



## FROM THE M&A FRONT

### Address tax considerations early in the process

By Paul Sassano

Approximately two-thirds of recent mergers and acquisitions failed to achieve their anticipated results and, of those, one-third actually destroyed value for the acquiring company, according to a 2007 review of 180 studies of M&A activity over the last 20 years conducted by Dr. Robert F. Bruner at the University of Virginia.

The main reasons for the dismal results were inadequate due diligence; poor, if any, transaction integration planning; and an inability to execute integration, primarily due to underestimating the effort required and the technical issues and options available. In some cases, departments or functions with the greatest opportunity to improve financial and operational performance were introduced too late in the M&A process or their participation in the process was poorly planned. Unfortunately, once certain decisions are made or overlooked relative to these functions, significant and sometimes permanent damage can be done and opportunities lost.

Tax due diligence and integration planning are two critical areas of opportunity that contribute to the success of a merger or acquisition. Involvement early and throughout the M&A process is the key to an optimally structured transaction and post-transaction strategy and compliance.

#### Tax due diligence

Tax advantages are rarely the primary reason for pursuing a merger or acquisition. So, it is not unusual for tax to be overlooked when the initial deal structure is contemplated. Tax diligence is usually performed late in the due diligence process when it could be characterized as compliance-focused. Missing early opportunities for involvement can mean considerations of optimal legal entity, financing and transaction structures, and others can be missed. During the late stages of negotiation, seller expectations may be locked in and inflexible.

When tax is viewed as a part of the corporate strategic vision, tax considerations can offer crucial decision-making insight during the strategic assessment and opportunity-seeking process. Critical tax considerations include:

- **Structure** – Most deals can be structured as taxable or tax-deferred. The rules governing tax-deferred treatment are extremely complex and involve careful planning and execution to ensure requirements are met. Additionally, tax implications will vary significantly for both buyer and seller with respect to asset versus stock and taxable versus tax-deferred deals.
- **Financing** – Considering potential tax implications relative to the finance structure in advance could allow time to alter the financing arrangement for current and future tax savings or benefits.
- **Entity** – Careful up-front planning regarding choice of entity could help optimize the tax position for both buyer and seller. Different types of entities have differing tax implications during and after a merger.

Crucial tax statutory and strategic considerations during due diligence include:

- **Compliance** – Understand and identify the additional compliance requirements resulting from the combination. This may include additional short-period returns or consolidated filings. Decisions can be made regarding changes to unitary or other filing positions that can yield a favorable tax impact.
- **Tax Positions** – Understand the impact on the combined entity's overall tax reserves. Careful review of the target company's tax returns and tax provisions could identify inconsistencies that impact tax reserves of the combined entity.

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- **Methods/Practices** – Plan around inconsistent treatment of methods or practices between the merged entities. This advance planning may yield significant tax savings. Examples such as inconsistent transfer pricing methodologies or cash repatriation practices should be examined to develop the right tax optimization strategies going forward.
- **Audits** – Anticipate the impact of existing or future audit activity and understand what effect the combination may have on the new entity. Some audit issues may overlap between the combined entities and allow for quicker resolution or remediation.
- **Incentives** – Explore the potential for negotiating tax incentives as a result of combining business operations. Certain tax authorities allow for tax incentives as part of the consolidation of facilities, personnel or functions, which could result in substantial savings.
- **Attributes** – Understand the combined impact on tax attributes. Preparing for changes can preserve and enhance future tax benefits. Examples of these attributes are foreign tax credits, net operating losses, research and development credits, and earnings and profits.

As transaction due diligence winds down and a determination has been made to close a deal, proactive tax consideration can be a tremendous benefit. Post-transaction, there will be a new, combined organization as the result of the merger or acquisition. Companies need to ensure the compliance standards of the new company are entirely realized.

### Tax integration planning

During the merger or acquisition process, the typical focus of integration planning is on high-priority strategic initiatives that were the basis for entering into the deal. However, this is also the optimal time to plan and establish future tax strategy. Old structures and methods, and new transactions and relationships will likely create new compliance challenges and tax minimization opportunities. New third-party suppliers, customers in new locations, intercompany relationships, corporate allocations, international trade and other factors frequently result from a merger or acquisition. These factors offer a combination of new compliance and tax-strategy responsibilities and opportunities, which should not be overlooked.

Post-transaction planning and execution opportunities resulting from a merger or acquisition include:

- **Staffing** – Careful consideration should be given to forecasting future staffing needs of the tax function. Expect additional compliance and data migration requirements. Be ready to reallocate staff or add resources to accommodate the increasing demands.
- **Data Integration** – Valuable tax-sensitive data may get lost when consolidating multiple general ledger systems or tax compliance and reporting software systems. These changes can impact timing and cause delays in financial reporting. They should be planned for in advance.
- **Reporting and Forecasting** – A merger or acquisition will significantly affect

the effective tax rate calculation and other reporting and tax forecasting calculations. These future consequences should be analyzed and communicated effectively to management.

- **Rationalization** – Creating a new organization may result in unwanted assets or entities. Develop plans to dispose of these assets or entities in the most tax-efficient manner possible.

When looking to effectively structure, efficiently evaluate and optimally integrate an acquisition, it is important to engage the tax function as a part of the strategic team. From transaction planning to due diligence to integration planning and execution, the tax advisor's involvement is critical to optimizing the overall tax-planning and compliance strategy for a merger or acquisition. If tax considerations are not part of the up-front deal strategy and strategic diligence role, tax transaction and post-transaction options may be limited.

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