Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID
No.
Telephone Number:

Refer Reply To:
CC:ITA:B02
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Date:
November 02, 2015

TY:

Legend

Taxpayer =
Chief Accounting Officer =
X =
Y =
Z =
Ltd =
Corp1 =
Corp2 =
Consultants =
Law Firm =
CPA Firm =
Tax Preparer =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =
Date6 =
City1 =
City2 =
State =
a% =
b% =
c%=

Dear :

This is in response to a letter dated Date1, requesting an extension of time to make a safe-harbor election under Rev. Proc. 2011-29, 2011-1 C.B. 746, to allocate success-based fees between facilitative and non-facilitative amounts for Taxpayer's transaction during the taxable year ending Date3. This request is made in accordance with §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations.

FACTS AND REPRESENTATIONS

Taxpayer represents the following:

Taxpayer is a corporation, also known as X, and provides Y to its customers. Taxpayer is headquartered in City1, and State. Prior to Date2, the date of the transaction described below, Taxpayer was owned a% by Ltd, with the remaining percentage held by minority shareholders. Taxpayer is currently a wholly-owned subsidiary of Corp2.

On Date2, Corp1 acquired b% of the shares of Taxpayer from its prior owners (the Transaction). Subsequent to the Transaction, on Date3, Corp1 contributed b% of Taxpayer's stock to Corp2. Upon being contributed to Corp2, Taxpayer became a member of Corp2's consolidated group. Taxpayer filed its final stand-alone Form 1120 with a taxable year ending Date3, and now reports on Form 851 filed with Corp2's Form 1120.

Taxpayer engaged Consultants for financial advisory and Z services, as well as negotiation support, relating to the Transaction. Based on the engagement letter, Consultants were to receive a fee of c% of any excess of the initial proposal made by Corp1. An initial payment was due to Consultants upon execution of the consulting agreement.

Taxpayer also engaged Law Firm to provide advice on, and to perform a due diligence review of, the Transaction. During the review, Law Firm identified certain transaction costs associated with Z and characterized these costs as success-based fees eligible for the safe harbor treatment under Rev. Proc. 2011-29.

Subsequent to Corp1's acquisition of Taxpayer, Corp1 engaged Tax Preparer, a tax partner in CPA Firm's City2 office. Tax Preparer assisted with the preparation of Taxpayer's Form 1120 for its taxable year ending Date3, the return on which the safe harbor election under Rev. Proc. 2011-29 should have been made.

At the time the tax return was prepared, Tax Preparer understood that there were consulting fees associated with the purchase of Taxpayer by Corp1. However, CPA

Firm and Tax Preparer had previously been told by Taxpayer that the fees related to general consulting services with no indication that any portion of the consulting fees was a success-based fee contingent on the execution of the sale of the business. Law Firm's characterization of certain transaction costs associated with Z as success-based fees during its due diligence review of the Transaction was not identified to CPA Firm or to Tax Preparer during the course of the return preparation. The finalized return was presented to Chief Accounting Officer for Taxpayer for review and signature. Chief Accounting Officer did not identify that the consulting fees that were capitalized on the return were eligible for the safe-harbor treatment under Rev. Proc. 2011-29, and in reliance on CPA Firm, Chief Accounting Officer of Taxpayer signed Form 1120. Consequently, at the time the return was filed, the entire amount of the consulting fees was capitalized on Taxpayer's return for taxable year ending Date3. Taxpayer's return for the taxable year ending Date3 was timely filed, pursuant to extension, on Date4.

After Taxpayer's Form 1120 for taxable year ending Date3 had been filed, Law Firm contacted CPA Firm on behalf of Taxpayer's former shareholders. Law Firm inquired about the treatment of the transaction costs and identified the success-based fees that had been capitalized on the tax return. It was only at this point, on Date5, that the transaction cost analysis conducted by Law Firm during its due diligence review of the Transaction was brought to Tax Preparer's and CPA Firm's attention.

Subsequently, CPA Firm contacted its own transaction costs professionals to evaluate whether Law Firm had correctly characterized the consulting fees as success-based fees. CPA Firm concluded on Date6 that a portion of the Z fee was success-based and thus eligible for the safe-harbor election under Rev. Proc. 2011-29.

Tax Preparer immediately informed Taxpayer's Chief Accounting Officer that Taxpayer qualified to elect the safe harbor treatment of allocating success-based fees pursuant to Rev. Proc. 2011-29. CPA Firm informed Taxpayer of the need to file a request for an extension of time to make a safe harbor election. Accordingly, Taxpayer is requesting an extension of time to make a safe-harbor election under Rev. Proc. 2011-29 for Taxpayer's taxable year ending Date3. This request is made in accordance with §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations. Taxpayer received no notification from the Internal Revenue Service that its Form 1120 for the taxable year ending Date3 is under examination. Taxpayer filed this request before the failure to make the election was discovered by the Internal Revenue Service.

LAW AND ANALYSIS:

Section 263(a)(1) of the Internal Revenue Code and § 1.263(a)-2(a) of the Income Tax Regulations 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.

A taxpayer's method for determining the portion of a success-based fee that facilitates a transaction and the portion that does not facilitate the transaction is a method of accounting under § 446.

Because the treatment of success-based fees was a continuing subject of controversy between taxpayers and the Service, the Service published Rev. Proc. 2011-29. Rev. Proc. 2011-29 provides a safe harbor method of accounting 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 a safe harbor election with respect to success-based fees. Section 4.01 provides that the Service will not challenge a taxpayer's allocation of success-based fees between activities that facilitate a transaction described in § 1.263(a)-5(e)(3) (costs that must be capitalized) and activities that do not facilitate the transaction (costs that may be deducted) if the taxpayer does three things. First, the taxpayer must treat 70 percent of the amount of the success-based fee as an amount that does not facilitate the transaction and thus may be deducted. Second, the taxpayer must capitalize the remaining amount of the success-based fee as an amount which does facilitate the transaction. Third, 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, stating that the taxpayer is electing the

safe harbor, identifying the transaction, and stating the success-based fee amounts that are deducted (treated as not facilitating the transaction) and capitalized (treated as facilitating the transaction).

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 301.9100-2 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(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 301.9100-1(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(c)(1) provides 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. 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.

Section 301.9100-3(c)(2) provides special rules for accounting method regulatory elections. Section 301.9100-3(c)(2) provides that the interests of the Government are deemed prejudiced, except in unusual or compelling circumstances, if the accounting method regulatory election for which relief is requested is subject to the advance consent procedures for method changes, requires a § 481(a) adjustment, would permit a change from an impermissible method of accounting that is an issue under consideration by examination or any other setting, or provides a more favorable method of accounting if the election is made by a certain date or taxable year.

CONCLUSION:

Based upon our analysis of the facts and representations provided, Taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the Government. Therefore, 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 a safe harbor election for success-based fees under Rev. Proc. 2011-29 with respect to the Transaction for its taxable year ending Date3.

The rulings contained in this letter are based on information and representations submitted by 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.

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 as to whether Taxpayer properly included the correct costs as its success-based fees subject to the retroactive election, or whether Taxpayer's Transaction is within the scope of Rev. Proc. 2011-29.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, a taxpayer filing its return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

In accordance with the provisions of the power of attorney currently on file with this office, a copy of this letter is being sent to your authorized representatives. We are also sending a copy of this letter to the appropriate operating division director. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed.

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.

Sincerely,

NORMA C. ROTTUNO

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NORMA C. ROTUNNO
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enc: copy for § 6110 purposes

cc: