Internal Revenue Service

Number: **200953014**
Release Date: 12/31/2009

Index Number: 263.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B03
PLR-127855-09
Date:
September 15, 2009

Legend

Company =

Merger Sub =

Parent =

Intermediate HoldCo =

Sponsors =

Legal Counsel =

Financial Advisors =

Financier	=	
Accounting Service Providers	=	
General Service Providers	=	
Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	
Year 1	=	

Dear :

This letter is in Reply to you authorized representative's letter dated Date 4, requesting rulings regarding Federal income tax consequences of certain transaction costs in completed transactions. The information submitted is summarized below.

SUMMARY OF FACTS

Company, a corporation, was acquired on Date 3 through a merger transaction. The acquisition was accomplished through the merger of Merger Sub 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.

In November of Year 1, the Company Board decided to explore the strategic alternatives available to Company to maintain its competitiveness, including a sale of Company. An exclusivity agreement was executed on Date 1. Company has represented that Date 1 is the "bright-line date" as defined in Treasury Regulation section 1.1.263(a)-5(e)(1).

The Company Board voted to sell Company to the Sponsors on Date 2. Also, Parent, Merger Sub, and Company executed the Merger Agreement on Date 2. Between Date 2 and Date 3, Intermediate Holdco was created as an indirect, wholly-owned subsidiary of Parent, and as the direct parent of Merger Sub. Merger Sub was created as a wholly-owned subsidiary of Intermediate Holdco.

The Transaction was financed under the terms of the Credit Agreement, which was executed on Date 3. Financier provided the highly confident and commitments letters which contemplated that Merger Sub would receive the debt proceeds, and that Company would be the ultimate obligor on such debt. Company was the obligor on the debt after the Transaction was completed.

The Transaction was consummated on Date 3. Intermediate Holdco acquired 100% of the common stock of Company in exchange for cash paid to Company's shareholders. Company became a wholly-owned subsidiary of Intermediate Holdco as a result of the Transaction.

Company has represented that the Transaction is a "covered transaction" as the term is defined in Treasury Regulation section 1.263(a)-5(e)(3). Company has also represented that all transaction costs were paid or reimbursed by Company at closing or prior to closing. In addition, Company has represented that its method of accounting for debt issuance costs complies with section 1.446-5.

DESCRIPTION OF TYPES OF TRANSACTION COSTS AND SERVICE PROVIDERS

Financial Advice

Company entered into a "going-private" transaction with the Sponsors to enhance Company's flexibility in making long-term investment decisions in development, acquisitions and partnerships that would benefit its customers. Company and the Sponsors agreed, based on the various due diligence services provided by the Financial Advisors and by the Sponsors, that this Transaction would raise the Company's growth trajectory, allowing greater long-term product and service development decisions, and accelerate Company's vision for its customers.

Sponsors, Financial Advisors, Legal Counsel, Accounting Service Providers, Financier and General Service Providers assisted with the evaluation of the transaction and securing Company's debt financing. Company paid the expenses related to these service providers and financing out of the debt proceeds.

Financing

Company incurred costs with Financier related to the acquisition of debt in connection with the Transaction. Company's financing-related costs also include amounts paid to various service providers, including the Sponsors, Financial Advisors, Legal Counsel, Accounting Service Providers, and General Service Providers, to assist with the evaluation of the transaction and securing Company's debt financing. Company paid these fees at closing out of the debt proceeds.

Financial Advisors, Legal Counsel, Accounting Service Providers, and General Service Providers

Between the Fall of Year 1 and Date 1, Company, Parent, the Sponsors, and Financier employed various service providers to perform a variety of services over the course of planning, modeling, investigating, pursuing, and completing the Transaction, including all activities necessary to put the financing portions of the Transaction into place.

Specifically, Legal Counsel and Accounting Service Providers advised the Company Board on liquidity and corporate governance considerations, reviewed strategic considerations for the Company Board, reviewed the significance of a transaction with the Sponsors, reviewed research and data collections for potential buyers, attended management presentations, and assisted with document collection for investigatory due diligence.

Similarly, The Financial Advisors investigated various alternatives available to Company, including strategic alternatives, and consideration of mergers or acquisitions with other companies. Some of the Financial Advisors advised the Company Board on possible equity transactions generally, and on various transactions that were considered as consideration by the Company Board progressed. Other Financial Advisors provided due diligence and other investigatory services to Intermediate HoldCo prior to the Company Board's vote to sell Company to the Sponsors on Date 2.

RULINGS

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

Ruling 1

Company requests a ruling confirming the standard for determining when costs associated with transaction-related services arranged for by one or more parties to the Transaction may be taken into account by the Company is when: (i) the Company demonstrates that the services were rendered to Company, and/or on behalf of Company; and (ii) the fees associated with such services were paid for by Company, and/or reimbursed by Company.

