



Tax in today's complex M&A market

Chief Tax Officer Outlook

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When a transaction is being considered, tax leaders should have a seat at the table from day one

As highlighted in the 2022 Chief Tax Officer Outlook, the success of the tax function and deal teams is not mutually exclusive. Every transaction has tax implications and the most strategic tax functions will only increase merger and acquisition (M&A) success and drive value throughout the deal lifecycle.

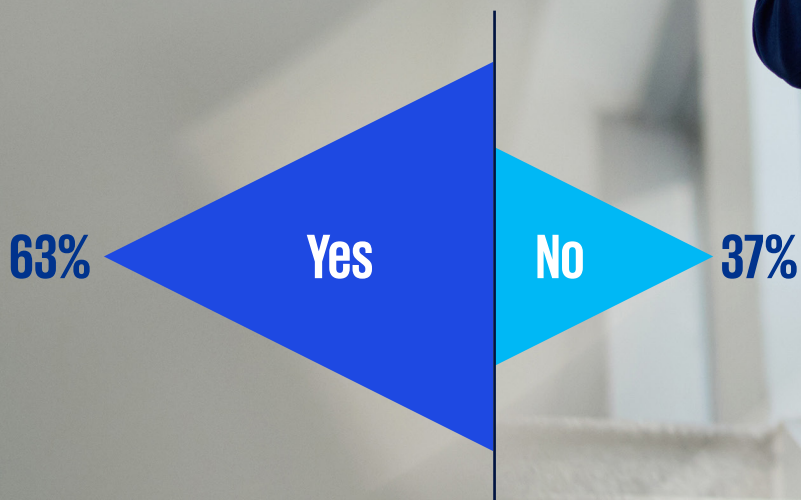
The global tax landscape has been evolving rapidly as tax laws and regulations attempt to keep up with planning practices and new technologies. Developed countries are working together to increase both consistency and substance in the tax footprints of multinational companies.

From the perspective of your company's next transaction, consider the following:

- When acquiring companies attempt to uncover latent risks and potential opportunities within a target's operating structure, a day one assessment of the portability of global cash and the current state of both the supply and value chains is critical. Increasing the ability to move cash and other resources between divisions and across national boundaries will have a significant impact on valuation. The complexity of the global tax system can leave impediments in the form of new limits on borrowing, transfer pricing, and movements of key assets necessary to integrate operations. These potential speed bumps are often inadvertently overlooked and can derail a transaction. If companies move forward with an agreed structure and commercial deal without addressing these critical global tax considerations, the ability to negotiate favorable terms may dissipate.
- An assessment of the projected economic benefits of a transaction is done through detailed financial modeling. The complexity of today's global tax system has amplified the necessity for deal teams to spend more time modeling the postdeal tax position of the combined business. Financial modeling exercises require the best available information, precision in the relevant algorithms, and, most importantly, sound judgments about the future trajectory of tax policy and the art of the possible in integrating two complex businesses. This judgment can only come from experienced tax leaders. If the process of modeling is rushed or key assumptions are left to chance, the exercise will yield inaccurate results and have a negative impact on various deal metrics, including the purchase price.
- Ideally, sellers will engage in an effort to tell their story before the buyer's team gets too deeply involved in the process in an effort to manage the narrative and minimize surprises. Similarly, on the buy side, players are encouraged to involve tax early to protect themselves from a purchase price adjustment by identifying tax risks and/or synergies that can be factored in if identified at the front end of the deal.

This report looks at the tax implications for the deal process through both chief financial officer (CFO) and chief tax officer (CTO) lenses. While the CFO is typically the key senior leader in a transaction, our work on global M&A transactions has shown that the successful execution is driven by CFOs and CTOs speaking the same language while seated at the same table at the same time.

CTOs say tax issues related to M&A are growing in number and complexity



Source: KPMG 2022 Chief Tax Officer Outlook.

Ensure tax is part of the integrated whole to streamline execution

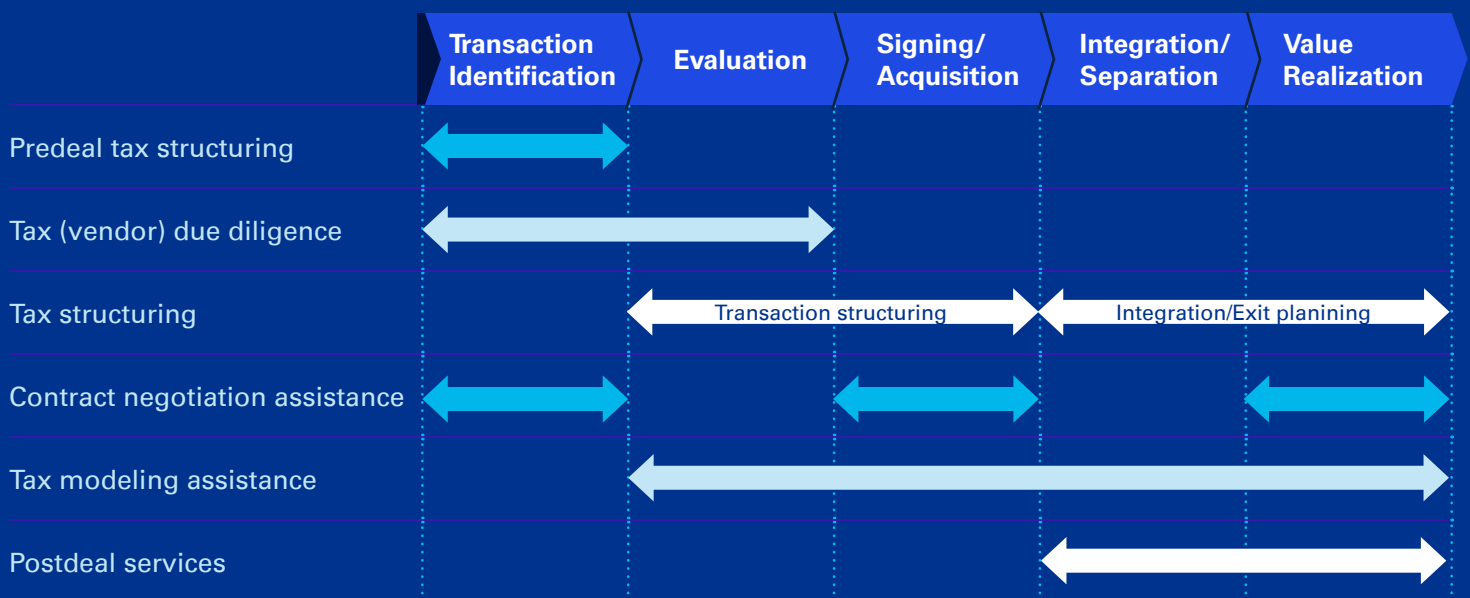
While the role of tax is as critical to deal success as it's ever been, the ability to balance the commercial, legal, and tax responses related to a transaction has become far more complicated.

In an effort to reduce the overall cost of transactions, deal teams should emphasize a start-to-close blend of all critical disciplines, including tax. A tax structure and its execution are to a large degree a result of understanding the risks, opportunities, and commercial limitations that are inherent across the target company's enterprise.

Our experience in M&A and other complex transactions has shown that deal structures that are driven forward without consideration of the tax impact often require a pause in the process to reset for tax to reach a successful closing. When tax considerations are factored in early, timing and efficiency are vastly improved. As a result, we have seen a trend toward a multidisciplinary approach to valuing and structuring transactions.

Companies are doing this work earlier in the process to clarify how to best finance the transaction and estimate how tax may impact return on investment. Accelerating the role of tax can also help determine whether there are features of the deal structure that should change on Day One to achieve synergies and address risks.

KPMG provides perspective and support across the deal life cycle



Source: KPMG 2021.

Cross-border complexity

It's rare in the current market to have a transaction that doesn't involve business activities in multiple countries. With an increase in both the substance of these activities and their importance to the combined businesses' commercial future, the transaction becomes more complicated and its successful execution more critical.

As companies look to overcome cross-border complications and successfully execute a transaction, the tax policies within most countries have become more agile and globally integrated. Tax policy leaders within governments realize that multinational corporations and their tax advisers have used stagnant tax laws and disparities between countries to plan around the local stand-alone tax provisions. The frequent iterations of cross-border tax policies and the collaboration of developed countries, such as the Organization for Economic Cooperation and Development (OECD), make it far more challenging for deal teams to achieve their commercial objectives in a tax-efficient manner.

As local country tax authorities and global cooperative organizations, such as the OECD, have grown in sophistication, various regimes have materialized, often with perplexing and overlapping consequences. In many cases, one country's treatment of a legal structure or financing arrangement may affect another country's view of the same transaction. To manage these matters, a company's deal team must include tax leaders from within the organization. As the company moves forward from Day One, the tax leaders should engage internal teams and external tax advisers around the world to help develop the relevant modeling and solidify the deal and financing structures to ensure commercial, legal, and tax outcomes are feasible under the current law.



Cross-border complexity (continued)

For most regions of the world, tax uncertainty and complexity will continue to be a prominent feature of the deal landscape. For example:

- Many jurisdictions in the Asia Pacific region have embarked on substantial tax reform initiatives, but these reforms look quite different from one jurisdiction to the next due to the diversity of the region's economies and varying levels of sophistication in their tax legislation and administration.
- Tax reform remains high on the European Union's agenda, in terms of both cooperation with the OECD and its own measures, such as Pillar One and Two. Environmental levies and decarbonization initiatives are also becoming a significant factor in transactions involving players in the EU.
- The U.S. administration has proposed sweeping changes to tax policy, that could have profound implications for transactions markets in North America and globally.

Source: KPMG, "Future of M&A: Rebounding markets focus on value creation and tax reform," 2021.

Another important consideration is the likelihood of foreign jurisdictions changing existing tax laws. Adding to today's complexity, tomorrow's unknown reforms could change the characterization of certain important cross-border operating models overnight. Targets and buyers are forced to create an investment thesis without knowing whether the changes are going to transpire and what impact they may have on the economics of the combined business. To combat this uncertainty, targets and buyers will run alternative models, create flexible structures, attempt to estimate the possible impact of any changes, and communicate the possible outcomes to all stakeholders.



Elevate the CTO's role in M&A

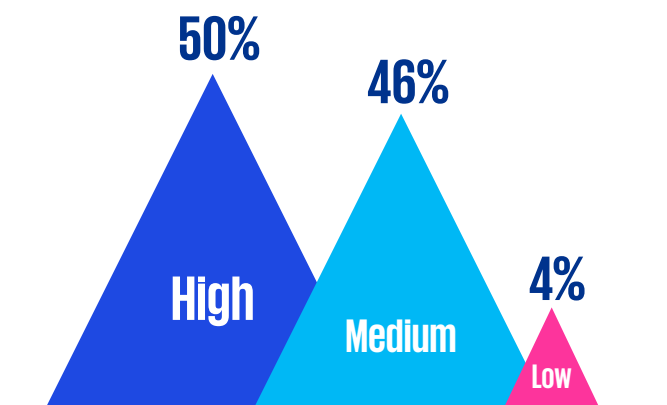
Ensuring the CTO has a seat at the table at the beginning of the process, alongside other areas of the business, is critical and depends, in large part, on the perspective of the CFO.

CFOs who understand the value of aligning the tax structure with the business in general and M&A in particular tend to invest in strong CTOs and ensure that those CTOs have a prominent role early in the transaction lifecycle.

There are, however, CFOs who do not necessarily view the tax impact on a transaction or go-forward operating model as a kick-off consideration. Such CFOs may not view the input of the CTO as critical to the overall commercial outcome. In those instances, the CTO has to play catch up, which can strain the ability to close the deal in an efficient manner and slow down or pause the integration of the new business as cash tax increases on each step.

We believe the leading practice is to help ensure the CTO is at the table from the outset and is part of the conversation from due diligence through exit.

Nearly 100 percent of CTOs say connectivity with other functions through the deal lifecycle has increased



Source: KPMG 2022 Chief Tax Officer Outlook; survey conducted August 2021.

There are four parties to most transactions: the buyer, the seller, the financing sources, and various taxing authorities. The CTO can assist the C-suite and board of directors in navigating the terrain between these stakeholders. A CTO and their team can help in three key areas:



Assessing which commercial terms balance the postclosing position of the buyer with the cash tax impact to the seller



Determining which financing packages provide the best after-tax benefit



Calculating the amount of money going to the tax authorities.

These insights can smooth negotiations among the various parties and help maximize the value that is divided between buyer and seller. This four-party concept is more manageable if both buyer and seller are well-advised and agree that minimizing cash taxes, while balancing commercial, legal, and regulatory limitations, is a mutually beneficial objective.

A transaction structure is only as good as its implementation and ongoing maintenance. One of the main reasons why business acquisitions fail is lack of proper integration of the target within the acquirer. These failures often result in a loss of both cost synergies and commercial opportunities. The synergy capture and value creation only happen if the dealmakers integrate the businesses effectively and regularly monitor the operating model of the combined business with an eye on tweaking policies, procedures, and processes. It's our strong view that CTOs need to be part of the integration process at all touch points in order to help capture synergies and preserve M&A valuations.

Take action: Key tax considerations throughout the deal life cycle

While a well-managed M&A transaction does have beginning, middle, and end phases—think of them as presign, preclose, and postclose—the lines between them are blurred. An experienced tax team that is integrated within the finance function and operating within the deal architecture will accelerate or pull back to change the cadence as warranted.

A deal is a fluid process. Each transaction has different commercial objectives, flows from the initial thesis in hard-to-predict ways, and requires different activities at different moments. An experienced tax deal team knows how to read both sides of the deal and assess what's needed and when. For example, some of the key considerations across the lifecycle of a deal include:

Acquisition of target

- Develop the optimal structure for the acquisition considering various tax factors, including (but not limited to) the availability of a tax basis step-up, jurisdictional tax rates and treaty relief, debt push-down and tax-efficient cash flow, and the potential use of a flow-through structure.
- Determine how the proposed financing sources will play a role in the closing of the transaction, from channeling cash to the proper acquiring entities and local country borrowing to the involvement of outside equity investors who may require specific structuring considerations.
- Identify historic exposure items and present alternatives to mitigate any risk items, prospectively.
- Assist in contract analysis, financing, closing documentation, and memorializing the funds flow.

Operation of portfolio company

- Optimize the tax structure and implement remedial measures for any exposures identified during acquisition stage.
- Provide tax compliance and consulting during the portfolio company operating period.
- Implement and manage transfer pricing policies for internal management costs, intercompany financing, and changes to the value or supply chain.
- Regularly monitor cash accumulation in local jurisdictions and prepare to address cross-border cash movements.
- Assist in the tax-efficient structuring of unwanted business assets or divisions.
- Maintain capital accounts for flow-through companies, tax basis and earnings and profits calculations, and any ongoing limits on the use of tax attributes.

Disposition/Exit

- Evaluate disposition alternatives to minimize impact of taxes on exit, thus enhancing cash return on investment and preserving optionality of exit structure (planning begins during initial structuring of the acquisition).
- Effectively communicate possible historical tax risks within the entities to be sold to align with the commercial realities of the transaction and the specific industry practices.
- Determine a balance between the cash tax liability of the seller and the ability to deliver a tax basis step-up to prospective buyers.
- In some cases, negotiate an income tax receivable agreement with the seller related to the tax benefits recognized by the buyer as a result of the tax attributes delivered on disposition.

KPMG can help

When tax performance is put under a microscope, you need precise knowledge and the latest facts. When you're called upon for a larger role, you need insightful, forward-thinking perspectives. When times present increased demands for transparency, you need a steady, trusted hand.

Passionate, collaborative, and committed to the success of your business, the KPMG Tax practice works with you to learn all we can about your organization, understand your goals, and uncover unexpected opportunities. We deliver a broad range of tax strategies, reimagined now and for the future.

The way we approach M&A is to make sure that the experience is integrated, thoughtful, and value-added the entire way through. In our view, tax does not drive the M&A market. Ultimately, tax benefits and the overall tax efficiency of a deal should be considered an added benefit of a good deal structure that aligns with the company's growth goals, as opposed to being the reason for the deal.

Learn more at tax.kpmg.us.





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Jim is the U.S. national leader for the M&A Tax practice and a partner in the Passthroughs Group for the Washington National Tax practice. Jim regularly advises asset management funds on both fund structuring considerations and portfolio company acquisitions and dispositions. As a member of the KPMG Complex Transactions Group, Jim also regularly advises on the largest transactions. He also has extensive experience in the real estate, debt restructuring, and energy spaces. Jim has served as an adjunct instructor and/or guest lecturer at Golden Gate University and Cal Poly University. He has also served as a member of the American Institute of Certified Public Accountants' Partnership Technical Resource Panel and a project leader for the American Bar Association.

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