

**Office of Chief Counsel  
Internal Revenue Service**  
memorandum

CC:ITA:B01:SDwyer  
POSTN-109627-20

Number: **AM 2020-003**  
Release Date: 5/15/2020

UILC: 263.00-00

date: April 27, 2020

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subject: Treatment of Costs Facilitative of an Initial Public Offering

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

ISSUE

May a taxpayer deduct its previously capitalized costs that facilitated an initial public offering (IPO) as an abandonment loss under section 165 of the Internal Revenue Code when the taxpayer later ceases to be a publicly traded company as a result of a take private transaction?

CONCLUSION

No, a taxpayer may not deduct under section 165 previously capitalized costs that facilitated an IPO when the taxpayer later ceases to be a publicly traded company as a result of a take private transaction. The costs are capitalized via netting against the proceeds, so there is no amount to later recover.

FACTS AND BACKGROUND

In Year 1, Taxpayer was a privately-held company. In Year 2, Taxpayer began planning an IPO and ultimately completed the offering and became a publicly traded company. Also in Year 2, Taxpayer incurred a number of costs in connection with the IPO. The costs included legal, accounting, investment banking, underwriting, printing, and regulatory and filing fees. Taxpayer capitalized the costs as a separate and distinct

asset. Taxpayer did not net the costs against the proceeds from the stock issuance. In Year 3, Taxpayer ceased to be a publicly traded company as a result of a take private transaction. Also in Year 3, Taxpayer deducted as an abandonment loss under section 165 the costs incurred in connection with the IPO from Year 2.

## LAW

Section 165(a) provides there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. To be deductible, a loss must be evidenced by a closed and completed transaction, fixed by an identifiable event, and sustained during the year. Treas. Reg. § 1.165-1(b). Further, only a bona fide loss may be deducted. Substance and not mere form governs in determining a deductible loss.

Deductions for abandonment losses are not specified in section 165. However, § 1.165-2(a) provides that a loss is deductible under section 165(a) if it is 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.

Section 165(b) provides that, for purposes of section 165(a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

Section 263(a)(1) provides that no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-5(a) provides, in part, that a taxpayer must capitalize an amount paid to facilitate an acquisition of a trade or business, a change in the capital structure of a business entity, and certain other transactions.

Section 1.263(a)-5(a)(8) provides that a taxpayer must capitalize an amount paid to facilitate a stock issuance.

Section 265 provides that no deduction shall be allowed for any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

Section 1.265-1(a)(1) provides that no amount shall be allowed as a deduction under any provision of the Code for any expense or amount which is otherwise allowable as a

deduction and which is allocable to a class or classes of exempt income other than a class or classes of exempt interest income.

Section 1032 provides that no gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

Section 1.1032-1(a) provides that the disposition by a corporation of shares of its own stock, including treasury stock, for money or other property does not give rise to taxable gain or deductible loss to the corporation regardless of the nature of the transaction or the facts and circumstances involved. For example, the receipt by a corporation of the subscription price of shares of its stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be equal to, in excess of, or less than, the par or stated value of such stock.

## ANALYSIS

### A. Capitalization

Taxpayer claims that (i) the costs created a distinct, nonamortizable intangible asset that must be capitalized, and (ii) when Taxpayer became privately held, certain synergistic and resource benefits it enjoyed as a public company ceased to exist, and the basis in the separate asset created by the costs became recoverable as an abandonment loss under section 165.

Taxpayer asserts that the Supreme Court's decision in Indopco v. Commissioner, 503 U.S. 79 (1992), and the § 1.263(a)-5 regulations overturned the IRS's historical view that stock issuance costs are "netted" against the proceeds. Taxpayer claims that the IPO costs resulted in future benefits to the Company and can be viewed the same as expenses incurred in the purchase of an asset. As a result, Taxpayer states that the IPO costs must be capitalized as a separate and distinct asset, which it retains basis in.

Next, Taxpayer asserts that a deduction under section 165 is appropriate once the synergistic and resource benefits that required capitalization no longer exist. Specifically, Taxpayer claims that as a result of the take-private transaction, it no longer benefited from the resource benefits that it enjoyed as a public company, including the ability to raise capital quickly to fund strategic acquisitions, an enhanced public profile, name recognition, and the ability to attract management and employees. Because a loss under section 165 may be available to taxpayers upon abandoning certain transactions, Taxpayer claims an abandonment loss is appropriate here even though Taxpayer did not abandon its plan to undertake an IPO.

An IPO refers to the first time a company offers its shares of capital stock to the general public. Underwriters are the investment banks that manage and sell the IPO for the company. An IPO helps to establish a trading market for the company's shares. In conjunction with an IPO, a company usually applies to list its shares on an established

stock exchange, such as the New York Stock Exchange or NASDAQ. See SEC Pub. No. 133.

It is well established that a corporation may not deduct or amortize costs incurred in connection with issuing its capital stock. See, e.g., McCrory Corp. v. United States, 651 F.2d 828 (2d Cir. 1981) (stating that costs incident to the issuance of stock or in raising capital are nondeductible capital outlays). Costs incurred in preparation for public offering of stock are considered costs incurred to sell the offered stock. Davis v. Commissioner, 151 F.2d 441 (8th Cir. 1945). Such costs offset or reduce the proceeds of the sale of the stock. See Revenue Ruling 79-2.

The Supreme Court's decision in Indopco did not overturn, and is not contrary to this analysis. In Indopco, the Court held, "The expenses that National Starch incurred in Unilever's friendly takeover do not qualify for deduction as 'ordinary and necessary' business expenses under § 162(a). The fact that the expenditures do not create or enhance a separate and distinct additional asset is not controlling; the acquisition-related expenses bear the indicia of capital expenditures and are to be treated as such." Indopco, 503 U.S. at 90. The expenses at issue included investment banking fees and legal fees incurred in facilitating a reverse subsidiary cash merger. Id. at 81-82. The Court disagreed with National Starch's contention that CIR v. Lincoln Savings & Loan Ass'n, 403 U.S. 345 (1971), "announced an exclusive test for identifying capital expenditures, a test in which 'creation or enhancement of an asset' is a prerequisite to capitalization." Indopco 503 U.S. at 85. The Court clarified, "Lincoln Savings stands for the simple proposition that a taxpayer's expenditure that 'serves to create or enhance ... a separate and distinct' asset should be capitalized under § 263. It by no means follows, however, that only expenditures that create or enhance separate and distinct assets are to be capitalized under § 263." Indopco, 503 U.S. at 87-88.

Following Indopco, FMR Corp. & Subs. v. Commissioner, 110 T.C. 402 (1998), addressed the issue of whether the costs of launching a new mutual fund were deductible or required to be capitalized. The Tax Court declined to find whether a separate and distinct asset has been created, but rather held that capitalization was required because the expected future benefits of managing the fund.

In Indopco, the Court addressed costs incurred in facilitating a merger; it did not consider stock issuance costs or an IPO let alone overrule the IRS's position that the costs relating to an IPO are capitalized via netting the costs against the proceeds. Our historical position remains unchanged and is consistent with Indopco.

This position is also consistent with § 1.263(a)-5, which provides that stock issuance costs must be capitalized. The stock issuance costs are capitalized via reducing the proceeds from the stock issuance. The stock issuance costs do not create a separate and distinct intangible asset, which Indopco confirms is not required for capitalization. Our position is not changed by § 1.263(a)-5(g)(3) being reserved. While Notice 2004-18 solicited comments on the possible treatment of capitalized costs, including stock issuance costs, no regulations or separate guidance have been issued which allow for

the recovery of such costs. Notably, the preamble to the final regulations states that the Service and the Treasury Department will consider whether amounts required to be capitalized for covered transactions, including perhaps, certain stock issuance costs, should be eligible for the 15-year safe harbor amortization period described in § 1.167(a)-3(b). By its very definition, a safe harbor is a provision that allows an action even though the action may not be in accord with a statute or law. Providing a safe harbor, or simply considering providing a safe harbor, does not change the law. It is merely a mechanism to simplify tax administration. Moreover, § 1.167(a)-3(b) has not been amended to apply to amounts required to be capitalized by § 1.263(a)-5.

Stock issuance costs in the context of an IPO are similar to commissions. Commissions and other transaction costs paid to facilitate the sale of property are not currently deductible under section 162 or 212. Instead, the amounts are capitalized costs that reduce the amount realized in the taxable year in which the sale occurs or are taken into account in the taxable year in which the sale is abandoned if a deduction is permissible. See § 1.263(a)-1(e)(1). Even though the costs reduce the amount realized, they are still considered capitalized. The costs are taken into account in the capital transaction via reducing the amount realized, and are thus netted against the proceeds.

Moreover, under section 1032 and § 1.1032-1, a corporation does not recognize taxable gain or deductible loss on the original issuance of its stock. Here, Taxpayer asserts that it does not receive an actual benefit by netting the stock issuance costs with the stock issuance proceeds since the proceeds are not includible in income. However, Taxpayer benefits by not including the proceeds in income. To allow Taxpayer to later recover the capitalized stock issuance costs would contravene the purpose of section 265, which was enacted to prevent a taxpayer from obtaining a double advantage by offsetting taxable income by expenses allocable both to taxable and to tax-free income.

In sum, because the stock issuance costs are capitalized by offsetting the proceeds from the stock issuance, there is no amount to later recover under section 165.

#### B. Abandonment Loss

The amount of a loss under section 165 is the adjusted basis in the property. Here, Taxpayer has no adjusted basis in the stock issuance costs. Thus, there is nothing to abandon.

Established precedent holds that costs incident to the sale of stock are never recoverable, except in instances where a planned public offering is abandoned. Taxpayer's attempt to analogize going private to altogether abandoning a decision to undertake an IPO is misplaced. Stock issuance costs may be deductible if the public offering is abandoned because there are no proceeds available to offset the costs. See Revenue Ruling 79-2. Taxpayer successfully completed its IPO and became a publicly traded company. Taxpayer sold its stock and received proceeds from the sale. These proceeds exceeded and were offset by the expenditures of acquiring them. Thus, even if Taxpayer had intangible assets to abandon, it would have no basis in them.

Even if Taxpayer did have basis in the intangible benefits that resulted from its IPO, an abandonment loss under section 165 would not be available to Taxpayer upon consummation of the take private transaction. No abandonment has occurred because Taxpayer continues to benefit from once being a publicly traded company even though it is now privately held. For example, the benefits Taxpayer has identified, such as the ability to raise capital quickly to fund strategic acquisitions, an enhanced public profile, name recognition, and the ability to attract management and employees, affected Taxpayer's corporate structure. These benefits are not an isolated item which Taxpayer can abandon. Rather, they have already affected Taxpayer's corporate structure and continue to provide benefits to Taxpayer.

In sum, Taxpayer may not deduct under section 165 previously capitalized costs that facilitated its IPO when Taxpayer later ceases to be a publicly traded company as a result of a take private transaction. There are no costs to recover and, even if there were, Taxpayer continues to benefit from once being a publicly traded company.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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