

Office of Chief Counsel
Internal Revenue Service
Memorandum

Release Number: 20133101F

Release Date: 8/2/2013

CC:LB&I:HMT:NEW:2:AHTravis
POSTF-118951-13

UILC: 165.13-00

date:

to: Ann Cunningham
(HMP Territory 8 - Iselin Team 1562)

from: Andrew H. Travis
General Attorney (Newark, Group 2)
(Large Business & International)

subject:

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE:

Whether _____ (the "Taxpayer") is entitled to a deduction for abandonment losses in the amount of _____ for costs incurred in attempting a _____ stock offering during the tax year ending _____,

in connection with its plan of reorganization?

CONCLUSION:

No. The Taxpayer is not entitled to the deduction because the facts provided indicate that although the planned _____ stock transaction was terminated, the Taxpayer did not abandon the _____ stock offering as part of its plan of reorganization.

FACTS:

On _____, _____, and _____ adopted a Plan of _____ Reorganization (the "_____ Plan"), pursuant to which (1) the ownership interest of _____ in _____ would be sold to the public by way of a stock offering; (2) _____ would convert from a _____ corporation to a fully public,

corporation; and (3) would cease to exist. The Taxpayer filed Form 8-K, Current Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 (the "Form 8-K") with the Securities and Exchange Commission ("SEC"), with respect to the Plan on . The Form 8-K stated that:

On , a Form S-1, Registration Statement under the Securities Act of 1933 ("Form S-1") was filed with respect to the proposed sale of common stock to the public (the "Form S-1").

In , filed an application with the

This application was filed for approval to convert from a , with a , holding the

(""), to a stock holding company (the "Conversion"), pursuant to , and . Also, approval was requested for to acquire (the "Acquisition"). In addition, requested approval, pursuant to , to make a capital distribution to of up to percent of the net proceeds of the proposed public offering (the "Capital Distribution").

On , the Boards of Directors of both ., the corporation, and , the recently formed Corporation (and proposed new holding company for) (collectively, " "), by resolution postponed the stock offering in connection with the conversion of . On , the Taxpayer filed Form 8-K with the SEC for the period ending , indicating that the company had "postponed its stock offering in connection with the conversion of ." (the "Form 8-K"). The Form 8-K included as an attachment a press release dated , which indicated the following:

The press release states further that the “

.”

Through _____, costs in connection to this postponed second-step offering (paid or accrued) amounted to \$ _____, outlined in the table below.

<i>Description</i>	<i>Amount</i>
State Tax Opinion	\$
Printing	\$
Business Plan	\$
Regulatory Filing Fees	\$
Appraisal	\$
Audit and Advisory	\$
Postage	\$
Legal	\$
Investment Banking	\$
Miscellaneous	\$
TOTAL	\$

The Taxpayer took a tax deduction for these costs in _____. In response to IDR # _____, however, the Taxpayer indicated that the _____ conversion was postponed for an indefinite period of time, and that the costs were evaluated to determine if there was any meaningful benefit which could be utilized in a future offering.¹ The items identified as having future value included the following:

<i>Description</i>	<i>Amount</i>
State Tax Opinion	\$
Regulatory Filing Fees	\$
Appraisal	\$

¹ As indicated below, it is our position that regardless of any residual value, none of the costs addressed herein may be deducted on the basis of abandonment.

TOTAL	\$
--------------	-----------

Although the _____ Plan was postponed on _____, it was not formally terminated by the Board of _____ until _____.² On _____, a new plan of conversion and reorganization (the “_____ Plan”) was adopted, and a new Form 8-K was filed with the SEC on _____ (the “_____ Form 8-K”). The _____ Form 8-K stated that:

On _____, the Taxpayer issued a press release in which _____, Chairman and Chief Executive Office of the Company, was quoted as saying the following:

On _____, a Form S-1 was filed with respect to the new proposed sale of common stock to the public (the “_____ Form S-1”).

The _____ Form S-1 and the _____ Form S-1 were structurally and formulaically similar, with certain quantitative differences, such as the range of shares, estimated proceeds, and purchase rights. For example, the “Conversion and Offering” section in the Form S-1 indicates the following:

² According to the Taxpayer, had the operation of 12 C.F.R. 192.420 on the _____ plan by vote on _____ would have 24 months to complete the

plan not been formally terminated, it would have expired by _____, two years after the members of _____ approved _____. By adopting a new plan of conversion, the Taxpayer Plan.

The “Conversion and Offering” section of the Form S-1 contains language that is identical to the above paragraph, with one exception: the plan indicates that the ownership interest of in which will be offered for sale in the stock offering is % rather than %.

TAXPAYER’S POSITION:

A Form 886-A (**attached as Attachment “1”**) was presented to the Taxpayer on , which disallowed the deduction. In response, the Taxpayer submitted a memorandum on (**attached as Attachment “2”**), indicating that at the time of the filing of the tax return, a determination was made that the stock offering was terminated as evidenced by the express terms of the offering, the cancellation of all subscription orders and the return of subscription proceeds in accordance with the Prospectus, and the absence of proposed or authorized plans for a future stock offering. The Taxpayer indicated that virtually none of the expenses incurred and deducted in the failed offering would have any carryover benefit – each of the costs would be incurred again in connection with the offering, rendering the costs worthless.

The Taxpayer maintains they are entitled to a deduction for these costs in per Treas. Reg. § 1.165-2(a), which provides that a loss incurred in a business transaction that is terminated “shall be allowed as a deduction under 165(a) for the taxable year in which the loss is actually sustained. For this purpose, the taxable year in which the loss is sustained is not necessarily the taxable year in which the overt act of abandonment occurs.”

The Taxpayer further maintains that the cancellation of all subscriptions and return of all subscription funds, as well as the filing of the Form 8-K and issuance of the press release on , evidence the company’s intent to

abandon the stock offering initiated on . Furthermore, even if the transaction is not deemed to have been abandoned until (the date on which the original Plan of Conversion was formally terminated), the Taxpayer maintains that pursuant to Treas. Reg. § 1.165-2(a), the deduction was properly taken in , the year in which the losses were sustained.

The Taxpayer indicated that for purposes of public perception, the press release indicated that the company postponed the stock offering, stating that:

The Taxpayer further stated:

The Taxpayer also notes that “in addition to the fact that the plan of conversion was formally terminated by the company on , it would have expired by operation of law on pursuant to (i.e. months after the member vote to approve the Plan.)”³

In a follow up conversation held on , the Taxpayer indicated agreement to the disallowance of \$ in expenses paid for state tax opinion, regulatory filing fees, and appraisal costs, as they held future value. However, the Taxpayer believes that the remainder of the costs (totaling \$) paid for

³ It is believed that the Taxpayer is referring to .

printing, business plan, audit & advisory, postage, legal, investment banking and other miscellaneous items should be allowed as current tax deductions in under I.R.C. § 165 because the plan of conversion and second-step offering was abandoned. The Taxpayer believes that there is no future value for these items; thus, they should be eligible as tax deductions in the year of abandonment.

RESPONSES TO IDR #31:

On , you issued Information Document Request (“IDR”) # to the Taxpayer. This section summarizes certain documents provided in response to IDR # which indicate that the Taxpayer intended to postpone the Plan.

On , a special meeting of the board of directors of the Taxpayer was held via teleconference (**Minutes attached as Attachment “3”**). During that meeting, Chairman indicated that it was “

” He indicated, however, that “

”

On , the regular monthly meeting of the Board of Directors was held in . , a representative from (“ ”), the Taxpayer’s consultant with respect to the Plan, presented an update on the market conditions as they pertained to the Plan. It was the consensus of the representatives that the Taxpayer would not get sufficient stock orders to close the transaction “at that time,” and that the reluctance of investors to participate was mainly “stock market driven.” The minutes (**attached as Attachment “4”**) indicate that:

At _____ on _____, a special meeting of the board of directors was held via teleconference. The minutes of this meeting (**attached as Attachment "5"**) indicate that:

In response to IDR # _____, the Taxpayer provided a copy of a letter dated _____, purportedly sent to subscribers to the stock offering (**attached as Attachment**

“6”). The letter explained that “

” The letter stated further that “[

”

On _____, the Taxpayer received a letter from the _____, regarding its application for approval of the Conversion, the Acquisition, and the Capital Distribution. The letter approved the application, subject to certain conditions, including a requirement that the transaction be completed within _____ of the date of the approval letter. However, the letter also stated that “[t]he _____ may, for good cause, extend any time period specified herein for up to _____ calendar days.”

In response to IDR # _____, the Taxpayer provided a copy of a letter to _____, dated _____, in which the Taxpayer requested a *second* _____ extension of the time period for completing the transaction (**attached as Attachment “7”**). In support of its request, the Taxpayer noted that _____ allows _____ months for completion of a _____ conversion. The Taxpayer stated that if _____ were to recommence its stock offering during the extension period, the applicants would submit updated documents and appraisals, but the extension would permit _____ to review and approve a smaller portion of the application rather than a complete review of a new application.

On _____ at _____, a joint meeting of _____ and _____ was held in _____. A discussion was held regarding the conversion plan. The minutes of this meeting (**attached as Attachment “8”**) indicate that:

On _____, the Boards of _____, _____ and _____ held a special meeting at _____, _____, and by conference call (**minutes attached as Attachment "9"**). Documents provided by the Taxpayer indicate that at such meeting, _____ discussed the impact of approving the plan if further postponement would be necessary. _____ indicated that:

At this meeting, the Boards unanimously approved the filing of the _____ Plan, a business plan and appraisal, and the Form S-1 for the _____ Plan.

Law:

I.R.C. § 165 allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Alternatively, I.R.C. § 263(a) provides that no deduction is allowed for any amounts paid out for permanent improvements or betterments made to increase the value of any property.

Treas. Reg. § 1.263(a)-5(a) states in part that a Taxpayer must capitalize an amount paid to facilitate any restructuring, recapitalization, or reorganization of the capital structure of a business entity, without regard to whether the transaction is comprised of a single step or a series of steps carried out as part of a single plan and without regard to whether gain or loss is recognized in the transaction.

Treas. Reg. § 1.165-1(b) provides that in order to be deductible under § 165, a loss must be evidenced by a closed and completed transaction, fixed by an identifiable event, and sustained during the year. Further, only a bona fide loss may be deducted. Substance and not mere form governs in determining whether a loss is deductible. The identifiable event required by Treas. Reg. § 1.165-1(b) “must be observable to outsiders and constitute ‘some step which irrevocably cuts ties to the asset’.” United Dairy Farmers, Inc. v. United States, 267 F.3d 510, 522 (6th Cir. 2001).

Treas. Reg. § 1.165-2(a) provides that a loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein, shall be allowed as a deduction under section 165(a) for the taxable year in which the loss is actually sustained. For this purpose, the taxable year in which the loss is sustained is not necessarily the taxable year in which the overt act of abandonment or the loss of title to the property occurs.

Accordingly, restructuring costs, otherwise capital pursuant to § 263(a), are deductible losses under § 165(a) when the proposed transaction is abandoned. Rev. Rul. 73-580, 1973-2 C.B. 86.

If a taxpayer investigates and pursues multiple separate transactions, costs properly allocable to any abandoned transactions are deductible even if some transactions are completed. Sibley, Lindsay & Curr Co. v. Commissioner, 15 T.C. 106, 110 (1950), acq. 1951-1 C.B. 3. Further, if a taxpayer engages in a series of transactions and abandons one of those transactions, a loss is allowed even if the taxpayer later proceeds with a similar transaction. Tobacco Products Export Corp. v. Commissioner, 18 T.C. 1100, 1104 (1952), nonacq., 1955-2 C.B. 3; Portland Furniture Manufacturing Co. v. Commissioner, 30 B.T.A. 878 (1934); Doernbecher Manufacturing Co. v. Commissioner, 30 B.T.A. 973 (1934), acq. XIII-2 C.B. 6, aff'd, 80 F.2d 573 (9th Cir. 1935).

However, if a taxpayer considers two (or more) mutually exclusive alternatives in pursuing a single transaction, then no abandonment loss is proper unless the entire transaction is abandoned. The costs of pursuing any alternatives not consummated

must be capitalized as part of the cost of the completed alternative. United Dairy Farmers, Inc. v. United States, 267 F.3d 510, 522-24 (6th Cir. 2001) (costs of engineering studies to evaluate potential sites to build a distribution facility are capital where the taxpayer intended to choose only one location to build the facility); Larsen v. Commissioner, 66 T.C. 478, 483 (1976) (costs of sale include costs of unsuccessful contacts); Nicolazzi v. Commissioner, 79 T.C. 109, 130-32 (1982) (investment was a single transaction rather than 600 separate efforts to obtain one successful lease).

Analysis:

Costs incurred in preparation for a public offering of stock must be considered costs incurred to sell the offered stock, and generally must be capitalized. Davis v. Commissioner, 151 F.2d 441 (8th Cir. 1945). However, if the plan to publicly sell such stock is abandoned, such costs may be deductible under § 165 in the year such losses were sustained. Rev. Rul. 79-2, 1979-1 C.B. 98. In Rev. Rul. 79-2, a trust held shares of stock of a privately held corporation. In December, 1975, the shareholders decided that they would make a public offering of not more than one-third of their combined holdings of the stock. During the ensuing months, legal, accounting, registration, and printing fees were paid by the shareholders preparatory to making the offering, which was scheduled for May 1, 1976, but the offering was postponed due to unfavorable market conditions. On July 1, 1976, the shareholders abandoned their plan to publicly sell a portion of their stock holdings in the corporation.

Documents provided by the Taxpayer indicate that in the present case, the Taxpayer did not abandon its public offering; rather, the Plan is a continuation of the Plan. For instance, the events of , indicate that although the Taxpayer intended to postpone the offering, there was full intention of completing the stock offering at some later date. The board members discussed the postponement of the public offering, but did not vote to do so until after the members voted to approve the plan of conversion of the Taxpayer from ownership to ownership the following day. Moreover, the Taxpayer was fully aware that the was by operation of law valid for a period of

a fact which was cited in the Taxpayer's letter to on , in which the Taxpayer requested a *second* extension of the time period for completing the transaction. As noted during the meeting of the Boards, “

”

The Plan and the Plan are merely two mutually exclusive alternatives for converting from ownership to ownership. In addressing the deductibility of abandonment losses, the courts have distinguished mutually exclusive "alternative plans," only one of which a Taxpayer may select and act

in accordance with, from multiple "suggestions" falling under one plan, one or more of which a Taxpayer may select and act in accordance with. United Dairy Farmers, Inc., 267 F.3d at 523. In order to abandon the Plan, it must have been separate and distinct from the Plan, such that the Taxpayer could have elected to adopt the Plan without terminating the Plan.

In Sibley, a Taxpayer employed an investment bank which submitted three alternative plans of restructure: a merger with a subsidiary; the refinancing of certain bonds, and recapitalization of its preferred stock, to coincide with a split-up of its common stock. The Taxpayer adopted only one plan, deducting costs and fees with respect to the two abandoned plans. The court held that the Taxpayer was entitled to deduct the costs and fees associated with the two restructuring plans that it did not adopt because each proposed plan, including the one adopted by the company, was separate and distinct, rather than alternative proposals, "all of which were recommended and all or any of which petitioner might have accepted." Sibley, 15 T.C. at 110.

In Nicolazzi, the taxpayer entered a "lottery" lease program, submitting multiple applications for leases on Federal lands for oil and gas exploration and development. Taxpayer participated in the program with the expectation of acquiring at least one lease and the hope of acquiring more than one. The taxpayer deducted the costs of each unsuccessful lease application, arguing that each lease application was an independent transaction under § 165. The Court rejected this argument, finding that "the relevant transaction is [the taxpayer's] investment in the [lottery] program, and the determination of whether [taxpayer] sustained a loss on that transaction must be based on overall program performance measured by reference to the aggregate of the lease applications." Nicolazzi, 79 T.C. at 131.

United Dairy Farmers involved the selection of a building site for a distribution center, and the deduction of costs incurred in exploring sites that were ultimately abandoned. The taxpayer argued that its payments to an engineering firm in connection with the exploration of multiple sites were more analogous to Sibley, which found deductible abandonment costs under § 165, than to Nicolazzi, which did not find deductible abandonment costs under § 165. The Court noted that in Sibley, the taxpayer was able to deduct under §165 the cost of unpursued plans, because the taxpayer could have accepted "all or any" of the multiple plans presented, whereas in Nicolazzi, the relevant "transaction" was the taxpayer's overall investment in the lottery lease program.

In the present case, the Plan and the Plan are not independent transactions, of which the Taxpayer could have accepted "all or any." Rather, the Plan and the Plan were mutually exclusive alternatives for completing a single transaction. As in Nicolazzi, the conversion from ownership to ownership through a public offering is the relevant transaction which the Taxpayer must abandon in order to deduct any of the costs. Thus, all the costs incurred in pursuing the public offering and conversion, including both the Plan and the Plan, must be capitalized, unless the entire transaction is abandoned.

The Taxpayer stated in its memorandum that:

If a taxpayer engages in a series of transactions and abandons one of those transactions, a loss is allowed even if the taxpayer later proceeds with a similar transaction. Tobacco Products Export Company v. Commissioner, 18 T.C. 106 (1950); Portland Furniture Manufacturing Co. v. Commissioner, 30 B.T.A. 878 (1934); Doernbecher Manufacturing Co. v. Commissioner, 30 B.T.A. 973 (1934) *acq.* XIII-2 C.B. *aff'd* 80 F.2d 573 (9th Cir. 1935).... The fact that the company is proceeding with another stock offering does not preclude the deduction for the losses sustained at the time the offering was initially attempted without success in . It should be also noted that we are distinguishing our situation from that of the taxpayer's in TAM 200749013, in that the failed IPO from was the only transaction we contemplated in . As such, once we abandoned that transaction, there were no alternative plans, and thus no other mutually exclusive transactions that we could have contemplated.

Despite the Taxpayer's assertion that the stock offering was abandoned, Taxpayer has provided no documentation showing that the stock offering was abandoned at any time prior to , when the Plan was formally terminated. The stock offering was not abandoned as of the end of , as shown by the minutes of the Board meetings, which draw a clear distinction between the "postponement" of the Plan on , and the "termination" of the Plan on . It is also shown by the letter to on , requesting a second extension of approval of the Conversion, the Acquisition, and the Capital Distribution. The provided documents, including the Board minutes, the regulatory filings and the press releases establish that for all purposes, the Plan was merely "postponed" as of the end of .

Moreover, the "termination" of the Plan on does not constitute an abandonment of the transaction. It appears from the minutes that on , the Plan was formally terminated by resolution of the Directors in contemplation of the eventual adoption of the Plan, which occurred by resolution of the Directors on . As the Taxpayer noted in its memorandum, the Plan "would have expired by operation of law on , pursuant to 12 C.F.R. 192.240." Had the Taxpayer not contemplated the adoption of the Plan on , it could have allowed the Plan to expire by operation of law. Instead, "because the eligibility date ha[d] changed and the possible investors now include[d] the of acquired companies subsequent to the terminated offering" the Taxpayer terminated the Plan, and replaced it with the Plan, so the Taxpayer would not be required to merely "resolicit the same potential investors who placed orders in ." Thus, neither the postponement of the Plan in nor

the termination of the _____ Plan in _____ was an abandonment of the intended stock offering for purposes of § 165.

In TAM 200749013, the Taxpayer investigated a variety of proposed restructuring transactions, including recapitalization as well as various divestiture scenarios. The Service determined that recapitalization and divestiture were not mutually exclusive, and allowed the deduction of costs of pursuing recapitalization upon the abandonment of any recapitalization when the board of directors voted to eliminate consideration of recapitalization. However, the Service also held that although the Taxpayer could have entered into a combination of subsidiary divestitures, the facts demonstrated that the Taxpayer pursued a single divestiture transaction. When the Taxpayer abandoned a post IPO split-off and “went back to the drawing board” to reconsider all its divestiture options (which ultimately resulted in a “spin-off” rather than a “split-off”), the cost incurred in consideration of the “split-off” was required to be capitalized as part of the eventual restructuring. TAM 200749013 (August 14, 2007).

Taxpayer attempts to distinguish TAM 200749013 in that in the present case the “failed” stock offering from _____ was the only transaction contemplated in _____. The reasoning of the TAM, however, was not based on the alternative divestiture plans having been contemplated during the same taxable year. According to the TAM, the “split-off” and the “spin-off” were mutually exclusive because “the end result of each transaction is the same for the distributing corporation -- it no longer owns any stock in the subsidiary.”

Taxpayer also cites Tobacco Products, Portland Furniture, and Doernbecher to support its assertion that “[i]f a taxpayer engages in a series of transactions and abandons one of those transactions, a loss is allowed even if the taxpayer later proceeds with a similar transaction.”

In Tobacco Products, a significant portion of the taxpayer’s shareholders demanded that the taxpayer distribute its interest in an investment in Philip Morris. Three proposals were explored in sequence: The transfer of taxpayer’s other assets to a new corporation and the distribution of all holdings in liquidation of the taxpayer; the distribution of assets with no new corporation created; and the distribution of the Philip Morris investment and cash, with a reduction in capitalization of approximately 90%. These proposals were not explored concurrently; each time a proposal was abandoned, a new plan was presented. In holding that the portion of expenses relating to the abandoned plans was deductible in the year of abandonment, the Court held that each proposal was separate and distinct in so far as the result to the taxpayer was concerned. Tobacco Products Export Company v. Commissioner, 18 T.C. at 1104.

In Portland Furniture, the taxpayer was part of a group of furniture companies which formed a committee which incurred expenses in 1929 to hire appraisers, accountants, attorneys and an engineer to investigate and carry out a proposed merger of several furniture companies. The proposed merger was subsequently abandoned. In the

following year, the assets of the taxpayer and several other furniture companies were acquired by Furniture Corporation of America, Ltd. ("Furniture Corporation"). The Furniture Corporation also assumed the liabilities of the acquired companies, including the expenses of the committee. According to the Board of Tax Appeals, the evidence supported the abandonment of the 1929 merger, holding that the deduction should not be denied "because of petitioner's subsequent participation in a different combination from that proposed in 1929." Portland Furniture, 30 B.T.A. at 881.

In Doernbecher, the taxpayer was part of the same group of furniture companies which explored a 1929 merger. The taxpayer in Dornbecher did not participate in the 1930 "merger," but the stockholders ultimately transferred the majority of their stock to the Furniture Corporation. The Board of Tax Appeals allowed the deduction of the taxpayer's share of the committee expenses, finding that as far as the taxpayer was concerned the proposed merger in connection with which it incurred the expenses was abandoned in 1929, because the taxpayer was not a party to the 1930 merger.

In each of these cases, the taxpayers incurred costs in exploring transactions that were clearly distinct from the transaction in which each taxpayer ultimately engaged. It is clear that had the "result to the taxpayer" under each option not been separate and distinct, as noted in Tobacco Products, the taxpayers may not have prevailed in those cases. Essentially, these cases are inverse to TAM 200749013, in which "the end result of each transaction [was] the same" for the taxpayer. In the present case, both the _____ Plan and the _____ Plan result in the shares of _____ owned by the public rather than _____. Thus, the present case is analogous to TAM 200749013, rather than the cases cited by the Taxpayer.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call _____ if you have any further questions.

By: _____
Andrew H. Travis
General Attorney (Newark, Group 2)
(Large Business & International)