

The Latest and Greatest in M&A and Other Transactional Tax Developments

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Agenda

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OBBBA: Bonus Depreciation
OBBBA: Business Interest Expense
OBBBA: Controlled Foreign Corporations
Basic QSBS requirements & Notable OBBBA changes
Sanofi/Inhibrx
Excise Tax

Break Fees

General Rules – Treas. Reg. Section 1.263(a)-5(a)

- Per Treas. Reg. Section 1.263(a)-5(a), a taxpayer must capitalize an amount paid to “facilitate” a “transaction” including most acquisitions of a target’s assets or stock.
- Thus, costs attributable to a buyer’s acquisition of a target’s assets or stock are usually not deductible and instead are added to the basis of the target assets or stock so acquired.
 - Examples: costs to draft deal documents, term sheets, due diligence costs, investment banker’s fees.

Application to Success-Based Fees

- A success-based fee is a fee “contingent on the successful closing of a transaction,” such as an investment banker’s fee.
- Such fee is paid to “facilitate” a transaction and thus is required to be capitalized.
 - “...*except to the extent* the taxpayer maintains sufficient documentation to establish that a portion of the fee is allocable to activities that do not facilitate the transaction.”
 - Historically, the question of what records are needed to substantiate a success-based fee deduction was a source of disagreement between taxpayers and IRS (see, e.g., PLRs 200953014 and 200830009 and TAM 201002036).

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Safe Harbor

- Due to numerous IRS and taxpayer disputes over difficulties in providing this “sufficient documentation,” IRS issued Rev. Proc. 2011-29, providing a safe harbor for deducting 70% of a success-based fee paid or incurred in a so-called “covered transaction.”
- Does not apply to a non-covered transaction.
- This applies in lieu of maintaining the documentation.

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PLR 202308010 (released Feb. 24, 2023)

- IRS addressed a taxpayer's request for relief under Treas. Reg. section 301.9100-1 through -3 (9100 relief) to elect to deduct a success-based fee under the Rev. Proc. 2011-29 safe harbor.
- The facts are like those of the numerous other taxpayers that have claimed a deduction for success-based fees under Rev. Proc. 2011-29.

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PLR 202308010 (released Feb. 24, 2023), continued

- Relief was denied.
 - IRS found that under the transaction agreement, the selling shareholders reduced the gross sales price by the amount of the success-based fee.
 - IRS claims that if Taxpayer deducts the success-based fee, this adjustment to the gross sales price creates a double benefit by reducing the shareholders' amount realized on the transaction and, by extension, their gain by the amount of the fee.
- *Further*, IRS concluded that a success-based fee paid to a financial adviser was a capitalizable cost incurred by the majority shareholder, a private equity fund, instead of a cost of the target (see Regs. Sec. 1.263(a)-1(e)(1)).

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PLR 202308010 (released Feb. 24, 2023), continued

- IRS conclusion seems to run contrary to past ruling practice and cut against the intent of Rev. Proc. 2011-29 to reduce controversy over substantiating the deductibility of success-based fees.
- Could mean a larger change in IRS policy (?).
 - If so, it becomes unclear whether a target may deduct success-based fees paid to financial advisers for their assistance with a sale and engagement with buyers, particularly when owned by a private equity fund.
 - IRS recently granted 9100 relief to a privately held corporation that “had no majority controlling shareholder” prior to the transaction (PLR 202349003).
 - Does this mean PLR 202308010 views private equity-owned companies as subject to special scrutiny when analyzing deductions for success-based fees?

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AbbVie Litigation

- AbbVie Inc. filed a 2023 petition in Tax Court re: IRS disallowance of a deduction claimed for a \$1.6 million termination fee it made to Shire plc after a failed merger in wake of anti-inversion guidance issues by Treasury shortly after merger’s announcement. (Note: FAA 20163701F appears to about this deal.)
- The deficiency notice, dated 12/6/22, relates to tax year 2014 and asserts that AbbVie owes \$572.4 million in additional taxes.
 - The \$1.64 billion ordinary tax deduction AbbVie claimed on its Form 1120 for the year “is not deductible as an expense under [S]ection 162 or as an ordinary loss under [S]ection 165 because the payment of that amount and termination of an agreement resulted in loss that is treated under [S]ection 1234A as a loss from the sale of a capital asset.”
- AbbVie argued that IRS erred in determining the payment was a capital loss under Section 1234A.

