

Client Alert

Latham & Watkins Tax Department

IRS Allows US Taxpayers to Treat 70 Percent of Success-Based Fees in Certain M&A Transactions as Deductible

"Compliance with the safe harbor provided in Revenue Procedure 2011-29 offers taxpayers the assurance that their deductions of success-based fees paid in connection with a covered transaction will be respected and relieves taxpayers of the burdensome documentation requirements otherwise required to establish the deductibility of success-based fees."

On April 8, 2011, the Internal Revenue Service (the IRS) issued Revenue Procedure 2011-29, which provides taxpayers with a safe harbor pursuant to which they may deduct 70 percent of success-based fees paid in connection with certain business acquisitions and reorganizations.

Current Treatment of Facilitative Costs

Taxpayers are generally required to capitalize, rather than deduct, fees paid to "facilitate" a wide range of business acquisitions and reorganizations.¹ Amounts are considered to "facilitate" a transaction where, based on all of the facts and circumstances, they are paid in the process of investigating or otherwise pursuing such transaction. If a fee is not paid to facilitate a transaction, then such fee is generally deductible. Existing Treasury Regulations provide a number of factors to be considered and presumptions to be made in determining whether and how much of a given fee was paid to facilitate a transaction. One such presumption treats a fee that is contingent on the closing of a transaction (a "success-based fee") as facilitating the transaction (and therefore required to be capitalized),

unless the taxpayer maintains detailed documentation, including supporting records, that establishes a portion of the success-based fee is allocable to activities other than facilitating the transaction.

Revenue Procedure 2011-29

Noting that the properly deductible portion of success-based fees paid in the context of "covered transactions" has been a source of controversy between taxpayers and the IRS, the IRS issued Revenue Procedure 2011-29. "Covered transactions" generally include the taxable acquisition of assets constituting a trade or business, the taxable acquisition of ownership interests in an entity where the taxpayer and entity are considered related after the transaction and certain tax-free reorganizations.² The safe harbor contained in Revenue Procedure 2011-29 allows taxpayers to treat 70 percent of a success-based fee incurred in connection with a covered transaction as deductible as long as the remaining 30 percent of the fee is treated as facilitative of the transaction and capitalized. Compliance with the safe harbor provided in Revenue Procedure 2011-29 offers taxpayers the assurance that their deductions of

success-based fees paid in connection with a covered transaction will be respected and relieves taxpayers of the burdensome documentation requirements otherwise required to establish the deductibility of success-based fees.

In order to elect the safe harbor, taxpayers must attach an identifying statement to their federal income tax return for the year in which the success-based fee is paid or incurred. The safe harbor has to be elected for each covered transaction entered into by a taxpayer and, once elected, is irrevocable and applies to all success-based fees paid with respect to a given covered transaction.

Revenue Procedure 2011-29 is effective for all success-based fees paid or incurred in taxable years ending on or after April 8, 2011.

Endnotes

¹ Treasury Regulation Section 1.263(a)-5(a).

² Treasury Regulation Section 1.263(a)-5(e)(3).

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