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If Musk Settles With Twitter, Taxes Play A Part

It has been a wild ride, and it's not over yet. First there was the offer by Elon Musk to buy the social media giant, the outrage, the pushback and more. Eventually, there was the deal struck for the Tesla[TSLA +0.8%] tycoon to pay $44 billion for the platform. Famously feisty Musk complained about bots and a lack of proof, just how many accounts was he buying anyhow? Meanwhile, the economy wasn't exactly improving, so some say that Musk was haggling to renegotiate. Then, Musk killed the deal, calling off his whopping purchase publicly and in a Securities and Exchange Commission filing. Like clockwork, Twitter[TWTR +0.3%] cried foul, and sued. It's facing up to be quite a battle, though maybe not with the appeal of say, Johnny Depp and Amber Heard. There was a kill fee in the deal, kind of a $1 billion nonrefundable deposit if Musk called it off. Musk and Twitter agreed that if either party chose to withdraw from the deal, that party would have to pay a fine of $1 billion. Musk's attorney, Mike Ringler, stated that Must called off the deal because Musk does not believe that Twitter provided adequate information about how many fake and spam accounts populate the platform. In a letter to Twitter, Ringler claimed that the company was in "material breach of multiple provisions" of its agreement with Musk.

Despite the negotiated price tag, Musk says Twitter failed to provide all the information it was required to provide, and that should let him off the hook without a payment. It's been the deal of the year, with many for and against votes and a media firestorm from throngs who were horrified or delighted that Elon was plopping down billions to take on Twitter. But that was then. And as the economy soured and the mudslinging grew worse, how could this play into taxes? Musk likes to talk taxes, from how much he should pay on selling Tesla stock, to high California taxes and why he moved himself and Tesla to Texas. But do taxes figure into the hubbub over his on-again off-again bid for Twitter? Was there a tax deduction anywhere in that $44 billion deal he signed on for?

When you buy something, you have basis in your purchase, but no deduction. In fact, in corporate deals of this sort, even the legal fees have to be capitalized, added to the purchase price. That is so even though in business, most legal fees are fair game to claim as business expenses. But what happens when Musk backed out? The tax law says he can write off the $1 billion fee if he has to pay it. And he can write off all the legal fees he is incurring in the big lawsuit Twitter just filed too. Not only that, but all those legal fees and other deal expenses that he could *not* deduct while his Twitter deal was active, now are suddenly deductible. IRS rules require those costs to be capitalized while the deal is negotiated, documented and closed. But if the deal is scuttled, there is no asset to capitalize the expenses to, and you can write them off.

Musk probably isn't thinking about taxes in this Twitter war. But can a payor deduct breakup fees as a business loss or expense? Termination fees are paid when an deal does not happen. This means capitalization is usually irrelevant. If the would-be acquirer drops a few billion when a court blocks a proposed merger, it will usually have no problem deducting the cost of the breakup. However, in some cases a fee paid to terminate one deal can be characterized by the IRS as a cost of carrying out a *second* transaction. That can trigger tax rules that require capitalization of costs that facilitate the acquisition of more than a 50 percent interest in a business entity.

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