Transactions in the age of tax reform

An M&A Outlook Survey Report
New tax law increases both the role and risk of tax in deals

Abundant capital. Low interest rates. Availability of debt. Pro-business legislation. Competitive pressure. Industry consolidation. There are countless factors that move the deal markets. Tax issues is just one of many—but their impact can’t be understated.

As trusted advisers on numerous mergers, acquisitions, dispositions, and restructurings, we understand the major role of tax in whether deals succeed or fail. No matter what’s driving it, every transaction has tax implications—some positive, some negative. We’ve seen time and time again in our client work, it takes careful planning throughout the lifecycle of the deal to mitigate tax risks and maximize tax efficiencies.

But getting a full picture of the long-term tax impact of deal-related decisions is no easy matter—especially since the 2017 U.S. tax reform. The largest overhaul of the tax code in three decades, the legislation made sweeping changes that impact the taxation of buyers, sellers, lenders, and investors.

In today’s strong deal environment, companies have a tremendous opportunity to create value through M&A. But are they prepared to take advantage? Are they paying enough attention to tax issues as they value, finance, structure, and execute deals? Do they incorporate new provisions under tax reform in their modeling and structuring decisions? Do they bring the right tax knowledge, skills, and perspectives to the table to add value at each stage of the transaction process?

This survey report—which draws on the experiences and insights of more than 100 tax and finance leaders—sets out to answer these questions and more. Read this report to gain an in-depth understanding of the role of today’s tax function in transactions and for practical advice on how corporate dealmakers can improve the odds of M&A success by factoring in tax.
Key findings

Tax reform is driving the deal market
…but adding immense complexity
…which companies are ill equipped to handle

Today, deals seem to be occurring everywhere at once. With high deal volume and value, the United States is coming off four consecutive near-record years for M&A activity, and 2019 appears on pace to continue the trend, with more than 10,000 deals representing almost $1.4 trillion in value on the books by October 2019.¹

Our survey reveals that tax reform is having a direct impact on deal flow. Nearly all respondents (95 percent) believe tax issues play the same or bigger role in deals compared to three years ago, and of those, the vast majority also think that tax reform is a cause of this increased importance. In addition, 74 percent of respondents say the 2017 tax legislation has helped, rather than inhibited, the deal market.

Importance of tax issues of deals

<table>
<thead>
<tr>
<th>Decreased in importance compared to three years ago</th>
<th>Increased in importance compared to three years ago</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>39%</td>
</tr>
<tr>
<td>Stayed the same as three years ago</td>
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Key takeaways
— Tax reform is helping drive the deal market.
— The new tax law is increasing the importance of tax issues in deals.

¹ M&A Statistics by Countries (IMAA Institute, October 2019)
Tax reform is driving the deal market
...but adding immense complexity
...which companies are ill equipped to handle.

As tax reform spurs a hot deal market, it is simultaneously making nearly every aspect of the transaction process more complicated. Of respondents who say tax issues are more important in M&A now than three years ago, nearly four out of five (78 percent) say greater complexity of tax legislation is a contributing factor—far more than other issues, such as heightened focus on reducing deal costs through tax efficiency or greater deal scrutiny by tax authorities.

Contributors to the increased importance of tax in M&A

Among those who say tax issue of deals are increased in importance compared to three years ago

- Greater complexity of tax legislation affecting deals: 78%
- Increased focus on tax efficiency to reduce the cost of deals: 41%
- Increased examination of deals by tax authorities: 14%

Multiple responses allowed

The complexity of tax reform is creating a great deal of uncertainty about the consequences of decisions made throughout the deal lifecycle. With thousands of pages of guidance to unpack and implementation of the rules still ongoing, making sense of the new provisions—especially at deal speed—can seem an insurmountable challenge.

A never-before-seen level of transaction risk ensues. Of the 63 percent of respondents who say the potential tax considerations of deals are growing in complexity, a striking 46 percent see this as a negative outcome. These respondents recognize that complexity breeds more traps for the unwary. If the traps aren’t uncovered and removed, dealmakers may be exposed to a range of financial, regulatory, and compliance issues and the chances of M&A failure may skyrocket.
Tax reform is driving the deal market  
…but adding immense complexity  

...which companies are ill equipped to handle

Those that master the increased complexities of transactions since the new tax law took effect are poised to gain a significant competitive edge in an active deal market. But our survey reveals that few deal teams likely have the capabilities or processes necessary to achieve true mastery.

For one, a significant number of companies haven’t made much progress incorporating 2017 tax provisions into transaction planning and execution. Although a significant majority of respondents say their companies consider income tax efficiencies (79 percent) and transfer taxes (86 percent) in deal structuring when relevant, nearly half (46 percent) do not yet incorporate new provisions into their models, including rules related to global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII).

