Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B01
PLR-105326-23

In Re:

Date:
September 11, 2023

LEGEND

Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Taxpayer	=
Merger Sub	=
Buyer	=
Stockholder Representative	=
Company	=
Financial Advisor	=
Subsidiary	=
Historic Advisor	=
Percent 1	=
Percent 2	=
Percent 3	=
Percent 4	=
Percent 5	=
$ a	=
$ b	=
$ c	=

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. 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 as of Date 3. 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 owned the following percentages of Taxpayer: Percent 1, Percent 2, Percent 3, Percent 4, and Percent 5.

Buyer acquired Taxpayer by causing Merger Sub, a direct, wholly owned subsidiary of Buyer, to merge with and into Taxpayer. Taxpayer survived the transaction as a 100 percent-owned subsidiary of Buyer. Buyer treated the transaction as a stock purchase of Taxpayer by Buyer.

Merger Sub was a domestic corporation created to effectuate the merger. 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 or its affiliates 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.

Taxpayer, Buyer, Merger Sub, and Stockholder Representative (on behalf of selling shareholders) entered into an Agreement and Plan of Merger (Merger Agreement) as of Date 3. After the board of directors for Taxpayer recommended the Merger Agreement to be in the shareholders' best interest, the Merger Agreement was submitted to Taxpayer's shareholders for their approval. Pursuant to the Merger Agreement, Buyer agreed to initial consideration of $ a to acquire Taxpayer's stock plus $ b of earnout consideration to be paid to the shareholders of Taxpayer.

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

Upon completion of the merger, advisory fees became payable to Financial Advisor ("Contingent Fee"). According to the Engagement Letter, in the event a transaction was agreed, Company was obligated to pay Financial Advisor the Contingent Fee payable in cash or other immediately available funds upon completion of the transaction. The contracted Contingent Fee was generally equal to a specified percentage of the aggregate value of the transaction. On Date 5, Financial Advisor issued a $ c invoice to Company for the Contingent Fee.

Taxpayer represents that the Engagement Letter appears to have referenced Company in error. Rather, the invoice and the Engagement Letter should have referenced Subsidiary, a wholly owned subsidiary of Taxpayer and a member of its consolidated group. Taxpayer represents that, pursuant to the Engagement Letter, Subsidiary was obligated to pay the contracted Contingent Fee.

Under the Merger Agreement, Buyer was obligated to pay (or to cause Taxpayer to pay) the Contingent Fee and other unpaid company transaction expenses. Taxpayer directly paid the Contingent Fee of $ c by wire transfer from its checking account on Date 6.

Historic Advisor was engaged to prepare Taxpayer's return for the taxable year that ended on Date 1. However, Historic Advisor represents that it did not advise Taxpayer of the opportunity to make the 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 failed to make the election. Taxpayer represents that it relied upon, and did not question, Historic Advisor's treatment of the Contingent Fee as it did not have sufficient internal expertise to do so.

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 tax treatment of the Contingent Fee payment or any other matter not expressly ruled upon.[1]

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

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 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 never informed of all material aspects of the required election. Furthermore, Taxpayer has represented that it is not using hindsight in requesting relief and that no specific facts have changed since the original deadline that would make the election more advantageous to Taxpayer now than if made timely.

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.

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 reduce the amount realized, and are, therefore, not also covered by § 1.263(a)-5, making Rev. Proc. 2011-29 also not applicable.

Section 162(a) provides a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. 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. *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 594 (1943); *Deputy v. du Pont*, 308 U.S. 488, 496, (1940); *Swed Distributing Company v. Commissioner*, 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 of $ c, identifying the transaction, and stating the success-based fee amounts that are deducted and capitalized.

The ruling letter is based upon information and representations submitted by 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 is properly treated, in whole or part, as a deductible or capitalizable cost of Taxpayer; (c) the Contingent Fee is a success-based fee under Rev. Proc. 2011-29;

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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 it did not reach 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).

(d) Taxpayer's payment of the constructive fee is a nondeductible constructive dividend, 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 Contingent Fee. Further, no opinion is expressed on the tax treatment of the selling shareholders or of 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,

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

cc: