

CAPITAL EXPENDITURES - AMOUNTS PAID TO FACILITATE ACQUISITION; SAFE HARBOR

Rev. Proc. 2011-29, 2011-18 IRB 746, 04/08/2011, IRC Sec(s). 263

Headnote:

In order to eliminate controversy over allocation of portion of success-based fees that are paid to facilitate transactions and thus are presumed to be capitalized rather than deducted in year paid, IRS established safe harbor to permit taxpayers who so elect to treat 70% of costs so paid as amount not paid to facilitate. Without election, taxpayer must maintain documentation under Reg § 1.263(a)-5(f) to rebut presumption that all fees paid are to facilitate transaction.

1. Purpose

This revenue procedure provides a safe harbor election for allocating success-based fees paid in business acquisitions or reorganizations described in § 1.263(a)-5(e)(3) of the Income Tax Regulations. 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. The remaining portion of the fee must be capitalized as an amount that facilitates the transaction.

2. Background

.01. Section 263(a)(1) of the Internal Revenue Code 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 [69 AFTR 2d 92-694] (1992); *Woodward v. Commissioner*, 397 U.S. 572, 575-576 [25 AFTR 2d 70-964] (1970).

.02. 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.

.03. 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. 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.

.04. 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.

.05. The Internal Revenue Service and the Treasury Department are aware that the treatment of success-based fees continues to be the subject of controversy between taxpayers and the Service. In particular, numerous disagreements have arisen 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) (" covered transaction"). The Service and the Treasury Department expect that much of this controversy can be eliminated by providing taxpayers a simplified method for allocating a success-based fee paid in a covered transaction between facilitative and non-facilitative activities. Accordingly, this revenue procedure provides a safe harbor election for allocating a success-based fee between activities that facilitate a covered transaction and activities that do not facilitate a covered transaction.

3. Scope

This revenue procedure applies to a taxpayer that-

- (1) 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); and
- (2) makes the safe harbor election described in section 4 of this revenue procedure.

4. Safe Harbor Election

.01. The Service will not challenge a taxpayer's allocation of a success-based fee between activities that facilitate a 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.

.02. An election under this revenue procedure applies only to the transaction for which the election is made and, once made, is irrevocable. The election applies with respect to all success-based fees paid or incurred by the taxpayer in the transaction for which the election is made.

.03. An election under this revenue procedure for any transaction does not constitute a change in method of accounting for success-based fees generally. Accordingly, a § 481(a) adjustment is neither permitted nor required.

5. Effective Date

This revenue procedure is effective for success-based fees paid or incurred in taxable years ending on or after April 8, 2011.

Source: IRS

Disclaimer:

These materials and the information ('this information') contained herein are provided by KNAV and are intended to provide general information on a particular subject or subjects and are not an exhaustive treatment of such subject(s). This information is not intended to constitute accounting, tax, legal, investment, consulting, or other professional advice or services and should not be relied upon as the sole basis for any decision which may affect you or your business. No reader should act on the basis of any information contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances. None of KNAV, its member firms, or its and their respective affiliates shall be responsible for any loss and any special, indirect, incidental, consequential, or punitive damages or any other damages whatsoever whether in an action of contract, statute, tort (including, without limitation, negligence), or otherwise, sustained by any person who relies on this information. If any of the foregoing is not fully enforceable for any reason, the remainder shall nonetheless continue to apply.

About KNAV

KNAV is India's first multi-national firm of accountants and business advisors with operations in India, US and UK. We are currently expanding our operations to Canada, France & Netherlands. Our partners and professionals are qualified in various countries including India, US, Canada, UK and Ireland allowing us to provide you with seamless service across Asia, North America and Europe.