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Date:
July 03, 2024

Attn:

Taxpayer	=
State1	=
Business1	=
Market1	=
Holdco1	=
Holdco2	=
Parent	=
Financial Advisor	=
Accounting Firm	=
Payment Agent	=
Entity 1	=
Buyer	=
Percent 1	=
Percent 2	=
Percent 3	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=

Date 8	=
Date 9	=
Year 1	=
Year 2	=
Year 3	=
$ a	=
$ b	=
$ c	=
$ d	=

Dear :

FACTS

Taxpayer is a limited liability company under State1 law that is treated as a partnership for U.S. federal income tax purposes. Taxpayer employs an accrual method of accounting on a calendar year basis. Taxpayer is engaged in the trade or business of Business1. Specifically, Taxpayer is engaged in Market1.

Taxpayer is owned directly by two holding corporations, Holdco1 and Holdco2 (collectively the "Holdcos"). At all relevant times, Holdco1's and Holdco2's shares of Taxpayer's profits, losses, and capital has been Percent 1 and Percent 2, respectively. Taxpayer represents that the activity of the Holdcos was limited to holding stock of the Taxpayer as single asset holding companies. The Holdcos were owned by dozens of shareholders ("Sellers") who sold their Holdco stock in the Transaction. None of the Sellers owned more than a Percent 3 indirect interest in Taxpayer through their Holdco stock.

Parent, an eligible entity that elected to be classified as an association taxable as a corporation for federal income tax purposes, is the Parent company of an affiliated group of corporations that files a consolidated federal income tax return. Buyer is a single member LLC that is disregarded for federal income tax purposes and is indirectly owned by Parent. Buyer is a cybersecurity company which provides a full suite of cybersecurity products.

Through its subsidiary Buyer, Parent acquired all of the outstanding stock of the Holdcos in exchange for cash in a taxable reverse subsidiary merger (the "Transaction"). Taxpayer represents that Buyer paid cash to acquire its interest in Taxpayer, and that the debt on Buyer's balance sheet was not incurred to finance the

acquisition of Taxpayer. Prior to the Transaction, there was no common ownership of Parent and the Holdcos.

On Date 1, Taxpayer, Holdcos, the acquiring entities, and Sellers' representative signed and executed an Agreement and Plan of Merger ("Merger Agreement"). Taxpayer represents that the purchase price paid by Buyer for Taxpayer's equity was equal to Taxpayer's enterprise value adjusted for the amount of Taxpayer's liabilities, including unpaid transaction costs.

Following the Transaction, Buyer directly owned the Holdcos. Taxpayer represents that the Transaction was a taxable acquisition of an equity interest in Taxpayer and, immediately after the acquisition, Parent and Taxpayer were related within the meaning of § 267(b) and § 707(b) of the Internal Revenue Code (i.e., a covered transaction under § 1.263(a)-5(e)(3)(ii) of the Income Tax Regulations). Holdcos did not sell their interests in the Taxpayer. Instead, Sellers sold their stock interests in the Holdcos to Buyer.

Taxpayer states that it restructured its debt in Year 1 but continued to generate losses and needed additional capital to continue operations and remain a going concern. Taxpayer's large enterprise customers had requested Taxpayer to extend its capabilities beyond data loss prevention to enable the customers to consolidate the number of vendors in their security stack.

On Date 2, Taxpayer engaged Financial Advisor, an unrelated third party that provides investment banking services, to assist Taxpayer in investigating and pursuing the Transaction. Taxpayer represents that the engagement letter was erroneously addressed to Entity 1., the predecessor entity to Taxpayer, but that Taxpayer was the contracting party with Financial Advisor.

Taxpayer represents that it engaged Financial Advisor to explore strategic alternatives to help Taxpayer maintain relevance in the marketplace, to fulfill Taxpayer's customers' desire to consolidate vendor relationships by procuring more services from a single vender, and to obtain capital. Financial Advisor provided financial advisory services to Taxpayer, assisted Taxpayer in preparing materials for prospective acquirers, identified and screened prospective acquirers, and managed communications with prospective acquirers related to Taxpayer's due diligence inquiries. Taxpayer states that it anticipated significant business benefits directly associated with the Transaction and related capital. Taxpayer represents that it is not aware of any strategic or financial advisory services regarding the transaction rendered by Financial Advisor to an entity other than Taxpayer.

Taxpayer incurred a fee of $ a for Financial Advisor's services that was contingent upon the successful closing of the Transaction (the "Contingent Fee"). Taxpayer also incurred $ b of reimbursable expenses payable to Financial Advisor, which were capitalized in connection with the Transaction and are not part of the Contingent Fee.

The Merger Agreement required Buyer to pay off (or cause to be paid off) all of Taxpayer's outstanding indebtedness and transaction expenses at or prior to closing, in part to ensure that Taxpayer's obligation to Financial Advisor was satisfied. A third-party Payment Agent handled the closing payments for the Transaction. Taxpayer transferred $ c of cash and Buyer transferred $ d of cash to the Payment Agent to effectuate the closing of the Transaction.

The Payment Agent transferred the cash for the Contingent Fee to Financial Advisor at the closing of the Transaction. Taxpayer represents that the Contingent Fee was either paid using funds provided by the Taxpayer or by Buyer on behalf of Taxpayer. Taxpayer states that is unclear whether Taxpayer or Buyer paid the Contingent Fee because the cash provided by each party to the Payment Agent is fungible, and both parties provided sufficient cash to the Payment Agent at closing that may have been used to pay the Contingent Fee.

Taxpayer maintains that if the Contingent Fee were paid by Buyer, the payment by Buyer was not paid out of sales proceeds. Instead, Taxpayer maintains that Buyer's payment would be treated as a payment of Taxpayer's liability, resulting in a capital contribution by Buyer to Taxpayer, rather than as a payment on behalf of Sellers.

Parent engaged Accounting Firm to prepare its consolidated federal income tax returns beginning with its taxable year ended Date 3. Due to the Transaction, Parent also engaged Accounting Firm to prepare Taxpayer's Form 1065 for the Year 2 taxable year as well as Holdcos' short period Forms 1120 for the period ended Date 1. Accounting Firm was also engaged to prepare the opening balance sheets ("OBS") with respect to the Transaction based on information provided by Buyer.

On Date 4, in connection with the preparation of the OBS, Accounting Firm sent an email to Buyer's then tax manager requesting general ledger detail for the account labeled "transaction costs" on Taxpayer's trial balance to determine the appropriate treatment of the costs in that account. On Date 5, Buyer's tax manager asked Taxpayer's financial controller by email if the Contingent Fee was a success-based fee. On Date 6, Taxpayer's financial controller responded by email, stating that he was unsure of the nature of the Contingent Fee because Taxpayer's agreement with Financial Advisor was handled by a former officer of Taxpayer.

Taxpayer represents that because Buyer and Accounting Firm were not able to determine that the Contingent Fee was a success-based fee at that time, Taxpayer capitalized the entire Contingent Fee on its financial statements. Taxpayer further represents that neither the Holdcos nor Buyer accounted for the Contingent Fee for book or tax purposes.

A timely extension was filed to extend the due date of Taxpayer's Year 2 Form 1065 to Date 7.

On Date 8, in connection with the preparation of Taxpayer's Year 2 Form 1065, Accounting Firm emailed Buyer's tax manager to again request detail with respect to the treatment of Taxpayer's transaction costs. On Date 9, Buyer's tax manager responded by email with a transaction cost summary spreadsheet ("Summary") which identified the Contingent Fee as a success-based fee because, by that time, Buyer's tax manager had determined that the Contingent Fee was a success-based fee. The Summary included a calculation showing that 70% of the Contingent Fee was deductible based on Taxpayer's intention to make the Rev. Proc. 2011-29 Safe Harbor Election. The Summary also included a reconciliation of the transaction costs capitalized on the OBS that Taxpayer inadvertently failed to remove.

Accounting Firm inadvertently overlooked and was not otherwise made aware of the new information regarding the deductibility of the Contingent Fee based on the application of the Rev. Proc. 2011-29 Safe Harbor Election ("Election") in the Summary. Accounting Firm interpretated the reconciliation included in the Summary to mean that Taxpayer's transaction costs were required to be capitalized on Taxpayer's Year 2 Form 1065.

Buyer's tax manager reviewed a draft of Taxpayer's Year 2 Form 1065 before it was filed. However, he did not realize that 70% of the Contingent Fee was not deducted or that the election statement required by section 4.01(3) of Rev. Proc. 2011-29 ("Election Statement") was not included before the Year 2 Form 1065 was signed and filed.

In connection with the preparation of Parent's Year 3 provision for income taxes, Buyer's tax manager realized both that 70% of the Success-Based Fee was not deducted on Taxpayer's Year 2 Form 1065 and that the Election Statement was omitted from Taxpayer's return. Taxpayer immediately asked Accounting Firm for assistance in remedying the late filing of the Election.