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AbbVie Litigation, continued

- AbbVie cites TAM 200438038 and PLR 200823012 as examples of IRS treatment of termination fees as ordinary income.
- Since the AbbVie merger was terminated, IRS released CCA 201642035 and CCA 202224010 (which guidance suggests a change to treat breakup fees as capital in nature).
- AbbVie also filed three FOIA lawsuits against IRS in the U.S. District Court for the District of Columbia, challenging IRS failure to hand over records concerning its handling of AbbVie's breakup fee and post-2014 guidance on the tax consequences of termination fees.
- AbbVie filed a lawsuit in September 2023 stating IRS is impermissibly withholding records.

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AbbVie Litigation, continued

- On June 18, the Tax court granted AbbVie's motion for summary judgment and cleared the company of alleged income tax deficiencies for the 2014 tax year.
 - In the opinion, the judge said that AbbVie "need not, on account of section 1234A(1), treat the Break Fee as a capital loss" and that the break fee "is not attributable to the 'termination of . . . a right or obligation . . . with respect to property'" for purposes of that section
 - The opinion further stated, "absent approval from Shire's shareholders or the Jersey court, [AbbVie] had [no] right or obligation to acquire the Shire shares."
- The IRS is appealing the Tax Court decision (per September 11 filing).

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Implications

- This area seems to be an area of IRS focus, especially noticing AbbVie appeal.
- Taxpayers should carefully examine their specific facts and circumstances when determining which party to a transaction is the appropriate entity to take transaction costs into account.
- This determination is critical to making a valid safe harbor election under Revenue Procedure 2011-29 for success-based fees.
- Timely filing of the safe harbor election under Revenue Procedure 2011-29 is critical as seeking 9100 relief provides the IRS an opportunity to challenge the location of transaction costs.

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OBBBA: Domestic R&D Expenses

Historic Treatment of Section 174 R&D Expenses

- **Historically (pre-TCJA)** – research and experimental expenses immediately deductible under Section 174.
- **Tax Cuts and Jobs Act of 2017.** For tax years beginning after Jan. 1, 2022:
 - Domestic R&E must be capitalized and amortized over 5 years
 - Foreign R&E must be capitalized and amortized over 15 years
 - Broad scope: software development costs, third party research. Notice 2023-63
- **One Big Beautiful Bill Act of 2025.** For tax years beginning after Jan. 1, 2025:
 - Domestic R&E may be deducted currently, capitalized and amortized over no less than 60 months, or deducted ratably over 10 years
 - Transition rules for unamortized balance of previously capitalized domestic R&E
 - Foreign R&E capitalization requirement remains unchanged.

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OBBBA Transition Rules

- **Default** – capitalized domestic R&E expense continues to be amortized over 5 year schedule
- **Accelerated Deduction** – taxpayer can elect to accelerate amortization into one or two tax years beginning on or after Jan. 1, 2025
 - Rev. Proc. 2025-28 provides rules for making election. Treated as accounting method change.
- **M&A Considerations**
 - Is accelerated amortization needed to offset Target's pre-closing income tax liability?
 - Will acceleration result in 382-limited NOLs less valuable to Buyer?
 - Tax returns prepared "in accordance with Target's past practices"?
 - Will accelerated amortization result in refunds (e.g. of estimated income tax payments)?

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OBBBA Transition Rules, continued

- **Additional Election for Small Businesses** – file amended tax returns for '22 – '24 to retroactively deduct the domestic R&E expenses that previously were required to be capitalized
 - Available to businesses IF combined gross receipts is \$31 million or less over the past three years
 - Requirement to coordinate with research tax credit under 280C
- **M&A Considerations**
 - Diligencing eligibility
 - Are resulting tax refunds for benefit of buyer or sellers?
 - Does retroactive deduction result in NOLs that are 382 limited?

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Asset Sales

- Disposition of property for which capitalized R&E expenses were incurred is not an opportunity to accelerate deduction of capitalized amounts.
- Cessation of taxpayer's business
 - If taxpayer's business ceases in a carry-over basis scenario (e.g. liquidation under Section 332 or reorganization under Section 368), the successor steps into the shoes of prior company with respect to amortization
 - If taxpayer's business ceases in a transaction where Section 381 does not apply, immediate recovery of unamortized R&E in final year. Notice 2023-63
- **M&A Considerations**
 - Corporate seller in taxable asset sale converts to DRE in same tax year in order to accelerate unamortized R&E amounts to offset corporate-level gain.
 - Technique may be of decreasing importance given OBBBA's transition rule permitting elective acceleration of domestic R&E.

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OBBBA: Bonus Depreciation

Bonus Depreciation Section 168(k)

- Amended section 168(k) permanently allows 100% bonus depreciation for qualified property acquired and placed in service after 1/19/2025 (additional year for longer production period property and certain aircraft).
 - Election to instead use 40% bonus rate for qualifying property placed in service during the first tax year ending after 1/19/2025 (60% for longer production period property and certain aircraft).
 - Any qualified property acquired before 1/20/2025 stays on the existing bonus rates.
- Considerations:
 - Substantial modifications for a new written binding contract
 - Potential for 100% bonus for self-constructed property even if construction began before 1/20/2025.
 - Potential application of elective component rules for self-constructed property.
 - Self-developed software is not eligible for bonus due to section 174A, but purchased software is eligible.
 - Interaction with the renewed DAD addback under section 163(j).
 - Impact on other tax attributes like CAMT, 163(j), etc.

New Bonus Depreciation for Certain Real Property Section 168(n)

- The legislation provides an elective 100% depreciation allowance for qualified production property (QPP).
- QPP is that portion of any nonresidential real property that meets the following requirements:
 - Subject to depreciation under section 168,
 - Used by the taxpayer as an integral part of a qualified production activity (QPA)
 - Includes manufacturing, production, or refining of a qualified product (defined as tangible personal property excluding certain food or beverages at retail establishments).
 - “Production” does not include activities other than agricultural production and chemical production, but no other clarification of “manufacturing” or “refining.”
 - Must result in a substantial transformation of the property.
 - Does not include the portion of any property used for offices, administrative services, lodging, parking, sales activities, software engineering, or other functions unrelated to manufacturing, production, or refining of TPP.
 - Placed in service in the United States or any possession of the United States,
 - Original use commences with the taxpayer,
 - Construction begins after January 19, 2025, and before January 1, 2029,
 - Subject to an election by the taxpayer to treat such portion as qualified production property, and
 - Placed in service after the date of enactment and before January 1, 2031, except in cases of Acts of God in which case the Secretary can extend the date by up to two years.

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OBBBA: Business Interest Expense

Business Interest Limitation – Section 163(j)

- Amends section 163(j) adjusted taxable income (ATI) computation to allow depreciation, amortization and depletion (DAD) addback for tax years beginning after 12/31/2024, going from 30% EBIT to 30% EBITDA.
 - The meaning of amortization addback is broad, so it could include catch-up deduction, ongoing section 174 amortization, new elective section 174A amortization, and section 59(e) amortization?
- Excludes from a taxpayer's ATI subpart F and GILTI inclusions and the associated section 78 gross-up amounts as well as amounts determined under section 956.
- Introduces new section 163(j)(10) ordering rules for certain capitalized interest expenses, effective for tax years beginning after 12/31/2025.
 - Business interest limitation generally applies prior to provisions that permit or require the capitalization of interest.
 - However, interest capitalized under section 263(g) or section 263A(f) is not business interest expense.
 - Elective capitalization of interest under section 263(a) or 266 no longer expected to yield section 163(j) benefit.

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OBBBA: Controlled Foreign Corporations

GILTI / NCTI

- **Income formerly known as “GILTI”**
 - “Net CFC Tested Income”
 - QBAI reduction eliminated
 - Permanently sets deduction at 40%, resulting in 12.6% effective tax rate
- **Pro Rata Allocation**
 - Historically, U.S. shareholders include their pro rata share of Subpart F and GILTI/NCTI if they own CFC stock on last day of year in which it is a CFC
 - OBBBA removes “last day” construct for taxable years beginning on or after Jan. 1, 2026. U.S. Shareholders now must include their pro rata share of Subpart F and GILTI/NCTI if they held CFC stock at any time during year.
- **M&A Considerations**
 - Analyze midyear ownership changes in acquisitions or divestitures of CFCs
 - Momentary ownership may now result in NCTI/Subpart F inclusion
 - Section 338(g) elections to close the CFC taxable year

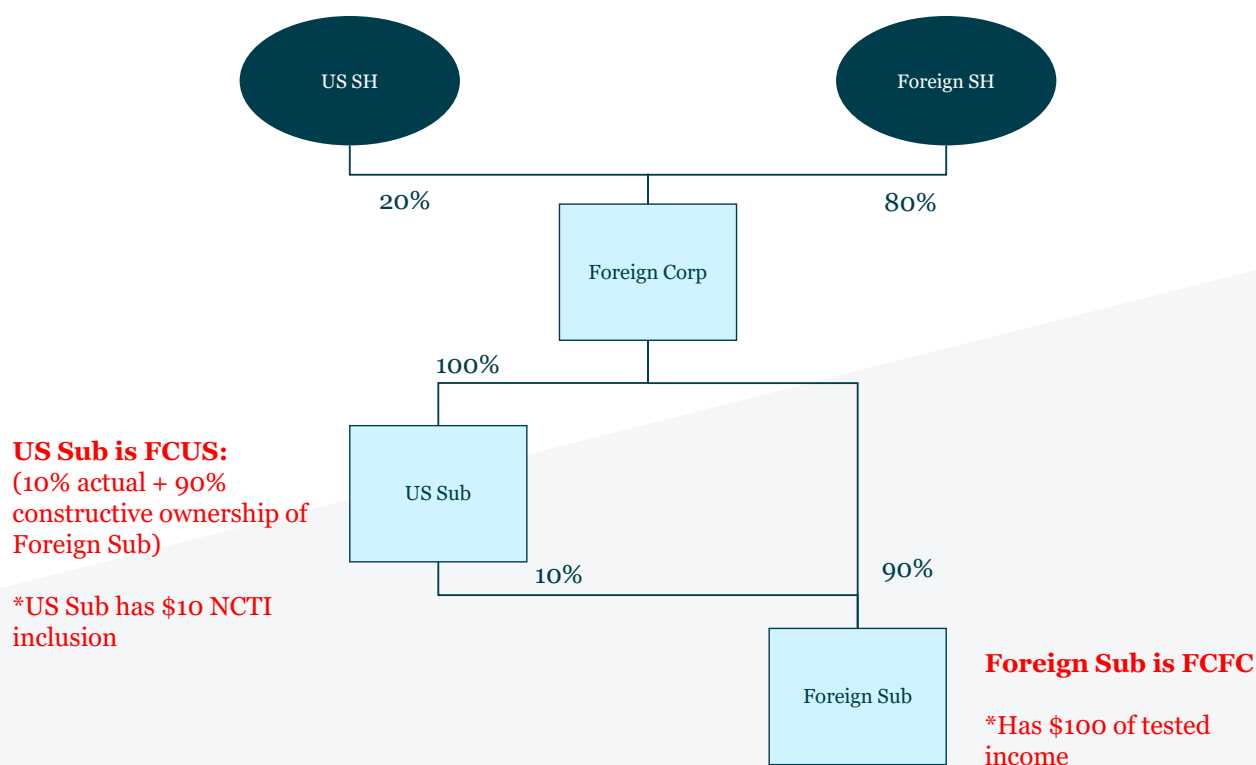
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Downward Attribution

- **Determination of CFC Status**
 - Historic prohibition on “downward attribution.” Code 958(b)(4)
 - Prohibition removed in TCJA, effective for tax years beginning 2018
 - OBBBA largely restores prohibition for tax years beginning 2026, except for more targeted set of circumstances.
- **Code Section 951B**
 - Foreign controlled US shareholders (FCUS) = U.S. shareholders that own more than 50% (by vote or value) of foreign corporation, applying downward attribution solely for this purpose.
 - Foreign controlled foreign corporation (FCFC) = Foreign corporation owned by FCUS.
 - FCUS must include pro rata share of FCFC’s GILTI/NCTI and Subpart F income.

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Section 951B – Targeted Downward Attribution Regime



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Section 951B – Targeted Downward Attribution Regime, continued

- **Post-OBDDA, a smaller universe of foreign subs that are CFCs**
 - Largely taxpayer-favorable:
 - Fewer income inclusions for U.S. Shareholders
 - Fewer foreign lenders caught by CFC-related exception to portfolio interest exemption
 - Reduction in Form 5471 filing burdens.
 - But can be problematic in certain cases:
 - Former CFCs generating excess credits to shelter income of other CFCs in group
 - Need to diligence whether former CFCs are PFICs, as overlap rule of Section 1297(d) no longer applies.
- **Section 1248(a)(2) still applies**
 - Possible dividend characterization of gain realized on sale of CFC stock

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Basic QSBS requirements & Notable OBBBA changes

Basic Exemption

- Reduced federal income tax for non-corporate taxpayers on capital gains from the sale of QSBS if certain holding periods are met (Section 1202)
- Potential to roll QSBS proceeds into new QSBS and tack holding period (Section 1045)

Gain Exclusion

Issue Date[2]	Holding Period	Applicable Cap on Eligible Gain Exclusion[3]	Exclusion Percentage	Effective Maximum Tax Rate	Effective Maximum Federal AMT Rate	Gain Subject to 3.8% NIIT
8/11/93 – 2/17/09	>5 years	\$10 million	50%	14%	14.98%	50%
2/18/09 – 9/27/10	>5 years	\$10 million	75%	7%	8.47%	25%
9/28/10 – 7/4/25	>5 years	\$10 million	100%	0%	0%	0%
7/5/25 – present	At least 3 and less than 4 years	\$15 million (indexed for inflation)	50%	14%	14.98%	50%
7/5/25 – present	At least 4 and less than 5 years	\$15 million (indexed for inflation)	75%	7%	8.47%	25%
7/5/25 – present	5 years or more	\$15 million (indexed for inflation)	100%	0%	0%	0%

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Basic Eligibility Requirements

- Only available to **non-corporate** taxpayers
- Issuer is a **domestic C corporation**
- Original Issuance Requirement
- Active Business Requirement
- Gross Assets Requirement
- No Redemptions Requirement
- Other special rules apply (e.g., for “pass-thru” entities, offsetting positions, rollover or successor transactions, etc.)

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Gross Assets Requirement

- Company's gross assets must not exceed the applicable threshold at any time prior to, or immediately after, purchase of stock being tested
- Gross assets = Cash + adjusted tax basis in assets + FMV of any assets contributed to corporation at the time of contribution
- Applicable Threshold:
 - Pre-OBBA: ≤\$50 million
 - Post-OBBA: ≤ \$75 million
 - Adjusted for inflation starting in 2027

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Acquisition Date of Carryover Basis Transactions

- When does holding period start?
- Which QSBS gain exclusion percentage and cap applies?

QSBS acquisition date	Holding period requirement	QSBS gain exclusion percentage	QSBS gain exclusion cap
8/11/1993 to 2/17/2009	5 years	50%	Greater of: \$10 million or 10x basis
2/18/2009 to 9/27/2010		75%	
9/28/2010 to 7/4/2025		100%	
After 7/4/2025	3 to 5 years*	50% if held for 3 years; 75% if held for 4 years; 100% if held for 5 years	Greater of: \$15 million or 10x basis

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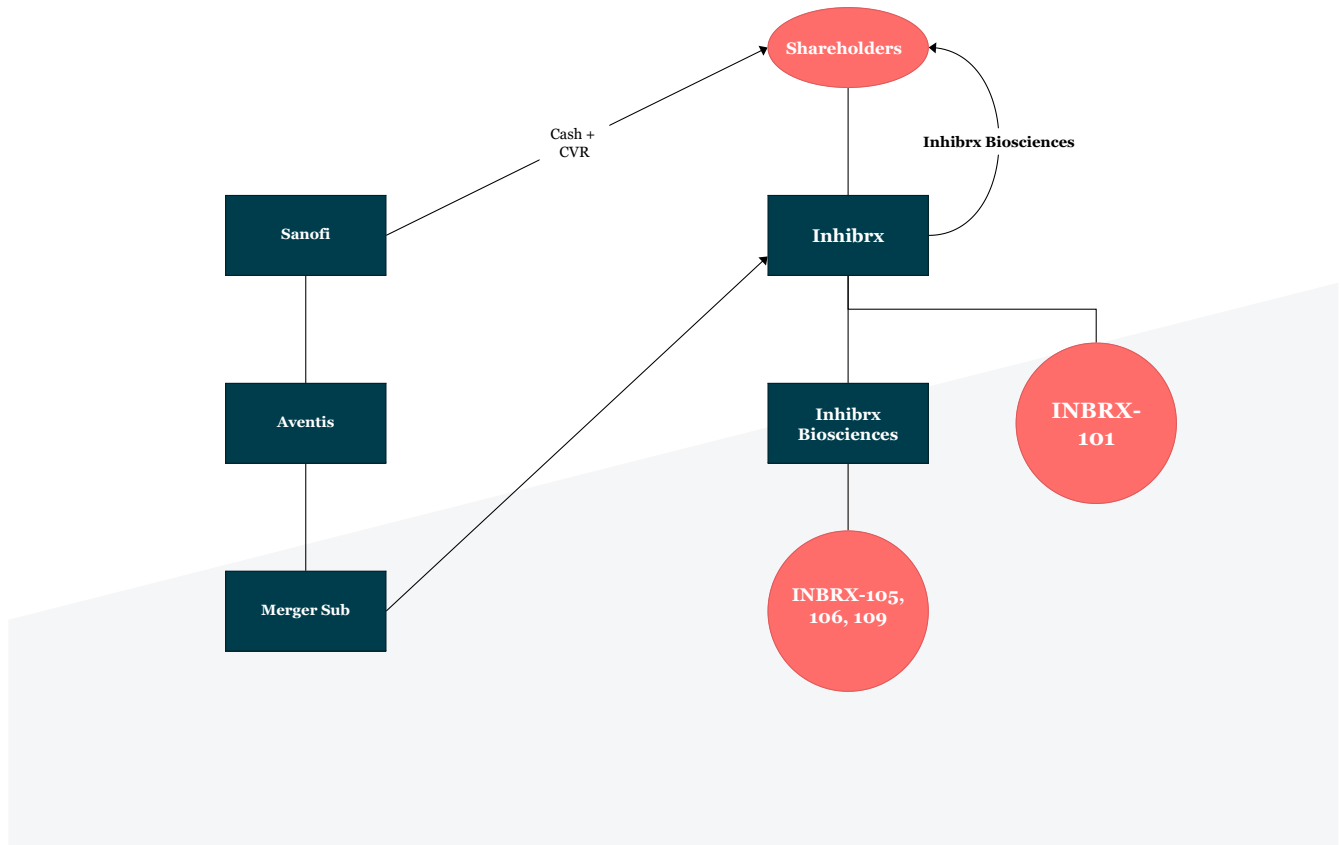
Applications

- Common scenarios
 - Property contributions
 - contribution of pre-OBBA property in a Section 351 transaction
 - Conversion of convertible debt
 - convertible debt originally issued pre-OBBA
 - convertible debt treated as equity for tax purposes? SAFEs?
- Partnership or LLC incorporations
 - incorporation of LLC originally formed pre-OBBA
 - form of conversion (“assets over” vs. contribution of interests)
- Tax-free reorganizations
 - exchange of pre-OBBA target stock for post-OBBA acquirer stock (both QSBS)
 - Single-entity reorganizations
- Section 1045 QSBS rollovers

