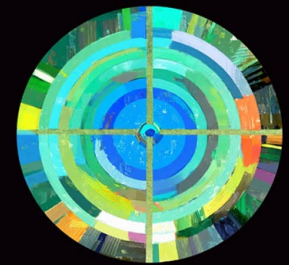


M&A Tax Talk

Essentials for a successful sale transaction



As buyers and sellers address economic and global challenges in an uncertain M&A Market, one trend is clear: an increased focus on seller preparedness. Divestitures of business lines and segments have become popular options for corporations and private equity firms focused on maximizing value for investors. Increasingly, sellers are focused on an organized and thoughtful sell-side preparation process. Accordingly, tax departments may need to keep pace by investing time to prepare for the sale at the earliest possible stages. The Tax department should begin the preparation process by gathering all relevant facts in order to support informed decision making, especially where deal parameters may change quickly and often. Below we explore a few areas where tax leaders can have a meaningful impact preparing their organization for a successful divestiture.

Understanding the perimeter of the sale

As a tax director approached to assist with a sale, it is critical to understand the perimeter of the transaction and determine where and how the business to be divested is held within the existing organization. For example, it is essential to understand the jurisdictional footprint of the business to be divested. Further, tax directors will need to know whether the business is held within 'dedicated' legal entities (i.e. there are no operations or assets that will remain behind), or if the business is held in 'commingled' legal entities (i.e. there are assets and/or operations that will remain behind). It is not uncommon for businesses to operate in multiple jurisdictions and in a mix of dedicated and commingled legal entities. Tax directors should expect that when the transaction perimeter impacts multiple jurisdictions and includes more

'commingled' entities, the complexity of the divestiture will likely increase.

After determining where and how legal entities hold the business to be sold, it is helpful to understand key metrics, such as the revenue composition and net assets, of each of the identified legal entities relative to the business segment as a whole. This information will be useful in determining which legal entities will be most material to the proposed transaction. It is important to note that buyers will likely focus their tax due diligence efforts on those legal entities and jurisdictions that are most impactful to the overall transaction. Therefore, understanding the relative materiality of the impacted entities will allow the tax director to focus their sell-side planning efforts accordingly.

Data Gathering

Once a tax director has a good understanding of the transaction perimeter, it is time to start gathering relevant data that will be necessary to evaluate structuring alternatives and to support a buyer's due diligence efforts. Common data points may include, legal entity tax returns, tax attribute documentation, tax audit correspondence, documentation regarding recent transactions and/or restructurings, intercompany transactions, including intercompany debt, and basis details (i.e. inside asset basis and outside stock basis). A tax director will also want to understand and potentially document key compliance policies and procedures (e.g. what is the target's process for sales and use tax compliance). By virtue of gathering this information, a tax director will be better prepared to provide requested data to a buyer due diligence team and to address

tax-related questions that may arise throughout the sale process. Further, this information will be helpful when 1) evaluating potential transaction structures, 2) assessing the need for a pre-sale vendor due diligence report or Tax Fact Book, and 3) assessing the need for carve-out financial statements. Read further to learn more about each topic.

Structuring the sale

While the structure of the sale may be a commercial decision, it is important to understand the tax implications of the transaction when evaluating various divestiture scenarios. Depending on the perimeter of the proposed transaction, certain structuring options may generate additional value for buyers and/or may result in incremental tax for the sellers. Sellers should analyze the tax consequences of structuring the sale as either a stock sale, asset sale, hybrid (partial stock and partial asset) sale, reorganization, or spinoff. The analysis of structuring options should consider the availability of tax attributes to offset gain or that may transfer to a buyer and whether it may be possible for a buyer to achieve a step up in the tax basis of the assets to be divested. Importantly, tax attributes that can be transferred to a buyer and a stepup in the tax basis of the assets to be divested may be perceived as transaction value drivers by the buyers.

Although not an exhaustive list, tax directors should consider evaluating the following additional structuring matters common to a divestiture transaction:

- Evaluation of tax planning opportunities, unrelated to the potential divestiture, which

may be available to unlock capital losses which may offset gains resulting from the proposed sale.

- Minimizing tax leakage (i.e. tax costs incurred in connection with a pre-sale restructuring or the transaction itself) in jurisdictions impacted by the transaction.
- Evaluation of international tax issues including transfer pricing implications, and potential tax treaties that may affect the transaction.
- Withholding taxes resulting from the movement of cash and/or settlement of intercompany loans in connection with the sale.
- Tax implications of transaction costs (i.e., tax expense, legal and professional fees, incremental time, etc.) of any internal restructuring that may be necessary to effectuate the sale.

As evidenced by the considerations noted above, the tax aspects of structuring a divestiture transaction can be complex. Further, it is not uncommon for the transaction perimeter and structure to change multiple times throughout the sale process. As such, it is important for tax directors to be well connected to other stakeholders within their organization at the earliest possible stages and throughout the entire divestiture lifecycle to ensure an efficient process.

Tax Due Diligence

Performing seller tax due diligence is crucial as it allows a tax director to uncover potential tax exposures, liabilities, and opportunities associated with the business being sold. By conducting thorough reviews of tax compliance, historical filings, and tax attributes such as net operating losses and tax credits, a tax director can identify risks and develop strategies to mitigate them. Furthermore, evaluating and concisely presenting the availability and viability of tax attributes can strengthen negotiations, ultimately maximizing the perceived value of the target company in the eyes of potential buyers.

In preparation for a buyer's tax due diligence, a tax director must ensure that all relevant tax documentation is

accurate, comprehensive, and readily accessible. This includes organizing financial statements, tax returns, transfer pricing documentation, and any other pertinent tax records. Proactively addressing potential tax issues and maintaining transparent communication with potential buyers can instill confidence, streamline negotiations, and facilitate a smoother transaction process.

The preparation of a Tax Fact Book or Vendor Tax Due Diligence ("VDD") report are two common options a tax director can use to organize, summarize, and analyze tax related information and facilitate a buyer's due diligence.

A Tax Fact Book generally serves as a centralized report detailing the company's tax positions and compliance history. It typically summarizes information from organized financial statements, tax returns, tax attributes, transfer pricing documentation, and other relevant tax-related information. The Tax Fact Book is used proactively by the seller to present critical tax information to potential buyers during the due diligence process. It aims to provide transparency, align expectations, and facilitate efficient negotiations.

A tax VDD report is generally prepared by an independent advisor on behalf of the seller to conduct a detailed examination of the company's tax positions and potential tax risks. It includes a thorough review of tax compliance, historical filings, tax strategies, and potential tax exposures. The tax VDD report provides an objective assessment of the seller's tax position and potential risks.

The tax VDD report, Tax Fact Book, or equivalent seller tax diligence process should give tax directors keen insight into potential risks and issues that may be inherent within the business to be divested (i.e. tax risk exposures that may be uncovered during a buyer's due diligence process). An assessment of such tax matters should be performed during the initial stages of the divestiture lifecycle to allow for more opportunities



to mitigate such risks before the buyer begins their due diligence. For example, a seller may choose to amend prior tax returns or enter into voluntary disclosure agreements. Further, a risk analysis will allow the tax team to maintain control of the narrative surrounding potential issues and avoid surprises which may delay the transaction.

The completion of a tax VDD report or Tax Fact Book allows a seller to manage the flow of sensitive tax information to potential buyers and their advisors. This controlled access ensures that only authorized parties with a legitimate interest in conducting due diligence have access to tax management and detailed tax information. Additionally, it allows the tax director to maintain oversight and track the dissemination of tax information, minimizing the risk of unauthorized disclosures and ensuring compliance with confidentiality agreements throughout the diligence process.

Carve-out financial statements

Whether the sale is structured as a spinoff or as a sale to a third-party buyer, carve-out financial statements may be necessary to effectuate the potential divestiture. While such statements are typically required in the event of a public company spinoff, they may also be necessary in the event of a sale to a third-party buyer in order to secure financing. The decision regarding whether audited carve-out financial statements are needed does not typically rest with the tax department; however, the implications resulting from the preparation of a carve-out tax provision cannot be overstated, and tax professionals should be engaged throughout the discussions in order to be prepared to move quickly to complete the required steps, in what is typically a tight timeframe.

A tax director's role encompasses several critical responsibilities, most importantly to collaborate closely with financial and legal teams to define the perimeter throughout the carve out process. There are several complexities to the preparation of a carve-out tax provision including, but not limited to, separating deferred tax balances of commingled legal entities, tax-effecting the accounting carve-out adjustments, applying a separate return methodology to tax-only adjustments (e.g., credits, NOLs, etc.), allocating uncertain tax positions of a consolidated group, and changes to audit materiality (e.g., lowered materiality), of the carved out business.

Separately, after a divestiture, the remaining company must carefully consider discontinued operations reporting for the business or assets that were divested. This involves adhering to accounting standards to classify and disclose the results of the discontinued operations separately in the financial statements, ensuring transparency and compliance with regulatory requirements. While the analysis needed to prepare discontinued operations reporting varies from carveout financial statements, the knowledge gained from preparing carve-out financial statements generally can lead to efficiencies when preparing discontinued operation reporting.

Conclusion

In conclusion, successfully navigating a divestiture transaction demands that tax directors embody the role of a prepared seller. From strategically structuring the transaction, facilitating a streamlined tax diligence process, and preparing carve-out financials, each phase plays a pivotal role in optimizing tax outcomes and minimizing risks. By leveraging a tax director's expertise to anticipate potential tax implications, and effectively communicating tax value with stakeholders, tax directors can enhance the transaction's efficiency and value. Embracing the responsibilities of a prepared seller will set the tax department on course to ultimately achieve a successful outcome for even the most complex divestiture transaction.

Want to learn more?
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