Post-acquisition integration—Trends, Traps, and Opportunities

June 11, 2024

Ahead of the wave

2024 U.S. Cross-Border Tax Conference

Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Course objectives

Post-Acquisition Integration – Trends, Traps, and Opportunities This panel will address current issues arising in connection with post acquisition integration of a newly-acquired business, including Pillar Two and CAMT considerations, entity rationalization, and resolving related party debt. You'll gain valuable knowledge and practical advice from professionals who have successfully tackled post-acquisition integrations.

01

Post-acquisition integration

Post-acquisition - Tax department considerations

Acquisition accounting considerations

- Opening balance sheet(s)
- ASC 740-30
- UTP assessment
- Valuation allowance
- Purchase price push-down

Short-period tax returns

- Buyer or seller prep/review
- Other immediate returns, systems etc.

Tax process considerations

- What does the go-forward look like?
- Internal controls
- Headcount
- Accounting systems

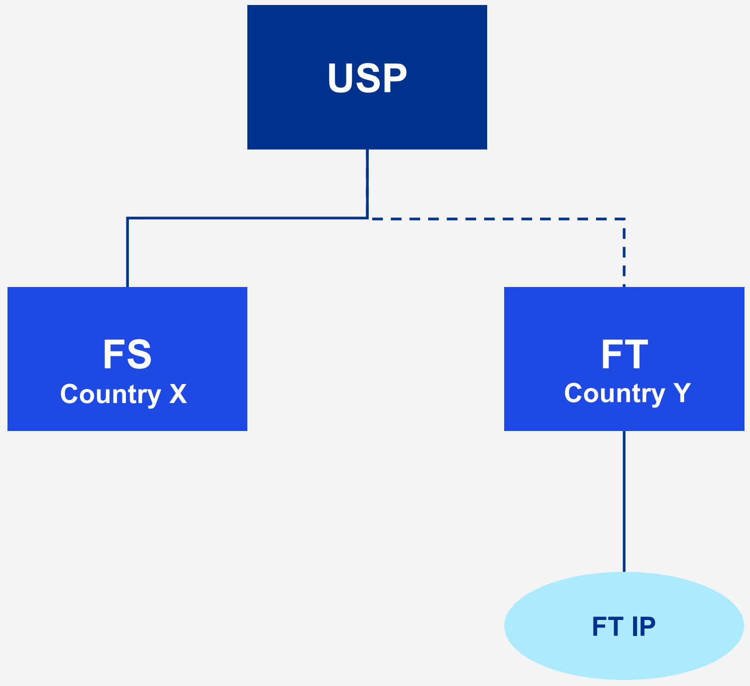
Computational considerations

- Transaction costs
- 382/383 limitations

02

Intellectual property integration

IP integration



Facts

- USP owns FS (Country X), which owns the USP group's IP.
- USP acquires FT (Country Y), which owns IP. USP makes a §338(g) election.
- USP is considering its options:
  - Move the FT IP to USP
  - Move the FT IP to FS
  - Keep the FT IP in FT

Optimizing location of intangibles in a Pillar 2 World

- 15% minimum rate
- FDII rate
- Qualified tax incentives
- Relation to DEMPE
- Toll charges
- Transitional safe harbor
- Transition period rule

Optimizing location of intangibles in a Pillar 2 World

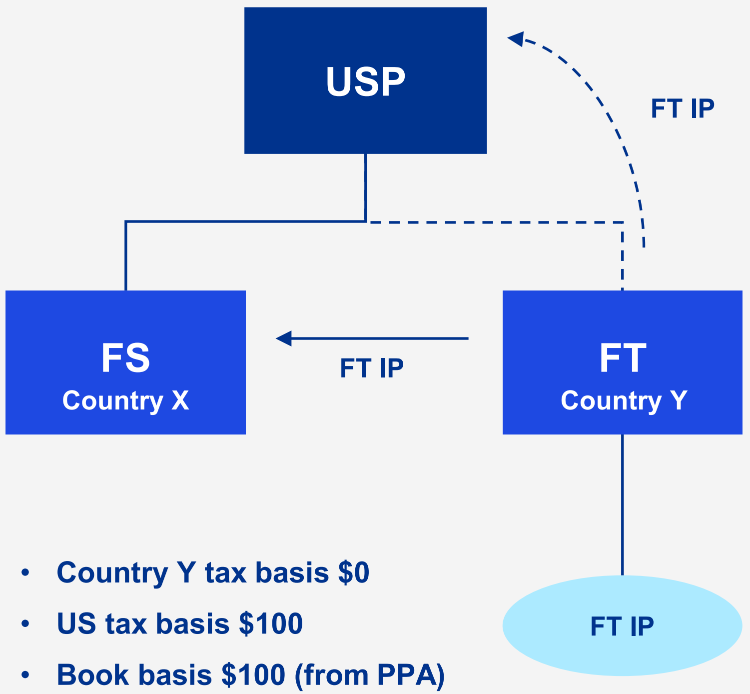
Changing considerations for IP planning

- Structures that were once tax efficient may no longer be so
- More emphasis on non-tax considerations
- Consider tax incentives with more favorable Pillar 2 treatment

Methods of transferring IP

- License
- Sale
- Die on the vine
- Section 367(d) contribution

IP integration – Long-term P2 implications



- Country Y tax basis $0
- US tax basis $100
- Book basis $100 (from PPA)
- GloBE basis $0 (no PPA)

- No purchase accounting
  - §338(g) election of CFC not a deemed asset transaction for GloBE
- Transfer to FS?
  - Does Country Y offer reduced rate?
  - Is Country Y otherwise high-tax?
  - How about Country X?
- Transfer to USP?
  - FDII eligible?
  - BEAT implications
- CAMT implications?

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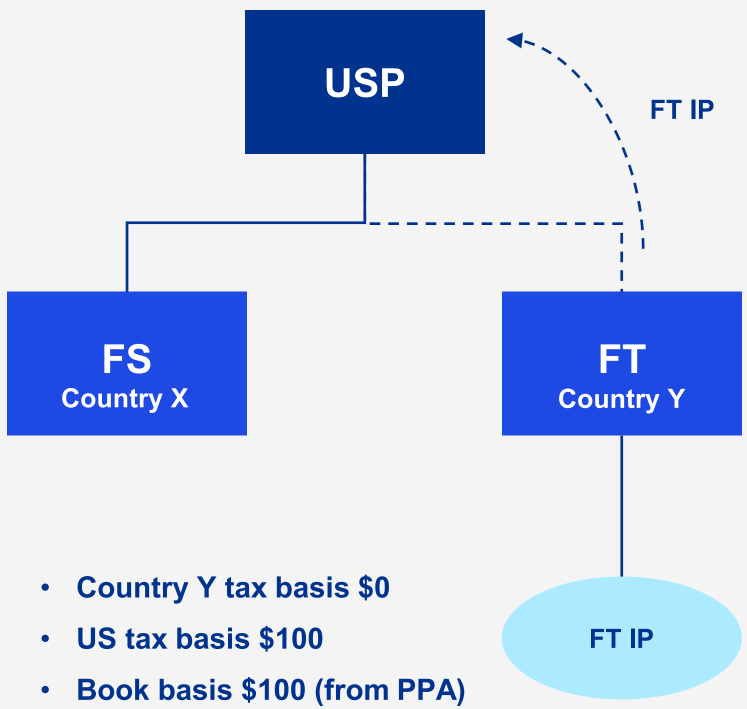
IP integration – Implications of foreign transfer



- Country Y tax basis $0
- US tax basis $100
- Book basis $100 (from PPA)
- GloBE basis $0 (no PPA)

Facts

- After USP acquires FT, FT sells (or distributes) FT IP to USP.
- Assume FT pays Country Y tax of $10, and USP pays an additional $2.5 of GILTI on the transaction, and takes a FMV basis in the FT IP for tax.
- USP accounts for the sale at cost – FT has no income, USP takes FT's carrying value of $100 (from PPA) and creates no DTA.

