BDO KNOWS: **TAX REFORM**

IMPACT OF TAX REFORM ON PRIVATE EQUITY M&A TRANSACTIONS

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With you today

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Introduction and Today’s Agenda

Agenda

- The transition tax as a debt-like item
- The global intangible low-taxed income regime
- Acquiring and utilizing tax attributes
- Interest deductibility
- Carried interest
- Questions and conclusion

Disclaimer: Today's webcast is intended to provide a high-level overview of certain provisions contained in the new tax law and is not intended to be a comprehensive discussion. For application of the new law to specific cases, a tax advisor should be consulted.

The "Transition Tax" as a Debt-like Item

The “Transition Tax” as a Debt-like Item

- What is the Transition Tax?
- A one-time issue…that lives on for 8+ years
- Why do I care, and what can I do about it?
  - Cash tax due?
  - Attribute reduction?
  - Timing?
  - Buyer’s watch vs. seller’s watch?
  - Purchase agreement mechanics
  - Risk profile / duration of risk

The “Transition Tax” as a Debt-like Item (cont’d)

EXAMPLE ONE, facts:

- A United States (“U.S.”) private equity group (“PEG”) is acquiring a U.S. C corporation
- Mid-2018 closing date (simultaneous sign and close)
- Target is estimating a transition tax of $75

The “Transition Tax” as a Debt-like Item (cont’d)

EXAMPLE TWO, facts:

- Same as prior EXAMPLE ONE, except the deal is closing in mid-2021

The transition tax bottom line:

- Can be material
- Typically very complex / prone to miscalculation
- Drags on for years / elongated statute of limitations
- Economics are a negotiated deal point / SPA mechanics are important

Global Intangible Low-Taxed Income

Global Intangible Low-Taxed Income (“GILTI”)

- What is GILTI?
- What is it not?
- EXAMPLE: U.S. PEG acquired 75% of a positive EBITDA generating foreign operating business in a classic LBO
  - Direct investment
    - Minimizing the GILTI inclusion
  - Indirect investment via a U.S. blocker corporation
  - Direct investment, although via a non-U.S. fund structure

GILTI (cont'd)

The GILTI bottom line:

- Casts a wide net / can wreak havoc at the fund level
- Implications of existing investments should be evaluated NOW
- New investments should be carefully structured
- Mitigation planning at the portfolio company level should be proactive, yet not overdone

Acquiring and Utilizing Tax Attributes

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Net Operating Losses (“NOLs”)

- Post 2017 NOLs (“new” NOLs)
  - Characteristics
- Pre 2018 NOLs (“old” NOLs)
  - Characteristics
  - Interaction with the Transition Tax
- Deal points
  - Accuracy
  - Value
  - Exit optimization strategies

Acquiring and Utilizing Tax Attributes (cont'd)

R&D Tax Credits

- Corporations not subject to AMT limitation on credit utilization for 2018+
- Credits can kick in to cover tax on 20% of taxable income left over after NOLs (limited to 80%)

Stepped Up Tax Basis

- Bonus depreciation
- Definition of capital asset narrowed
- Tax PPA / make-whole payments / stepping up foreign subsidiaries

Interest Deductibility

Interest Deductibility

- Back of the envelope: limited to 30% of EBITDA?
- Carried forward indefinitely (generally)
- Interaction with Section 382: limitations / optimization
- Foreign context
- Small business exception

Carried Interest

Carried Interest

- Gain on sale of capital assets held more than 1-year is generally subject to long-term capital gain tax rates
- Gain attributable to “applicable partnership interests” is subject to recharacterization as short-term capital gain unless the underlying asset has been held for at least 3 years
- Premise that long-term capital gains should apply to returns from the investment of capital, rather than compensation for the provision of services
- Keep an eye on add-on acquisitions

Questions and Conclusion

Questions?

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Thank You!