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Person To Contact:
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CC:ITA:B01
PLR-116403-22

Date:
March 20, 2023

In Re:

LEGEND:

a%=

b%=

Buyer=

Date 1=

Date 2=

Date 3=

Date 4=

Date 6=

Date 7=

Date 8=

Date 9=

Date 10=

Date 11=

Former Shareholders=

Investment Bank=

Officer=

Preparer=

Professional=

State A=

State B=

Taxpayer=

Year 1=

$x=

$y=

$z=

Dear :

This is in response to a letter dated Date 1 and supplemental correspondence dated Date 2, Date 3, and Date 4, in which Taxpayer requests an extension of time under §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations for Taxpayer to make the safe harbor election for success-based fees described in Rev. Proc. 2011-29, 2011-18 I.R.B. 746 ("Election") in connection with Taxpayer's acquisition by Buyer during Year 1.

FACTS AND REPRESENTATIONS

Taxpayer is a C corporation incorporated in State A and headquartered in State B. Taxpayer uses an accrual method of accounting. Taxpayer uses the calendar year as its taxable year.

On Date 7, Taxpayer entered into an agreement with Investment Bank, which provided that Investment Bank would act as Taxpayer's financial advisor in connection with the sale of Taxpayer (whether in the form of a merger, asset sale, or equity sale) ("Sale"). Investment Bank would help Taxpayer with strategy and marketing materials, identify

and evaluate candidate buyers, contact promising buyers, make sales pitches to them, and provide them any appropriate information they request, conduct due diligence on Taxpayer, evaluating Sale proposals and negotiating and structuring Sale. Investment Bank would receive b% of the consideration received, or to be received, for Sale ("Contingency Fee") and would also be reimbursed for its expenses (some details omitted).

Buyer, in a merger, acquired Taxpayer on Date 6, and Taxpayer continued its existence as a separate entity. Four days before Date 6, Investment Bank invoiced Taxpayer $x for Contingency Fee. The day following Date 6, Taxpayer transferred $y, and Buyer transferred $z, to Investment Bank. The sum of $y and $z was approximately equal to (i) the $x Contingency Fee plus (ii) a much smaller expense reimbursement due Investment Bank.

Former Shareholders were generally interrelated private equity funds which owned Taxpayer prior to Sale. Former Shareholders received their proceeds from Sale after such proceeds were reduced by Contingency Fee (among other items).

For Year 1 and at least one tax year preceding Year 1, Taxpayer has retained Preparer to prepare Taxpayer's federal income tax return, Form 1120, *U.S. Corporation Income Tax Return*. On Date 8, Taxpayer entered into an agreement with Preparer, which provided that Preparer would identify and document the federal income tax consequences of Contingency Fee and would include a Rev. Proc. 2011-29 statement.

Preparer represented to Taxpayer that Taxpayer could elect to deduct 70% of Contingency Fee in Year 1 pursuant to the Rev. Proc. 2011-29 safe harbor, or Taxpayer could forego making Election, in which case Taxpayer might be able to deduct more than 70% of Contingency Fee in Year 1. Preparer discussed with Taxpayer the safe harbor provided by Rev. Proc. 2011-29 and explained to Taxpayer that if Taxpayer made Election, Taxpayer would be provided some audit protection.

Preparer helped Investment Bank draft a letter, dated Date 11 ("Bank Letter"). Bank Letter classified the fees and expenses charged by Investment Bank as follows: (i) a% as related to investigatory/due diligence services rendered prior to approval of Sale by Taxpayer's Board of Directors and (ii) 100% minus a% as facilitating Sale.

Preparer represented to Taxpayer that Bank Letter, combined with Preparer's workpapers, was sufficient documentation that supported deducting a% of the $x Contingency Fee in accordance with § 1.263(a)-5(f) of the Income Tax Regulations. Preparer presented to Taxpayer a numerical comparison of Election (and its 70% allocation) versus Bank Letter (and its claimed a% allocation). The a% allocation is greater than 70%. Preparer did not advise Taxpayer whether or not to make Election. Preparer informed Taxpayer that the results of Preparer's analysis could be examined by the IRS. Taxpayer chose not to make Election and deducted a% of the $x Contingency Fee on its Form 1120 for Year 1.

Taxpayer's Officer was primarily responsible for communicating with Preparer, including all aspects of the Contingency Fee reporting. Officer is a Certified Public Accountant with a bachelor's degree in accounting and an expert in corporate finance. Officer is not an expert in federal income taxation. About three months prior to filing its Year 1 Form 1120, Taxpayer had hired Professional. Professional is an expert in federal income taxation. Prior to hiring Professional, Taxpayer had not employed an in-house expert in federal income taxation. Professional cursorily reviewed Taxpayer's Year 1 Form 1120 prior to its filing but did not evaluate the Contingency Fee reporting. Taxpayer did not alert Professional to the Contingency Fee reporting and did not provide Professional all the documents required to evaluate the Contingency Fee reporting. Taxpayer filed its Form 1120 for Year 1 years before Date 1.

Taxpayer's federal income tax return, Form 1120, for Year 1 was examined by the Internal Revenue Service ("IRS"). On Date 9, several months prior to Date 1, the IRS issued to Taxpayer a Letter 950-Z, proposing to fully disallow the claimed Contingency Fee deduction for Year 1 because Bank Letter did not meet the substantiation requirements under § 1.263(a)-5(f). The IRS subsequently extended, to Date 10, Taxpayer's deadline to respond to the Letter 950-Z. On Date 10, still several months prior to Date 1, Taxpayer filed a protest requesting an appeal. Taxpayer's case for Year 1 is currently pending resolution with IRS Appeals. Taxpayer represents that an accuracy-related penalty under § 6662 of the Internal Revenue Code has not been, and could not be, imposed against it with respect to its Year 1 Form 1120 Contingency Fee deduction.

Taxpayer represents that it failed to make Election because Preparer did not explain to Taxpayer that not making Election could result in full disallowance of Contingency Fee as a deduction in Year 1. Taxpayer also claims that Preparer incorrectly advised Taxpayer that Bank Letter, along with Preparer's workpapers, provided sufficient substantiation for deducting a% of Contingency Fee in Year 1. Taxpayer does not concede that Taxpayer cannot substantiate Contingency Fee, nor does it concede that Bank Letter and Preparer's workpapers constitute insufficient substantiation for Contingency Fee.

LAW & ANALYSIS

We decline to grant Taxpayer relief to make a late election under Rev. Proc. 2011-29 to deduct 70 percent and capitalize 30 percent of the Contingent Fee paid by Seller. This letter sets forth the primary reasons for declining to grant a favorable ruling.

Section 263(a)(1) and § 1.263(a)-2(a) generally 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). 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 of the facts and circumstances. See § 1.263(a)-5(b)(1).

Section 1.263(a)-5(f) provides that an amount that is contingent on the successful closing of a transaction described in § 1.263(a)-5(a) ("success-based fee") is presumed to facilitate the transaction and thus must be capitalized. A taxpayer may rebut the 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.

Rev. Proc. 2011-29 provides a safe harbor for allocating success-based fees paid in business acquisitions or reorganizations described in § 1.263(a)-5(e)(3). In lieu of maintaining the documentation required by § 1.263(a)-5(f), this safe harbor permits electing taxpayers to treat 70 percent of the success-based fee as an amount that does not facilitate the transaction (i.e., an amount that can be deducted). The remaining portion of the fee must be capitalized as an amount that facilitates the transaction.

Section 4.01 of Rev. Proc. 2011-29 allows a taxpayer to make the 70/30 safe harbor election with respect to success-based fees. Section 4.01(3) of Rev. Proc. 2011-29 provides that the taxpayer must attach a statement to its original federal income tax return for the taxable year the success-based fee is paid or incurred. This statement should state that the taxpayer is electing the safe harbor; identify the transaction; and state the success-based fee amounts that are deducted and capitalized.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election.

Section 301.9100-1(b) defines a "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) provides that 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) provides, in relevant part, that a taxpayer is deemed to have acted reasonably and in good faith, except as provided in § 301.9100-3(b)(3), if the taxpayer:

. . .

(v) 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.

Section 301.9100-3(b)(3) provides, however, that a taxpayer will not be deemed to have acted reasonably and in good faith if the taxpayer:

(i) 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, and the new position requires or permits a regulatory election for which relief is requested;

(ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election;

or

(iii) uses hindsight in requesting relief.

Section 301.9100-3(c)(1) provides that an extension of time to make a regulatory election will be granted only when the interests of the Government are not prejudiced by the granting of relief. The interests of the Government are prejudiced if granting relief would result in a 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)(i).

A. Taxpayer Was Informed of Election and Its Consequences in All Material Aspects but Chose not to Make the Election

Preparer informed Taxpayer of the Rev. Proc. 2011-29 safe harbor. Preparer also presented to Taxpayer a numerical comparison of making Election versus not making Election. Taxpayer does not claim that another substantive or procedural aspect specific to Election was not explained to it. Taxpayer argues that Preparer's failure to alert it to the potential for the claimed deduction to be challenged by the IRS is a material aspect of the consequences of not making the Election that it was not informed of. However, the potential exists for any claimed deduction and its underlying substantiation to be challenged on examination. The Election provides a safe harbor from the substantiation requirements in § 1.263(a)-5(f). Therefore, we conclude that Taxpayer was informed in all material respects of the required election and related tax consequences, but chose not to file it. Section 301.9100-3(b)(3)(ii).

Taxpayer claims it was unaware that Contingency Fee could be disallowed in full for Year 1 upon an IRS examination. Section 301.9100-3(b)(3)(ii) speaks to Election's material aspects and tax consequences and not to the likelihood of success upon an examination. In general, all deductions must be substantiated, and IRS examination

and disallowance of deductions is always a risk. Preparer told Taxpayer that Preparer's analysis of Contingency Fee could be examined by the IRS. Preparer discussed with Taxpayer the safe harbor provided by Rev. Proc. 2011-29 and explained to Taxpayer that if Taxpayer made Election, Taxpayer would be provided some audit protection. Further, the structure of Preparer's engagement letter indicates that the Election could be made without Preparer gathering the additional substantiation required when the Election is not made. Therefore, Taxpayer should have been aware that audit risks associated with not making Election were greater than those of making Election, given the sophistication of Taxpayer's staff, which did not require expertise specific to Rev. Proc. 2011-29 to assess the presence of material risk .

Taxpayer's additional claim that Preparer incorrectly advised it that Bank Letter sufficiently substantiated deducting a% of Contingency Fee is irrelevant and self-contradictory because Taxpayer does not concede that such substantiation (by itself or combined with other documents that Taxpayer may have) is insufficient to substantiate deducting a% of Contingency Fee. Preparer did not advise Taxpayer that the substantiation could not be challenged, only that they believed it to be sufficient.

Therefore, Taxpayer's request fails under § 301.9100-3(b)(3)(ii).

B. Taxpayer Had the Benefit of Hindsight in Light of Policies behind Rev. Proc. 2011-29

For hindsight, "the relevant inquiry is whether allowing a late election gives the taxpayer some advantage that was not available on the due date." Vines v. Commissioner, 126 T.C. 279, 293. The scope of the phrase "advantage that was not available" is not entirely clear, but it is not limited to completely new facts that did not exist at the time the return was filed. An election made in response to additional income discovered upon an examination was considered made based on hindsight. Estate of Clemons v. Commissioner, T.C. Memo. 2022-95. Here, somewhat similarly, Taxpayer is attempting to make Election after its deduction was disallowed in an examination for not meeting the substantiation requirements under § 1.263(a)-5(f). Hindsight is a concern here also because Taxpayer claimed an amount greater than the 70% allowed under Election, and seeks to elect the safe harbor only due the unfavorable result in the audit.

Additionally, the policies behind Rev. Proc. 2011-29 amplify hindsight concerns here. Section 2.05 of Rev. Proc. 2011-29 explains that the purpose of providing the safe harbor was to eliminate much of the controversy "regarding the type and extent of documentation required to establish that a portion of a success-based fee is allocable to activities that do not facilitate a business acquisition or reorganization transaction described in § 1.263(a)-5(e)(3)." Taxpayer waited until Date 1 to apply for an extension of time to make a late Election—months after the IRS sent Taxpayer the adverse Letter 950-Z and years after Election for Year 1 was due. Taxpayer's case has gone through examination and is now pending before Appeals. Clearly, the goal of avoiding controversy has been frustrated in Taxpayer's case. The idea behind Rev. Proc. 2011-

29, was avoiding controversy over the substantiation requirements of § 1.263(a)-5(f), not taking cases out of Appeals' hands.

"[A] taxpayer cannot first seek to deduct" an amount of success-based fee greater than 70% "without making the 70% election, while seeking to invoke the 70% safe harbor as a 'protective' fall back measure on audit if it cannot meet the documentation requirements." Martin D. Ginsburg, Jack S. Levin & Donald E. Rocap, Mergers, Acquisitions, and Buyouts ¶402.3.3.3 (2021).

Therefore, we conclude that Taxpayer's request fails under § 301.9100-3(b)(3)(iii).

C. The Service Has Discretion to Deny a Taxpayer Relief to Make a Late Election for Which It Fails to Qualify

Section 301.9100-1 states: "[a]n extension of time is available for elections that a taxpayer is otherwise eligible to make." The preamble implies that the rejection of an extension of time may, in some cases, be made on the grounds that a taxpayer is otherwise ineligible to make the election.

Additionally, the preamble to T.D. 8742, 1998-1 C.B. 388, states:

> The IRS and the Treasury Department believe it is in the interest of sound tax administration to deny § 301.9100 relief when it becomes apparent in considering the request for an extension of time that the taxpayer is not otherwise eligible to make the election. This ensures that the resources of the IRS are brought to bear in the resolution of the issue regarding eligibility at the earliest stage of the administrative process.

Here, many doubts surround Taxpayer's eligibility for Election.

Contingency Fee likely was not Taxpayer's expense, and Taxpayer likely was not "otherwise eligible to make" the safe-harbor election. The costs originated from and directly and proximately related to Former Shareholders' generation of sales proceeds from the disposition of Taxpayer, a portfolio company invested in by the interrelated private equity funds. Therefore, Contingency Fee would likely have been taken into account by Former Shareholders, not Taxpayer, as an offset to amount realized. Section 1.263-1(e)(1).

Based solely on the information provided and representations made, we conclude that Taxpayer did not act reasonably and in good faith. Additionally, Taxpayer may well have been ineligible to make the election under Rev. Proc. 2011-29. Accordingly, Taxpayer's request for an extension of time to make a late election under §§ 301.9100-1 and 301.9100-3 for Year 1 is denied.

CAVEATS

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

Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Code.

Except as expressly set forth 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 Taxpayer that is requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the provisions of the power of attorney currently on file with this office, we are sending a copy of this letter ruling to your authorized representatives. We are also sending a copy of this letter ruling to the appropriate operating division director.

Sincerely,

/s/

Sean M. Dwyer
Senior Technician Reviewer Branch 1
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure:

Copy for § 6110 purposes

cc: