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Success-Based Fee Safe Harbor Not Limited to Investment Bankers.

Taxpayers can include success-based fees paid to professionals other than just investment bankers when making a safe harbor election for allocating such fees paid in business acquisitions or reorganizations, an IRS official said May 29.

The safe harbor is available as long as the payment adheres to the definition of a success-based fee in Rev. Proc. 2011-29, 2011-18 IRB 746 , and meets the other requirements, Scott Dinwiddie, special counsel, IRS Office of Associate Chief Counsel (Income Tax and Accounting), said at a Federal Bar Association insurance tax seminar in Washington.

Rev. Proc. 2011-29 offers taxpayers a simplified method for allocating success-based fees paid in transactions described under reg. section 1.263(a)-5(e)(3) that contain both activities that facilitate a covered transaction and those that do not. In lieu of maintaining the supporting documentation required by the regulation, taxpayers electing the safe harbor can treat 70 percent of the success-based fee as an amount that does not facilitate the transaction. The remaining portion of the fee must be capitalized as an amount that does facilitate the transaction.

Practitioners attending a panel on capitalization at the seminar said that though companies have historically paid success-based fees to investment bankers, they have seen a recent increase in such fees paid to attorneys.

In a July 2012 legal memorandum (ILM 201234027), the IRS concluded that nonrefundable milestone payments are not success-based fees and do not qualify for the safe harbor. However, in two later directives (LB&I-04-0413-002 ; LB&I-04-0114-001), the IRS Large Business & International Division told examiners not to challenge a taxpayer's treatment of eligible milestone payments for investment banking services made or incurred in a covered transaction under reg. section 1.263(a)-5(e)(3) regarding a success-based fee if the requirements are met. Jennifer Kennedy of PricewaterhouseCoopers LLP said the LB&I directives do not appear to afford the same treatment to milestone payments made to attorneys.

Dinwiddie said the directives' limitation to only investment banking payments may create some tension for practitioners. However, he said, LB&I's exam function has the authority to determine that it doesn't want to pursue those fees for reasons of administrative convenience as long as the taxpayer is otherwise in compliance. The directives are likely of limited scope because they reflect the issues field agents are actually dealing with and "where the dollars are," Dinwiddie said.

In several recent letter rulings, such as LTR 201405010 and LTR 201338009, the IRS granted a taxpayer an extension of time to file the mandatory statement regarding the election to use the safe harbor method of allocating success-based fees. Dinwiddie said that in those cases the taxpayers simply forgot to attach the election statement but that they deducted 70 percent in accordance with the safe harbor. He said that while the IRS would consider similar relief for a taxpayer that had neither attached the statement nor taken the deduction on its tax return, it would be a much harder

case for the taxpayer to make.

by Jaime Arora