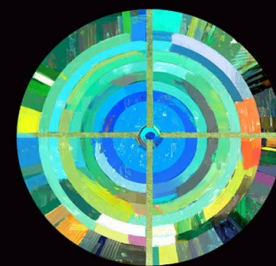


## M&A Tax Talk

### Abandoned transactions



Taxpayers may decide to cancel M&A transactions (e.g., mergers, acquisitions, spin-offs, initial public offerings (IPOs), and dispositions) because it may no longer be feasible to obtain the anticipated benefits (such as synergies and operational efficiencies).

As part of pursuing a transaction, businesses may incur a wide range of costs, including costs related to third-party service providers (for example, financial advisers, attorneys, consultants, accountants, and others). Certain costs incurred by businesses pursuing a transaction may be deemed facilitative of the transaction and are generally required to be capitalized. However, if the transaction is determined to be abandoned, the taxpayer may be allowed an abandonment loss under IRC § 165(a) for these costs in the tax year in which the transaction is abandoned.

The costs paid by a business to third-party service providers while pursuing a transaction that is ultimately abandoned may be deductible. The character and timing of the deduction varies depending on the facts of the particular transaction. To take an abandonment loss for the costs incurred in pursuing a transaction, the taxpayer must establish that the transaction is conclusively abandoned. Establishing abandonment is based on the specific facts and circumstances giving rise to the abandonment. According to Treas. Reg. § 1.165-1(b), a deduction is allowable under IRC § 165(a) only if the loss is fixed by an identifiable event(s) and sustained during the taxable year. Taxpayers considering an abandonment loss must establish that a sufficient identifiable event(s)

indicating the abandonment loss occurred in the taxable year in question.

Some examples of identifiable events include 1) one party terminating deal negotiations in a transaction; 2) a business withdrawing its Form 10 for an IPO; and 3) a board of directors voting to terminate the transaction. The identifiable event(s) requirement is generally satisfied when the event(s) is observable to outside parties and cuts ties to the asset and when the taxpayer can provide documentation that clearly demonstrates the occurrence of the identifiable event(s) leading to the abandonment of the transaction in the tax year in question. However, in many instances, the identifiable event(s) may not be clear, making it necessary to gather additional facts to determine whether an abandonment has occurred and to ensure that the events are properly documented to support the position for IRS audit. Without developing, gathering, and maintaining this documentation, the abandonment loss may not be supportable from the perspective of the IRS. Under certain circumstances, taking a deduction for an abandonment loss may qualify as a reportable transaction and require the completion of Form 8886 – Reportable Transaction Disclosure Statement. This form should be attached to the taxpayer's Federal Income Tax Return for the year the deduction is taken.

Another important consideration for the taxpayer when determining if an abandonment loss has occurred is whether the transaction is mutually exclusive of any other transactions that the business is pursuing. A transaction is considered mutually exclusive of another transaction if it

is not possible for the business to complete both of the transactions (due to financial or structural constraints). Alternatively, if the business is able to complete both pursued transactions, the transactions are not considered mutually exclusive (for example, a business acquiring two separate targets). To determine whether two transactions are mutually exclusive, one must consider whether the transactions are part of a single plan. If separate, an abandonment loss may be taken for the abandoned transaction. However, if it is determined that the abandoned transaction and the other contemplated transaction(s) are part of one plan, then the transactions are considered mutually exclusive, and no abandonment loss is allowed unless the entire plan (all transactions) is abandoned.

#### Example A – Abandonment loss allowed Facts

In October 2024, Company ABC (ABC) entered into a confidentiality agreement with Company XYZ (XYZ) to conduct due diligence on XYZ as part of ABC's contemplated acquisition of XYZ. ABC engaged a variety of service providers to assist with the due diligence efforts. In December 2024, at the direction of the ABC board of directors (the ABC board), ABC's legal counsel sent a letter of intent providing high-level terms of a proposed acquisition to XYZ, subject to the completion of due diligence and further negotiation on certain terms. XYZ countersigned the letter of intent, and the two parties continued with due diligence efforts and worked toward structuring and negotiating the acquisition agreement. In March 2025, macroeconomic conditions deteriorated, and ABC reported poor business performance for the most recent

quarter-end. In April 2025, ABC made the decision to pause its proposed acquisition of XYZ. In May 2025, the ABC board decided that it would not move forward with the acquisition of XYZ and instructed legal counsel to send a letter to XYZ notifying them that ABC would be terminating their due diligence efforts, it no longer intends to pursue an acquisition of XYZ, and it is terminating the letter of intent.

### Analysis

Company ABC must establish that the transaction is conclusively abandoned to take an abandonment loss under IRC § 165(a) for the transaction costs incurred as part of its contemplated acquisition of XYZ. ABC establishes that sufficient identifiable events evidencing the abandonment loss occurred in ABC's 2025 tax year (ABC board's decision to not move forward with the acquisition of XYZ and legal counsel's letter to XYZ notifying them of the decision) and documents these events by obtaining a signed representation from the ABC board noting 1) ABC's decision to abandon the transaction; and 2) the letter sent to XYZ notifying them of ABC's decision. As such, Company ABC may take an abandonment loss in its 2025 tax year for the transaction costs incurred as part of its abandoned acquisition of XYZ.

### Example B – Mutually exclusive transactions

#### Facts

In late 20XX, Company ABC is pursuing a sale of itself, and ABC's advisers have identified five potential buyers. ABC has engaged service providers and incurred transaction costs related to the potential sale transactions with each potential buyer during late 20XX and early 2025. In February 2025, ABC decides to sell itself to one of the potential buyers and instructs legal counsel to notify the other four potential buyers that ABC is terminating its due diligence efforts and no longer intends to pursue a sale transaction with them. In March 2025, ABC successfully completes the sale of itself.

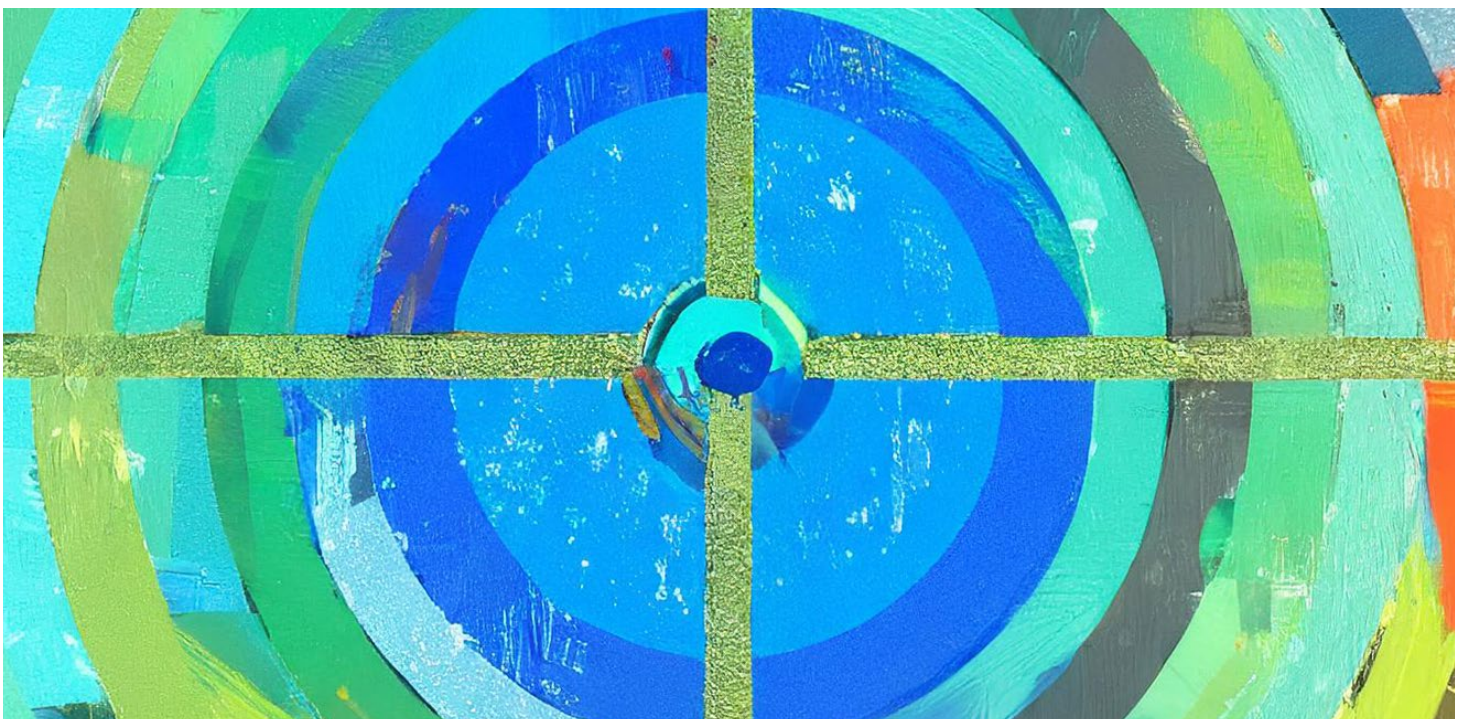
#### Analysis

Company ABC must establish that the sale transactions that it pursued with the other four potential buyers are conclusively abandoned to take an abandonment loss under IRC § 165(a) for the transaction costs incurred as part of its contemplated sales to the other potential buyers. Further, ABC must establish that the five sale transactions that it pursued were not mutually exclusive to take an abandonment loss related to the abandoned sales. ABC determines that the four abandoned sale transactions and the successful sale transaction are part of one

plan (one plan to sell Company ABC) and that it is structurally impossible to complete all five transactions (ABC cannot sell itself to five potential buyers). Therefore, the five transactions are mutually exclusive, and no abandonment loss is allowed related to the transaction costs incurred by ABC as part of ABC's abandoned sale transactions with the other potential buyers.

#### Conclusion

There are a number of factors to consider when determining if an abandonment loss has occurred and whether the costs may be deducted. To successfully claim an abandonment loss, a business should consult with a tax adviser on whether the actions taken with respect to an abandoned transaction support the loss.



## Want to learn more?

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