Why a Total Tax Approach Is Critical to IPO Readiness

AND HOW TO ELEVATE THE ROLE OF TAX LEADERS TO IMPROVE LONG-TERM GROWTH

ARE YOU PRIORITIZING TAX PLANNING IN YOUR IPO READINESS?

Tax is a critical but often overlooked part of the IPO process. According to the 2022 Tax Outlook Survey, 41% of tax executives say they are not very involved in their organization's business restructuring processes, such as IPOs or entity changes. But tax planning for an IPO goes beyond ticking the boxes for compliance and preparing for new reporting requirements — it's important for mitigating risk and building a foundation for long-term growth. Additionally, while performance at private companies is often measured using some level of adjusted EBITDA that overlooks the impact of tax, post-IPO greater focus is placed on overall net income and the impact of taxes. Consequently, determining the optimal structure for the tax department and aligning tax planning with business strategy are critical to success.

While only 17% of companies surveyed plan to embark on IPOs in 2023, according to the 2023 BDO CFO Outlook Survey, companies that plan to conduct an IPO in the future should start preparing now so they are ready to go public when market conditions support it.

Read on to learn the benefits of prioritizing a total tax approach in the IPO readiness process.

Tax considerations during an IPO

Public companies are under greater regulatory and public scrutiny than private companies, and unaddressed areas of tax risk can cause significant harm to the business. Failure to address tax risk can lead to regulatory issues, financial and reputational damage, and ultimately diminish the new value created by the IPO.

Begin the process with an assessment to help uncover areas of tax risk related to IPO readiness and operating as a public company. The tax risk assessment should ask critical questions, including:

- Does the company understand the tax implications of all business decisions?
- Does the business fully understand its total tax liability?
- Is tax infrastructure set up to support expansion?
- If the business is multinational, does it comply with the tax laws in the jurisdictions in which it does business (for example, in the areas of tax compliance and transfer pricing)?
- Are the company's transfer pricing policies and documentation up to date and reflective of how the business operates today?
- Is the company making use of all available credits and incentives?
- If the company is acquisitive, is the tax integration of previously acquired companies successfully completed?
- Does the company have an adequate tax control framework in place?

Following the tax risk assessment, the business can develop a roadmap to address governance and IPO readiness — and prepare for sustained public success. Common areas to address include:

Determining the right tax structure: Depending on ownership circumstances and goals, different tax structures will have different tax planning implications. Options may include becoming a C corporation or an umbrella partnership C corporation (Up-C) structure. Public companies spun out of larger entities must provide specific historic financial statements, while SPACS have unique structuring and tax-related considerations.

Tax attributes planning: IPOs may result in annual limitations on the use of certain tax attributes (e.g., net operating loss (NOL) carryforwards) to offset future income, so companies must scenario plan to understand what the IPO means for existing NOLs and their future tax planning.

Executive and stock awards compensation planning: Ahead of an IPO, the company should analyze all stock-based compensation for employees and executives, existing or future deferred compensation plans, and other relevant arrangements to help ensure compliance with applicable tax rules and they are tax efficient for all parties.

Bolstering tax controls and processes: A strong control environment helps improve reporting accuracy and efficiency and mitigate risk. Establishing consistent controls and processes is important for meeting new compliance standards, such as greater income tax accounting requirements, shorter close timelines to meet SEC reporting requirements and Sarbanes-Oxley (SOX) compliance.

One particularly important consideration related to executive compensation in the IPO process is the impact of Internal Revenue Code (IRC) Section 162(m). Section 162(m) generally limits the deductibility of compensation paid by public companies to "covered employees" to $1 million per year. "Covered employees" include the CEO, the CFO and the three next highly compensated officers. The American Rescue Plan of 2021 (ARPA) **expanded Section 162(m) for taxable years beginning after Dec. 31, 2026**, to cover the next five most highly compensated employees, who do not need to be officers, in addition to "covered employees" defined in Section 162(m). This change means that beginning in 2027, public companies will be subject to the Section 162(m) limit on the deductibility of compensation over $1 million for 10 employees instead of five. This rule can have a material impact on both a company's tax return and its tax provision. As a result, it is critical to understand its potential impact prior to the IPO.

It is also important to anticipate the likely increase in post-IPO activity by employees regarding their equity awards as they gain access to liquidity, e.g., exercise of vested stock options. As a result, it is important that the company be ready to satisfy payroll withholding and reporting requirements regarding such activity. If the company has issued awards in multiple countries, it will need to be ready to comply with these requirements in all those countries. If some employees have worked in multiple countries, it is possible that a single equity award could be taxable in more than one country, which adds a layer of complexity.

Transfer pricing planning: There are also transfer pricing implications to consider for stock-based compensation. The U.S. transfer pricing regulations explicitly require the inclusion of stock-based compensation in the cost base when charging affiliates for services and in cost sharing arrangements. Further, stock-based compensation paid to foreign employees may give rise to deductibility issues. Some jurisdictions will treat stock-based compensation charges from the U.S. as nondeductible, while others may allow a deduction if a stock recharge agreement is in place. Stock-based compensation paid to non-U.S. employees can also have an indirect impact on U.S. taxes.

Transfer pricing requires a deep understanding of the activities being performed by affiliates, where and how key decisions are made, and ensuring that profits align with the parties that invest in, drive and support the key value drivers (and/or intangibles) of the group. This comprehensive approach can assist in addressing issues that may increase risk, such as:

- Verification that there is support for existing intercompany transactions, including any documentation that is required in the jurisdictions in which the business operates as well as executed intercompany agreements that align with the transactions.
- Intercompany services or intangible transactions that may be missed or mischaracterized.
- Profits/losses that don't align with the entity(ies) that drive key decisions and bear the main business risks.
- A transfer pricing structure that is no longer valid because it does not reflect recent major changes made to the business.
- Whether the company is complying with its filing obligations in all jurisdictions.
- Possible permanent establishment risks in jurisdictions where the company does not file.

Tax staffing model: As part of preparing the tax department for an IPO, organizations should examine their staffing model and consider what their tax department needs to look like in the future as the business grows. As the business scales, it needs to establish a plan for how the tax function will also scale to strategically support the business. This may involve a **combination of outsourcing, co-sourcing and hiring**.

Taking a total tax approach: Understanding total tax liability — the sum of all taxes at the international, federal, state and local levels — should be a goal for all companies, private and public. While both private and public companies can benefit from a total tax approach, the higher level of scrutiny associated with being a public company makes understanding total tax liability more urgent for businesses preparing to IPO. If any tax issues are uncovered by tax authorities post-IPO and the company is fined, that news could hurt the company's value. A total tax approach will enable a company to answer key questions that could uncover areas of tax risk, including: Is the company filing in every jurisdiction where it has a compliance obligation? Has it assessed its activities outside the U.S. to confirm it hasn't created a permanent establishment in a jurisdiction where it hasn't filed? Has the company reviewed its transfer pricing policies recently to ensure there are no historical issues that need to be fixed? A total tax approach can also help improve decision-making and elevate the ability of tax leaders to provide strategic input to the broader business.

Elevating the strategic value of tax teams

The IPO readiness process is also a significant opportunity to elevate the tax team's role as a strategic advisor to the broader business. According to the **2022 BDO Tax Outlook Survey**, only 45% of tax executives said they are included in business planning and only 36% said their recommendations carry a lot of weight – which means many organizations are not unlocking the full potential of their tax departments as strategists.

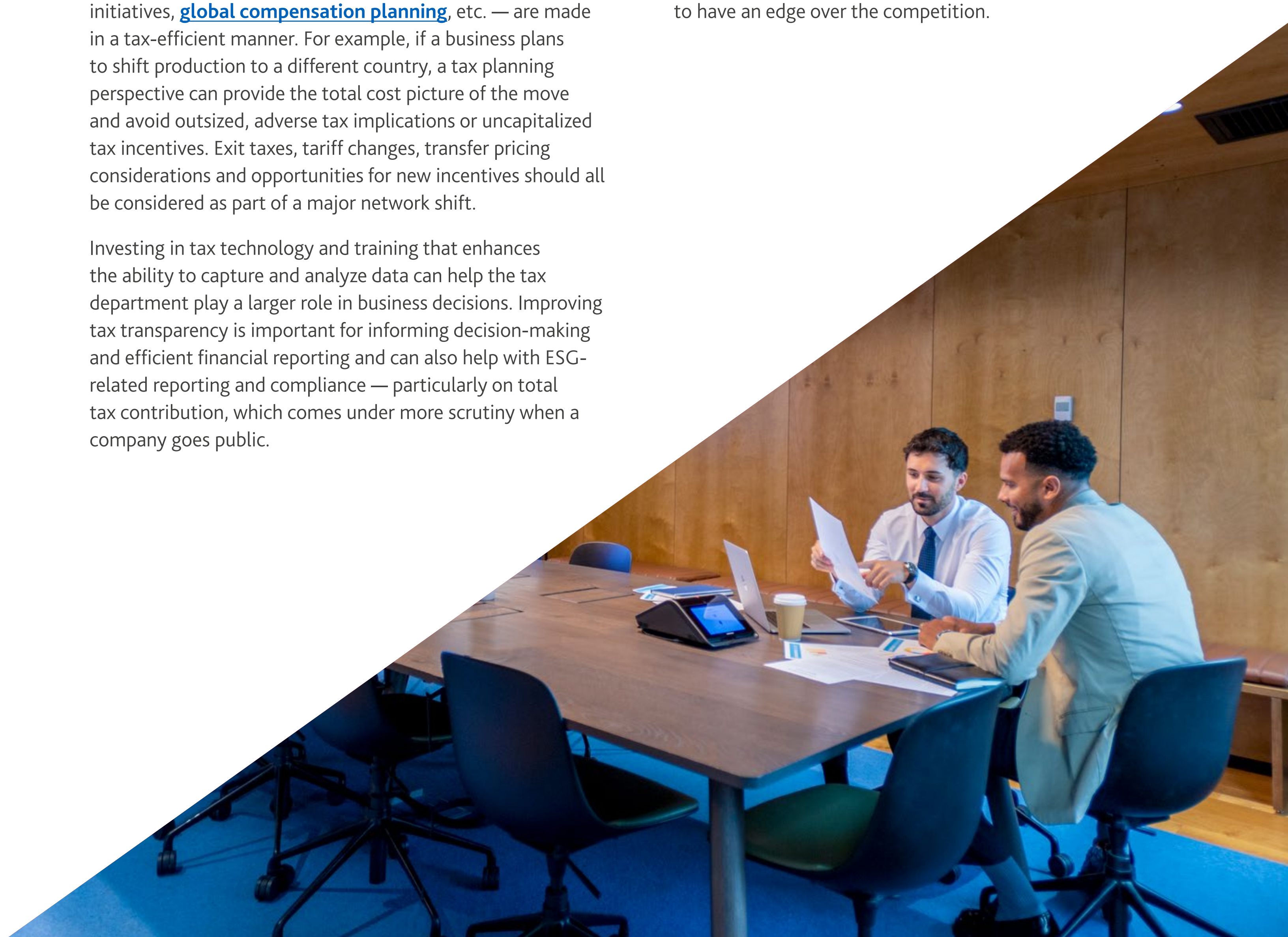
Taking a total tax approach and aligning tax strategy with overall business strategy can help ensure all decisions — including supply chain management strategies, ESG initiatives, **global compensation planning**, etc. — are made in a tax-efficient manner. For example, if a business plans to shift production to a different country, a tax planning perspective can provide the total cost picture of the move and avoid outsized, adverse tax implications or uncapitalized tax incentives. Exit taxes, tariff changes, transfer pricing considerations and opportunities for new incentives should all be considered as part of a major network shift.

Investing in tax technology and training that enhances the ability to capture and analyze data can help the tax department play a larger role in business decisions. Improving tax transparency is important for informing decision-making and efficient financial reporting and can also help with ESG-related reporting and compliance — particularly on total tax contribution, which comes under more scrutiny when a company goes public.

Building the tax department of the future

To navigate a dynamic and increasingly complex tax landscape, organizations need to determine which tax roles they want to invest in hiring and which to outsource to external advisors. An IPO is a significant opportunity to make these workforce decisions and prepare the tax department to support long-term growth.

Every business decision has a tax implication, and companies that incorporate tax into business planning will be more agile, resilient and profitable. If your company is considering an IPO, invest in the tax department beyond compliance requirements to have an edge over the competition.



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