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Department of the Treasury
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Person To Contact:
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Date:
June 6, 2023

Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	
Date 5	=	
Date 6	=	
Date 7	=	
Buyer	=	.
Taxpayer	=	
Merger Sub	=	
Financial Advisor	=	
Stockholder Representative	=	
Historic Advisor	=	
Accounting Firm	=	
Percent 1	=	
Percent 2	=	
Percent 3	=	
Percent 4	=	
Percent 5	=	
$ a	=	
$ b	=	

Dear :

This letter responds to a request for a private letter ruling filed by Taxpayer with the Internal Revenue Service (Service). In the letter ruling request and subsequent submissions, you seek an extension of time for Taxpayer to make a late safe harbor election under Rev. Proc. 2011-29, 2011-18 I.R.B. 746, effective for the taxable year that ended on Date 1. This request for relief to make a late election relates to a contingent fee Taxpayer represents was made on its behalf pursuant to § 1.263(a)-5(k) of the Income Tax Regulations. The request is made in accordance with §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations. Taxpayer's request was filed with our office on Date 2.

FACTS

Taxpayer, a privately-held corporation, entered into a merger agreement dated Date 4. Taxpayer employs an accrual method of accounting on a calendar year basis. Taxpayer had no majority controlling shareholder prior to the merger between Taxpayer and Merger Sub. Taking into account voting rights and relatedness, the top five shareholders of Taxpayer owned the following fully diluted ownership percentages of Taxpayer: Percent 1, Percent 2, Percent 3, Percent 4, and Percent 5.

Taxpayer was acquired in a reverse merger with Merger Sub, a domestic corporation created to effectuate the reverse subsidiary merger. Merger Sub was a direct, wholly owned subsidiary of Buyer. Taxpayer merged into Merger Sub with Taxpayer surviving.

Merger Sub did not engage in any activity other than to effectuate the merger and did not issue any debt to effectuate the merger. Taxpayer represents that no funds of Taxpayer were used to acquire Taxpayer's stock. Additionally, Taxpayer represents that it did not assume any debt of Merger Sub or Buyer and did not incur any debt that was used to purchase Taxpayer stock in connection with Buyer's acquisition. After the merger, Taxpayer became a direct, wholly owned subsidiary of Buyer. Buyer and selling shareholders treated the transaction as a stock purchase of Taxpayer by Buyer.

The Taxpayer, Buyer, Merger Sub, and Stockholder Representative (on behalf of selling shareholders) entered into an Agreement and Plan of Merger (Merger Agreement) on Date 4. After the board of directors for Taxpayer recommending the Merger Agreement to be in the shareholders' best interest, the Merger Agreement was submitted to Taxpayer's shareholders for their approval. The total consideration from the conversion of shareholder stock into cash was $ a. Taxpayer represents that the acquisition was treated as a taxable acquisition of

stock pursuant to which, immediately after the acquisition, Buyer and Taxpayer were related within the meaning of § 267(b) or § 707(b) (i.e., a covered transaction) of the Internal Revenue Code (Code).

There was no pre-existing agreement among the selling shareholders that enabled one or more selling shareholders to effectively control the sale of Taxpayer stock.

On Date 3, Taxpayer and Financial Advisor had entered into an agreement (Engagement Letter) pursuant to which Financial Advisor would act as Taxpayer's financial advisor in a connection with a transaction which resulted in the effective sale of the principal business and operations of Taxpayer by the shareholders to a third party. The Engagement Letter described a number of services that Financial Advisor was to perform for or on behalf of Taxpayer in connection with a possible transaction.

Upon consummation of the merger, a contingent fee became payable to Financial Advisor ("Contingent Fee"). According to the Engagement Letter, in the event a transaction was consummated, Taxpayer was obligated to pay Financial Advisor the Contingent Fee payable in cash or other immediately available funds at the closing of the transaction. The contracted Contingent Fee was equal to a specified percentage of the aggregate value of the transaction. On Date 6, Buyer's board of directors approved a cash purchase price of Taxpayer in the amount of $ a. On Date 7, Financial Advisor issued a $ b invoice to Taxpayer for its advisory fees. Pursuant to the Merger Agreement, Buyer was obligated to pay Financial Advisor and other transaction costs, which reduced sales proceeds to Taxpayer's selling shareholders.

Historic Advisor was engaged to prepare and file Taxpayer's return for the taxable year that ended on Date 1. However, Historic Advisor represents that it was unaware of the existence of the Contingent Fee and failed to alert Taxpayer to the potential to make a safe harbor election provided under Rev. Proc. 2011-29.

The Merger Agreement provided that pre-closing date taxable income would be calculated on the assumption that a Rev. Proc. 2011-29 election was made. However, Taxpayer represents that it overlooked making the election under Rev. Proc. 2011-29.

Taxpayer did not directly pay the Contingent Fee of $ b; rather the cost was paid by Buyer out of sales proceeds. Taxpayer represents that the Contingent Fee was paid on behalf of Taxpayer in accordance with § 1.263(a)-5(k). Taxpayer also claims that the payment of the Contingent Fee by Buyer is part of the purchase price that is included in its stock cost basis and that the Contingent Fee portion of the purchase is appropriately viewed as being received by the selling shareholders (but excluded from gain) and then contributed by the selling shareholders to Taxpayer as a capital contribution (that increases basis consistent with the amounts not being reported as gain).

Taxpayer represents that it was eligible to make the success-based fee election. Taxpayer has not requested and the Service is not expressing an opinion on the above claimed tax treatment or any other matter not expressly ruled upon.[1]

LAW AND ANALYSIS

Sections 301.9100-1 through 301.9100-3 of the Procedure and Administration regulations provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, procedure, notice or announcement published in the Internal Revenue Bulletin. Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make certain regulatory elections.

Section 301.9100-3(a) provides extensions of time to make a regulatory election under Code sections other than those for which § 301.9100-2 expressly permits automatic extensions. Requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) states that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer: (1) requests relief before the failure to make the regulatory election is discovered by the Service, (2) failed to make the election because of intervening events beyond the taxpayer's control, (3) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election, (4) reasonably relied on the written advice of the Service, or (5) reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make the election.

Under § 301.9100-3(b)(3), a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer: (1) seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time the taxpayer requests relief (taking into account § 1.6664-2(c)(3)) and the new position requires or permits a regulatory election for which relief is requested, (2) was informed

[1] A list of specific caveats is set forth below.

in all material respects of the required election and related tax consequences, but chose not to file the election, or (3) uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

Taxpayer has represented that it is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time Taxpayer requests relief, and was not informed in all material respects of the required election, and its related tax consequences, but chose not to file the election. Furthermore, Taxpayer has represented that it is not using hindsight in requesting relief and that specific facts have not changed since the original deadline that made the election advantageous to Taxpayer.

Section 301.9100-3(c)(1) provides that the Commissioner will grant a reasonable extension of time only when the interests of the Government will not be prejudiced by the granting of relief. Section 301.9100-3(c)(1)(i) provides, in part, that the interests of the government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Section 301.9100-3(c)(1)(ii) provides, in part, that the interests of the government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment under § 6501(a) before the taxpayer's receipt of a ruling granting relief. Under these criteria, the interests of the government are not prejudiced in this case.

Section 263(a)(1) and § 1.263(a)-2(a) provide that no deduction shall be allowed for any amount paid out for property having a useful life substantially beyond the taxable year. In the case of an acquisition or reorganization of a business entity, costs that are incurred in the process of acquisition and that produce significant long-term benefits must be capitalized. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 89-90 (1992); *Woodward v. Commissioner*, 397 U.S. 572, 575-576 (1970).

Under § 1.263(a)-5, a taxpayer must capitalize an amount paid to facilitate a business acquisition or reorganization transaction described in § 1.263(a)-5(a). In general, an amount is paid to facilitate a transaction described in § 1.263(a)-5(a) if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all the facts and circumstances. *See* § 1.263(a)-5(b)(1).

Section 1.263(a)-5(f) provides that an amount paid that is contingent on the successful closing of a transaction described in § 1.263(a)-5(a) is presumed to facilitate the transaction and, thus, must be capitalized. A taxpayer may rebut this presumption by maintaining sufficient documentation to establish that a portion of the fee is allocable to activities that do not facilitate the transaction and thus may be deductible. This

documentation must be completed on or before the due date of the taxpayer's timely filed original federal income tax return (including extensions) for the taxable year during which the transaction closes.

Section 1.263(a)-5(k) states that, for purposes of § 1.263(a)-5, references to an amount paid to or by a party include an amount paid on behalf of that party.

To reduce controversy between the Service and taxpayers over the documentation required to allocate success-based fees between the activities that facilitate the transaction and activities that do not facilitate the transaction, the Service issued Rev. Proc. 2011-29.

Section 4.01 of Rev. Proc. 2011-29 states that the Service will not challenge a taxpayer's allocation of a success-based fee between activities that facilitate the transaction described in § 1.263(a)-5(e)(3) and activities that do not facilitate the transaction if the taxpayer: (1) treats 70 percent of the amount of the success-based fee as an amount that does not facilitate the transaction; (2) capitalizes the remaining 30 percent as an amount that does facilitate the transaction; and (3) attaches a statement to its original federal income tax return for the taxable year the success-based fee is paid or incurred, stating that the taxpayer is electing the safe harbor, identifying the transaction, and stating the success-based fee amounts that are deducted and capitalized.