The payments that are the subject of this ruling request were made to the Financial Advisors, Legal Counsel, Accounting Service Providers, Financier, and

General Service Providers. Some service providers were engaged directly by Company and rendered services directly to Company. Others were engaged by, and rendered services to, the Sponsors, Parent, and Financier. Company has represented that all services were rendered directly to, or on behalf of, Company, and its ongoing business.

The transaction costs include fees for financial advice, legal services, due diligence services, and other miscellaneous transaction related services. Expenses were also incurred to arrange the debt financing for the transaction. These expenses include underwriting fees, rating fees, due diligence searches, and various agent fees.

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 includes an amount paid on behalf of the party.

Company requests permission to allocate the transaction costs incurred based on (i) the entity to whom the services were rendered and/or on whose behalf the services were provided; and (ii) the entity that paid and/or reimbursed the fees associated with such services. Company's position is that this treatment is appropriate because Company directly and proximately benefited from the services and incurred the economic burden of these services.

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).

Company cites Square D v. Commissioner, 121 T.C. 168 (2003), as support for the proposition that the standard for determining whether a party may take a deduction for costs it did not initially incur is whether the costs were incurred to provide a direct and proximate benefit to the party that paid or reimbursed such costs. Company cites other cases, such as Dinardo v. Commissioner, 22 T.C. 430 (1954), and Fishing Tackle Products Co. v. Commissioner, 27 T.C. 638 (1957), as supporting this approach.

Whether the analysis is labeled "direct and proximate" or not, costs may be taken into account by a taxpayer where the taxpayer properly incurs the liability associated with the costs. The determination of the appropriate allocation of costs is based upon the particular facts of the transaction, including the object of the expenditure, the nature of the transaction, the relationship of the parties, and the anticipated benefit.

We conclude that costs associated with transaction-related services arranged for by one or more parties to the Transaction may be taken into account by the Company when: (i) the Company demonstrates that the services were rendered to Company, and/or on behalf of Company; and (ii) the fees associated with such services were paid for by Company, and/or reimbursed by Company.

Ruling 2

Company requests a ruling that in determining which service provider fees may be taken into account by Company, Company should evaluate certain documents and information, including: service provider invoices; service provider attestation regarding the scope and timing of services; service provider engagement letters; board of director minutes; corporate and service provider meeting minutes and calendar entries; documents developed by the providers and presented to the board of directors; general ledger entries; financial statements; management agreement; flow of funds memo; wire transfer and other bank records; transaction documents; and Company's internal accounting information.

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, Company 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.3d 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).

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. Courts have considered "the [taxpayer's] records, the files of the attorneys, the testimony of witnesses who know the facts, and opinion testimony," including materials such as board meeting minutes and presentations, "even if the apportionment derived . . . is 'less scientific'." See Putnam-Greene Financial Corp. v. United States, 308 F. Supp. 2d 1374 (Mid. D.Ga. 2004) (citing to Estate of Morgan v. Commissioner, 332 F.2d 144 (5th Cir. 1964) and Dye v. United States, 121 F.3d 1399 (5th Cir. 1974)).

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). Determining whether an expense is ordinary and necessary requires an analysis of the facts and circumstances. Jones v. Commissioner, 242 F.2d 616, 620 (5th Cir. 1957). The determination of which service provider fees may be taken into account by Company should be based on all available evidence, including the above referenced documentation, and requires a weighing of the evidence.

We conclude that Company should evaluate all available evidence, including the above referenced documentation in determining which service provider fees may be taken into account by Company.

Ruling 3

Company requests a ruling that the transaction costs, which are properly characterized for federal tax purposes as investigatory pre-decisional due diligence, may be taken into account by Company as amounts that are immediately deductible under Section 162.

The costs at issue arise from due diligence and other investigatory services provided to, and on behalf of, Company by several providers, including Financial Advisors, Legal Counsel, Accounting Service Providers, and General Service Providers.

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 1.263(a)-5(k), Example 4, provides an example of due diligence costs which are properly deductible under section 162.

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 Date 1, the bright-line date, and were not inherently facilitative costs. Further, Company anticipates the transaction will speed the growth of Company's business.

We conclude that due diligence costs which are incurred before the bright-line date and not inherently facilitative may be deducted under section 162.

Ruling 4

Company requests a ruling that costs paid by Company in connection with financing the Transaction are eligible for amortization in accordance with Treas. Reg. section 1.446-5. These costs include a portion of the fees paid to Financier, Financial Advisors, Legal Counsel, Accounting Service Providers, and General Service Providers.

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. In general, under section 1.446-5, debt issuance costs are allocated over the term of the debt based on a constant yield method.

We conclude that the capitalized costs paid by Company in connection with financing the Transaction are allocated to each underlying debt instrument. In addition, we conclude that the capitalized costs are deductible by Company over the term of each underlying debt instrument in accordance with the provisions of section 1.446-5.

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. More specifically, we express no opinion as to the application of Ruling 1 in this letter to the particular facts of the transaction.

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.

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,

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

cc: