

Tax Treatment of Success Fees

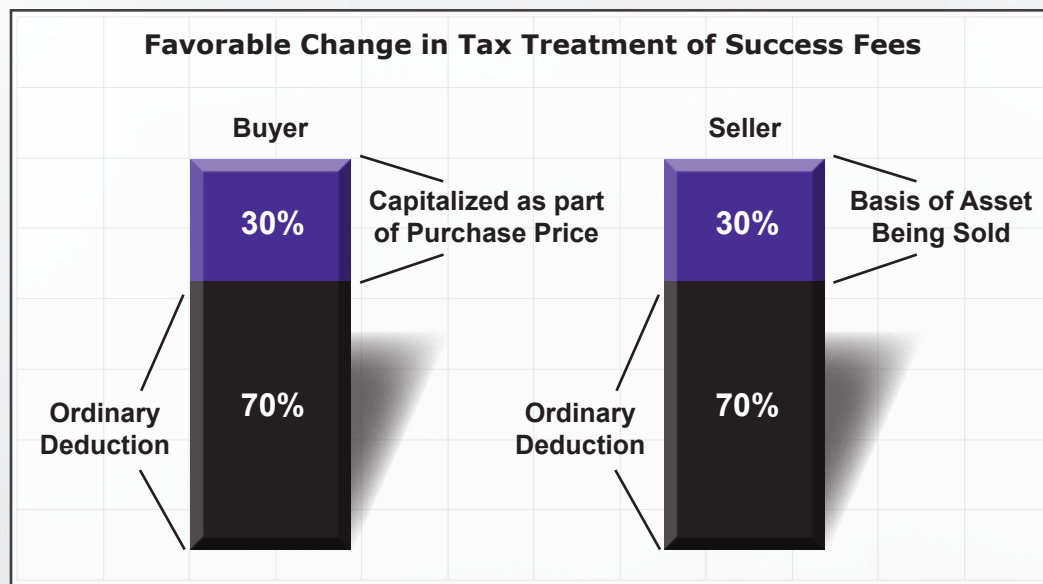
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It is common practice for buyers or sellers to hire professionals to advise them in merger and acquisition transactions. Upon successful closure of the transaction, the fee often involves payment of "success" fees by the buyer or by the selling target to these professionals. Traditionally the IRS has viewed such fees as a cost that produces long-term benefits, and therefore taxpayers are required to capitalize these fees and may not deduct any amount paid to facilitate such transactions. Deductions for such fees were available only to the extent that the taxpayer has sufficient documentation that establishes the portion of the fee allocable to activities that do not facilitate the transaction. Such documentation must consist of more than merely an allocation between activities that facilitate the transaction and those that don't. It must consist of supporting records such as itemized invoices, time records and other records that identify the activities performed, the fee (or percentage) allocable to those activities, the date of the performance and the service provider's contact information. Any documentation requirement must be satisfied prior to the timely filing of the tax return for the year in which the taxpayer claims the deduction.

The treatment of success fees continues to be the subject of contention between taxpayers and the IRS, particularly with regard to the extent of documentation required to support the deductible portion of the success fee.

To eliminate this contention, the IRS published Revenue Procedure 2011-29 in April of 2011, providing a safe harbor for allocating success fees paid or incurred in transactions involving acquisitions or reorganizations. This revenue procedure creates a taxpayer-favorable safe harbor election allowing taxpayers to treat 70 percent of the success fee as an amount that does not facilitate the transaction and therefore is deductible. The taxpayer will be required to capitalize the remaining 30% of the fee. Therefore, the election should be beneficial to taxpayers that do not have documentation supporting an allocation of more than 70% of a success fee, that do not have sufficient supporting documents or that want to avoid a dispute with the IRS as to the proper allocation of such fees.

To make the election, the taxpayer must attach a statement to the original income tax return for the tax year in which the success fee is paid or incurred stating that the taxpayer is electing the safe harbor, identifying the transaction and stating the success fee amounts that are deducted and capitalized.



for which the election is made and is irrevocable. The safe harbor election is available for success fees paid or incurred in tax years ending on or after April 8, 2011. In addition, the IRS recently issued a directive to its large business and international examiners that they should not challenge a taxpayer's treatment of success fees paid or incurred in taxable years not covered by the safe harbor if the taxpayer capitalizes at least 30% of the success fee.



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