

High Tech M&A Developments Selected Topics

2015 High-Tech Tax Institute
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AGENDA

- **High-Tech Spin-offs**
- **Inversion Update**
- **Developments for Integration Transactions**
- **Revisiting the Tax-Free Reorg**

High-Tech Spin-offs

AGENDA

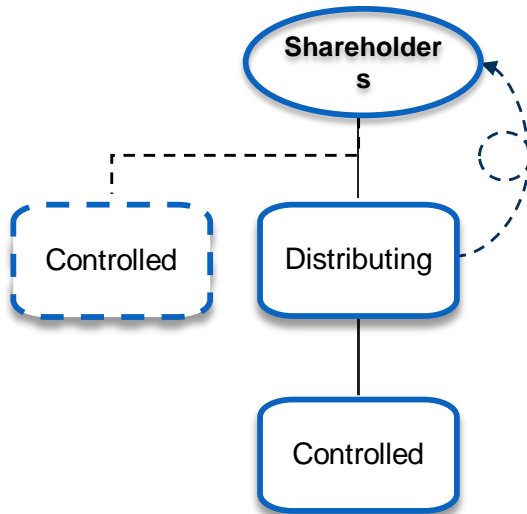
Section 355 Spin-Off Transactions

- **Overview**
- **Comparison to Section 301 Distributions**
- **Monetization Strategies**
- **New 355 ATB Guidance – Rev. Proc. 2015-43, Notice 2015-59**
- **Other Considerations**

SPIN-OFF TRANSACTIONS – OVERVIEW

Section 355 Distributions

- Allows “Distributing” to make a tax free distribution of “Controlled” shares
 - Statutory Requirements
 - Control
 - Active trade or business
 - Distribution of all “Controlled” stock, or an amount constituting “Control”
 - Not a device for distribution of E&P
 - Judicial Requirements
 - Business purpose
 - Continuity of business enterprise
 - Continuity of interest
- May be a pro-rata “Spin-Off”, non-pro-rata “Split-Off” or “Split-Up”



SPIN-OFF TRANSACTIONS - COMPARISON TO SECTION 301 DISTRIBUTIONS

	Section 301 Distribution	Section 355 Spin-Off
Income/Gain	<ul style="list-style-type: none"> • Corporate level deemed sale treatment under Section 311(b) • Apply Section 301(c)(1) – (c)(3) to determine shareholder tax treatment (dividend to extent of Distributing’s E&P, reduction of Distributing’s stock basis, excess capital gain) • For internal distributions within consolidated group-deferral triggered on external distribution 	<ul style="list-style-type: none"> • Non-recognition treatment
Impact to Attributes	<ul style="list-style-type: none"> • Gain on deemed sale of target shares <ul style="list-style-type: none"> ▪ Subpart-F ▪ Section 964(e) or Section 1248 • Shareholders’ tax basis in Controlled shares equal to fair market value of the shares 	<ul style="list-style-type: none"> • Treas. Reg. Section 1.312-10 impact • Treas. Reg. Section 1.367(b)-5 analysis • Shareholders’ tax basis in Controlled shares equal to a proportionate allocation of their tax basis in Distributing’s shares
Elective?	<ul style="list-style-type: none"> • No, distributions that do not meet qualifications of Section 355 transactions are treated as Section 301 distributions 	<ul style="list-style-type: none"> • No, Section 301 distributions that meet qualifications of Section 355 transactions are treated as Section 355 transactions

SPIN-OFF TRANSACTIONS - MONETIZATION STRATEGIES

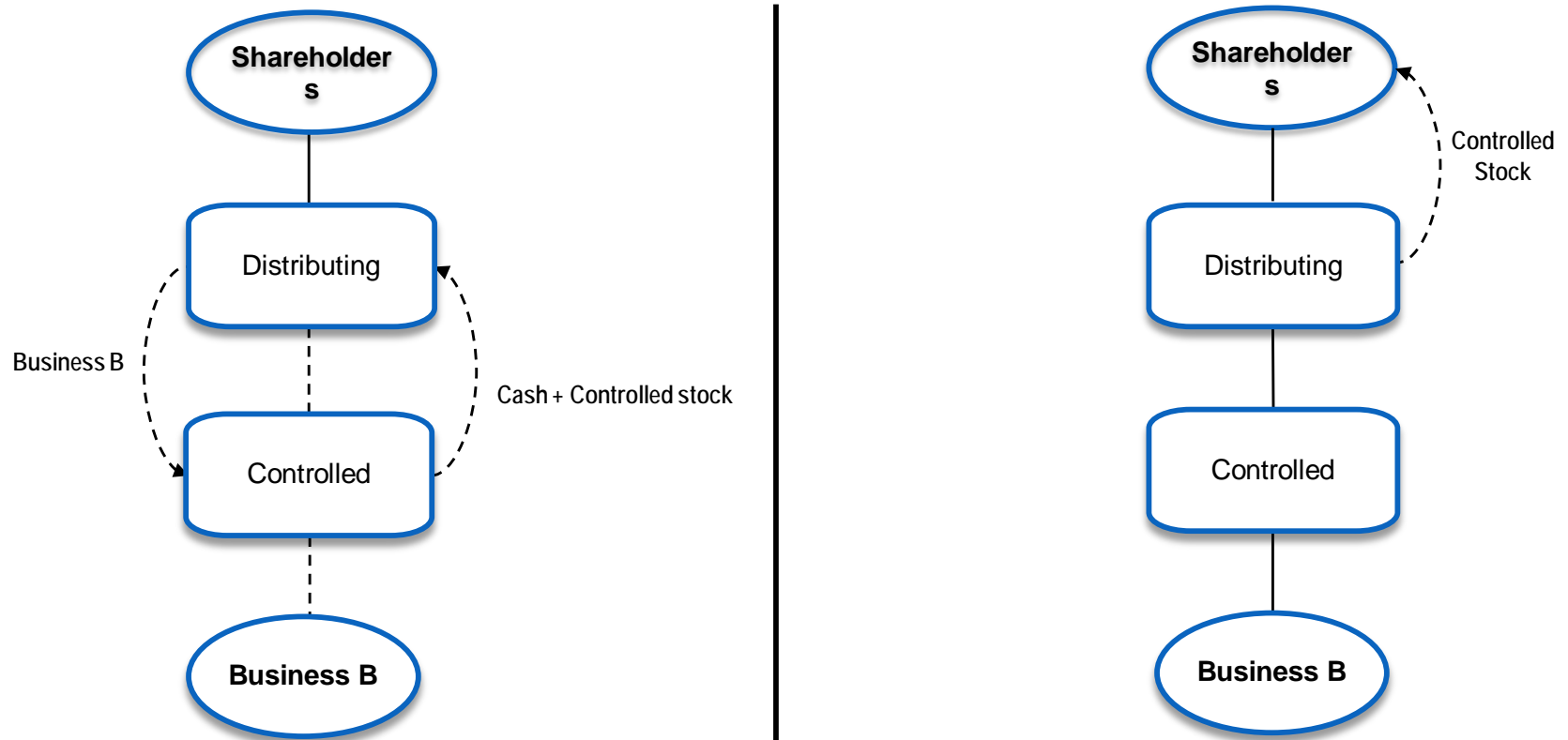
- **Generally, there are five ways Distributing can extract value in connection with a spin-off:**
 - **Liability assumption:** Controlled assumes a liability of Distributing as part of a Section 368(a)(1)(D) reorganization.
 - **Cash distribution:** Controlled distributes cash to Distributing as part of a Section 368(a)(1)(D) reorganization.
 - **Securities-for-debt exchange:** Distributing transfers Business to Controlled in exchange for Controlled stock and Controlled securities (i.e., long-term debt). Distributing repays “old and cold” Distributing debt with the Controlled securities and distributes **Controlled** stock to its shareholders.
 - **Stock-for-debt exchange:** Distributing transfers Business to Controlled in exchange for Controlled stock. Distributing uses up to 20% percent of the Controlled stock to repay “old and cold” debt and distributes the balance of the Controlled stock to its shareholders.
 - **Reverse spin-off:** Distributing borrows money, contributes the proceeds, along with Business to Controlled and then distributes the Controlled stock to its shareholders.

SPIN-OFF TRANSACTIONS - MONETIZATION STRATEGIES (continued)

- **Liability assumption and cash distribution are subject to**
 - A basis limitation – that is, for the assumption or distribution to be tax-free to Distributing, the amount of cash distributed/liabilities assumed cannot exceed Distributing's basis in its Controlled stock (if Controlled is a preexisting subsidiary) or Distributing's basis in the contributed assets (if Controlled is newly formed in connection with the transaction).
 - Cash obtained in the first two methods also have limitations for usage (pay off debt, distribution to shareholders).

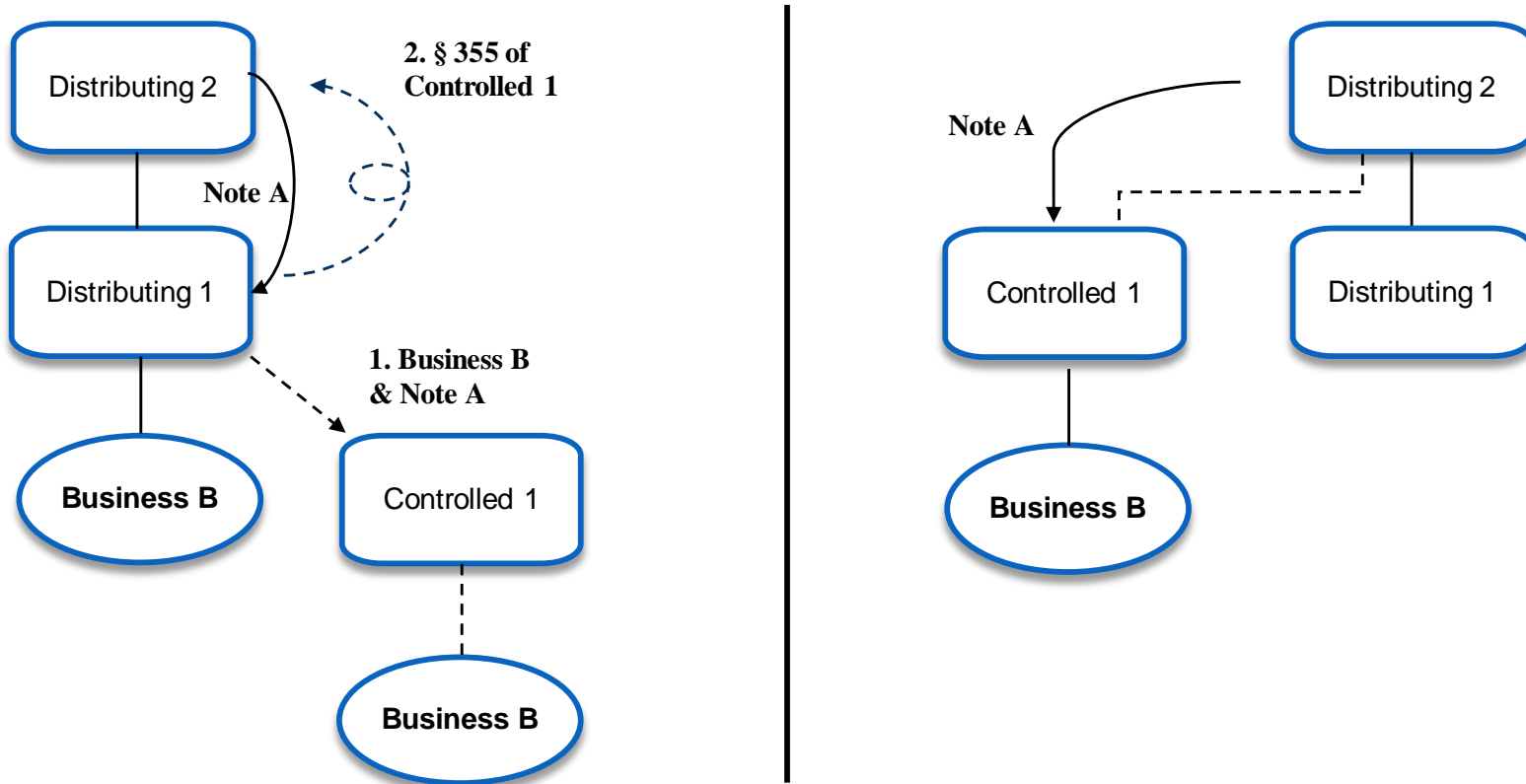
- **The last three methods (securities-for-debt exchange, stock-for-debt exchange, reverse spin-off) generally are not subject to such a basis limitation**

SPIN-OFF TRANSACTIONS – CASH DISTRIBUTION



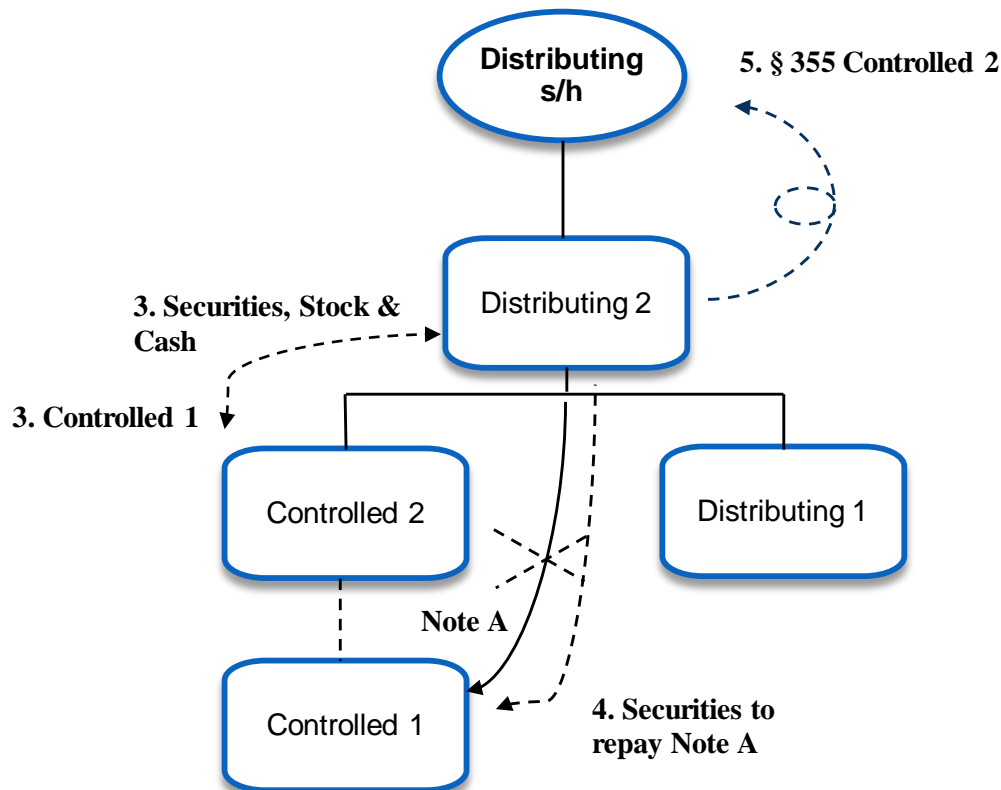
- Note that cash distributed by Controlled in excess of tax basis may have gain implications
- **Cash needs to be distributed within 18 months- can be used to repay debt, make distributions to shareholders or for stock buybacks**
- Debt repaid can be incurred post-distribution and may include ordinary course liabilities (e.g., compensation)

SPIN-OFF TRANSACTIONS – SECURITIES FOR INTERCO DEBT



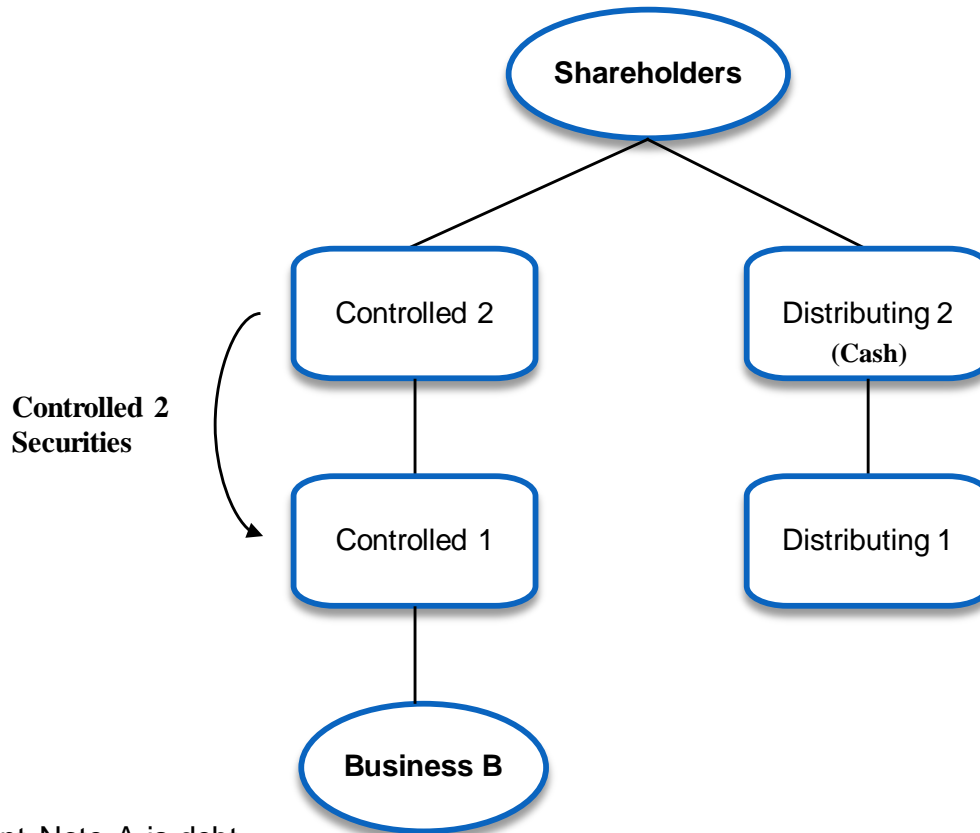
1. Distributing 1 transfers Business B & Note A to Controlled 1
2. Distributing 1 distributes Controlled 1 to Distributing 2

SPIN-OFF TRANSACTIONS – SECURITIES FOR INTERCO DEBT



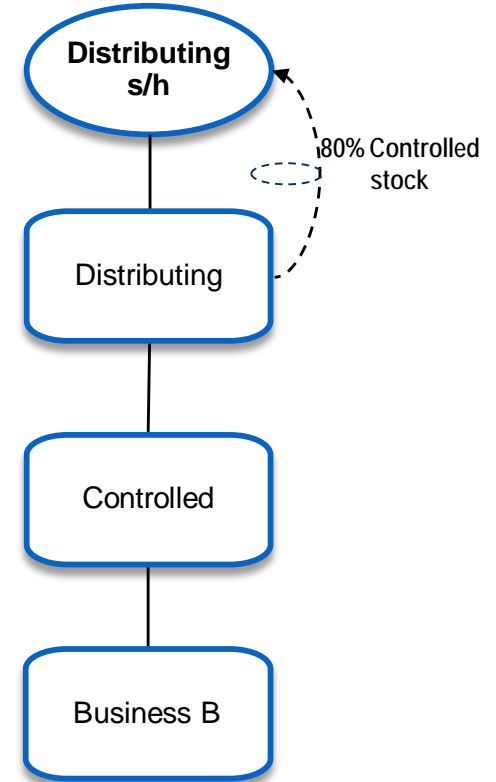
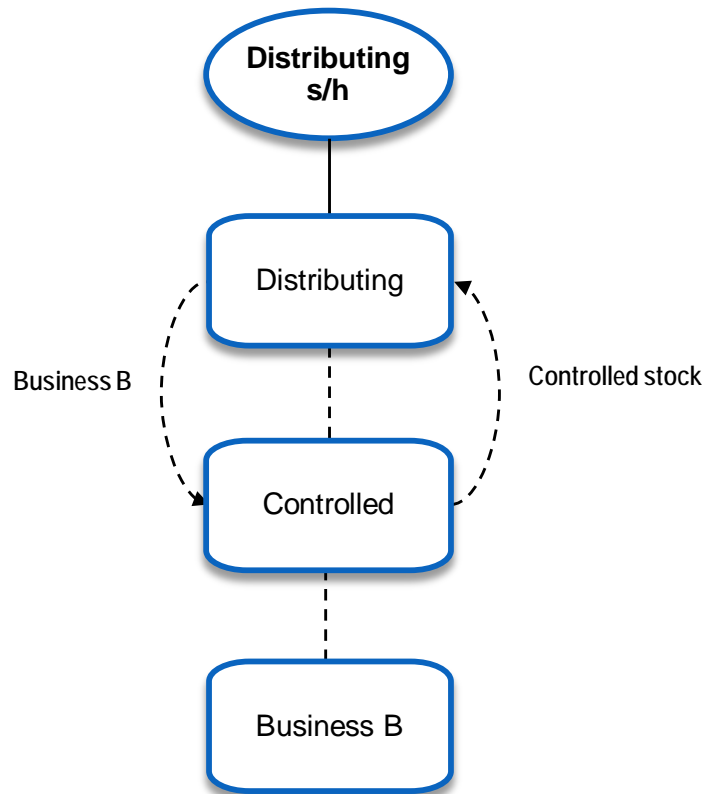
3. Distributing 2 transfers Controlled 1 to Controlled 2 for Controlled 2 securities, cash, & Controlled 2 stock
4. Distributing 2 repays Note A with Controlled 2 Securities
5. Distributing 2 distributes Controlled 2 to its shareholders

SPIN-OFF TRANSACTIONS – SECURITIES FOR INTERCO DEBT

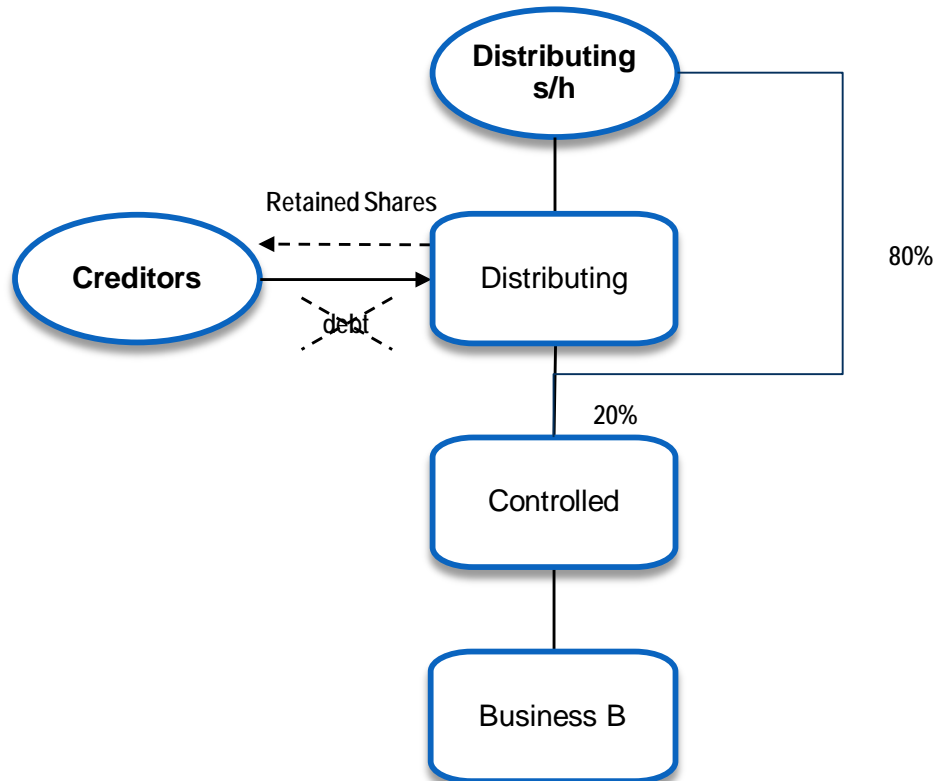


- Represent Note A is debt
- Debt not issued “in anticipation of” distribution
- Consider if refinanced debt is “old and cold”
- Consider consolidated return implications. See Treas. Reg. Section 1.1502-13(g)(3)(i)(b)(7)

SPIN-OFF TRANSACTIONS – RETAINED SHARES



SPIN-OFF TRANSACTIONS – RETAINED SHARES



- Note that the retained share transfer is often intermediated by an investment bank. Within at least five days before entering into the Retained Shares exchange agreement Bank acquires debt of Distributing. Bank may enter into hedging arrangements (for interest and/or credit risk) with respect to Debt. Pursuant to an exchange agreement Bank will exchange an amount debt for the Retained Shares at least 14 days after the acquisition of debt by Bank. (Retained shares should be transferred to Bank within 18 months of the distribution).
- Within [18 months] Retained shares may also distributed to Distributing shareholders as a distribution or in exchange for shares of Distributing under Section 355. If not used to repay debt or distributed to shareholders, within five years shares will be sold.
- Consider business purpose, continuing relationships, overlapping board. Representation that there is no tax avoidance motive.

Overview of Rev. Proc. 2015-43

- Rev. Proc. 2015-43 (released September 14, 2015)
- Adds 3 new, distinct no-rule policies:
 - RIC/REITS: IRS ordinarily will not rule distributions involving certain RIC or REIT elections for either D or C
 - Relative value: The IRS ordinarily will not rule where, immediately after the distribution, the FMV of the gross ATB Assets of D or C is less than 5 percent of the total FMV of the gross assets of such corporation.
 - Investment assets: The IRS will not rule where, immediately after the distribution, all of the following conditions exist:
 - The FMV of the investment assets of D or C is two-thirds or more of the total FMV of its gross assets;
 - The FMV of the gross ATB Assets of D or C is less than 10 percent of the FMV of its investment assets; and
 - The ratio of the FMV of the investment assets to the FMV of the assets other than investment assets of D or C is three times or more of such ratio for the other corporation.

SPIN-OFF TRANSACTIONS– Rev. Proc. 2015-43

- The no-rules prevent the IRS from ruling on “any issue relating to the qualification under Section 355 and related provisions”.
- Section 4 of Rev. Proc. 2015-3 is a “ordinarily will not rule” list, which permits taxpayers to show the IRS “unique and compelling” circumstances to overcome a no-rule.
- The Notice identifies “unique and compelling” circumstances as
 - (i) the presence of non-ATB Assets that would be ATB Assets but for the five-year requirement of Section 355(b)(2)(B), and
 - (ii) a relationship between the business purpose for the distribution and the ATB Assets of D or C.
- Section 5 of Rev. Proc. 2015-3 is a “will not rule” list, and taxpayers’ circumstances will not be considered.

SPIN-OFF TRANSACTIONS– NOTICE 2015-59

- Notice 2015-59 identifies four characteristics which, if present, are of concern to the IRS:
 - The distributing corporation or the controlled corporation owns investment assets with a substantial value in relation to (a) the value of all of the assets, and (b) the value of the assets of the ATB;
 - The ratio of investment assets to assets other than investment assets are significantly different between D and C;
 - D or C owns a small amount of ATB Assets in relation to all of its assets;
 - D or C (but not both) elect to become a RIC or a REIT.
- The IRS is concerned that a transaction with one or more of these characteristics may (i) present evidence of device, (ii) lack adequate business purpose, (iii) violate other Section 355 requirements (e.g., an implicit requirement that tax-free spin-offs are reserved for transactions effecting a genuine separation of two businesses), or (iv) circumvent Section 337(d)'s repeal of *General Utilities & Operating Company Co. v. Helvering*, 296 U.S. 200 (1935) (“GU Repeal”).

SPIN-OFF TRANSACTIONS– REV. PROC. 2015-43

(i)

Distributing

FMV Gross Assets: \$90

FMV Shares of public holding : \$65 → $\$65/\$90 > 2/3$

FMV ATB: \$5 → $5 < 10\%$ of \$65

FMV non-ATB: \$20

Ratio of Investment assets over non-investment assets $\$65/\$25 = 2.6$

(ii)

Controlled

FMV Gross Assets: \$90

FMV of Excess Cash: \$80 → $\$80/\$90 > 2/3$

FMV ATB: \$7 → $\$7 < 10\%$ of \$80

FMV non-ATB: \$3

Ratio of Investment assets over non-investment assets $\$80/\$10 = 8$

For each of Distributing and Controlled the FMV of ATB $< 10\%$ of Investment assets, Investment assets are $> 2/3$ of gross assets, and ratio of Investment Assets/Non-Investment Assets of Controlled is 3 times greater than ratio for Distributing. IRS will not rule on such transaction.

SPIN-OFF TRANSACTIONS – OTHER CONSIDERATIONS

Continuing relationships and Tax Sharing Agreement

- Impact to business purpose
- Developing structure of IP rights between Distributing and Controlled
- Go forward treasury strategies
- Business infrastructure and systems

State Issues – What's tax free for federal purposes may not be for state

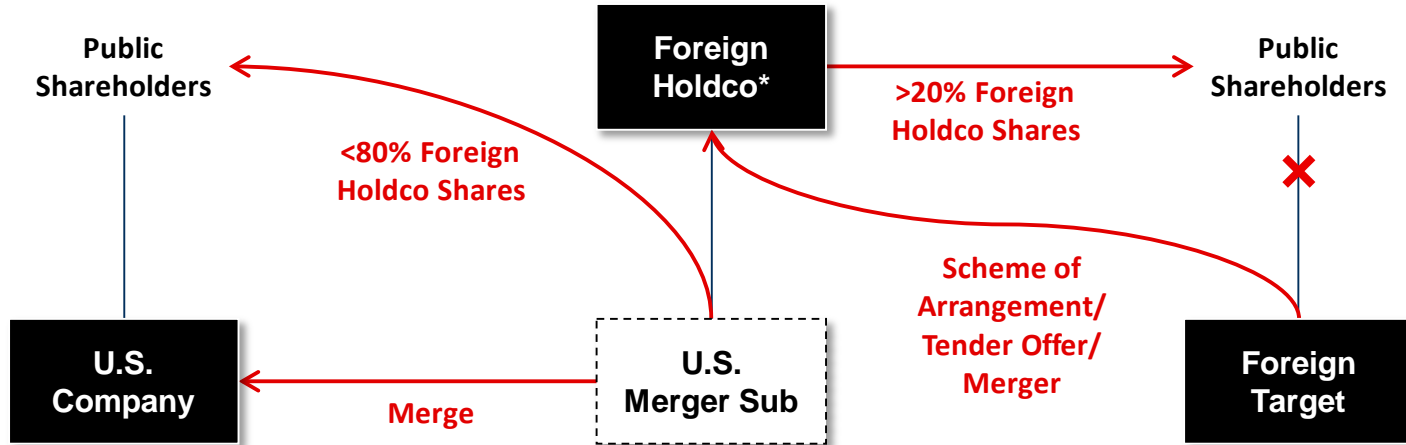
- California recently conformed with current active trade or business test (“SAG” rules)

Other acquisitions, dispositions and restructuring pre or post spin – Section 355(e)

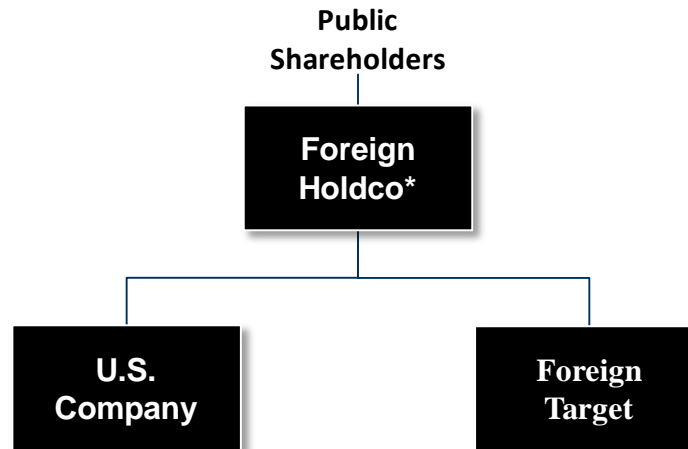
- Implications of pre-spin activity
- Implications of post-spin activity

Inversion Update

“BASIC” TRANSACTION – TWO PUBLIC COMPANIES



POST-ACQUISITION



*A new corporation that may or may not be domiciled in the same jurisdiction as Foreign Target.

BENEFITS OF BEING ACQUIRED BY A FOREIGN CORPORATION

Reduction in Effective Tax Rate	<ul style="list-style-type: none">• Ability to grow business (organically and through acquisitions) in a jurisdiction with lower tax rate• Subsidiaries of foreign parent escape the U.S. CFC regime• Potential to move assets from high tax jurisdictions to lower tax jurisdictions• Use of intercompany debt to reduce taxable income and taxes paid
Access to Worldwide Cash	<ul style="list-style-type: none">• Potential for post-acquisition restructuring and integration transactions to access trapped cash• Eliminate future trapped cash issues through growth of the business outside the U.S.
Impact on M&A	<ul style="list-style-type: none">• Greater access to ex-U.S. cash to fund acquisitions• Become a more attractive acquisition counterparty given foreign domicile

RECENT DEVELOPMENTS

- Notice 2014-52. In Fall 2014, IRS Notice issued describing regulations that will:
 - Limit ability to access “trapped cash” in 60+% inversions
 - Make qualification as a foreign corporation more difficult for certain transaction
 - Limit certain post-inversion restructuring options

- Model Treaty Update.

- 163(j) modifications?
 - Notice 2014-52 reserves on modifications of the earnings stripping rules
 - Awaiting possibility of future guidance
 - Limited to inverted companies?
 - All-cash deals?
 - Effective date?
 - Inbound investment?

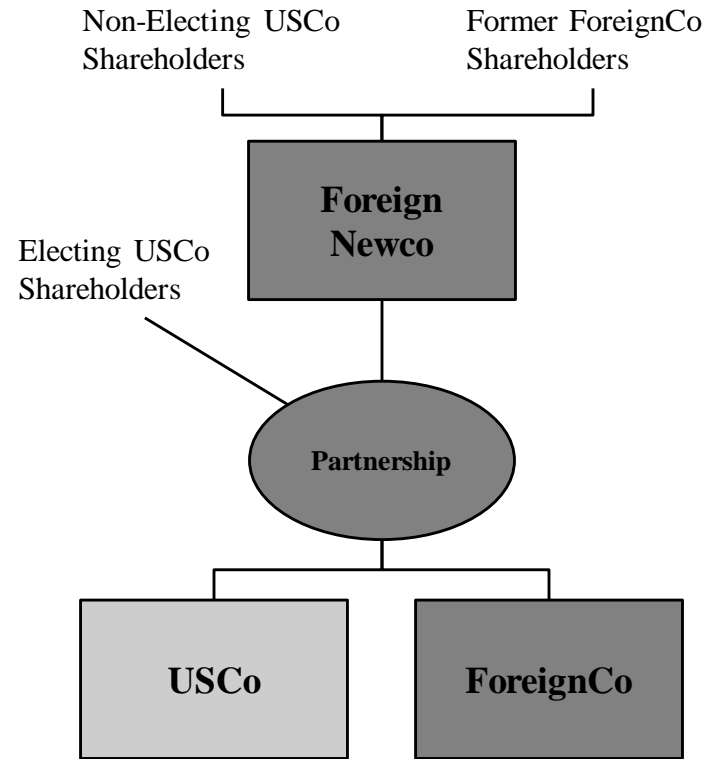
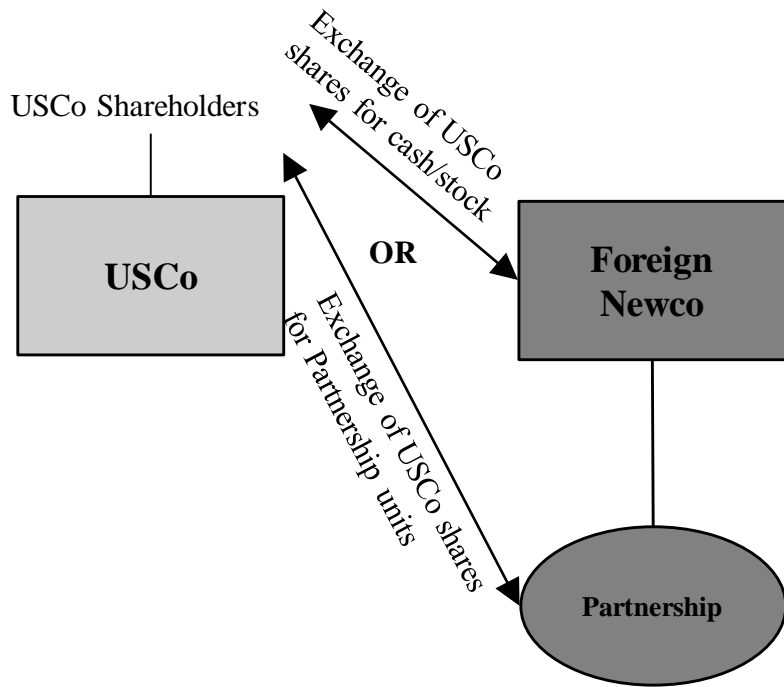
ALTERNATIVE STRUCTURES

- While transactions are tax-free at the corporate level, generally triggers gain for taxable U.S. shareholders of U.S. party under Section 367(a)
 - Potential exception if foreign counterparty is larger and certain other requirements are met
 - Can produce resistance among large individual shareholders who desire to maintain their ownership stakes

- Alternative: Provide shareholders of U.S. party with option to receive exchangeable partnership interests rather than stock for foreign holdco

- Defers gain until a later sale/exchange of such partnership interests

ILLUSTRATIVE STRUCTURE (SIMPLIFIED)



CONSIDERATIONS

- Limitations on availability of partnership units?
 - Tag, Drag and “Clean-up” provisions?

 - Qualification as a partnership?
 - Lock-up period
 - Cash vs. stock exchange
 - Economic rights

 - PTP status?
 - Actual market?
 - Permitted transfers?
 - Redemption/exchange mechanics?
 - Qualifying income?

 - Qualified dividend income?
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Developments for Integration Transactions

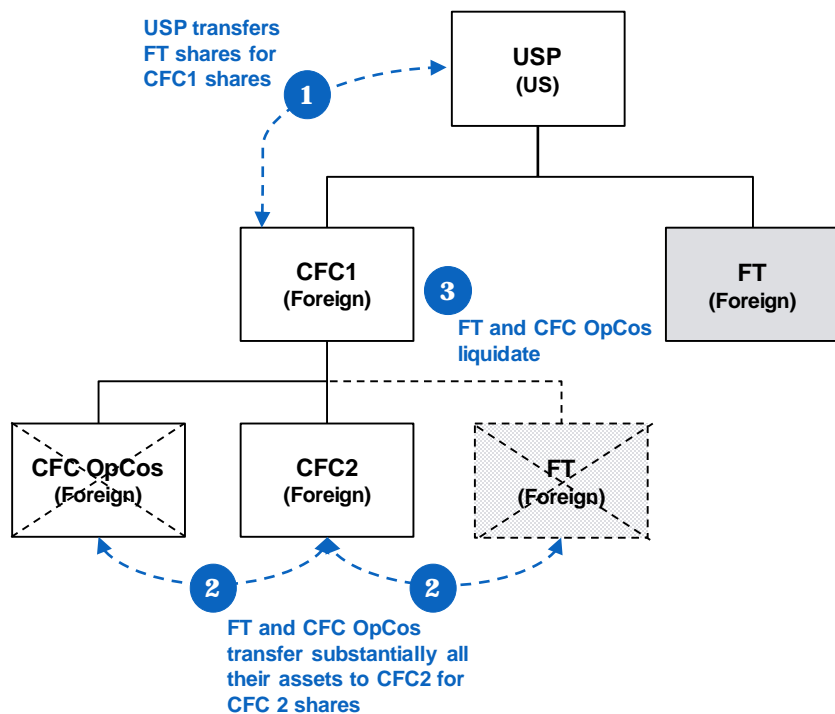
Developments for Integration Transactions

- Revenue Rulings 2015-9 and 2015-10 on Step Transaction
 - Revoking Rev. Rul. 78-130 on triangular § 368(a)(1)(C) reorganizations
 - Clarifying treatment of “triple drop and check” transactions

- Proposed Regulations under § 367
 - Taxing “outbound” transfers of foreign goodwill and going concern value under either § 367(a) or § 367(d)
 - Immediate effective date

- Notice 2015-54 on Contributions to Certain Partnerships
 - Requiring either (i) recognition of gain on contribution or (ii) election of the “remedial allocation method” under section 704(c)

Rev. Rul. 2015-9



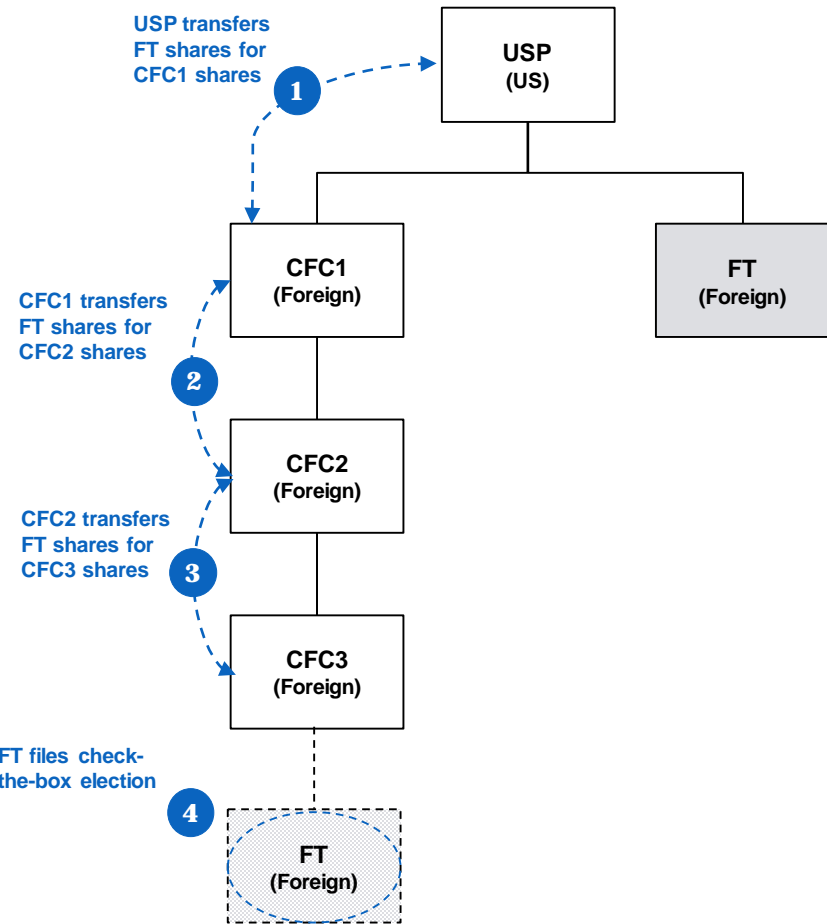
Transaction Description

- Step 1:** USP transfers FT shares to CFC1 in exchange for CFC1 voting common shares
- Step 2:** FT and CFC OpCos transfer substantially all their respective assets (subject to liabilities) to newly-formed CFC2 in exchange for CFC 2 common shares
- Step 3:** FT and CFC OpCos liquidate (distributing the CFC 2 common shares received in Step 2 to CFC1)

Discussion Points

- Step 1 should be treated as a transfer under § 351
- Steps 2 and 3 (viewed together) should be treated as multiple § 368(a)(1)(D) reorganizations (See Rev. Rul. 2015-9, revoking Rev. Rul. 78-130. See also Treas. Reg. 1.368-2(m)(1)(vi); Treas. Reg. 1.368-2(m)(4), Ex 14)
- Considerations under § 367
 - USP should enter into a GRA under Treas. Reg. 1.367(a)-3(b) and Treas. Reg. 1.367(a)-8
 - USP should not recognize the “section 1248 amount” with respect to FT under Treas. Reg. 1.367(b)-4 (because CFC status and “section 1248 shareholder” status are preserved)

Rev. Rul. 2015-10 (“Triple Drop and Check”)



Transaction Description

- Step 1:** USP transfers FT shares to CFC1 in exchange for CFC1 voting common shares
- Step 2:** CFC1 transfers FT shares to CFC2 in exchange for CFC2 voting common shares
- Step 3:** CFC2 transfers FT shares to CFC3 in exchange for CFC3 voting common shares
- Step 4:** FT files a check-the-box election to be treated as a disregarded entity (effective no earlier than one day after Step 3)

Discussion Points

- Steps 1 and 2 each should be treated as a transfer under § 351
- Steps 3 and 4 (viewed together) should be treated as a § 368(a)(1)(D) reorganization (See Rev. Rul. 2015-10; Letter Ruling 201150021; Letter Ruling 201252002)
 - The deemed liquidation of FT should be treated as occurring immediately before the close of the day before the check-the-box election is effective (See Treas. Reg. 301.7701-3(g)(3)(i))
- Considerations under § 367
 - USP should enter into a GRA under Treas. Reg. 1.367(a)-3(b) and Treas. Reg. 1.367(a)-8
 - USP should not recognize the “section 1248 amount” with respect to FT under Treas. Reg. 1.367(b)-4 (because CFC status and “section 1248 shareholder” status are preserved)

