June 1, 2017

UIA-NYSBA INTERNATIONAL SECTION
CORPORATE MERGERS AND ACQUISITIONS
Thursday, June 8 & Friday, June 9, 2017

Transaction Structure and Tax Issues

Thursday, June 8, 2017 from 12:00 pm – 1:15 pm

Moderators:
EU: Pedro Pais De Almeida, Abreu Advogados, Lisbon, Portugal
U.S.: James Russell Shorter, Jr., Shorter Law Offices, New York

Speakers:
Pere M. Pons, Uría Menéndez, New York
Christoph R. Ramstein, Pestalozzi Attorneys at Law, Zürich, Switzerland
Sandra Hazan, Dentons, Paris, France
Klas Holm, Curtis, Mallet-Prevost, Colt & Mosle LLP, New York

PANEL DISCUSSION OUTLINE

I. Setting the Scene.

A. **Initial comments, introduction of the participants in the panel, and key issues** – Pedro Pais De Almeida and James R. Shorter, Jr., Panel Co-Chairs.

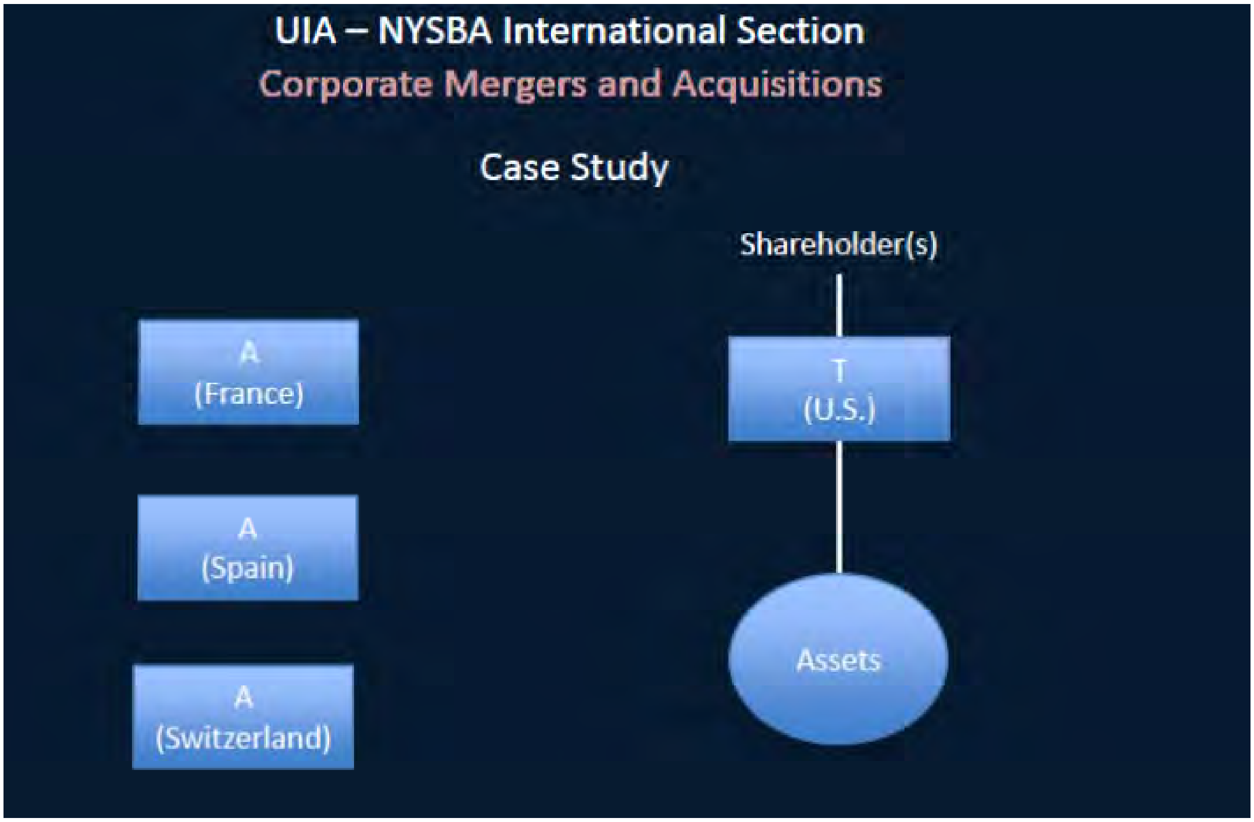
B. **General scope of the Presentation** - Presented as a case study, the panel will explore typical structures of a Merger & Acquisition transaction and discuss the related tax issues.

1. The Merger & Acquisition transaction will be viewed from the perspectives of the jurisdictions in which the acquirer(s) are based.
2. The panel also will discuss the transaction from the perspective of the target company.
3. The U.S. tax considerations will be discussed.

II. Discussion/Case Study - Fact Pattern for Panel Discussion

A. This Case study consists of an acquisition of stock or assets of a U.S. corporation of LLC (an inbound acquisition from a U.S. perspective) by a French/Spanish/Swiss Acquirer, respectively.

B. See the Diagram on the next page.



• Acquirer ("A") is either a French, Spanish or Swiss corporation.

• Target ("T") is a U.S. corporation or, alternatively, limited liability company ("LLC") with U.S. shareholder(s).

• For U.S. tax purposes, a LLC may elect[1] to be treated either as a corporation or as a "transparent" entity.

• As will be discussed by the panel, the two treatments will have dramatically different U.S. tax consequences to A, T, and the seller(s) of T.

.

[1] The U.S. "check-the-box" ("CTB") regulations permit certain eligible business entities to select how the business entity will be classified for U.S. income tax purposes. These regulations apply to foreign as well as domestic entities. Treas. Reg. §§ 301.7701-2(a), 3(a). Generally, under the CTB rules, unless it elects otherwise, a "domestic eligible entity" (such as a LLC) is (i) classified as a partnership if it has two or more members, or (ii) disregarded as an entity separate from its owner if it has a single owner. Treas. Reg. §301.7701-3(b)(1). In either case the LLC will be "transparent", and accordingly the LLC itself is not subject to U.S. income tax. Alternatively, the LLC may elect to be treated as a corporation for U.S. income tax purposes, with the consequence that it would be a "non-transparent" taxable entity.

III. **Issues for Discussion**

A. Non-tax considerations regarding U.S. Target ("T")

1. What is the A's objective in the acquisition?
2. T's business attributes
3. Legal issues in the T's State/local jurisdiction
   - a. Labor
     - (i) State and local laws; e.g., is T located in a "right to work state"; minimum wage laws
     - (ii) educated work force
   - b. Market access and regulations
     - (i) Government filings and approvals (if needed depending on the nature of T's business/assets)
   - c. Cross-border supply chain and sales restrictions, tariffs, etc.
4. Due diligence (including certain tax attributes)
   - a. Potential liabilities of T
     - (i) Financial liabilities
     - (ii) Pending lawsuits
     - (iii) Legal - e.g., Foreign Corrupt Practices Act
   - b. Essential assets, including IP rights
   - c. Government incentives; e.g. property and other State and local tax reductions/holidays, local zoning concessions, State and local subsidies.
   - d. Industry (practice, regulations, permits, risks etc.)
   - e. Integration into Acquirer's group of companies and business
     - (i) Analysis of the business structure of, both, Acquirer and the U.S. Target
     - (ii) Effect on supply and distribution chains
   - f. U.S. Target's tax attributes
     - (i) Net operating loss carryforwards
     - (ii) Foreign tax credit carryforwards
     - (iii) other relevant tax attributes

B. How to structure the acquisition - Overview:

1. Stock Purchase vs. Asset Purchase - U.S. Non-Tax Considerations
   - a. <u>Stock purchase</u>
     - (i) A plain stock purchase or LLC membership purchase is probably the most common acquisition structure

(ii) U.S. Target retains its assets and liabilities which are typically subject to negotiated seller representations and indemnities

b. Asset purchase

(i) A pure asset purchase structure generally protects Acquirer from inheriting U.S. Target's liabilities (including T's tax liabilities) and is therefore typically desirable for A from a non-tax perspective.

