Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:ITA:B03
PLR-132734-05

Attn:

Date:
June 13, 2007

In re:

Legend

Taxpayer 1 =
Taxpayer 2 =
Corp X =
Business A =
State A =
Investment =
Investment Banking Firm 1 =
Investment Banking Firm 2 =
Accounting Firm =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 ---=

Dear :

This ruling is in reply to a letter dated June 15, 2005, submitted by Corp X (as successor to Taxpayer 1 and Taxpayer 2), requesting an extension of time under § 301.9100-3 of the Procedure and Administrative Regulations for Taxpayer 1 and Taxpayer 2 (collectively referred to as Taxpayers) to complete the documentation of success-based fees required under § 1.263(a)-5(f) of the Income Tax Regulations in order to be excepted from the requirement to capitalize such fees under § 263(a) of the Internal Revenue Code.

FACTS

Prior to the termination of their corporate existence, both Taxpayer 1 and Taxpayer 2 were Business A holding companies incorporated in State A and owned all of the outstanding capital stock of one or more operating subsidiaries.

On Date 3, Taxpayer 1 acquired Taxpayer 2 in a transaction qualifying as a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E) of the Internal Revenue Code, wherein Taxpayer 2 survived a merger with a merger subsidiary controlled by Taxpayer 1. Subsequently, Taxpayer 2 merged with and into Taxpayer 1 in a statutory merger described in § 368(a)(1)(A) and ceased to exist. Taxpayer 2's operating subsidiary was also merged with and into one of Taxpayer 1's subsidiaries. In conjunction with the acquisition of Taxpayer 2 (Acquisition 1), Taxpayer 1 engaged Investment Banking Firm 1 on Date 1 and incurred fees for investment banking services, including a success-based fee. In conjunction with Acquisition 1, Taxpayer 2 engaged Investment Banking Firm 2 and also incurred fees for investment banking services, including a success-based fee.

In a separate subsequent transaction qualifying as a reorganization under § 368(a)(1)(A), Taxpayer 1 merged with and into Corp X on Date 6 and ceased to exist (Acquisition 2). Taxpayer 1's operating subsidiaries were also merged with and into Corp X's operating subsidiary. In anticipation of Acquisition 2, Taxpayer 1 engaged Investment Banking Firm 1 on Date 2 and incurred fees for investment banking services, including a success-based fee.

On Date 4, Taxpayer 1 engaged Accounting Firm to provide tax consulting and analyze the transaction costs incurred by both Taxpayer 1 and Taxpayer 2 with regard to Acquisition 1 and Acquisition 2. Accounting Firm determined that certain amounts of Taxpayer 1's and Taxpayer 2's success-based fees incurred in conjunction with Acquisition 1 and Acquisition 2 were allocable to activities that did not facilitate the transactions.

Taxpayers relied on Accounting Firm to advise them about the treatment and the documentation requirements for success-based fees that were allocable to non-facilitative activities under § 1.263(a)-5(f). Under this provision, the Taxpayers were required to complete documentation of these amounts on or before the due date of the Taxpayers' timely filed original federal income tax returns (including extensions) for the taxable years during which the transactions closed. The original due date for Taxpayer 1's final tax return for the short period ended Date 6 was Date 7, and the extended due date for its final tax return would have been Date 9. In the case of Taxpayer 2, the original due date for its final tax return for the short period ended Date 3 was Date 5, and the extended due date for its final return would have been Date 8. However, Accounting Firm miscalculated the original due dates of Taxpayers' tax returns and failed to advise Taxpayers to file an extension of time to file their returns. As a result, Accounting Firm failed to complete the documentation requirement for Taxpayers' success-based fees incurred with regard to Acquisition 1 and Acquisition 2 before the due dates of Taxpayers' timely filed original tax returns (including extensions). Accounting Firm completed the documentation required under § 1.263(a)-5(f) for Taxpayer 1 by Date 9 and for Taxpayer 2 by Date 8, but after the returns were due. Thus, Corp X, as successor to Taxpayers, filed a request under § 301.9100-3 to ask for an extension of the time provided in § 1.263(a)-5(f) for documenting that certain success-based fees were non-facilitative.

LAW AND ANALYSIS

Section 263 provides that no deduction shall be allowed for any amounts paid out for new buildings or permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-5(a) provides, in part, that a taxpayer must capitalize an amount paid to facilitate certain transactions, including reorganizations described in § 368.

Section 1.263(a)-5(f) provides as follows:

> An amount paid that is contingent on the successful closing of a transaction described in paragraph (a) of this section is an amount paid to facilitate the transaction except to the extent the taxpayer maintains sufficient documentation to establish that a portion of the fee is allocable to activities that do not facilitate the transaction. This documentation must be completed on or before the due date of the taxpayer's timely filed original federal income tax return (including extensions) for the taxable year during which the transaction closes. For purposes of this paragraph (f), documentation must consist of more than merely an allocation between activities that facilitate the transaction and activities that do not facilitate the transaction, and must consist of supporting records (for example, time records, itemized invoices, or other records) that identify--

> (1) The various activities performed by the service provider; (2) The amount of the fee (or percentage of time) that is allocable to each of the various activities performed; (3) Where the date the activity was performed is relevant to understanding whether the activity facilitated the transaction, the amount of the fee (or percentage of time) that is allocable to the performance of that activity before and after the relevant date; and (4) The name, business address, and business telephone number of the service provider.

