

SAFE HARBOR FOR DEDUCTION OF MERGER & ACQUISITION TRANSACTION FEES

On April 8, 2011, the IRS released Revenue Procedure 2011-29 providing a safe harbor for electing taxpayers to allocate success-based fees paid in certain acquisitions between activities that facilitate the transaction and activities that do not facilitate the transaction.

Electing taxpayers can treat 70 percent of the success-based fees paid in connection with a covered transaction as not facilitating the transaction, and therefore expense the costs. The remaining 30 percent must be capitalized as an amount that facilitates the transaction.

The revenue procedure applies to a taxpayer that "pays or incurs a success-based fee for services performed in the process of investigating or otherwise pursuing a transaction described in §1.263(a)-5(e)(3)";

"1.263(a)-5(e)(3) Covered Transactions:

- A taxable acquisition by the taxpayer of assets that constitute a trade or business.
- 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 section 267(b) or 707(b).
- A reorganization described in section 368(a)(1)(A), (B), or (C) or a reorganization described in section 368(a)(1)(D) in which stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354 or 356 (whether the taxpayer is the acquirer or the target in the reorganization)".

The election is available for success-based fees paid or incurred in taxable years ending on or after April 8, 2011. The election is made by the taxpayer by attaching "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 election is not a change in method of accounting. The election, once made, is irrevocable and applies to all success based fees incurred by the taxpayer with respect to that particular transaction.

Success providers in a transaction often spend a great deal of time prior to a letter of intent is signed on tasks that are not necessarily directly facilitative to finding an actual target, including, improving the business, working with management, understanding the business operations, market and prospects; preparing marketing materials, contacting presenting to potential suitors; responding to due diligence inquiries; coordinating the process; arranging financing and other activities that may not require capitalization. These are tasks that may be expensed with proper records and analysis for work performed prior to a letter of intent is signed.

Careful consideration should be given to the pros and cons to making, or not making, the election. Advantages of making the election are:

- IRS will not challenge the allocation and therefore detailed records do not need to be produced and maintained and time could be saved in analyzing the records.
- If a letter of intent, or similar agreement, is entered into early on in the transaction actual records may not be beneficial to support more expense and less capitalized cost; therefore the 70/30 safe harbor may be very beneficial.

Disadvantage of making the election:

- Due to the nature of the work involved and/or timing, if actual records may produce a better result than the 70/30 allocation.

Please contact us to discuss this change in the treatment of transaction fees and how this will affect you.

FGMK, LLC

PLEASE NOTE, BASED ON INTERNAL REVENUE SERVICE RULES, ANY TAX ADVICE PROVIDED OR IMPLIED HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER.