Proskauer

Tax Court Breaks New Ground on the Deductibility of Termination Fees with AbbVie Ruling

Tax Talks on **July 9, 2025**

On June 17, 2025, the Tax Court opinion in *AbbVie Inc. and Subsidiaries v. Commissioner of Internal Revenue* was issued,[1] holding that the approximately $1.6 billion termination fee AbbVie (a Delaware corporation) paid to its abandoned merger partner Shire plc (an Irish company) was properly an ordinary deductible business expense, and not a capital loss. The Tax Court's analysis included significant interpretations of both fact and law, focusing on the specific terms of the "Co-operation Agreement" (one of the main agreements effectuating the merger of AbbVie and Shire), and the scope of Section 1234A of the U.S. Internal Revenue Code of 1986, as amended (the "Code")[2] —perhaps greatly limiting the statute's reach.

Tax Court followed the Fifth Circuit in *Pilgrim Pride Corp. v. Commissioner*[3] and held that the merger agreement was not itself property for purposes of Section 1234A. The Tax Court then held that the shares of AbbVie itself (which were the subject of the merger agreement) also were not property. Finally, the Tax Court held that because AbbVie did not have the right to acquire Shire's shares (as that depended upon a shareholder vote), Shire's shares could not be "the property" for purposes of Section 1234A. Accordingly, the Tax Court concluded the termination fee was not subject to Section 1234A.

While this opinion should be welcomed by taxpayers, it is not yet known whether the IRS intends to appeal the decision or whether the IRS might decline to acquiesce to the Tax Court's opinion in other similar cases.

Background

In July 2014, AbbVie and Shire announced that they would combine under a new holding company, New AbbVie, to be incorporated in Jersey (one of the Channel Islands).[4]

The key documents governing the proposed business combination were (1) a "scheme of arrangement" between Shire and its shareholders (to effectuate the non-U.S. side of the transaction), (2) a merger agreement under U.S. law to facilitate a Delaware law merger involving AbbVie and a subsidiary of New AbbVie (to effectuate the U.S. side of the transaction), and (3) a Co-operation Agreement that governed the responsibilities of AbbVie and Shire in respect of all aspects of the combination. The Co-operation Agreement garnered the most attention of the Tax Court in analyzing the character of the break fee.

The Co-operation Agreement required AbbVie to take the lead in getting regulatory approval, to recommend AbbVie's shareholders approve the Delaware merger, to cooperate with Shire, and other related obligations. Shire promised to assist AbbVie with regulators, to provide information, and other related obligations. Both sides agreed to be bound by the scheme and to carry out the merger (assuming both were approved). Importantly, the Co-operation Agreement was the agreement which provided that AbbVie would pay a break fee to Shire if the AbbVie board of directors refused to recommend the merger or the AbbVie shareholder approval was not obtained.

In September 2014, prior to either party's shareholders voting on the combination, the U.S. Treasury Department issued Notice 2014-52, proposing new regulations affecting inversion transactions completed after the date of the Notice. The AbbVie/Shire combination would be subject to these regulations. Consequently, in October 2014, AbbVie's board of directors withdrew its support for the combination, and AbbVie and Shire entered into a termination agreement to cancel the Co-operation Agreement, wherein AbbVie agreed to pay the break fee specified in the Co-operation Agreement (calculated to be approximately $1.6 billion) to Shire.

AbbVie, in its 2014 tax return, treated the entire break fee as an ordinary deductible business expense. The Internal Revenue Service (the "IRS") rejected this treatment, instead recharacterizing the break fee as a payment for the "termination of an agreement" under Section 1234A, and thus a capital loss. AbbVie challenged this IRS determination in the Tax Court.

The Opinion

The Tax Court began with a basic summary of the tax law relating to capital losses and ordinary deductions, before turning to a more in-depth analysis of Section 1234A. Section 1234A provides, in relevant part, that "gain or loss attributable to the … termination of…a right or obligation … with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer…shall be treated as gain or loss from the sale of a capital asset." The Tax Court focused on whether the "terminated right or obligation" (*i.e.*, the rights in the Co-operation Agreement, whose termination triggered the payment of the break fee) was "with respect to" property—and concluded that the Co-operation Agreement's rights and obligations were *not* "with respect to" property and, therefore, not within the scope of Section 1234A.

First, the Tax Court analyzed the term "with respect to property" in great depth, concluding that the usual tools of statutory interpretation establish that "with respect to property" in Section 1234A means a right or obligation to exchange an interest in property. Second, the Tax Court turned to the Co-operation Agreement, and concluded that the "essence of the agreement taken as a whole" was that it did not involve rights or obligations to transfer property, but rather rights or obligations to perform services related to property.

On this second point, the Tax Court relied upon several factors. It noted that the Co-operation Agreement could *not* be a contract to sell or transfer property as the parties (AbbVie and Shire) did not even own the relevant property (i.e., their own shares). AbbVie's board of directors, the Tax Court stated, could exert some influence over the AbbVie shareholders—by, for example, recommending the proposed combination—but could not effect any exchange of property on its own.

Furthering the point that the Co-operation Agreement was a contract for services, the Tax Court concluded that AbbVie's core obligations were in the nature of services to increase the likelihood that the combination would occur. The Tax Court highlighted the requirements for AbbVie to pursue regulatory approvals, to recommend the combination to shareholders, and to host a shareholder meeting for the vote. The Tax Court felt that these facilitative services were the "crux" of the Co-operation Agreement. As further support, the Tax Court noted that the obligation to pay the break fee was triggered merely by the failure of the AbbVie board to recommend the combination and not by the failure of the combination to occur (i.e., the exchange of property itself).

The Tax Court dismissed the other aspects of the Co-operation Agreement, such as the obligations to carry out the merger agreement under Delaware law and to actually effectuate the exchange of shares. The Tax Court felt that these obligations were merely mechanics to effect the wishes of the AbbVie and Shire shareholders, which were secondary to the specific obligations of AbbVie itself. Fundamentally, the Tax Court felt that only the shareholders could actually exchange the shares of AbbVie and Shire, and that meant the Co-operation Agreement was not an agreement "with respect to property."

Ramifications

Assuming the Tax Court opinion stands, it could have a dramatic impact on the relatively underdeveloped area of the tax treatment of break fees or other cancellation fees, and could represent a significant interpretation of Section 1234A. The Tax Court took a very specific view of the types of rights and obligations that a public company has in a typical merger agreement, reducing virtually all of the key aspects of such an agreement to, at core, a mere promise to encourage its shareholders to engage in the transfer of shares. The most important part of the Tax Court's analysis seems to be the conclusion that, given AbbVie and Shire did not own their own shares and in particular that AbbVie and Shire "lack[ed] authority to agree firmly to an actual combination", it would not have been possible for any contract between AbbVie and Shire involving the exchange of shares to be anything more than just a promise to engage in services.[5]

It is unclear how narrowly other courts may read this opinion. Given how particularly focused the Tax Court was on the specifics of the Co-operation Agreement, which included the break fee obligation, it may be that other merger agreements will be found to have a "crux" (to use the Tax Court's term) more toward the acquisition of property versus services. Consider, for instance, a fact pattern where a U.S. public company planned to acquire a U.S. target via a Delaware law reverse subsidiary merger but canceled the contract in a way as to trigger an obligation to pay a break fee to the target—in such a case, the acquirer company had certainly contemplated acquiring the stock of the target directly. It is also unclear whether the IRS will appeal this decision, or otherwise decline to acquiesce to the holding in the Tax Court opinion in other cases.

Barring any appeal or other development, the Tax Court decision could provide certain taxpayers with legal authority to justify characterizing termination, break, or other such fees as ordinary deductions. Proskauer is monitoring this case for any future developments.

[View original.](#)

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[1] 164 T.C. No. 10 (June 17, 2025).

[2] All section references herein are to the Code, unless otherwise noted.

[3] 779 F.3d 311 (5^{th} Cir 2015).

[4] This proposed merger was a prominent so-called "inversion" transaction, whereby a U.S.-headed corporate group would merge into a non-U.S. corporate group, installing a new, non-U.S. holding company at the top to manage the joint business. At the time, such a structure was believed to create future tax benefits, in part due to the comparatively high U.S. corporate income tax rate relative to other global jurisdictions prior to 2017.

[5] "Here, AbbVie and Shire did not own their own shares and lacked legal authority to agree to transactions with respect to those shares. Nor is there any indication in the record that they had control over the outcome by other means. The most they could do, therefore, was to agree to convince their shareholders to buy and sell (i.e., in essence to perform services)." Opinion, at 23.

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