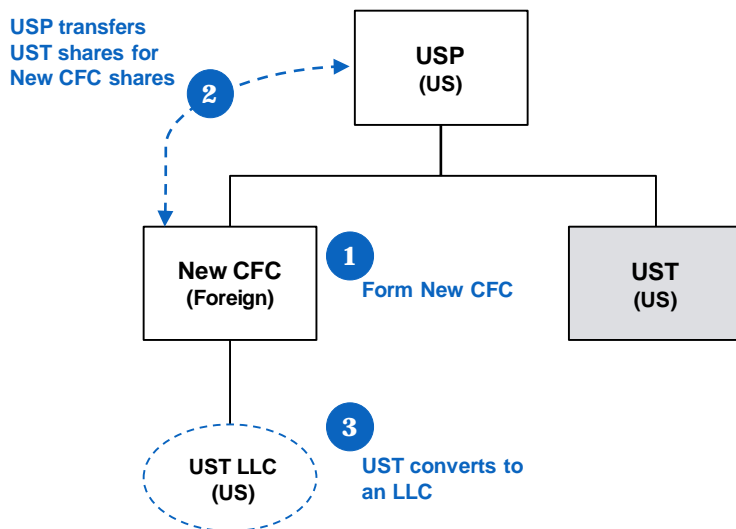
Proposed Regulations under § 367

- “Outbound” Transfers of Foreign Goodwill and Going Concern Value
 - Gain recognized on transfer under § 367(a)(1); or
 - Limit exception for property used in the active conduct of a trade or business outside the US to specified “Eligible Property” – (i) tangible property, (ii) oil and gas property, and (iii) certain financial assets
 - Annual income inclusions under § 367(d)
 - Eliminate (i) exception for foreign goodwill and going concern value and (ii) 20-year limit on the “useful life” of intangible property
 - New election to apply § 367(d) to property – other than Eligible Property – that otherwise would be subject to § 367(a)

 - Key Issue Not Addressed
 - Whether goodwill and going concern value are described within § 936(h)(3)(B) and thus are subject to § 367(a) vs. § 367(d)

 - Effective Date
 - Once finalized, applicable to transfers by US persons of property to foreign corporations occurring on or after September 14, 2015
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US Target Integration



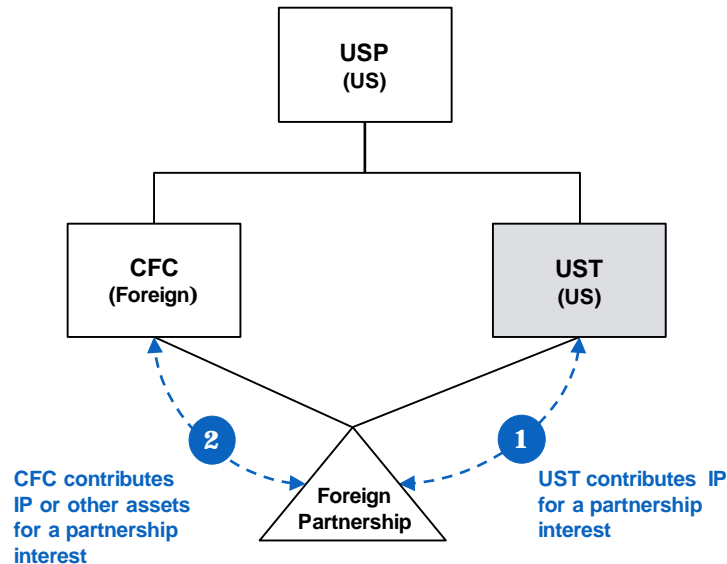
Transaction Description

- Step 1:** USP forms New CFC in a foreign jurisdiction (with the minimum capital required under foreign law)
- Step 2:** USP transfers UST shares to New CFC in exchange for New CFC shares
- Step 3:** UST converts to a limited liability company (and thus becomes a disregarded entity)

Discussion Points

- Steps 1 through 3 (viewed together) should be treated as an “outbound” § 368(a)(1)(F) reorganization
 - UST treated as transferring its assets to New CFC in exchange for New CFC shares under § 361(a);
 - UST treated as distributing the New CFC shares to USP; and
 - USP treated as exchanging its UST shares for the New CFC shares under § 354 (See Treas. Reg. 1.367(a)-1(f))
- Proposed regulations under § 367 would require that in the case of goodwill and going concern value, either:
 - UST recognizes gain on the transfer under § 367(a)(1) (See Prop. Reg. 1.367(a)-2(a)-(b)); or
 - USP, as the “qualified successor” to UST, recognizes annual income inclusions under § 367(d) (See Prop. Reg. 1.367(d)-1(b); Prop. Reg. 1.367(a)-1(d)(5); Prop. Reg. 1.367(a)-1(b)(5). See *also* Notice 2012-39)

Partnership for IP Integration



Transaction Description

- Step 1:** UST contributes the foreign rights to its IP to Foreign Partnership in exchange for a partnership interest
- Step 2:** CFC contributes its IP, operating assets, foreign subsidiaries, or cash to Foreign Partnership in exchange for a partnership interest

Discussion Points

- Foreign Partnership should be treated as a “Section 721(c) Partnership” under Notice 2015-54:
 - CFC as a “related foreign person” (determined under §§ 267(b) or 707(b)(1)) is a direct or indirect partner; and
 - UST and CFC as a “related person” own more than 50% of the interests in partnership capital, profits, deductions, or losses
- Notice 2015-54 provides that future treasury regulations will require:
 - UST to recognize the built-in gain in its IP on contribution to Foreign Partnership (§ 721(a) will not apply, subject to a *de minimis* exception); unless
 - Foreign Partnership elects to apply the “remedial allocation method” under Treas. Reg. 1.704-3(d) with respect to all built-in gain property contributed by UST (and the other requirements of the “Gain Deferral Method” are satisfied)

Revisiting the Tax-Free Reorg

REPRESENTATIVE TAX-DEFERRED TRANSACTIONS

- Section 368(a) Reorganizations. Typically, acquisitions with a significant (>40%) stock component have been structured as tax-deferred “reorganizations” under Section 368(a).
 - Continuity of Interest test generally satisfied if 40% of consideration consists of Buyer stock - this lower threshold only applicable to forward mergers
 - Importance of “signing date” rule – requires “fixed consideration” – otherwise continuity test applied at closing date
 - There are many current examples of this type of transaction - see, e.g., Abbvie's acquisition of Pharmacylics for \$21B in cash and stock (41%)
- Section 351 Alternative. Even transactions that do not meet the 40% “continuity of interest” threshold are often structured to fall under Section 351, usually by interposing a holding company
 - The recently announced acquisition of EMC by Dell involves the formation of a holding company and the issuance of “tracking stock” by Dell
 - Oracle's acquisition of Siebel Systems.
- Partnership structures. When a tax-free transaction cannot be found in Subchapter C, parties sometimes engineer complicated partnership structures to achieve tax-deferred treatment.
 - See, e.g., the pending acquisition of Broadcom by Avago, in which shareholders of Broadcom may swap their shares for units in a partnership formed by the non-U.S. Avago, with such units ultimately exchangeable for Broadcom stock. See also Tim Hortons/Burger King

TREND AWAY FROM TAX-DEFERRED REORGANIZATIONS?

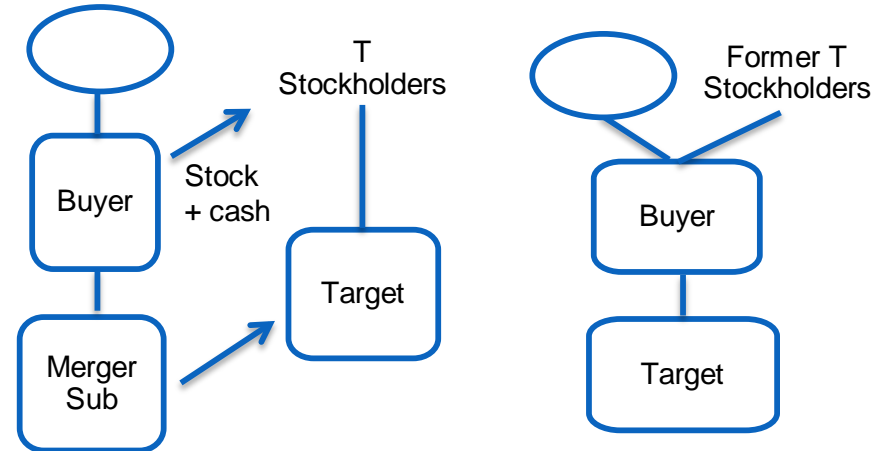
- In the last few years, however, the historic presumption has seemingly relaxed, with many potentially tax-deferred transactions completed on a fully taxable basis.
- Leading the way have been the “inversion” transactions, most of which trigger substantial stockholder gain.
 - Shareholder tax considerations would often have resulted in the U.S. party being the acquired.
 - This consideration has all but disappeared, especially in light of potential alternatives in selected situations, e.g., Broadcom/Avago
- However, many recent cross-border and wholly domestic acquisitions that seemingly could have qualified as tax-deferred reorganizations have been structured as taxable transactions.
 - For example, the recently announced acquisitions of Atmel by Dialog (a UK company) and of Chubb Corp. by ACE Ltd. (a Swiss company) are structured as taxable transactions even though each provided for roughly 50% stock consideration and seemingly could have qualified under Section 367(a).
 - Other recent examples of wholly domestic taxable acquisitions with substantial (i.e., ≥40%) stock consideration include the acquisition of Audience by Knowles and the acquisition of Yodlee by Envestnet.
- Seemingly, the decision to pursue the tax-deferred alternative is much more “in play”