The revenue procedure applies to covered transactions described in § 1.263(a)-5(e)(3), which includes, inter alia, a taxable acquisition by the taxpayer of assets that constitute a trade or business and 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 § 267(b) or § 707(b). *See* § 1.263(a)-5(e)(3)(i) and (ii).

Section 1.263(a)-1(e)(1) provides that commissions and other transaction costs paid to facilitate the sale of property are not currently deductible under § 162 or § 212. Instead, the amounts are capitalized costs that reduce the amount realized in the taxable year in which the sale occurs or are taken into account in the taxable year in which the sale is abandoned if a deduction is permissible. These amounts are not added to the basis of the property sold or treated as an intangible asset under § 1.263(a)-4. Section 1.263(a)-5(b)(2) provides that an amount required to be capitalized by § 1.263(a)-1, among other provisions, does not facilitate a transaction described in § 1.263(a)-5(a). Thus, commissions and transaction costs that are paid to facilitate a sale and that reduce amount realized are not also covered by § 1.263(a)-5, making Rev. Proc. 2011-29 also not applicable.

Section 162(a) provides that a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business is allowed. To be deductible as an ordinary and necessary expense, the cost must be "directly

connected with" or have "proximately resulted from" a taxpayer's business activity. *Kornhauser v. United States*, 276 U.S. 145, 153 (1928). In related party settings, the deductibility of a cost is not necessarily controlled by the party that undertakes the legal obligation. *Deputy v. du Pont*, 308 U.S. 488, 496, (1940); *Interstate Transit Lines v. Comm'r*, 319 U.S. 488 (1943); *Swed Distributing Company v. Comm'r*, 323 F.2d 480, 483 (5th Cir. 1963). In evaluating which related party is the appropriate party to take a § 162 deduction, courts generally focus on the connection of the expense to the respective business of those parties. In denying an individual shareholder (owning about 16 percent of company stock) the ability to deduct a contracted cost that benefited the shareholder, the Court in *du Pont* observed that implicit in the statutory words "expenses paid or incurred in carrying on any trade or business" is a proximate relationship between the expense and business of the taxpayer. *du Pont*, 308 U.S. at 496.

The issue of whether an expense is that of a corporation or a controlling shareholder is given heightened scrutiny. *Hood v. Commissioner*, 115 T.C. 172, 179 (2000).[2] Section 1.263(a)-5 expressly applies to costs paid or incurred by a target company. *See*, e.g., § 1.263(a)-5(e)(3)(iii). The Service generally has not asserted that costs directly paid by a non-majority controlled public target company must be treated as the costs of selling shareholders so as to preclude a § 162 deduction by the target company. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992) (the Service has, however, successfully challenged a target company's claim that it could deduct rather than capitalize investment banking fee and legal fees paid by the target in its friendly takeover). In *INDOPCO*, the taxpayer's stock was publicly traded and listed on the New York Stock Exchange and its ownership was diversified, with its largest shareholder owning approximately 14.5 percent of its common stock.[3]

CONCLUSION

Based on the facts and representation submitted, we conclude that Taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government. Accordingly, the requirements of §§ 301.9100-1 and 301.9100-3 have been met.

Taxpayer is granted an extension of 60 days from the date of this ruling to file the statement required by section 4.01(3) of Rev. Proc. 2011-29, stating that it is electing the safe harbor for the Contingent Fee success-based fee of $ b, identifying the transaction, and stating the success-based fee amounts that are deducted and capitalized.

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[2] In this case, there was no controlling shareholder as the largest shareholder, taking into account related party interests, had only a Percent 1 interest.

[3] Although not reaching a determination on the factual issue, the Chief Counsel's Office has advised against asserting that the payment of expenses by a public company target in defending against a hostile takeover were constructive dividends paid for the primary benefit of its public shareholders. FSA, 1993 WL 1469586 (June 16, 1993).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by the appropriate parties. This office has not verified any of the materials submitted in support of the request for a ruling and the information materials are subject to verification on examination.

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. In particular, no opinion is expressed on whether (a) Taxpayer is otherwise eligible or otherwise qualifies to make the Rev. Proc. 2011-29 election; (b) the Contingent Fee was paid on Taxpayer's behalf within the meaning of § 1.263(a)-5(k); (c) the Contingent Fee is properly treated, in whole or part, as a deductible or capitalizable cost of Taxpayer; (d) the Contingent Fee is a success-based fee under Rev. Proc. 2011-29; or (e) the Contingent Fee is subject to §§ 162(k), 195 or any other Code provision or regulation that would preclude the deduction or capitalization of the Fee. Further, no opinion is expressed on the tax treatment of the selling shareholders or of the buyer. Finally, no opinion is expressed on the application of § 1.263(a)-1(e)(1) to the facts in this matter.

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.

A copy of this ruling should be attached to Taxpayer's federal tax returns for the tax years affected. 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,

Patrick White
Senior Counsel, Branch 1
(Income Tax & Accounting)

Cc: