IPO And Other Stock Issuance Costs Still Not Deductible

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New IRS memo, same old story. In a recently issued technical advice memorandum, the IRS puts an old spin on yet another attempt to deduct the costs of an initial public offering. The taxpayer had filed a claim for a refund, asking that the costs it incurred in investigating its IPO be allowed as a deduction. In a new twist, the company had taken an aggressive stand, deducting legal, accounting, and investment banking fees. In fact, the deduction covered all the costs incurred prior to the board approving the public offering. The company based its argument on a similar case in which a taxpayer deducted some costs of investigating a new business and amortized others. When a company investigates a new business that is similar to its existing one, editor-in-chief Robert Wood explains, those costs are generally deductible. On the other hand, startup costs are amortized, usually over five years. The IRS apparently did not have to think too long or hard about its response: No.

Timing of costs crucial for determining treatment. The IRS distinguishes between costs paid while searching for a business to buy and those incurred in deciding whether to invest in a particular operation. This whether-or-which test—whether to purchase something and which one to buy—determines how the costs are treated. The “whether costs” in the particular case included travel, advertising, and audit expenses the taxpayer incurred to decide whether to invest in a new business. These searching costs, the author indicates, were not deductible because the company was not already in a similar business; expenses that helped the company decide not to acquire a specific business were deductible. In a 2000 decision, the Eighth Circuit Court of Appeals applied similar reasoning. The tax court had concluded that a target’s investigatory costs before a corporate consolidation, even though they preceded the decision, were connected with a significant long-term benefit and must be capitalized.
Distinguish between stock issuance and investigation. Costs must be allocated when they apply to more than one activity. The IRS also distinguishes between investigation costs and stock issuance expenses. The latter are not related to any asset and do not provide the company with any operational benefit; thus they are not capitalized, expensed, or amortized. The costs simply reduce the proceeds from the stock issue (normally through a reduction in additional paid-in capital). Unlike with the investigational costs, timing is not a concern for stock issuance fees. Whether the company incurs such costs before or after the stock issue is irrelevant in determining their treatment. This rule is time-tested, the author notes, and the IRS memo cites numerous authorities in drawing the distinction. The company might try to link certain costs with the investigation phase, but if those expenses support an equity issuance or an IPO, they will not be allowed as a deduction.