Deducting Transaction Costs

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Here's a subject that is near and dear to M&A Tax Report readers' hearts. When it comes to transaction costs, you want to deduct as much as possible. Of course, *INDOPCO* stands as a barrier, but it may be possible to particularize fees, to bifurcate and trifurcate the fees. Some may be deductible, and in general, the more specific your vendors or service providers are about exactly what they did and to what end, the better.

Yet, even if you are resigned to capitalizing fees, it can matter into which entity you put them. Thus, you should consider to which company transactions costs should be attributed. It can make a difference, as shown by LTR 200830009 (Apr. 11, 2008).

Who Paid?

There, a surviving company ("Survivor") was acquired in a merger, and sought to allocate merger transaction costs between itself and the target company ("Target"), which merged into it. The facts are worth reviewing but are too involved to lay out here. Notably, however, most of the actual contracts and costs came at the parent level ("Parent"), Parent of what became Survivor.

Parent arranged for a number of transaction costs, including fees for financial advice, legal services, due diligence services, *etc.* The question the IRS addressed was exactly who could claim credit for these fees.

The ruling begins with a recitation of the deduction versus capitalization rules. The regulations under Code Sec. 263 carve out "covered transactions," making it clear that transaction fees to pursue covered transactions must be capitalized.

However, the question here was *how* those fees should be *allocated*. The IRS ruled that Survivor could allocate the transaction costs to Target or the acquisition company (which merged into Survivor) based on the entity to which the services were rendered and/or the entity on whose behalf they were provided.

That can allow some flexibility. Indeed, the ruling notes that these were lump-sum costs from the various vendors, and that detailed billing records were not available. Still, the IRS found the records sufficient to support an appropriate allocation between the entities.

Conclusion

You may be used to the old saw that one taxpayer cannot deduct costs paid on behalf of another. Yet here, we're only talking about an allocation of transaction costs, with appropriate sharing based on which entity received the services. The silver lining of LTR 200830009 is simply that transaction costs can be allocated among entities. This in itself provides some flexibility, even though it is obvious that a current deduction is the real bonanza.

On that point, there were some costs here that the IRS said *could* be deducted (for example, some investigatory expenses). Similarly, there were some financing costs related to a securitization financing plan that the IRS ruled were eligible for an abandonment loss under Code Sec. 165. Notably, a particular financing plan was abandoned, and its abandonment (along with the sunk costs to pursue it) therefore allowed that abandonment loss deduction.

There may be no good substitute for the deduct-or-bust mantra that was so often in evidence prior to *INDOPCO.* Even in the current climate, in which you may be lulled into thinking that everything must be capitalized, it's worth particularizing legal and accounting fees, banking costs, *etc.* You may be surprised at the results of such efforts.

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