Rev. Proc. 2011-29.

LAW AND ANALYSIS

A taxpayer must capitalize amounts paid to facilitate certain enumerated business transactions, regardless of whether the transactions are 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 transactions. Treas. Reg. § 1.263(a)-5(a). The list of enumerated business transactions includes, but is not limited to, "an acquisition of assets that constitute a trade or business (whether the taxpayer is the acquirer in the acquisition or the target of the acquisition)." Treas. Reg. § 1.263(a)-5(a)(1)-(10).

A success-based fee is paid to facilitate a transaction described in Treas. Reg. § 1.263(a)-5(a) if the amount is paid in the process of investigating or otherwise pursuing the transaction. Success-based fees are presumed to facilitate the transaction and, therefore, must be capitalized. Treas. Reg. § 1.263(a)-5(f). A taxpayer may rebut the presumption, and deduct the amount of the fees, by maintaining sufficient documentation to establish that a portion of the success-based fees is allocable to activities that do not facilitate the transaction. Treas. Reg. § 1.263(a)-5(f).

Rev. Proc. 2011-29 provides a safe-harbor election in which a taxpayer may, in lieu of maintaining the documentation required in Treas. Reg. § 1.263(a)-5(f), allocate success-based fees between activities that facilitate a transaction and activities that do not facilitate a transaction. The safe-harbor election is available only for "covered transactions," as defined under Treas. Reg. § 1.263(a)-5(e)(3). See Rev. Proc. 2011-29, Sec. 4.01. Treas. Reg. § 1.263(a)-5(e)(3) lists three transactions as "covered transactions:"

- (1) A taxable acquisition by the taxpayer of assets that constitute a trade or business.
- (2) A taxable acquisition of an ownership interest in a business entity (whether the taxpayer is the acquirer in the acquisition or the target of the acquisition) if, immediately after the acquisition, the acquirer and the target are related within the meaning of I.R.C. § 267(b) or 707(b).
- (3) A reorganization described I.R.C. § 368(a)(1)(A), (B), or (C) or a reorganization described in section 368(a)(1)(D) in which stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354 or 356 (whether the taxpayer is the acquirer or the target in the reorganization).

In this case, the Transaction is a deemed asset acquisition because of the I.R.C. § 338(h)(10) election. Target cannot, however, treat the Transaction as a “covered transaction.” Treas. Reg. § 1.263(a)-5(e)(3)(i) uses the phrase “taxable acquisition *by the taxpayer*,” which means that the provision only applies to acquiring taxpayers and not to acquired taxpayers. Nowhere in Treas. Reg. § 1.263-5(e)(3)(i) is there language like the parenthetical “(whether the taxpayer is the acquirer in the acquisition or the target of the acquisition),” which is found in Treas. Reg. § 1.263(a)-5(a). Accordingly, with regard to an asset acquisition, the term “covered transaction” under Treas. Reg. § 1.263(a)-5(e)(3)(i) only applies to the acquiring taxpayer and not the acquired taxpayer.

The Transaction does not qualify as either of the other “covered transactions” listed in Treas. Reg. § 1.263-5(e)(3). The Transaction was not a “taxable acquisition of an ownership interest in a business entity;” Target cannot demonstrate stock ownership post-acquisition. Additionally, the Transaction is none of the reorganizations listed in Treas. Reg. § 1.263(a)-5(e)(3)(iii).

Accordingly, Target is not eligible to elect safe-harbor treatment under Rev. Proc. 2011-29 for its success-based fees paid in 2012. Taxpayer must capitalize the success-based fees that it claimed as a current expense on its 2012 return, unless it establishes through documentation that a portion of the costs are allocable to activities that do not facilitate the transaction. Treas. Reg. § 1.263(a)-5(f).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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