WELCOME TAX RELIEF FOR THE DEDUCTIBILITY OF CERTAIN INVESTMENT BANKING FEES

April 8, 2011

To Our Clients and Friends:

Earlier today, the Internal Revenue Service announced a safe harbor election that generally allows electing taxpayers to deduct 70% of their success-based fees (such as investment banking fees) paid in M&A transactions.

This safe harbor will likely make it possible for taxpayers in M&A deals to deduct a greater amount of fees that are contingent on the closing of the deal. It is a significant liberalization of the existing regime under the Treasury Regulations, which generally presumes such fees to be non-deductible.

The current Treasury Regulations require taxpayers to maintain documentation to establish the portion of a deal fee that is "allocable to activities that do not facilitate the transaction" to support deductibility. In practice, this requirement has often forced taxpayers to undertake an intensive examination of their deal fees in an effort to establish the deductible portion and has led to numerous disputes between taxpayers and the IRS during audits.

In Revenue Procedure 2011-29, the IRS states that it is "aware that the treatment of success-based fees continues to be the subject of controversy… [N]umerous disagreements have arisen regarding the type and extent of documentation required to establish that a portion of a success-based fee [is deductible]… [We] expect that much of this controversy can be eliminated by providing taxpayers a simplified method."

The new safe harbor election applies to success-based fees for services performed in the process of investigating or otherwise pursuing one of certain enumerated types of M&A transactions, such as a merger or another acquisitive corporate reorganization, a purchase of a majority ownership interest in a target company, or an asset purchase of a business. It is effective for fees paid or incurred in taxable years ending on or after April 8, 2011. If the election is made with respect to a transaction, it applies to all similar fees paid with respect to that transaction, but does not extend to other transactions.

A taxpayer that wishes to make the election must:

- treat 70% of the success-based fee as an amount that does not facilitate the transaction (i.e., as deductible);

- capitalize the remaining 30% as an amount that does facilitate the transaction; and
- attach a statement to its original federal income tax return for the taxable year in which the 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.

Once the election is made, it is irrevocable.

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Please do not hesitate to call us should you have any questions.

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