Taxpayer represents that it intended to make the Election for the Transaction and to deduct 70% and capitalize 30% of the Contingent Fee on its Year 2 Form 1065. Taxpayer further represents that it relied on its tax advisors for advice on the requirements to make the Election. Taxpayer believed that its advisors possessed sufficient experience to guide Taxpayer through the process of making the Election.

Taxpayer represents that it is not seeking to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time this request for relief was submitted. Taxpayer further represents that no specific facts have changed since the due date for making the Election and filing the Election Statement that would make the Election more advantageous now than it would have been if the Election been made and had the Statement been included with the timely filed return.

Taxpayer represents that its liability will not be lower in the aggregate for all taxable years affected by the Election than it would have been if the Election had been timely made. Taxpayer further represents that the period of limitations on assessment under § 6501(a) has not yet expired for the taxable year in which the Election Statement should have been attached to Taxpayer's return or for any other taxable years that would have been affected by the Election had it been timely made.

LAW AND ANALYSIS

Sections 301.9100-1 through 301.9100-3 of the Procedure and Administration regulations provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make certain regulatory elections. Section 301.9100-1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) provides that requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1) states that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer: (i) requests relief before the failure to make the regulatory election is discovered by the Service; (ii) failed to make the election because of intervening events beyond the taxpayer's control; (iii) failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return at issue), the taxpayer was unaware of the necessity for the election; (iv) reasonably relied on the written advice of the Service, or (v) reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Section 301.9100-3(b)(3) provides that a taxpayer is deemed to have not acted reasonably and in good faith if the taxpayer: (i) seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under § 6662 at the time the taxpayer requests relief (taking into account any qualified amended return filed within the meaning of § 6664-2(c)(3)) and the new position requires or permits a regulatory election for which relief is requested; (ii) was informed in all material respects of the required election and related tax consequences, but chose not to file the election, or (iii)

uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

Section 301.9100-3(c)(1) provides that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be prejudiced by the granting of relief. Section 301.9100-3(c)(1)(i) provides, in part, that the interests of the government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Section 301.9100-3(c)(1)(ii) provides, in part, that the interests of the Government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment under § 6501(a) before the taxpayer's receipt of a ruling granting relief.

Section 263(a)(1) 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 (1992); Woodward v. Commissioner, 397 U.S. 572, 575-576 (1970).

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). Section 1.263(a)-5(b)(1) provides that, in general, 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. Section 1.263(a)-5(b)(1) also provides that whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all the facts and circumstances.

Under § 1.263(a)-5(f), an amount paid that is contingent on the successful closing of a transaction described in § 1.263(a)-5(a) ("a success-based fee") is an amount paid to facilitate the transaction and, thus, must be capitalized. A taxpayer may rebut this presumption by maintaining sufficient documentation to establish that a portion of the fee is allocable to activities that do not facilitate the transaction, and thus may be deductible. 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.

Section 1.263(a)-5(k) states that, for purposes of § 1.263(a)-5, references to an amount paid to or by a party include an amount paid on behalf of that party.

To reduce controversy between the Service and taxpayers over the documentation required to allocate success-based fees between the activities that facilitate the transaction and activities that do not facilitate the transaction, the Service issued Rev. Proc. 2011-29. Rev. Proc. 2011-29 provides a safe harbor method of accounting for allocating success-based fees paid in business acquisitions or reorganizations described in § 1.263(a)-5(e)(3) (“covered transactions”), including a taxable acquisition of an ownership interest in a business entity (whether the taxpayer is the acquirer in the acquisition or the target of the acquisition if, immediately after the acquisition, the acquirer and the target are related within the meaning of § 267(b) or § 707(b). 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, meaning that amount can be deducted. The remaining 30 percent of the success-based fee must be capitalized as an amount that facilitates the transaction.

Section 4.01 of Rev. Proc. 2011-29 allows the taxpayer to make a safe harbor election with respect to success-based fees. Section 4.01 provides that 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) (costs that must be capitalized) and activities that do not facilitate the transaction (costs that may be deductible) if the taxpayer: (1) treats 70 percent of the amount of the success-based fee as an amount that does not facilitate the transaction and thus may be deducted; (2) capitalizes the remaining 30 percent as an amount that does facilitate the transaction and thus may be capitalized; 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 pursuant to the safe harbor election.

