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THE CRITICAL ROLE OF TAX TREATMENT AND STRUCTURING IN INTERNATIONAL M&A

There can be additional complexities involved in cross-border acquisitions. It is important to understand the tax treatment in each country in order to ensure the acquiror and target receive the desired result. Techniques for acquisitions in one country can be different than in the other and the resulting tax implications can be significant even if unintended.

Impact of Entity Classification on Tax

In one acquisition where a European private equity fund ("**PE Fund**") was acquiring the majority equity interest in a U.S. target company ("**Target**") a common European acquisition technique was used for the acquisition. The technique was to set a date where all cash received after that date would be the acquiror's cash even though actual closing of the transaction would occur more than six months later ("**Locked Box Acquisition**").

The letter of intent was worded like the acquisition was of a target taxed as a c-corporation in the U.S. even though the Target was a partnership for U.S. federal income tax purposes. For an acquisition proceeding as a Locked Box Acquisition, the Target being treated as a partnership instead of a c-corporation has very important tax implications to the after-tax proceeds received by the Target equity holders.

If the Target were a c-corporation, the Locked Box Acquisition would have less of an impact on an equity acquisition to the Target equity holders as the Target has an entity level tax and the tax implications would simply be taxed at the Target level post-acquisition with little impact to the Target equity holders' after-tax return from the acquisition.

The tax implications are entirely different for the Locked Box Acquisition where the Target is a partnership as the cash accumulated preacquisition that goes to the acquiror would be taxed to the Target equity holders. That is, the acquiror would receive the cash during the six plus months of the Locked Box period but the Target equity holders would bear the burden of the tax. This clearly would not be the intended result for the Target equity holders.

The Importance of Proper Tax Planning and Engaging with Qualified Tax Professionals

Under these circumstances and depending on the net income of the Target during the Locked Box period, the Target equity holders could bear the burden of millions of dollars in tax for

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revenue that goes to the acquiror. In determining the Target equity holders' after-tax return on the acquisition, the tax the Target equity holders bear during the Lock Box period must be subtracted from the purchase price, which will likely significantly reduce the amount received by the Target equity holders.

If the tax the Target equity holders bear during the Locked Box period is not planned for, the Target equity holders will not receive the return they believed they were receiving. While the Target companies a lot of times want to rely on acquisition tax counsel, they must understand acquisition tax counsel does not represent the interest of the Target equity holders. It is therefore imperative that the Target have competent counsel that fully understand the tax implications of the acquisition to ensure the Target equity holders receive the desired after-tax return.

For cross-border acquisitions it is important to have tax professionals in place that understand the tax treatment of the transaction. Not having the proper tax professionals at the table can have a significant impact on the expected result to the acquiror and target.

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