(ii) The need for seller representations and indemnities is typically less than a stock purchase.

(iii) Transfer of individual assets and liabilities is cumbersome and may not be feasible.

c. Structuring payment of the purchase price

(i) Debt/Equity structure and characterization of an instrument as debt or equity for U.S. tax purposes

(ii) Interest stripping rules under

d. Representations and covenants regarding tax matters

e. Purchase price adjustments

(i) failure of T to meet stipulated performance standards (e.g., sales)

(ii) failure of T to satisfy other representations and covenants

2. Stock Purchase vs. Asset Purchase - A's Non-Tax Considerations

a. In general

(i) Acquirer's acquisition vehicle - Should a holding company structure be used?

(ii) Type of entity (corporation, fiscally transparent or hybrid?)

b. French Non-Tax Considerations

(iii) One of the main advantages of an asset transaction, compared to a share transaction, for A is the protection from inheriting tax and other liabilities; no due diligence needed

(iv) The transfer of real estate assets may trigger heavier registration procedures.

(v) Transfer of going concerns can be more burdensome.

(vi) In both cases an SPV, particularly for leveraging will be set up.

c. Spanish Non-Tax Considerations

(i) Spanish investors tend to prefer share deals to asset deal due to a number of factors:

a. Usually, simpler documentation package,;

b. Protection from potential liabilities inherent or attached to the assets;

c. Easier management and compliance in connection with acquisition of various assets, regulatory framework, etc.

(ii) This may be a bit different in real estate intensive deals, but legal entities would be in any case interposed due to high risks perceived in the U.S. from a legal standpoint.

d. Swiss Non-Tax Considerations

(i) Purchase of U.S. assets leads to direct liability of A in the U.S. and A will become a party to local contracts (rental, employment, sourcing etc.)

(ii) Will an asset purchase structure fully protect A from inheriting any liabilities if employees are taken over? If an ongoing business is taken over?

(iii) If in a regulated business environment: will manufacturing validation, product certifications, business permits be upheld?

(iv) What reporting requirements will the Swiss company be subject to in the U.S.?

C. Tax Issues (by country: U.S., France, Spain, and Switzerland)

1. Stock Purchase vs. Asset Purchase - U.S. Tax Considerations

a. For U.S. tax purposes the tax consequences of a stock and an asset purchase are dramatically different.

b. <u>Stock purchase</u>

(i) In a stock purchase, A generally inherits the tax attributes of T, subject to limitations intended to combat trafficking in tax attributes.

(ii) In addition, T has a carryover tax basis in its assets.

(iii) U.S. tax treatment of sale of stock by T's U.S. shareholders generally results in capital gain or loss, which will be long term or short term depending on the shareholder's holding period.

c. <u>Asset purchase</u>

(i) In an asset purchase, A generally does not inherit T’s tax attributes and gets a step-up in the tax basis of T’s assets.

(ii) An asset purchase may afford the best tax consequences to A (notably a "step-up" in the basis of assets) but produce significant adverse tax consequences to the seller if T is a stand-alone corporation.

(iii) If T is (1) a subsidiary of a corporate "consolidated group", (2) an LLC treated as a transparent entity, or (3) an "S Corporation", the transaction can potentially be structured to provide A the benefits of an asset purchase without adverse tax consequences to the seller.

d. Hybrid structures for U.S. tax purposes. It may be possible in certain cases to structure an acquisition as a share (or LLC interest) purchase but to treat the transaction as an asset purchase for U.S. tax purposes.

(i) For example, IRC § 338(h)(10) transactions, sale of transparent LLC, LLC conversions.

(ii) IRC §338(h)(10) share purchase treated as asset purchase

a. Potential step up in tax basis

b. Allocation of purchase price among classes of assets

c. Possible MACRS (cost recovery) elections?

(iii) Buy/sell DRE (disregarded entity for U.S. tax purposes under CTB rules) treated as asset purchase for tax purposes in U.S. but as stock acquisition in acquirer's jurisdiction.

e. Transaction Issues relating to U.S. Tax Considerations

(i) Purchase price allocation among classes of assets.

(ii) Separate acquisition of intellectual property.

(iii) Covenant not-to-compete.

(iv) Contractual aspects: Need for seller representations and indemnities; control of tax returns and proceedings.

2. Stock Purchase vs. Asset Purchase - French Tax Considerations

a. Stock Purchase.

(i) In a stock purchase, A inherits tax attributes of T. In addition, A will support the taxation of the asset's unrealized gain in the US. However, the gain derived from the sale of T's shares by A will qualify for the favorable long term capital gain regime in France (4.67 % effective rate).

(ii) It must be noted that A and T cannot form a group tax consolidation. T losses may not be used by A. In addition, a WHT on dividends paid by T to A will generally apply.

(iii) Also, the French thin capitalization rules applying to all loans granted to the borrowing company by any related undertaking may limit the deduction of the interest paid by A.

b. Asset Purchase.

(i) In an asset purchase, A generally does not inherit T's tax attributes and gets a step-up in basis of T's assets which will allow amortization (but not on goodwill). No pregnant gain.

a. It must be noted that if an acquisition structure is not set up in the U.S., the asset purchase can create a permanent establishment and thus a taxable presence of A in the U.S.

3. Stock Purchase vs. Asset Purchase - Spanish Tax Considerations

a. Spanish investors usually focus on:

(i) Ensuring that the so-called "participation exemption" for dividends and gains may apply - or maximization of foreign tax credit is achieved,

(ii) Whether tax treaty benefits are available and how LOB (limitation on benefit provisions may impact cash flows, particularly if the Spanish company is a holding company, and

(iii) Financing structure for the deal (leveraged acquisitions and debt pushed down). In case of an asset deal, it is extremely relevant whether such assets constitute a permanent establishment(PE) or not.

b. It must be noted that investment into LLCs may pose problems for the application of the "participation exemption" (tax credits may be available). Tiered structures or groups need also to be carefully analyzed. Solutions may come through new partnership entities available in Spain (checking the box in the US).

c. The 2013 protocol to the US-Spanish tax treaty (pending to be ratified) could create more favorable environment (0% tax on certain dividends, gains, royalties and interest, etc).

d. Although depreciation of foreign goodwill and other domestic tax incentives have been limited, post-closing cash flows and transfer of business profits to Spain is of interest (25% tax).

4. Stock Purchase vs. Asset Purchase - Swiss Tax Considerations

a. The Swiss – U.S. Tax Treaty of October 2, 1996 applies to income (on U.S. side only federal income tax).

b. The tax consequences of a stock and an asset purchase are dramatically different for local U.S. tax but also for international tax aspects:

(i) Asset purchase creates a permanent establishment (PE) and thus a taxable residence of A in the U.S. subjecting A to U.S. taxation for U.S. business profits (arts. 5 and 7 US-Swiss Tax Treaty).

(ii) Stock purchase transfers control over T-company leaving T under U.S. taxation, not subjecting A to U.S. taxation.

(iii) However, under both asset and stock purchase, business profits from the A-business are taxed in the U.S.

(iv) Switzerland doesn't consolidate subsidiaries for tax purposes: asset purchase allows A to off-set losses from T; share purchase would not. Asset purchase allows A to "step-up" assets acquired.

(v) In the case of a stock purchase, transfers of business profits (dividends) from T to A are subject to 5% non-recoverable U.S. withholding.

(vi) Art 10, paragraphs 7 and 8 of the U.S.-Swiss Treaty applies to distributions from a U.S. PE of a Swiss company. As a consequence the U.S. 5% branch profits tax applies to the "dividend equivalent amount". Not all Swiss Treaties have the same rule, so that in certain cases profits from T to A are not subject to non-recoverable withholding.

(vii) Investment into LLCs creates problems, because unclear legal qualification under Swiss law (partnership or company).

5. BEPS driven tax law changes

   a. Loosening PE Threshold; Digital Economy

   b. CbC Reporting

   c. Tax rulings

IV. Closing Remarks from members of the Panel.