

ALERT

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August 11, 2011

Tax Treatment of Success-based Fees Incurred In an Acquisition or Reorganization

Dear Clients and Friends,

Transactions often involve payment of fees by the acquiror or by the selling target. Traditionally the IRS has viewed such fees, referred to as “success-based fee”, as costs that produce significant long-term benefits, and therefore required to be capitalized. Taxpayers would be able to rebut the IRS presumption by demonstrating that the fees incurred were not paid in order to facilitate a transaction. This often involves gathering and maintaining documentation to establish the portions of the success-based fee which do not facilitate a transaction.

In April of 2011, IRS issued a significantly taxpayer-friendly Revenue Procedure, which provides a safe harbor for allocating success-based fees paid or incurred in transactions involving acquisitions or reorganizations. As a result, with respect to success-based fees paid or incurred on or after Apr. 8, 2011, the IRS allows electing taxpayers to treat 70% of the success-based fees as an amount that doesn't facilitate the transaction and therefore deductible. The remaining 30% of the fee must be capitalized. To make the election, the taxpayer must attach a statement to its original federal income tax return for the tax year in which the success-based fee is paid or incurred. In the attachment, the taxpayer must state that it is electing the safe harbor, identify the transaction to which the election relates, and state the success-based fee amounts that are deducted and capitalized.

Additionally, on August 10, 2011 the IRS issued a directive in which it directs its examiners not to challenge a taxpayer's treatment of success-based fees paid or incurred prior to April 8, 2011 in a business acquisition or reorganization. The treatment of the success-based fee must be claimed on a taxpayer's originally filed, and not for refund claims. Therefore, taxpayers can avail themselves of the taxpayer-friendly position of the IRS for transactions which closed prior to April 8, 2011, where the original return is currently on extension.

If you have any questions about how this case may apply to your company or any other questions, please contact your Green Hasson Janks advisor at (310) 873-1600.

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