The Taxes of Selling Your Business

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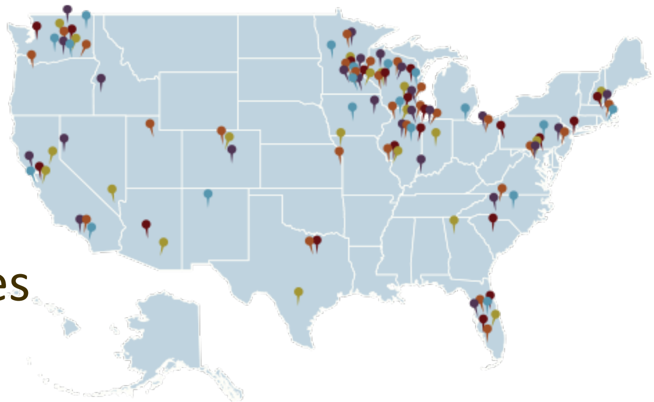

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Speaker Introductions

Andrew E. Finkle, CPA, JD, LL.M.
Principal, Philadelphia, PA

- Provides transactional tax planning and structuring advice on domestic and cross-border mergers, acquisitions, restructurings, joint ventures, spin-offs, bankruptcies, and dispositions
- Leads tax due diligence projects for private equity investor groups, venture capital funds and strategic buyers across various industries
- Creates and presents alternative structuring models to identify the most tax effective structure for the buyer, seller and continuing business

Speaker Introductions

John Greenling, CPA, MBA, MST
Manager, Pittsburgh, PA

- Pittsburgh Office Tax Leader
- Advises clients on the tax implications and structuring of proposed transactions including complex modeling
- Manages and directs buy-side and sell-side tax due diligence engagements across geographies and industries

Audience Poll

Learning Objectives

- Recognize the difference between stock and asset transactions and the tax considerations for each
- Consider questions to ask throughout the transaction process to minimize tax surprises
- Consider the impact of some of the new or pending legislation may have on deal structure

Stock Transactions

Stock Transactions

- Transaction between the buyer and the target company’s shareholders
  - Does not involve assets of the target
  - Target company remains in existence and intact after the transaction

Stock Transactions

- Shareholders recognize gain or loss on the difference between the selling price and their basis in the stock/equity interests
- Highly desirable for selling shareholders
  - Results in one layer of taxation
  - Character of the gain recognized is generally long-term capital gain

Stock Transactions

- Can also be favorable to Buyers under specific facts and circumstances:
  - Significant tax attributes within the corporation
  - Requirement to keep the legal entity in existent (e.g. contracts)

Stock Transactions

- Stock sale generally tax-unfavorable to Buyer
  - Tax basis of the target company's business assets do not get adjusted to fair market value
  - Inherits the target company's undisclosed liabilities and uncertain tax positions
- Buyer can negotiate representations, warranties, indemnifications, and perhaps escrows, to protect itself against potential undisclosed liabilities

Asset Transactions

Asset Transactions

- Transaction occurs between the buyer and the target company
- Target company can liquidate, dissolve or otherwise cease to exist, or choose to remain in existence
  - Tax consequences to owners dependent on treatment of the target company

Asset Transactions

- Target company recognizes gain or loss on the difference between the sales price allocated to the assets and the tax basis of the assets on an asset-by-asset basis
  - Sales price includes transaction costs incurred by the buyer to facilitate the transaction and the target company's liabilities assumed

Asset Transactions

- Advantages to Buyer
  - Generally does not assume undisclosed income tax liabilities or non-tax liabilities (check state successor liability statutes for tax liabilities that follow the assets)
  - Receives step-up in basis of assets acquired to fair market value
  - Recovers the purchase price “premium” through future depreciation and amortization deductions

Asset Transactions

- Disadvantages to Seller
  - Double taxation occurs in asset sales of C corporations and S corporations subject to the built-in gain tax
  - Portion of the gain may be subject to ordinary income treatment rather than capital gains
    - ◊ Example – gain on sale of assets attributable to prior depreciation deductions subject to recapture provisions

IRC §338(h)(10) and §336(e) Elections

IRC §338(h)(10) and §336(e) Elections

- Treats a stock transaction as an asset transaction for income tax purposes
  - Target corporation treated as making a deemed sale of its assets to a new target corporation followed by a liquidation
  - Affords the buyer a basis step-up in the target corporation's assets (to fair market value)
  - Must meet certain criteria to make elections
  - Could lead to additional taxes to the sellers, e.g., ordinary vs. capital and state tax consequences

Partnership Transactions

Partnership Transactions

- Special considerations for target companies taxed as a partnership
  - Sale of "Hot Assets" subject to ordinary income treatment
  - Sale of 100% of the equity interests in a partnership treated as a sale of partnership interests to the sellers, and a purchase of assets to the buyer

Common Pitfalls

Common Pitfalls

- S corporation documentation and acceptance
  - Original Form 2553
  - IRS acceptance letter
  - Qsub elections and IRS acceptance letters
- Use of proper accounting methods
  - Cash, accrual, inventory, industry-specific methods

Common Pitfalls

- State Taxes
  - Nexus standards
  - Bright line economic nexus
  - State gross receipt taxes
- Sales Tax
  - Nexus standards and filing requirements
  - Exemption certificates

Common Pitfalls

- Payroll tax issues
  - Withholding requirements for employees that travel
  - Employees vs. independent contractors
- Unclaimed property

Tax Reform

Tax Reform

- House bill approved on November 16^{th}
- Senate bill approved on December 2^{nd}
- House and Senate conference committee to begin work on resolving the differences between the two versions of legislation

Tax Reform, Key Business Provisions

- Top corporate tax rate cut to 20%
  - Buyers will need to model projected after-tax cash flows
  - Targets with large tax attributes need to model the potential impact of the reduction of deferred tax attributes
- Net operating losses limited to 90% of taxable income
  - NOL carrybacks repealed

Tax Reform, Key Business Provisions

- Interest expense – Generally caps net business interest expense deductions at 30% of adjusted taxable income
    - ◊ Increases after-tax cost of debt
- Depreciation – ability to immediately deduct the cost of certain property
    - – Could apply to assets acquired in asset or deemed asset acquisitions

Tax Reform, Key Individual Provisions

- Four tax (House) or seven tax brackets (Senate), top bracket (39.6%) remained unchanged
- Capital gain tax rates remain unchanged (0/15/20%)
- Standard deductions doubled, personal exemptions repealed
- AMT repealed in House bill
- Elimination of certain itemized deductions

Tax Reform, Key Individual Provisions

- Pass through income – House bill
  - Passive business income taxed at 25%
  - Active business income:
    - ◊ 30% of net business income eligible for the 25% rate,
    - ◊ Remaining 70% subject to ordinary individual income tax rates
- Pass through income – Senate bill
  - 23% deduction for qualified business income

Q&A

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