Section 1.263(a)-1(e)(1) provides that commissions and other transaction costs paid to facilitate the sale of property are not currently deductible under § 162 or § 212 . Instead, the amounts are capitalized costs that reduce the amount realized in the taxable year in which the sale occurs or are taken into account in the taxable year in which the sale is abandoned if a deduction is permissible. These amounts are not added to the basis of the property sold or treated as an intangible asset under § 1.263(a)-4. Section 1.263(a)-5(b)(2) provides that an amount required to be capitalized by § 1.263(a)-1, among other provisions, does not facilitate a transaction described in § 1.263(a)-5(a). Thus, commissions and transaction costs that are paid to facilitate a sale and that reduce amount realized are not also covered by § 1.263(a)-5, making Rev. Proc. 2011-29 also not applicable.

Section 162(a) provides that a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business is allowed. To be deductible as an ordinary and necessary expense, the cost must be "directly connected with " or have "proximately resulted from" a taxpayer’s business activity. Kornhauser v. United States, 276 U.S. 145, 153 (1928). In related party settings, the

deductibility of a cost is not necessarily controlled by the party that undertakes the legal obligation. Deputy v. Du Pont, 308 U.S. 488, 496 (1940); Interstate Transit Lines v. Commissioner, 319 U.S. 488 (1943); Swed Distributing Company v. Commissioner, 323 F.2d 480, 483 (5th Cir. 1963). In evaluating which related party is the appropriate party to take a § 162 deduction, courts generally focus on the connection of the expense to the respective business of those parties. In denying an individual shareholder (owning about 16 percent of company stock) the ability to deduct a contracted cost that benefited the shareholder, the Court in Du Pont observed that implicit in the statutory words "expenses paid or incurred in carrying on any trade or business" is a proximate relationship between the expense and business of the taxpayer. Du Pont, 308 U.S. at 496.

The issue of whether an expense is that of a corporation or a controlling shareholder is given heightened scrutiny. Hood v. Commissioner, 115 T.C. 172, 179 (2000). Section 1.263(a)-5 expressly applies to costs paid or incurred by a target company. See, e.g., § 1.263(a)-5(e)(3)(iii). The Service generally has not asserted that costs directly paid by a non-majority controlled public target company must be treated as the costs of selling shareholders so as to preclude a § 162 deduction by the target company. INDOPCO, Inc. v. Commissioner, 503 U.S. 79 (1992) (the Service has, however, successfully challenged a target company's claim that it could deduct rather than capitalize investment banking fee and legal fees paid by the target in its friendly takeover). In INDOPCO, the taxpayer's stock was publicly traded and listed on the New York Stock Exchange and its ownership was diversified, with its largest shareholder owning approximately 14.5% of its common stock.

CONCLUSION

Based on the facts and representation submitted, we conclude that Taxpayer acted reasonably and in good faith and granting relief will not prejudice the interests of the government. Accordingly, the requirements of §§ 301.9100-1 and 301.9100-3 have been met.

Taxpayer is granted an extension of 60 days from the date of this ruling to file the statement required by section 4.01(3) of Rev. Proc. 2011-29, stating that it is electing the safe harbor for the fee paid to Financial Advisor of $ a, identifying the transaction, and stating the success-based fee amounts that are deducted and capitalized.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by penalty of perjury statements executed by the appropriate parties. This office has not verified any of the materials submitted in support of the request for a ruling and the information materials are subject to verification on examination.

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. In particular, no opinion is expressed on whether: (a) Taxpayer is otherwise eligible or otherwise qualifies to make the Rev. Proc. 2011-29 election; (b) the fee paid to Financial Advisor was paid by Taxpayer, or else was paid by its acquirer Buyer on Taxpayer's behalf within the meaning of § 1.263(a)-5(k); (c) Taxpayer was the proper legal party to make the Rev. Proc. 2011-29 election and claim a deduction for 70 percent of the fee paid to Financial Advisor; (d) the fee paid to Financial Advisor is properly treated, in whole or part, as a deductible or capitalizable cost of Taxpayer; (e) the fee paid to Financial Advisor is a success-based fee under Rev. Proc. 2011-29; (f) § 1.263(a)-1(e)(1) applies to the facts in this matter; (g) the fee paid to Financial Advisor was directly connected with or proximately resulted from Taxpayer’s business activity; or (h) the fee paid to Financial Advisor is subject to §§ 162(k) ,195 or any other Code provision or regulation that would preclude its deduction or capitalization. Further, no opinion is expressed regarding the tax treatment of Sellers, Holdcos, Buyer, or Parent resulting from the payment of the fee to Financial Advisor.

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.

A copy of this ruling should be attached to Taxpayer's federal tax returns for the tax years affected. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

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Bridget E. Tombul
Branch Chief, Branch 2
Office of Associate Chief Counsel
(Income Tax and Accounting)

cc: