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A Threat to M&A Market Vitality:

"Break-Up Fee" Taxation in the Pending Appeal of *AbbVie v. Comm. of Internal Revenue*

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EXECUTIVE SUMMARY

What's at Stake? Why Should You Care About a Tax Court Decision?

The June 2025 U.S. Tax Court opinion in *AbbVie Inc. and Subsidiaries v. Commissioner of Internal Revenue*[1] interpreted the U.S. Tax Code in a manner that properly characterized "break-up fees" under the U.S. Tax Code as an "ordinary business expense" in a way that helps fuel a robust mergers and acquisitions (M&A) market in the United States. Plus, it was an accurate statutory interpretation, faithful to the text. Reversing that decision will hurt the M&A market and would be an improper statutory interpretation.

The M&A market has proven itself to be an engine of economic growth, moving resources to higher and better management and uses. Economic growth and productivity are good for consumer welfare and contribute to the nation's competitiveness. Competitiveness is key to national security and prosperity.

If break-up fees are treated as "capital losses" under Section 1234A of the Tax Code—as the IRS has recently advocated in a change in position—then the added risk to investing in the M&A market will mean less of that investment. A less robust M&A market will be less capable of contributing to economic growth and all the positive spillover effects of growth.

Thus, to advance economic growth and avoid adding a disincentive to investing in the M&A market, the U.S. Court of Appeals for the Seventh Circuit should uphold the Tax Court, treating break-up fees as deductible "ordinary business expenses." Doing so will fulfill the duty of judges to give Section 1234(A)(1) a proper textualist interpretation consistent with foundational principles of property law that are relevant to the meaning of the words in that statutory provision.

Current Posture: Why Is This Timely?

The *AbbVie* opinion interpreted the Tax Code in a manner that properly characterized break-up fees—also called "termination fees"—as an ordinary business expense in a way that is beneficial for the effective and efficient functioning of the mergers and acquisitions market, a key contributor to a healthy and robust economy and consumer welfare. The Tax Court's ruling was a positive one for the free market. A ruling to the contrary would have had serious consequences for efficient market functioning.

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[1] *Abbvie Inc. v. Commissioner*, No. 2597-23, 164 T.C. No. 10, 2025 BL 210531, 2025 US Tax CT Lexis 1533 (June 17, 2025), https://perma.cc/T7QP-MGHN. For an earlier analysis of this case upon which this paper builds, *see* Donald J. Kochan, *Competitiveness Wins if IRS Accepts Tax Court Ruling in* AbbVie, BLOOMBERG LAW, Sept. 12, 2025, https://perma.cc/XTN7-ES5S.

Yet such a contrary ruling is what the IRS seems to still be requesting. In September 2025, the IRS filed a notice of appeal,[2] preserving its right to appeal this June 2025 Tax Court ruling and seek its reversal at the Seventh Circuit.

Several things are possible next. The IRS could decline to file an opening brief with the Seventh Circuit, now due in early February 2026,[3] and thus abandon the appeal. That would be the best course. If the IRS continues to support its own market-debilitating interpretation through an appeal, the fate of the Tax Court's proper course correction will fall to the Seventh Circuit and, perhaps ultimately, the U.S. Supreme Court. Certainly, if either court or both reverse the Tax Court, Congress could ultimately amend the Code to clarify that break-up fees are ordinary business expenses. One thing is clear though: The interpretation of this Tax Code provision is not a sleepy matter for tax geeks alone. We should all care about getting it right, as we all will be affected when the vibrancy of the general market is buttressed by the vitality of the merger markets within it.

[2] *See* https://perma.cc/AQQ3-2DBT.

[3] Natalie Olivo, *Busy DOJ Tax Atty Seeks More Time In 7th Circ. AbbVie Case*, LAW360, Jan. 2, 2026, https://perma.cc/TLY6-JF6P (noting "the U.S. solicitor general has not yet concluded his review of the case and made a final decision whether to authorize the appeal;" and "If the appeal is authorized, the opening brief will need to include the solicitor general's views, and then the Internal Revenue Service's Office of Chief Counsel will need to review it prior to filing, according to extension request.").

A THREAT TO M&A MARKET VITALITY:
"BREAK-UP FEE" TAXATION IN THE PENDING APPEAL OF *ABBVIE V. COMM. OF INTERNAL REVENUE*

I. BACKGROUND: THE JUNE 2025 U.S. TAX COURT DECISION

On June 17, 2025, the U.S. Tax Court decided *AbbVie Inc. and Subsidiaries v. Commissioner of Internal Revenue*.[1] The court considered whether certain losses, known as break-up fees, associated with an unsuccessful and abandoned merger negotiation, could be deducted as "ordinary business expenses"—like any other risk-based expenditure in pursuit of a business strategy—or whether, as the IRS demanded, they must be treated as "capital losses" with less favorable consequences. The court rejected the IRS position and found the former—they are ordinary business expenses.

As a matter of background, it is important to recognize that break-up fees are a normal cost of doing high-stakes business. Penalizing companies for how they write down those costs discourages future risk-taking, research and development, and strategic M&A. To understand the market function of break-up or termination fees, consider the following summary of their operation and utility:

> Termination fees, or 'break-up fees,' are a common tool used to compensate the buyer for the loss of a signed deal as a result of the exercise of the target board's fiduciary duties. Typically, payment of a fee is triggered either when (i) the target board terminates the agreement to accept a superior offer from an interloping bidder or (ii) the buyer terminates the agreement because the target board no longer supports the buyer's deal for any number of reasons, including the occurrence of an 'intervening event' that materially [alters] the value of the target (practitioners often colloquially describe an intervening event as 'discovering gold under the

[1] *See Abbvie Inc. v. Commissioner*, No. 2597-23, 164 T.C. No. 10, 2025 BL 210531, 2025 US Tax CT Lexis 1533 (June 17, 2025), https://perma.cc/T7QP-MGHN.

company headquarters').[2]

Break-up fees are a regular and necessary risk-allocation component in and incentive for public-company M&A transactions.[3] Without cost-effective break-up fee options, something which is dependent in no small part on their tax treatment, deals do not get initiated.

Here are the basic facts of the *AbbVie* case: In July 2014, pharmaceutical powerhouse AbbVie, through its managers, entered into an agreement with Shire plc in which it agreed to take steps to further a merger. In the agreement, AbbVie committed to work to obtain regulatory approvals, recommend the merger to its shareholders, cooperate with Shire in steps toward the merger, and otherwise advance the plan. The agreement also included a break-up fee that required AbbVie to pay Shire a certain "inconvenience fee" or an "assignment of risk of failure fee," if the effort was abandoned. These kinds of break-up fees incentivize parties to enter uncertain deals that are nonetheless potentially quite profitable in ways that inure to the benefit of shareholders, consumers, and the market as a whole.

The Shire-AbbVie deal never came to fruition. In September 2014, the U.S. Treasury Department announced proposed regulatory amendments that rendered the merger less profitable for all parties. Consequently, AbbVie and Shire entered a termination agreement in which AbbVie agreed to pay an approximately $1.6 billion break-up fee.

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[2] Jillian Mulroy Wright & Lyla Sax, *Termination Fees: Breaking Up Usually Comes with a Price*, MARKETCHECK: THE DEBEVOISE M&A REPORT, Spring 2025, at 4, https://perma.cc/AWS8-USY7. *See also* J.W. Verret, *The Abbvie Decision and the Economics of Corporate Control Markets*, NAT'L L. REV., Nov. 3, 2025, https://perma.cc/YY9P-Q6AK (explaining the market mechanics surrounding the conclusion that "[t]he economic logic underlying breakup fees reflects a sophisticated solution to what information economists recognize as a classic free-rider problem in two-sided markets."). A similar analysis would apply if a break-up fee were triggered by failing to gain necessary regulatory approvals.

[3] Westlaw, Practical Law Corporate & Securities, *Break-Up or Termination Fees* ("Almost all public company transactions between unaffiliated parties include a break-up fee payable in one event of termination or another.").

AbbVie then deducted the break-up fee as an ordinary business loss and the IRS rejected the deduction, deciding the company must label the loss as a capital loss because the break-up fee was essentially a disposal of a right to acquire property under Section 1234A(1) of the IRS Code. The IRS in turn issued AbbVie a deficiency notice of approximately $572, and litigation followed.

Judge Toro of the U.S. Tax Court rejected the IRS's position.[4] Basic rules of property law and statutory interpretation very clearly support that holding. A loss cannot be a "loss with respect to property" if the triggering commitments were made by managers of a company who themselves lack authority to sell or transfer property. At the time the parties signed the merger agreement, the necessary shareholder votes had not yet occurred.

Judge Toro explained that, "Close consideration of the context here tells us that a right or obligation 'with respect to property' within the meaning of section 1234A is a right or obligation to exchange (i.e., to buy, sell, or otherwise transfer or receive) an interest in property."[5] AbbVie shareholders had the exclusive authority to transfer property of AbbVie, i.e. shares of AbbVie, to complete a merger. As Judge Toro relayed, "At its core, the Co-operation Agreement is not an agreement to buy, sell, or otherwise transfer property. . . . In fact, it could not be such an agreement, because the parties to the agreement (AbbVie and Shire) did not own the valuable property (their own shares) that would have been exchanged in the proposed combination." In other words, none of the Co-operation Agreement's terms could have conferred "rights or obligations with respect to [AbbVie or Shire shares]" because the power to confer such rights rested with the companies' public shareholders."[6]

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[4] *See Abbvie*, *supra* note 1.

[5] *Id.*

[6] *Id.*

The most the managers could do was make a recommendation to the shareholders and, indeed, that is what the agreement required. Judge Toro explained that "[a]lthough AbbVie's board of directors could exert some influence over the choices of AbbVie's shareholders—for example, by placing the Delaware Merger Agreement for a vote and recommending the proposed combination—it could not, under the terms of the proposed combination, effect any exchange of property rights on its own."[7]

Judge Toro continued, "As a result, the best AbbVie and Shire could do was an aspirational arrangement, with each party agreeing to do everything it could to facilitate a potential combination. But neither side could commit to the combination, because that decision was in the hands of the companies' shareholders and, to some extent, regulators and the Jersey court."[8] The agreement's sole purpose was to incentivize the setting of conditions for a transfer of property. And the losses paid were based on an inability to complete the provision of those services. Thus, Judge Toro articulated the limited nature of the agreement that triggered the payment of the break-up fee as meaning, "Consistent with this reality, AbbVie's core obligations under the Co-operation Agreement were in the nature of services to increase the likelihood that a combination would occur"[9] and nothing else.

Consequently, Judge Toro concluded that "because the Break Fee is not attributable to the 'termination of . . . a right or obligation . . . with respect to property' but is instead attributable to the termination of an Agreement that set out certain mutual commitments to regulate the basis on which [AbbVie and Shire] [were] willing to implement the [proposed combination]," Section 1234A(1) does

[7] *Id.*

[8] *Id.*

[9] *Id.*

not apply. Accordingly, AbbVie need not, "on account of section 1234A(1), treat the Break Fee as a capital loss."[10]

II. DEEPENING THE PROPERTY LAW FOUNDATIONS THAT COMPEL UPHOLDING THE TAX COURT'S INTERPRETATION IN *ABBVIE*

Because the AbbVie managers who entered into the break-up fee agreement did not have any authority to make promises with respect to property, the agreement itself could not have been one with respect to property. A deeper dive into the fundamentals of property law reinforces Judge Toro's statutory interpretation analysis and the application of law to facts in the AbbVie case and, more broadly, in the proper interpretation of Section 1234A(1) and its inapplicability to break-up fees.

A fundamental governing principle in property law is *nemo dat quod non habet*—which "roughly translates to 'one can only transfer what one owns' or, in the negative, 'one cannot transfer property that one does not own.'"[11] And under the facts in *AbbVie* (or in any similar breakup-fee agreement), the managers had no property to give. The Tentative Draft of the Fourth Restatement of Property recently memorialized the principle in its volume 5, division 1, on the transfer of title and ownership of property provides the full principle:

> § 1.1 Right to Transfer an Interest in Property (Nemo Dat)
>
> Subject to exceptions, a person may not transfer an estate or interest in property unless that person is the owner of the estate or interest in

[10] *Id.*

[11] Comment a, REST 4th PROP § 1.1 (Vol. 5d1) TD5. *See also* Donald J. Kochan, *Dealing with Dirty Deeds: Matching* Nemo Dat *Preferences with Property Law Pragmatism*, 64 U. KANSAS L. REV. 1 (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2642130.

question or has the legal authority to act on that owner's behalf.[12]

Nemo dat just makes sense.[13] It is a matter of only being permitted to do what is within your legal authority. And, consequently, the *nemo dat* principle holds a special place in our law and is so strong that it has broad applications associated with the transfer of most assets, not just real property.[14] It is principled, in line with respect for autonomy and the promotion of individualism, better-situated within rule-of-law concepts and the limits of individual authority, rewards honesty, protects the integrity of the legal system, promotes the legitimacy of the system, and prevents bad actors and fraud (including preventing such actors' unjust enrichments). The principle preserves the sanctity of ownership.

Consequently, it is perfectly appropriate to interpret statutory terms regarding property in a manner that considers whether they can reach agreements that could not possibly involve the transfer of property interests because those agreements are by persons without ownership and thus without authority to make property-respective promises. Understanding that this lies at the heart of property

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[12] REST 4th PROP § 1.1 (Vol. 5d1) TD5. *See also* BLACK'S LAW DICTIONARY 1933 (10th ed. 2014) ("No one gives what he does not have; no one transfers (a right) that he does not possess. . . . no one gives a better title tom property than he himself possesses."); *Mitchell v. Hawley*, 83 U.S. 544, 550 (1872) ("No one in general can sell personal property and convey a valid title to it unless he is the owner or lawfully represents the owner. *Nemo dat quod non habet.*"). A related maxim is also relevant here: *nemo plus juris ad alienum transferre potest quam ipse haberet,* meaning "No one can transfer to another a greater right than he himself might have." BLACK'S LAW DICTIONARY 1934 (10th ed. 2014).

[13] Carl S. Bjerre, *Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection*, 84 CORNELL L. REV. 306, 333 (1999) ("The principle has strongly intuitive justificatory force; even children understand the power of the righteous claim, 'I had it first!'").

[14] Stephen T. Black, *Psst! Wanna Buy a Bridge? IP Transfers of Non-Existent Property*, 31 GA. ST. U. L. REV. 523, 529 (2015) (discussing the broader applications of *nemo dat*-like norms); Adam J. Levitin, *Finding Nemo: Rediscovering the Virtues of Negotiability in the Wake of Enron*, 2007 COLUM. BUS. L. REV. 84, 90 (2007) (defining "the commercial law principle of *nemo dat quod non habet* – you can transfer only what you have"); Carl S. Bjerre, *Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection*, 84 CORNELL L. REV. 306, 333 (1999) ("if the owner grants a security interest to one lender, the *nemo dat* principle standing alone would dictate that the owner may not thereafter grant a security interest of the same or greater priority to a later lender."); Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L.J. 639, 700 (2013) ("Under the basic commercial-law rule of *nemo dat*, a transferor cannot transfer rights it does not have; I cannot sell you the Brooklyn Bridge.").

law makes Judge Toro's conclusions even more persuasive.

III. THE TAX COURT'S STATUTORY INTERPRETATION OF SECTION 1234A(1) IS CONSISTENT WITH LONGSTANDING IRS INTERPRETATIONS

The ruling in *AbbVie Inc.* may seem obvious and unexceptional. Indeed, until now, the IRS has long recognized break-up fees as legitimate, deductible ordinary business expenses under U.S. tax law.

Numerous prior IRS rulings and court decisions support that position. For example, a 2004 IRS memo addressed the following: "ISSUE: Is a termination fee received by Taxpayer as the result of a failed merger and acquisition ordinary income or a return of capital and includible in income only to the extent that it exceeds the basis in Taxpayer's property?"[15] And, the IRS succinctly concluded: "CONCLUSION: The termination fee received by Taxpayer is ordinary income." A 2008 IRS Memo provided a similar statement of interpretation, which explained that "The Service has concluded that § 1234A does not apply to the termination fees received by Taxpayer. CONCLUSION The termination fees paid by B to Taxpayer will be treated as ordinary income to Taxpayer."[16]

The IRS changed the interpretation at issue in *AbbVie* in 2016.[17] The Tax Court's rejection of that erroneous turn brings the IRS back in line with its prior precedents.

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[15] IRS Memorandum, TAM 200438038 (June 2, 2004), https://perma.cc/SH52-W3C7.

[16] IRS Memorandum, PLR 200823012 (June 6, 2008), https://perma.cc/CF5E-LMFQ.

[17] https://perma.cc/K3JN-YHF3. For an analysis of the change in position this 2016 opinion effected, consider Baker McKenzie, *Insight: IRS Reconsiders the Treatment of M&A Termination Fees*, Tax News and developments: North America Newsletter, Dec. 2016, at 11-13, https://www.bakermckenzie.com/-/media/files/insight/publications/2016/12/nl_na_taxnewsdevelopments_dec16.pdf?la=en.

IV. THE TAX COURT'S INTERPRETATION FOSTERS THE M&A MARKET, WHICH WOULD BE STYMIED BY THE IRS'S REJECTED POSITION

The *AbbVie* case becomes especially important because it rejects the IRS's departure from precedent and its attempts to penalize ordinary costs in a way that would have discouraged future risk-taking, research and development, and strategic mergers and acquisitions. Break-up fees are a necessary way to "allocate completion risk"[18] in a manner that incentivizes parties to begin discussions about potentially beneficial M&A transactions that have the potential to inure to the benefit of shareholders and to the public.

"The ubiquity of termination fees in public company transactions stems from the tension between a buyer's desire for closing certainty and the target company board's need to retain flexibility to fulfill its fiduciary duties to the target company's stockholders."[19] Managers have a fiduciary duty to consider bids beyond the most immediate one, creating an inherent risk for any buyer making an offer. Or, "From the buyer's perspective, a termination fee somewhat reduces the risk of losing the deal between signing and closing by making competing offers a bit more expensive and provides the buyer with some recompense for the time, expense and opportunity cost it has incurred in connection with the terminated deal."[20] The target company needs to have some way to offset the losses effectively to be incentivized to offer the break-up fee that induces the buyers. And along both lines, the tax code can help.

Without a cost-effective way to allocate risk such as this, fewer parties will initiate M&A deal negotiations. Break-up fees are less cost effective if they receive

[18] Jillian Mulroy Wright & Lyla Sax, *supra* note 2, at 4.

[19] *Id.* at 1.

[20] *Id.* at 2.

less favorable tax treatment, such as being considered capital losses instead of ordinary business expenses. This is why the interpretive choice in the *AbbVie* case is so consequential for the M&A market.

If the costs of engaging in M&A deals are higher because of less favorable tax treatment, then the number of deals will be artificially limited. And many benefits of M&A activity will not materialize in the market. These include the reallocation of assets to more productive uses by acquirers recognizing under-utilized, under-performing, under-managed, or under-valued assets.[21] Productivity growth will suffer when M&A activity is under-incentivized, because M&A activity allows high-productivity firms to purchase low-productivity firms. It allows for adjustments to changed market or regulatory conditions.

Henry G. Manne, Michael C. Jensen, and a host of other law-and-economics scholars who have followed in their tradition have provided both the theoretical foundations and empirical evidence explaining how the M&A market transforms under-performing assets, drives competition, reduces firm inefficiencies, and generates vast economic growth. Manne has demonstrated the benefits of mergers designed to improve the performance of existing but under-managed corporate assets.[22] Similarly, Jensen, for example, has explained that "The takeover market also provides a unique, powerful, and impersonal mechanism to accomplish the major restructuring and redeployment of assets continually required by changes in technology and consumer preferences. Scientific evidence indicates that activities in the market for corporate control almost uniformly increase efficiency and shareholders' wealth."[23] The vitality of the Tax Court's interpretation is critically

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[21] *See, e.g.,* Verret, *supra* note 2.

[22] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

[23] Michael C. Jensen, *Takeovers: Folklore and Science*. HARV. BUS. REV., Nov.- Dec. 1984, SSRN: https://ssrn.com/abstract=350425 or http://dx.doi.org/10.2139/ssrn.350425. *See also generally*

important for the market because it rightly encourages risk-taking through M&A transactions that provide a pathway for the beneficial effects that Manne, Jensen and others demonstrate. Conversely, the IRS position applied to the *AbbVie* facts is one that broadly discourages or punishes risk-taking.

Tax policy almost always works to either encourage or discourage innovation. It determines which costs will be deductible and how, and which types of gains will be taxed at what amounts. In other words, tax policy becomes a factor in how, where, and to what extent individuals invest. And it all works within the law of supply and demand. Thus, when you tax risk, for example, you get less of it. When you avoid taxing risk or allow deductions for losses from risk, you get more of it.

The IRS's position in the *AbbVie* case reduces innovation, capital expenditures for investment, and thus jobs. Treating break-up fees as capital losses would limit deductibility and lock in losses until capital gains arise, consequently trapping capital and delaying reinvestment. The Tax Court's decision that break-up fees should instead be treated as ordinary business expense deductions means capital can be freed up sooner and then reinvested in ways that boost economic productivity, including for new research and development, new hiring, expansion, technology upgrades, and other improvements.

Finally, the Trump Administration is designing policies to drive investment in American companies and bring back investment to the United States. For that, we need free flowing market forces, not constrained ones.[24] In that sense, the *AbbVie* case isn't just about accounting or tax treatment under the Code. It is about

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Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN ECON. 5 (1983)

[24] See, e.g., Steve Forbes, *The IRS Should Boost American Businesses, Not Punish Them,* Forbes, Oct. 7, 2025, https://perma.cc/LT3T-C4JS.

where companies expand, where they site a new plant, where they invest in a new laboratory, what products they launch, and whether they do these things here or in other countries. The climate for mergers is directly correlated with the climate for investment and progress. The IRS position on break-up fees risked bringing a storm into that atmosphere. The *A66Vie* decision helped clear the skies a little, reducing the clouds that act as barriers to merger-facilitated market improvements. In the face of current legal uncertainties, the next goal should be to keep those skies clear.

CONCLUSION

Courts should reject an interpretation of the Tax Code that is contrary to the rules of property law and statutory interpretation, would limit economic growth, and would dangerously weaken U.S. competitiveness. The IRS should abandon such interpretations, too.

As new analysis and data from the *Wall Street Journal* recently documented, the country is embracing a new dealmaking environment to foster economic growth.[25] An unforced error should not chill this momentum. But if the IRS pursues an appeal in *A66Vie* or embraces other efforts to hang on to its interpretation of Section 1234A(1), or if courts do not follow Judge Toro's interpretative path, then that is exactly what will be committed.

Fundamental basics of economics teach that if you raise the cost of something, you will get less of it. If federal agency policy raises the costs of break-up fees in M&A transactions, then American businesses will pursue fewer break-up fee agreements. And, given that break-up fee agreements have become a necessary component to incentivize M&A transactions, businesses will initiate fewer M&A deals. Consequently, resources that should be reallocated through

[25] Dave Michaels & Ben Glickman, *Corporate Dealmaking Is Getting Bigger and Bolder Under Trump*, WALL ST. J., Nov. 26, 2025, https://perma.cc/ACK6-5X4V.

M&A transactions will remain in their suboptimal place and opportunities for efficiencies that should be realized through deals will be lost. Such effects can be avoided if the U.S. Tax Court's interpretation of Section 1234A(1) in *AbbVie* is allowed to stand and break-up fees are deducted as ordinary business expenses rather than being subject to the tortured and economically harmful interpretation currently pressed by the IRS.

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