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M&A Dealmakers: Do Not Overlook Tax Implications

Abstracted from: *Taxes Aspects Of M&A Deals: A Pervasive And Intricate Part Of Any Transaction*
By: Robert Wood
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Plan tax structure carefully. The parties to every merger—large or small—must plan a coordinated tax strategy, suggests tax attorney Robert Wood. The M&A deal may be fully taxable, partially taxable, or not taxed at all, based largely on what type of consideration the buyer pays and whether the payment goes to the target or its shareholders. Tax planning should begin in the early stage of negotiations, since the tax costs ultimately affect the final price. The buyer normally wants to increase the tax basis of any assets it acquires and take advantage of the seller's tax attributes (NOLs, for example). The seller, of course, takes what is normally a competing approach by trying to minimize its tax cost. The parties must also factor in state and local sales, income, and franchise taxes; the more states, the more complex, the more important.

Step-transaction doctrine gives IRS clout. Not all tax law is codified, the author reminds. Much emanates from case law that sets precedent for many M&A tax principles. Among the most prominent of these nonstatutory principles is the step-transaction doctrine. This commonly used provision allows the federal and state taxing authorities to restructure the many steps involved in an M&A deal and view them as one taxable event. The author indicates that the application of this authority can produce a "truly terrible" result for the taxpayer. Step-transaction doctrine allows the IRS to attack the deal's form, as it was designed and negotiated by the lawyers, and to assess tax based on the merger's substance. Lawyers and accountants complain that the Internal Revenue Code and its regulations are lengthy and complicated enough; adding the generations of case law makes the US tax system the most complex in the world.

The IRS changes a long-held position. Rarely does the IRS change a long-held position, but the IRS's recent reversal of the long-standing *Bausch & Lomb* doctrine struck the author. In 1959, a federal court found that Bausch & Lomb's acquisition of a target violated the "solely for voting stock" requirement in the M&A tax laws. The acquiror had owned a 79% interest in the target for some years. To gain complete ownership, it transferred Bausch & Lomb stock to the minority shareholders. The IRS determined (and the courts agreed) that it had acquired 100% of the target's assets but had transferred shares to only 21% of the target's stockholders. Therefore, the taxing authorities concluded, the rest of the target's assets must have been acquired for consideration other than stock. This precedent stood for years and persisted through numerous challenges, but, after 45 years, the IRS reversed its position. It declared that preexisting ownership no longer violates the "solely in exchange" provision of the law.

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