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Lecture 8: 3/1/04

Guest: Martin Allen, Partner at Kirkpatrick & Lockhart

- Tax considerations in transaction are important in knowing why a deal is done one way or another.
- To structure a transaction ask what is the legal form pass through entity?
 - Partnership, S corp., C corp. subsidiary of another corp.
 - it has income
 - Income is passed through to the owner (taxed once to the owner).
 - Profit on sale is taxed to partner not partnership
- 1986: There is double taxation
- C Corps: If there is an income, it is subject to operational tax. Then, if it goes to shareholders, they are taxed as well.
- According to Badge: there is asset acquisition, stock acquisition, and merger. But, Martin thinks there are only 2 kinds: asset acquisition and stock acquisition.

When smoke clears, target has disappeared, and buyer has all of the assets.

- discussed forward triangular mergers
- taxable transactions
- What are tax objective's of partners
- Buyer's objective: acquire assets of a target company with the most beneficial tax attributes as possible.
- If NBV < fair value, then buyer wants to take it with a stepped-up basis so they can claim tax on this basis
- Tax sheltered cash discussion
- The buyer in the transaction wants a stepped-up basis

- C-Corp (basic corp.) Example: GM. treated as a separate tax payer. 35% of dividends are taxed.

- It's hard to buy NOL's around election-time; politicians want to close tax loopholes.

- Seller's (in class he used Gibson as an example) goals
 - he wants to pay as little tax as possible
 - wants as much money as he can get

- may want to defer tax if he wants to pay for it
- If Gibson set up a C corp. and Allen wants to buy it...what happens?

Allen refers to example 1:

He states, what if Gibson doesn't want to sell assets, but stocks?

- Buyer's investment is \$13,000. Gibson gets \$11,000- 10,000 + tax (.15).
- Gibson wants \$9500

- Stand alone corporation: not part of a group

Allen talked about how to value corporations? What should you consider?

- one way to value equity, is after tax-value
- Suppose someone wants to buy a subsidiary of United Tech. Co.
 - Introduces possibility of getting a stepped-up tax basis (to get rapid depreciation) when you buy assets.
- Buyer will allocate a lot for depreciation and a little to goodwill
- It is difficult for subsidiary to sell asset by asset by asset.
- It would be easier to buy stock of the subsidiary. (assume depreciation bookvalue = 0)
- Section 338: Election:
 - When a corporate buyer buys a C-Corp, the seller and the buyer can elect to treat the transaction as an asset transaction even though the buyer bought the stock.
 - Selling Corp. would have generated a profit on the sale (as if it sold assets)
 - This election would make sense if subsidiary had way to absorb the gain
- Section 338 – H-10 Election
 - The deemed asset sale is treated as it happened the moment before the sale.
 - Therefore, UT pays tax, not subsidiary.
 - UT is in the same position had it sold stocks (illustrated in Example 2)
- Forward triangular asset transaction: no need for Section 338.
- Reverse Triangular merger: has more limitations than a direct merger.

Non-Taxable reorganizations:

- entitled to special tax things
- Allowed to swap tax, without paying current tax... “carry-over” basis
- there is no step-up (swap parent stock for business's asset)
- sellers don't get cash → they get stock for the new stock or promissory notes called “boot”

- ABC (companies)
 - A: assets for stock subject to liabilities
 - B: stock for stock swap → i.e. tender offer
 - C: merger forward or direct or triangular

1.) Limitation to “boot” in C corp.

- if you swap target’s assets for stock + cash then this treated as “boot”
- boot makes it hard to qualify a transaction

2.) substantially “all” requirements there will be buyers that may not want to buy all of the “target”

- By not taking B, you lost qualification but buyer buys A and B, not C of the target.

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- Direct mergers are the most permissive.
 - Target mergers entice buyers.
 - 50% needs to be stock and 50% needs to be cash
 - Gain is realized at the extent of the boot that is received.

B-reorganization:

- * Share stock of B for T
- * Only voting stock can be used (this is a tax problem, so no boot can be used)
- * Difficult to do with a widely-held company, because you may not get all of the shares.
- * This is a tender offer (usually followed by a squeeze-out merger to get 20%)
- * You need 80%