VALLEY M&A PRACTICE

- Notwithstanding the range of options available under Section 368, the vast majority of tax-free reorganizations are structured as mergers, and within that fall into 2 categories
- All stock transactions are usually accomplished as reverse triangular mergers under Section 368(a)(2)(E)
- Part stock, part cash transactions are usually accomplished as so-called “2-step” transactions under Section 368(a)(1)(A)
 - First step is usually acquisition of target in reverse triangular merger
 - Second step is merger of target into acquirer or sub of acquirer, with sub often an LLC.

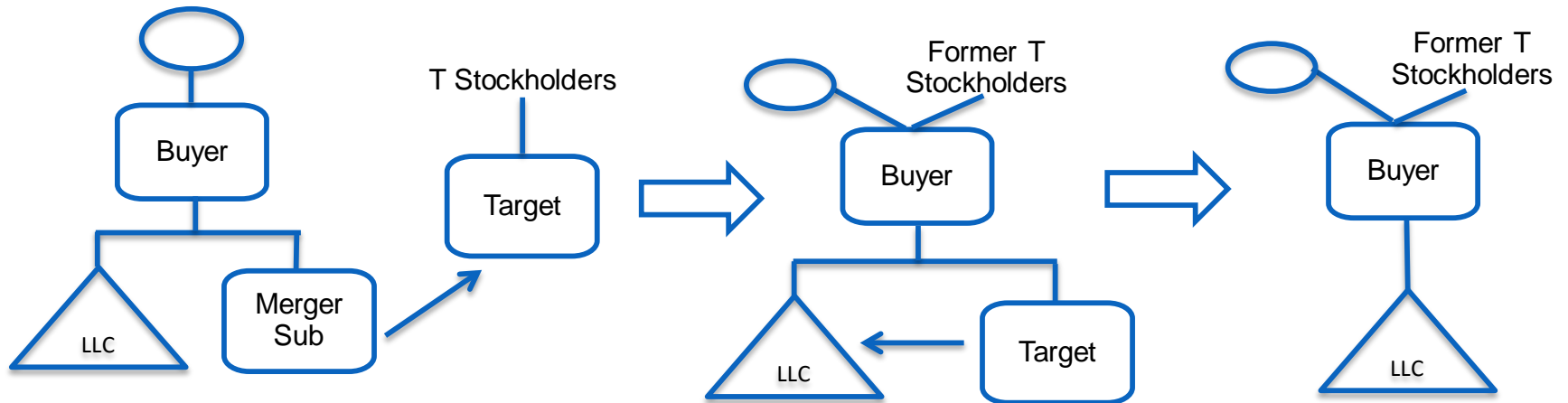
REVERSE TRIANGULAR MERGER

- Reverse triangular merger involves merger of controlled subsidiary of Buyer (usually transitory) into Target with Target surviving
 - Section 368(a)(2)(E)
 - Target must retain “substantially all” of its assets
 - Buyer must acquire “control” in transaction (within meaning of Section 368(c), i.e., 80% of vote and 80% of each class of non-voting stock) in exchange for Buyer voting stock
 - Any non-trivial cash usually necessitates shift to two-step merger, since “signing date” rule is not available for purpose of 80% control test



TWO-STEP “A” REORGANIZATIONS

- Rev. Rul. 2001-46 – reverse triangular merger followed by a direct (usually upstream) merger as part of an integrated plan characterized as an “A” reorganization
- Typically only real technical issue is 40% continuity of interest test
- If fails to qualify as a reorganization, taxed as a stock sale rather than an asset sale – Rev. Rul. 2008-25
- Second step is often a forward merger into an LLC, with the LLC surviving since this avoids the “substantially all” test of Section 368(a)(2)(D), provides a liability shield and allows for maximum restructuring flexibility post-closing



FACTORS INFLUENCING TAX-DEFERRED DECISION

CONS

- Calculation mechanics of Section 356 reduce benefits of tax-deferred treatment in transactions with significant cash, since cash is taxed up to the gain realized
 - In forward merger with 40% stock component, only stockholders with basis equal to less than 40% of deal price receive any benefit from gain deferral.
 - Often, only founders may benefit from deferral of gain.
- Buyer may want to step up basis of target stock to reflect value paid
 - May aid in restructuring or in the event of future sale
 - Some transactions are structured under Section 351 rather than Section 368 in order to achieve a higher basis in the target stock attributable to the cash paid.
- Reverse triangular merger is simpler than a 2-step merger and is favored by corporate lawyers, even if taxable
 - Minimizes contract assignment issues arising from forward merger
 - However, since “signing date” rule does not apply for purpose of Section 368(a)(2)(E) 80% “control” test, may be difficult to guarantee tax-deferred status if any cash in transaction

FACTORS INFLUENCING TAX-DEFERRED DECISION

- Even in 2-step merger, if “signing date” rule does not apply, may be difficult to guarantee tax-deferred treatment.
 - NYSE and Nasdaq limits on stock issuances may make it impossible to guarantee that 40% continuity test will be met.
 - Rules limit stock issuances to 20% of current stock outstanding in the absence of a stockholder vote
- Several recent deals have been structured with no guarantee of tax-deferred status.
 - The transactions are structured as reverse triangular mergers with the second-step merger triggered only if the continuity of interest test would be met based on the closing price
 - See, e.g., St. Jude/AGA Medical Holdings
- Second-step forward merger may trigger tax liability on transfer of lower-tier subsidiaries, e.g., in China and India.

FACTORS INFLUENCING TAX-DEFERRED DECISION

PROS

- Taxable transaction “locks in” gain at value of acquiror stock at closing date
 - Inability to carry back capital losses from subsequent years a significant risk factor
- Buyer may be private so that stock consideration is illiquid.
- Tax-deferred transaction allows stockholders to “tack” holding period (Section 1223)
 - preserves holding period for capital gain purposes
 - available even in taxable inversions to the extent would qualify as a Section 368(a) reorganization absent Section 367(a) – but notwithstanding this most inversions are affirmatively taxable
 - preserves QSBS status, e.g., to achieve 0% tax rate after five years for stock acquired on or after September 28, 2010

IMPACT OF QUALIFIED SMALL BUSINESS STOCK

- Reduced federal income tax on capital gains from QSBS held for more than 5 years

Acquisition Date	Effective Tax Rate	Effective AMT Rate
8/11/93 – 2/7/09	14%	14.98%
2/8/09 – 9/27/10	7%	8.47%
9/28/10 – 12/31/14*	0%	0%

* Unless extended through 2015 QSBS acquired after 12/31/14 taxed at rates effective for QSBS acquired before 2/8/09

- Ability to tack holding period may allow individual stockholders to complete 5-year holding period
 - Gain eligible for rate benefit usually capped at transaction value unless Buyer stock also QSBS
 - Prospect of 0% federal tax has already resulted in restructuring of transactions
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