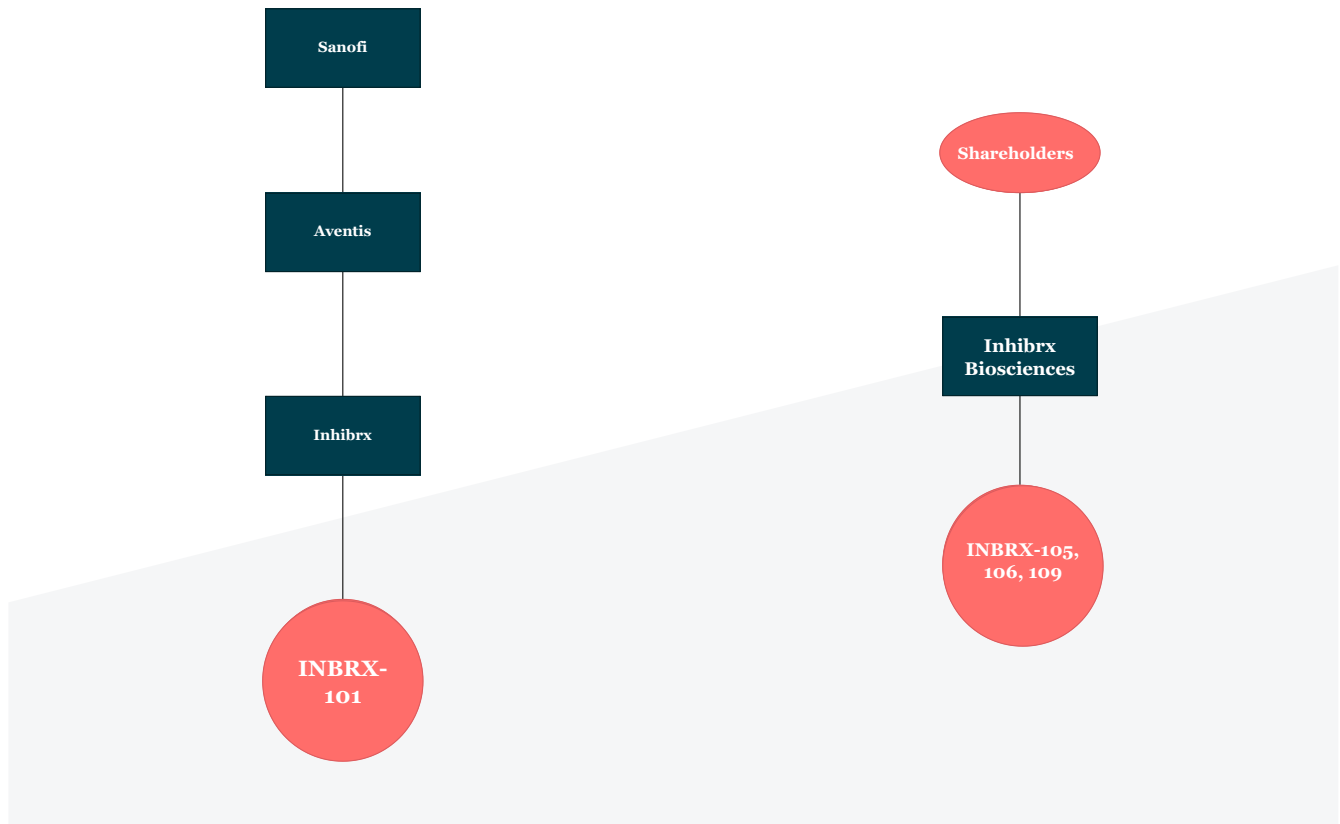
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Pre-Merger



Post Merger



Excise Tax

Background

- Section 4501 added by Inflation Reduction Act in August 2022.
- Imposes 1% excise tax on net amount of repurchases of corporate stock (value of stock repurchased minus value of stock issued).
- Applies to buybacks made after December 31, 2022 by publicly traded domestic corporations, some domestic subsidiaries of foreign corporations, and covered surrogate foreign corporations.
- Example exemptions:
 - Corporations with less than \$1 million in net buybacks in a tax year are exempt.
 - Dividends for tax purposes.
 - If part of a tax-free reorganization and no gain/loss is recognized on such repurchase by the shareholder by reason of such reorganization qualification.

Guidance

- Initial guidance issued in January 2023 (Notice 2023-2).
- Proposed regulations issued in April 2024.
- Final regulations regarding procedural matters issued on June 28, 2024.

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Ongoing Discussion Points

- Some industry groups/others argue that the so-called “funding rule” introduced in Notice 2023-2 and maintained (with some modification) in the proposed regulations should be withdrawn.
 - The “funding rule” applies the buyback tax to publicly-traded foreign-parented domestic corporations that fund “by any means” purchases or repurchases of certain foreign corporation stock if avoidance of the excise tax is a principal purpose of the funding.
 - The rule according to some industry groups may go beyond the scope of Section 4501 and so some say it should be struck down in the courts (see, notably, the Supreme Court’s decision in *Loper Bright Enterprises Inc. v. Raimondo*, No. 22-451 (S. Ct. 2024), which requires courts to determine the “best” interpretation of statutes that aren’t clear on their face).
 - The IRS has said however that statutory language under section 4501(f) that allows for regs that are “necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of this section.” (Richard Reinhold, special counsel in the IRS Office of Associate Chief Counsel (International) at Jan 6 Practising Law Institute sponsored event)

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Revenue

- The IRS collected more than \$4.5 billion in stock repurchase excise tax revenue during the 2024 federal fiscal year, according to agency statistics released on September 10.
- Well below the \$7.875 billion estimate for fiscal 2024 calculated by the Joint Committee on Taxation (JCX-18-22) in August 2022.