**Key takeaways**

— Under tax reform, deals are more complex and, therefore, more risky.
— To manage added complexity, deal success demands a greater focus on tax issues throughout the deal cycle.

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**Change in the complexity of tax considerations of deals**

<table>
<thead>
<tr>
<th>Complexity Type</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Growing in complexity negatively</td>
<td>46%</td>
</tr>
<tr>
<td>Lessening in complexity</td>
<td>2%</td>
</tr>
<tr>
<td>Growing in complexity positively</td>
<td>17%</td>
</tr>
<tr>
<td>Staying roughly the same in terms of complexity</td>
<td>35%</td>
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</tbody>
</table>

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**Consideration of income taxes in deal structuring**

- **It’s not considered as it is deemed immaterial to the desired income tax objectives.**
  - 14%

- **It’s rarely considered because it’s overlooked during the acquisition structuring process.**
  - 7%

- **It’s sometimes considered depending on the magnitude of any attainable income tax savings.**
  - 55%

- **It’s an essential piece to structuring the transaction for tax purposes.**
  - 8%

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May not equal 100% due to rounding.
In addition, the organizational structures of many companies don’t support the inclusion of the tax function in important deal decisions. Sixty-one percent of respondents say their tax department doesn’t have a formal protocol to align with other functions when a transaction is being considered. This is a critical but all-too-common misstep in a time when tax issues matter to more than ever to deal success. It’s easy to see how such an ad hoc approach could cause dealmakers to overlook potential tax problems and miss potential tax-saving opportunities.

We only seek to identify transfer taxes if the transaction structure involves the transfer of real or tangible business assets, and we do not consider transfer taxes in equity deals.

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Consideration of transfer taxes in deal structuring
Transfer taxes are never considered regardless of the transaction structure.

- 14% Yes
- 39% No

We only seek to identify transfer taxes if the transaction structure involves the transfer of real or tangible business assets, and we do not consider transfer taxes in equity deals.

Postdeal tax department challenges
- Lack of knowledge among the deal team of how the tax team can be utilized to make the posttransaction integration go smoothly 41%
- Tax professionals not being brought in early enough in the process 34%
- Lack of knowledge among the deal team of what insight and recommendations the tax team can bring to the table 33%
- Relationship between tax and deal teams 26%
- Other 21%

Multiple responses allowed

Key takeaways
- Tax functions aren’t involved early or deeply enough in deal decisions to effectively add value.
- Inadequate connections between tax and deal teams prevent organizations from appropriately assessing critical tax issues.
How the tax function can add value to M&A

M&A, under the new tax law, is also incredibly complex. With so much uncertainty, it’s become increasingly challenging for deal teams to evaluate the tax implications of potential transactions and effectively structure deals to maximize tax efficiencies and reduce risks.

Companies can increase their odds of success by having tax teams play a bigger role in all aspects of dealmaking. The following actions can help corporate dealmakers transform their organizations to increase the focus on tax issues, make better deal decisions, and get the value they want out of their transaction.

Formalize the role of tax: From diligence to planning to structuring, every aspect of a transaction could have significant tax implications. It is critical tax specialists are included at the outset, not after key deal terms are already decided. However, oftentimes, tax teams and deal teams don’t share sufficient knowledge and aren’t well aligned. To ensure tax’s voice is heard, define the tax function’s role and responsibilities in the transaction process up front and communicate it to the broader deal team. Then, establish official processes and protocols to engage the tax team in strategic decisions at every stage.

View risk through a wide lens: In today’s highly competitive M&A market, it can be easy to get hung up on concerns about overpriced deals. But valuation risk is just one of many challenges that could potentially limit value capture. Don’t overlook possible regulatory, tax, and compliance risk of transactions. When regulatory, tax, and compliance risks go unmanaged, it can lead to very different deal outcomes down the line. Proper risk management should be an ongoing process that incorporates relevant global tax provisions as well as potential changes to existing tax law.

Plan ahead for tax liabilities: Tax expenses that result from a transaction can considerably alter its economics. Early in the deal cycle—before anything is set in stone—it’s critical to identify the cash and financial impact of tax liabilities under the proposed deal structure. Given current complexity and uncertainty of certain key M&A tax provisions, it is prudent to have flexible financial transaction models that project the financial impact of alternative tax positions under numerous scenarios.
Achieving the full expected value of your company’s transactions is crucial to future success. And you’re probably spending countless hours and dollars chasing that value. But you may be overlooking a key piece of the puzzle: the tax implications of the deal.

