




BDO KNOWS: TAX REFORM

IMPACT OF TAX REFORM ON PRIVATE EQUITY M&A TRANSACTIONS



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With you today



NATE COLLINS

Partner -
Transaction Advisory Services
San Francisco Office

415.490.3285
bcollins@bdo.com



CHIP MORGAN

Partner -
International Tax
Orange County Office

310.557.7517
cmorgan@bdo.com

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?

NATE COLLINS

Partner -

Transaction Advisory Services

San Francisco Office

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bcollins@bdo.com

CHIP MORGAN

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International Tax

Orange County Office

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cmorgan@bdo.com

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