During Transition Period

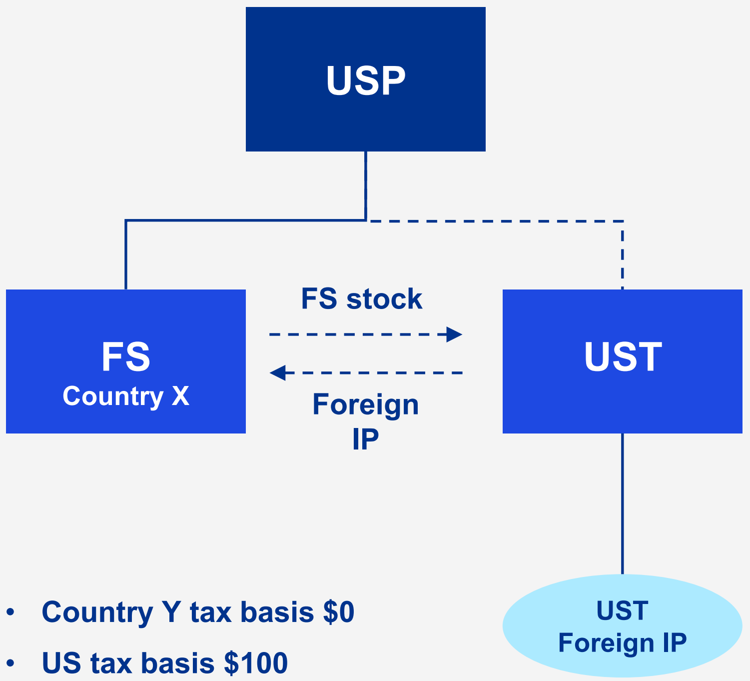
- USP takes FT's carrying value (ignoring PPA) of $0, but is permitted a $12.5 GloBE DTA for taxes paid on the transaction.

After Transition Period

- FT recognizes GloBE income (ignoring PPA) of $100.
- USP takes FMV carrying value of $100 with no DTA for GloBE.

CAMT Implications?

IP integration – Implications of US transfer



- Country Y tax basis $0
- US tax basis $100
- Book basis $100 (from PPA)
- GloBE basis $0 (no PPA)

Facts

- After USP acquires UST, UST contributes its foreign IP to FS in a §351 transaction. UST is deemed to receive a royalty from FS over the 15-year useful life of the IP under §367(d).
- FT takes a stepped-up basis in the foreign IP under Country X law.
- USP accounts for the sale at cost – UST has no income, FS takes UST's carrying value of $100 (from PPA) and creates no DTA.

During Transition Period

- FS takes FT's carrying value (ignoring PPA) of $0; FT is permitted to set up a GloBE DTA to the extent of taxes "UST paid in respect of the transaction," but it is not clear whether (and how) the tax paid by UST over the useful life of the IP will be taken into account in determining the DTA.

After Transition Period

- FT recognizes GloBE income (ignoring PPA) of $100 (while recognizing taxable income over useful life of IP).
- USP takes FMV carrying value of $100 with no GloBE DTA.

CAMT Implications?

03

Legal entity rationalization

Legal entity rationalization, U.S. LBM example

Initial State

147+ legal entities

- Inefficient tax structure
- Complex operations
- Burdensome cost structure

Target State

Operating companies

Employee service companies

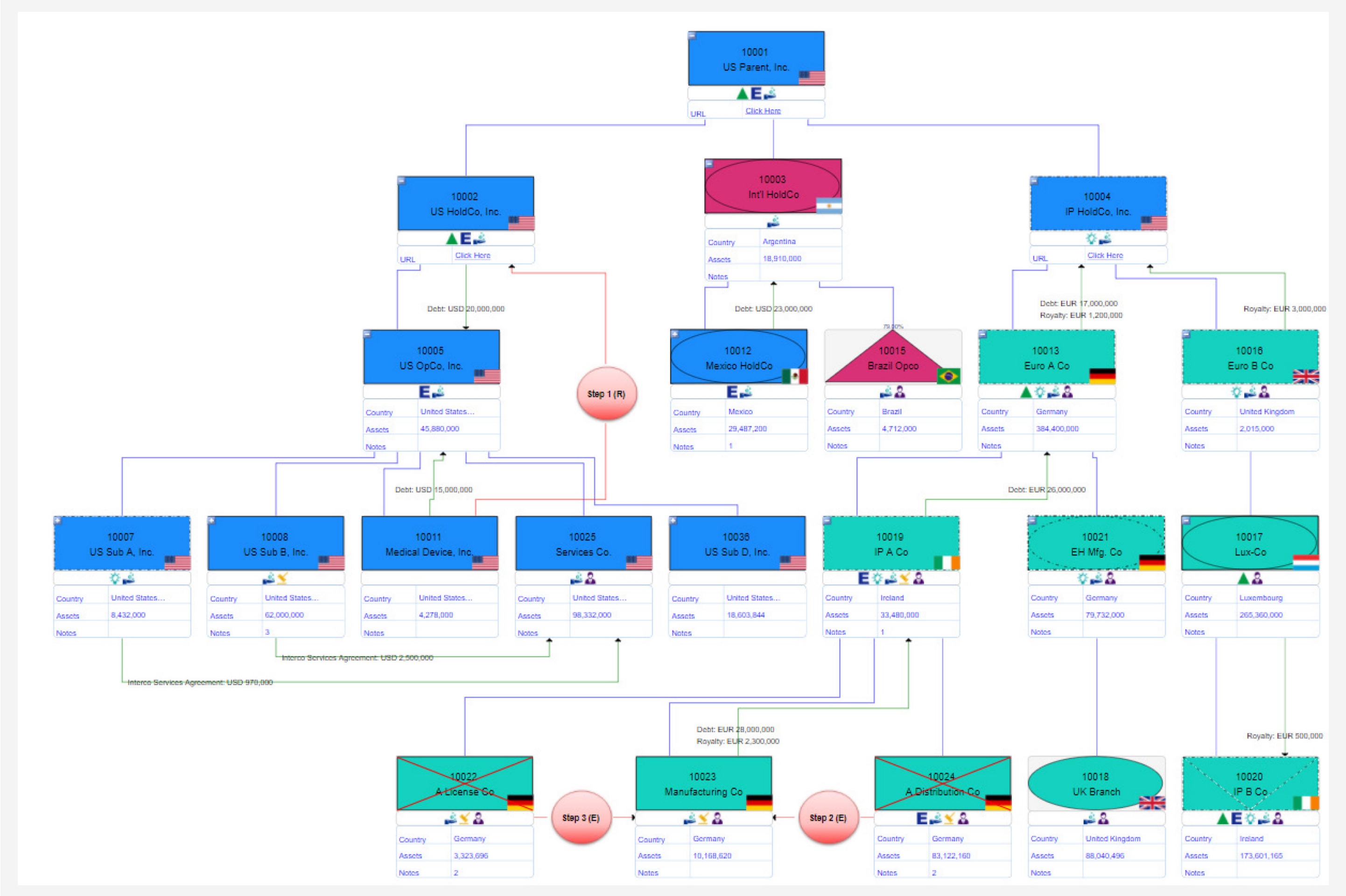
Logistics company

- Streamlined operations and processes
- Efficient tax structure
- Realized operational savings

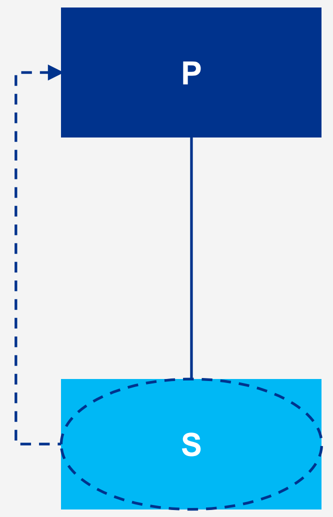
Legal entity rationalization, intercompany debt

Some critical information to gather:

- Location and amount of existing intercompany debt
- Recourse or non-recourse
- Treatment as **debt** or **equity**
- **Value** of relevant entities
  - For a creditor, value may depend on the debtor's ability to support the debt
- Commercial constraints
  - external covenants
  - guarantees
- Historical transactions
  - Deferred intercompany items
  - Historical movements of the debt



Legal entity rationalization, intercompany debt



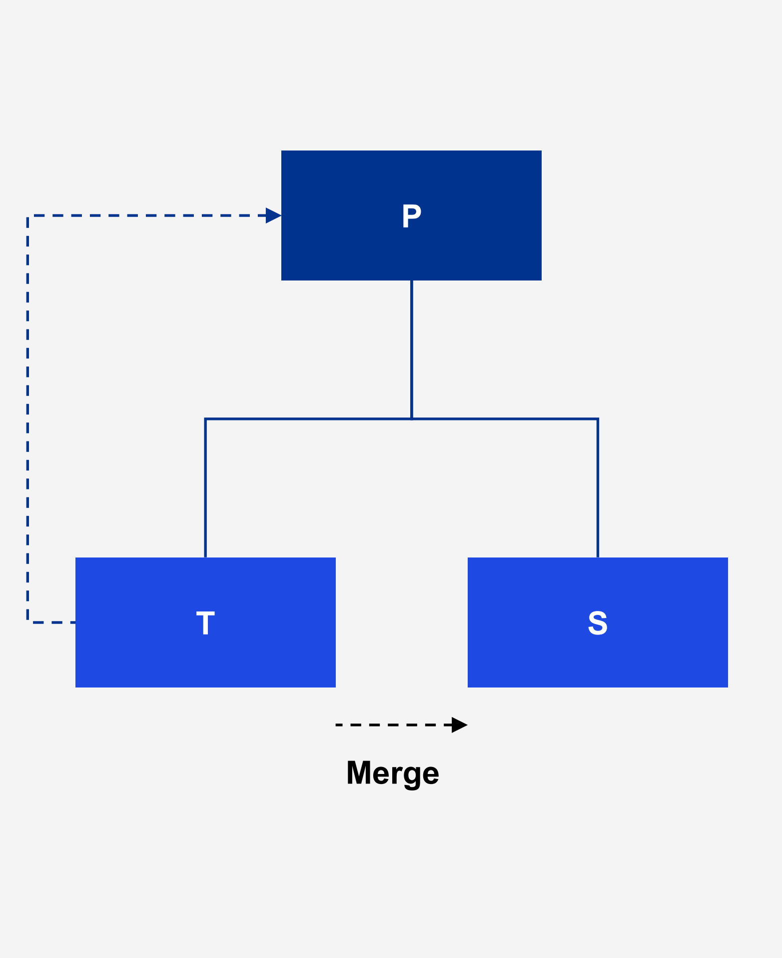
Facts

- S is solvent.
- S has debt outstanding to P.
- S converts under local law from a corporation to a disregarded LLC.

US federal income tax considerations

- S is treated as first transferring assets to P in satisfaction of its debt.
- Because S also makes at least partial payment to P with respect to its stock, the deemed liquidation of S constitutes a complete liquidation under section 332. *See* Treas. Reg. §1.332-2(b); Rev. Rul. 2003-125, Situation 1.
- S does not recognize gain or loss, including on the satisfaction of its debt. *See* section 337(b)(1).
- However, P recognizes any gain in the S debt. *See* Treas. Reg. §1.332-7.

Legal entity rationalization, intercompany debt



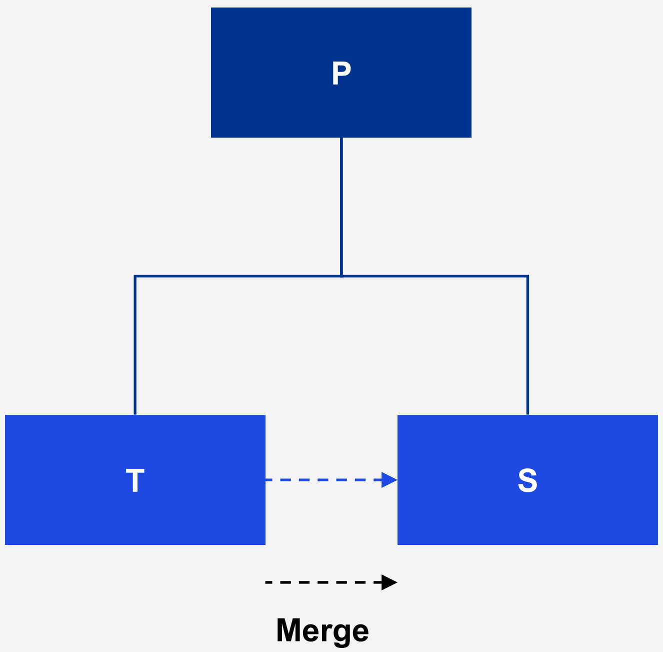
Facts

- T is indebted to P.
- P cancels the T debt.
- T merges with and into S in a section 368(a)(1) reorganization.

US federal income tax considerations

- The cancellation of the debt is respected and treated as a capital contribution by P to T. *See* Rev. Rul. 78-330; *Cf.* Rev. Rul. 68-602.
- Consider cancellation of indebtedness income to T.
- Consider potential impact on the application of section 357(c) to the reorganization.

Legal entity rationalization, intercompany debt



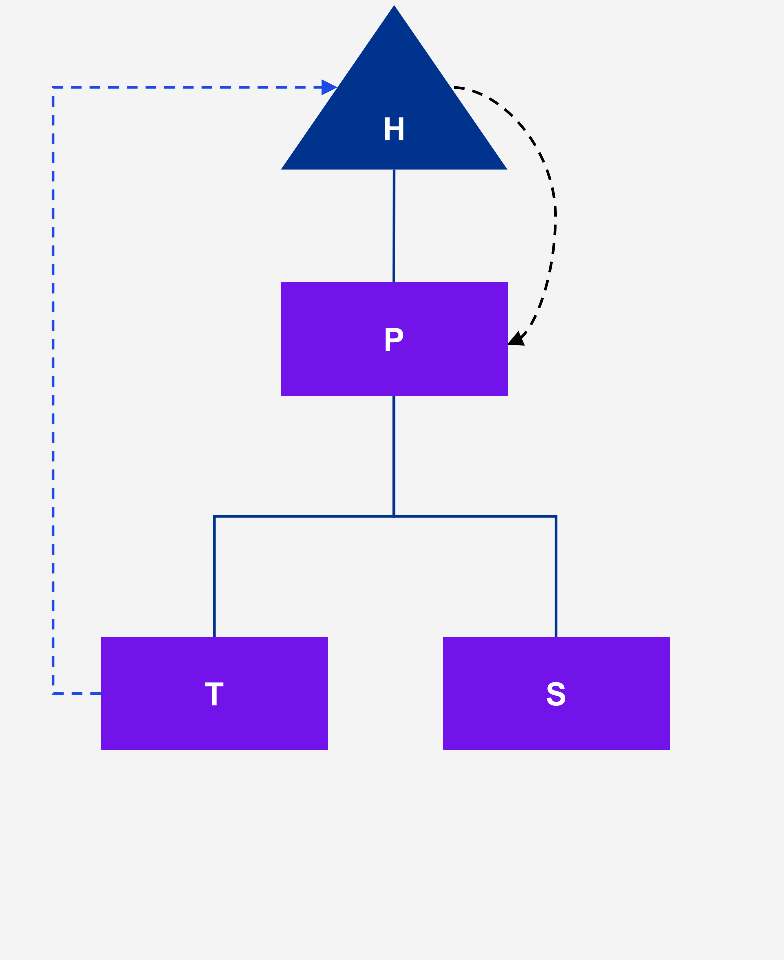
Facts

- T has gross assets in excess of T's debt owing to S.
- T merges with and into S in a section 368(a)(1) reorganization.

US federal income tax considerations

- T is treated as transferring its assets in satisfaction of its debt. See Rev. Rul. 72-464.
- T does not recognize gain or loss on the satisfaction of its debt under sections 361 and 357(a).
- However, S recognizes any gain in the T debt.
- S takes a carryover basis in the assets under section 362(b) (including with respect to the assets used to satisfy the T debt).

Legal entity rationalization, intercompany debt



Facts

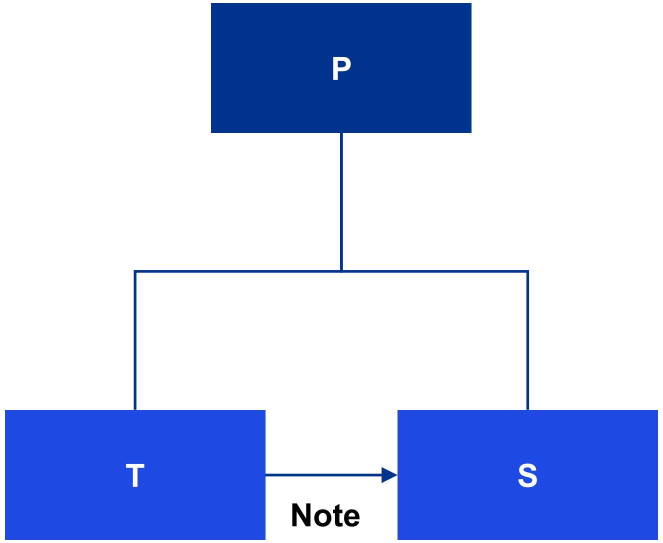
- P, T, and S are members of the P consolidated group.
- T owes a debt to H with an issue price and face amount of $100x.
  - The T debt has declined in value to $90x due to an increase in market interest rates.
- H transfers the T debt to P.

US federal income tax considerations

- The T debt is treated as satisfied and reissued for its FMV immediately after the transfer. Treas. Reg. § 1.1502-13(g)(5).
- Consider CODI to T.
- If H makes an election under section 362(e)(2)(C), consider loss to P.
  - However, if H is foreign, consider application of section 362(e)(1).

Consider converting T to a disregarded LLC to avoid CODI.

Legal entity rationalization, intercompany debt



Facts

- S holds a note from T that has an adjusted issue price and basis in the hands of S of $100, but the note has depreciated in value to $80 due to T's insolvency.
- P desires to clean up the intercompany debt structure of S and T.

US federal income tax considerations

- Can the note be eliminated without the recognition of CODI by T?
- Possible transactions:
  - S distributes the note to P and P contributes the note to T.
  - P contributes cash to T to allow T to satisfy the note in full.
  - T repurchases the note for $80.
- Consider, e.g., sections 108(e)(6) and (8); section 267(f); Rev. Rul. 69-630; Rev. Rul. 78-83; GCM 38800; *Wilkof v. Comm'r,* 37 T.C.M. (CCH) 1851-31 (1978), *aff'd*, 636 F.2d 1139 (6th Cir. 1981); *J.F. Stevenhagen Co. v. Comm'r*, 34 T.C.M. (CCH) 852 (1975), *aff'd*, 551 F.2d 106 (6th Cir. 1977); *Sammons v. Comm'r*, 472 F.2d 449 (5th Cir. 1972).

04

Implicit support & impact on intercompany loans

Intercompany transactions

Section 482:

- In the case of two or more “organizations, trades, or businesses” that are owned or controlled directly or indirectly by the same interests, Section 482 permits the Secretary to “distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or business, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.”

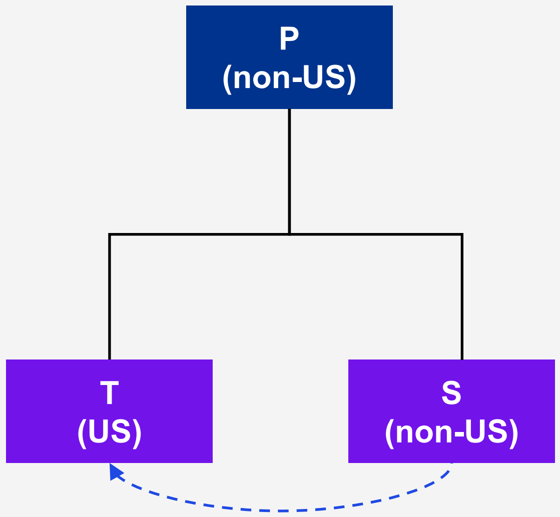
OECD guidance on implicit support

- In 1995, the OECD released transfer pricing guidelines that, among other things, provided an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits because of passive association with a group.
- The guidelines noted a higher credit rating as an example of an incidental benefit.
- Fast forwarding, in 2020, the OECD released the Transfer Pricing Guidance on Financial Transactions, Inclusive Framework on BEPS: Actions 4, 8-10 ("OECD Guidance").
- The OECD Guidance provides that group membership is relevant in evaluating intercompany loans. See OECD Guidance, Section 10.77.
- The stronger the link between the debtor and its group, the more likely implicit support will be assumed. If there is no evidence that support would be provided by the group, it may be appropriate to evaluate on a stand alone basis. See OECD Guidance, Section 10.78.
- Consequences to other parts of the group of supporting or not supporting the borrower are considered. See OECD Guidance, Section 10.79.
- Further OECD transfer pricing guidance released in 2022, mirroring the 2020 guidance as regards implicit support.