(emphasis added).

Sections 301.9100-1 through 301.9100-3 set forth the standards the Commissioner will use in determining whether to grant an extension of time to make an election.

Section 301.9100-1(b) provides, in part, that an election includes an application for relief in respect of tax; a request to adopt, change, or retain an accounting method or accounting period; but does not include an application for an extension of time for filing a return under § 6081 of the Code.

Section 301.9100-1(c) generally provides that the Commissioner has discretion to grant a taxpayer a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election under all subtitles of the Code, except subtitles E, G, H, and I.

Section 301.9100-3(a) generally provides that requests for relief subject to this section (i.e., requests for extensions of time for regulatory elections that do not meet the requirements of § 301.9100-2 for automatic 12-month extension) will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

We do not believe that the timely documentation requirement for success-based fees in § 1.263(a)-5(f) constitutes an election to which the provisions of § 301.9100 apply. Specifically, we do not believe that the documentation provision constitutes an application for relief in respect of tax, or a request to adopt, change, or retain an accounting method or accounting period as described in § 301.9100-1(b), for which an extension of time under § 301.9100-3 is available.

First, the documentation requirement in § 1.263(a)-5(f) does not fall within the meaning of the term, “an application for relief in respect of tax” described in § 301.9100-1(b). Because the phrase is not well-defined, it should be interpreted and applied based on its ordinary and usual meaning. See Commissioner v. Brown, 380 U.S. 563, 570 (1965). In the ordinary sense, the term, “application” means a request or petition. See Black’s Law Dictionary 108 (8th ed. 2004). An application for relief in respect of tax, for

which § 301.9100 relief has been available and granted, has generally required the filing of a request, notice, form or other information with the Internal Revenue Service. These filings can be made by means such as providing a separate notice, filing a relevant document with a tax return, or by taking an affirmative position on a tax return. See, e.g., § 1.195-1(b); § 1.508-1(a); § 1.612-4(d). However, the timely documentation requirement of § 1.263(a)-5(f) does not require any filing with the Service. Under the regulation, a taxpayer must complete the appropriate documentation by the due date of the return (including extensions) in order to establish that certain amounts are exempt from capitalization. Under this provision, the timely documentation requirement is more like a record-keeping requirement to substantiate the taxpayer's characterization, rather than a request for relief from the imposition of tax.

Additionally, the explicit language of § 1.263(a)-5(f) suggests that it was not intended to be treated as an election under § 301.9100-1. The provision does not require the filing of information with the Service, but does require that the taxpayer complete detailed documentation in close proximity to the taxable year in which the acquisition transaction closes. This information must include supporting records identifying the precise activities performed, the amounts allocable to those activities, and the service provider that performed them. Thus, the emphasis of this regulation is on the maintenance of contemporaneous and accurate records that clearly demonstrate that a portion of the success-based fee is allocable to activities that do not facilitate the acquisition. The application of § 301.9100 to allow an extension of the time to complete this information would seem to undermine the clear intent of underlying regulation. For these reasons, we believe that § 1.263(a)-5(f) does not constitute an application for relief in respect of tax and an election for which relief under § 301.9100 is available to Taxpayers.

Furthermore, we believe that the documentation requirement for success-based fees in § 1.263(a)-5(f) is not (i) a request to adopt an accounting method; (ii) a request to change an accounting method; or (iii) a request to retain an accounting method. These three conclusions all implicate the same threshold issue, namely, whether the timely documentation of non-facilitative success-based fees under § 1.263(a)-5(f) constitutes a method of accounting under §§ 446 and 481 and the regulations thereunder. We do not believe it does. Rather, the method of accounting is the timing principle articulated by § 1.263(a)-5(f) in its entirety: success-based fees are capitalized, except to the extent they are timely documented as non-facilitative. The existence (or absence) of timely prepared documentation is an objective and verifiable fact external to the accounting method that determines the application of the accounting method. The method of deducting non-facilitative success-based fees does not apply to fees that are not timely documented any more than it applies to fees that are not in fact success-based or facilitative.

In summary, the documentation of non-facilitative success-based fees under § 1.263(a)-5(f) is not in itself a method of accounting; rather, documentation is an extrinsic fact that affects the operation of the method of accounting established by § 1.263(a)-5(f). For

this reason and for other reasons previously stated, the completion of documentation under § 1.263(a)-5(f) does not constitute a request to adopt, change or retain a method of accounting as described in § 301.9100-1(b).

Conclusion

Based on the discussion above, we conclude that the provision of § 1.263(a)-5(f), which requires a taxpayer to complete the documentation of success-based fees allocable to non-facilitative activities on or before the due date of its timely filed return (including extensions) for the taxable year in which the transaction closes, does not constitute an "election" as defined in § 301.9100-1(b) for which relief is available to Taxpayers under § 301.9100-3. Accordingly, Taxpayers' request for an extension of time under § 301.9100-3 to satisfy the documentation requirement relating to success-based fees under § 1.263(a)-5(f) is hereby denied.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file in this office, a copy of this letter is being furnished to your authorized representatives.

Sincerely,

Christopher F. Kane
Branch Chief, Branch 3
(Income Tax & Accounting)