Understanding and planning for the tax implications of your transaction can mean the difference between exposing your business to dire risk and taking advantage of valuable transaction opportunities.

Our M&A Tax professionals can help. With deeply knowledgeable tax specialists, including former IRS and Treasury professionals, all dedicated to covering corporate transactions, we are experienced in helping companies drive deal success and enhance deal value.

We deliver a wide range of tax advisory services for companies considering a merger, acquisition, liquidation, disposition, spin-off, joint venture, reorganization, or restructuring:

— **Tax structuring** to help companies shape the tax impact of transactions
— **Tax due diligence** to help companies uncover potential risks and benefits of a transaction
— **Acquisition integration** to help companies combine in the most tax-efficient way
— **Partnerships and joint ventures** to help companies gain tax benefits by using these structures
— **Tax restructuring** to help companies with debt negotiation, layoffs, shutdowns, bankruptcy, liquidations, etc.
— **Tax attribute studies** to help companies determine the proper use of tax attributes
— **Tax accounting and reporting** to help companies account for deal-related income tax issues

**Case study: Mitigating transaction risk in the software industry**

**Challenge:** The software industry has always competed in a challenging tax environment and tax reform only made it more so. So when a computer software company with operations in multiple jurisdictions, an intricate global supply chain, and a complex legal entity structure was considering acquiring a marketing software company in 2018, it turned to KPMG for help.

**Approach:** The KPMG team conducted a thorough evaluation of the proposed acquisition from a tax perspective, taking into account a wide range of global tax regulations impacting the business. Leveraging insights from the tax due diligence, the team worked closely with the company to develop an acquisition structure that quickly aligned the operations of the target company with the acquirer in a tax-efficient manner. The team also helped analyze the tax treatment of certain transaction costs and identify a number of postacquisition integration opportunities.

**Results:** KPMG’s tax due diligence and consulting work helped the software company identify and mitigate critical transaction risks while providing insights that will help the combined company create tax-efficient operations.
Case study: Structuring a tax-efficient disposition through the bankruptcy process

**Challenge:** A retail company needed to deleverage through the bankruptcy process. The cancellation of indebtedness income arising from debt modification would have resulted in the retailer reducing the tax basis in critical operating assets, thus setting up the company for an inefficient tax structure when it emerged from bankruptcy.

**Approach:** The KPMG team helped analyze the tax basis balance sheet, net operating loss (NOL), and other tax attributes of the company as well as the impact of cancellation of indebtedness under numerous scenarios. The KPMG team developed a tax-efficient structuring alternative that involved a sale of the retailer assets to its creditors through the bankruptcy process.

**Results:** The structuring alternative mitigated the potential reduction to the retailer’s tax basis of critical operating assets while maximizing recovery to the creditors and overall transaction value.

Learn more about how KPMG helps corporate dealmakers unlock value and mitigate risks through tax efficiencies: [https://tax.kpmg.us/services/mergers-acquisitions-tax.html](https://tax.kpmg.us/services/mergers-acquisitions-tax.html).

KPMG recently conducted an online survey of more than 100 senior-level tax and finance professionals representing both large and small companies in 18 different industries about their experiences with and perspectives on dealmaking since the passage of the Tax Cuts and Jobs Act of 2017.

### Title

<table>
<thead>
<tr>
<th>Role</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Head of Tax/VP of Tax</td>
<td>37%</td>
</tr>
<tr>
<td>Tax Director</td>
<td>25%</td>
</tr>
<tr>
<td>Tax Manager</td>
<td>15%</td>
</tr>
<tr>
<td>CFO</td>
<td>12%</td>
</tr>
<tr>
<td>Other</td>
<td>12%</td>
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*May not equal 100% due to rounding*

### Company size

<table>
<thead>
<tr>
<th>Company size</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Less than $500 million</td>
<td>35%</td>
</tr>
<tr>
<td>$500 million to less than $1 billion</td>
<td>13%</td>
</tr>
<tr>
<td>$1 billion to less than $10 billion</td>
<td>31%</td>
</tr>
<tr>
<td>$10 billion or more</td>
<td>22%</td>
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Learn more about how KPMG supports companies in understanding the tax implications of a deal, structuring deals in a tax-efficient way, and creating tax efficiencies through the lifecycle of the deal.

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Howard Steinberg is national leader for KPMG’s Mergers & Acquisitions Tax and Tax Restructuring, and Corporate Recovery practices. A recognized thought leader on tax and M&A topics, he has provided tax structuring and due diligence services for numerous acquisitions in various industries and has also advised numerous debtor corporations on the tax aspects of debt restructuring.

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