AM 2023-008

- Issue was whether the IRS should consider group membership when determining the arm’s length rate of interest chargeable on an intercompany loan under Section 482.
- The advice memorandum from the IRS Chief Counsel’s office concluded that under the Section 482 regulations, the arm’s length rate of interest on an intragroup loan is generally the rate that the borrower could obtain from an unrelated party. Since commercial lenders take into account the fact that the borrower is part of a larger group (even absent an explicit guarantee), the benchmark for an intercompany loan should also take this into account.
- A controlled lender is thus expected to enforce repayment of an intercompany debt according to its terms as in an arm’s length financing (e.g., its status as a shareholder is disregarded for this purpose).
- A fee from the borrower to the lender to reflect the value of this implicit support is not imposed, so the benefit remains with the borrower.

AM 2023-008, Example 1



Entity	Credit Rating	Market Interest Rate
Parent	A	7%
Group	BBB	8%
Subsidiary (standalone)	B	10%

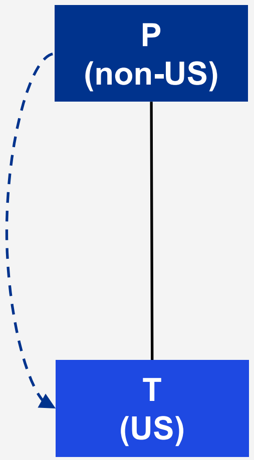
Facts

- Non-US Subsidiary makes a loan to a brother / sister borrower US Subsidiary with a rate of 10% (i.e., based on the credit rating of US Subsidiary as a stand-alone enterprise).
- Parent does not provide an explicit guarantee.

US federal income tax considerations

- Potential deemed distribution from US Subsidiary to Parent and deemed contribution from Parent to Non-US Subsidiary equal to the excess 2% interest that has been charged once implicit support is considered.
- Withholding tax on deemed distribution? Need to calculate E&P to determine amount of dividend? Return of capital and FIRPTA considerations?

AM 2023-008, Example 2



Entity	Credit Rating	Market Interest Rate
Parent	A	7%
Group	BBB	8%
Subsidiary (standalone)	B	10%

Facts

- P lends to S at a 10% interest rate. The loan is not supported by an explicit guarantee or any other legally enforceable financial support from another entity.

US federal income tax considerations

- The IRS has broad latitude to adjust a taxpayer's tax items to comply with an arm's length standard under Section 482.
- The Section 482 regulations apply an arm's length standard by directing that the interest rate on an inter-company loan be generally equivalent to the rate charged between unrelated parties.
- Because an uncontrolled commercial lender would factor in implicit support from affiliates of the lender when setting the rate, this arm's length rate should be used when setting the intragroup lending rate (in this case 8%).
- The IRS can adjust above market intra-group rates to reflect this arm's length standard under Section 482.

AM 2023-008, implications

- Is the application of AM 2023-008 limited to Section 482 adjustments or does it have broader implications?
  - Footnote 13 analogizes the benefit of being a member of a group to an asset of the member during its period of membership, analogous to a non-compensable contribution to capital.
  - Is there an additional asset that should be considered when determining whether a subsidiary is insolvent, apart from what is reflected on its balance sheet?
- Note that AM 2023-008 provides that parent "would be expected to likely provide financial support to [subsidiary] to prevent a potential default on [subsidiary's] obligations, at least if owed to unrelated parties. For example, if such a default were to become imminent, [parent] might contribute capital to [subsidiary] or forgive debt owed to it by [subsidiary]." Oddly, the possibility of making of a new loan to the subsidiary by parent or the acquisition of the subsidiary's obligation from the creditor are not given as examples.
- Cf . Rev. Rul. 2003-125, 2003-2 C.B. 1243.
- Basis implications?
- Cf. AM 2020-005.
- Other implications of this "non-compensable contribution to capital" approach?

04

Q&A

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