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# The Importance of M&A Tax Advisory for Your Next Deal

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No buyer wants to find out after a deal has closed that they are responsible for the tax liabilities of a company with which they just merged. Conversely, no seller wants an unexpected tax obligation that can impact a deal closing. M&A tax complexities can affect the synergies of the merged companies and lead to loss of value and control.

The team at SRS Acquiom advises clients to keep tax concerns top-of-mind early in the dealmaking process and to engage in comprehensive M&A tax due diligence from the start.

The following M&A tax considerations can help you navigate common tax issues that arise within deals.

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## What Should Deal Parties Consider from an M&A Tax Perspective?

When contemplating a merger or acquisition, a thorough tax review is necessary for businesses of all sizes. A tax surprise at or near closing can often derail what would otherwise have been a smooth transaction. If sellers are not adequately counseled from a tax perspective, they may find themselves leaving money on the table or not sufficiently protecting themselves against M&A tax issues and claims that arise after the close.

- **Federal Issues in M&A Transactions**

There are many M&A tax considerations when it comes to federal, and state and local taxes, particularly with respect to net operating losses. From a federal view, Internal Revenue Code Section 382 governs the applicability and usage of net operating losses and certain acquisitions. If a proper study isn't conducted from a federal tax standpoint, it can be highly difficult to have equally good results on the state side.

A potential pre-closing liability that is only determined after closing may result in a buyer seeking a claim from the escrow account. It is wise to ensure that your M&A deal has adequate expense fund coverage in the event such claims arise.

- **State Tax Surprises in M&A Transactions**

When considering state tax implications on your M&A deal, watch for net operating losses, whether sales tax was appropriately charged, and whether the seller has been filing in the appropriate jurisdictions. Sellers can often be caught off-guard by income or sales tax "nexus," thinking that they do not have sufficient presence within a state (physical or economic) for tax remittances to apply. Knowing the governing nexus requirements in the states where sellers operate can be a key step in the M&A due diligence process.

Many sellers have experienced their deal going sideways when they learn that they have not been collecting adequate state sales taxes. For example, some online businesses operating globally often do not fully know where they are doing business and do not understand the resulting tax implications and associated liabilities. From a sales tax perspective, some may incorrectly believe their services are not subject to sales tax. Additionally, these companies typically obtain treaty exemptions at the U.S. federal level or do not have a permanent establishment in the U.S., and therefore mistakenly assume that they also do not have any U.S. state and local income tax obligations.

However, each state operates as its own separate entity, and as such, sellers must separately determine their taxability with each state and pay the appropriate taxes. More states are pursuing stricter enforcement of their statutes, and collection of sales taxes is one attractive way a state can address budget shortfalls.

- **Sales Tax Complications in Technology and Pharmaceuticals**

A sales tax issue in the M&A deal process is dangerous. In the worst case, the purchase price may have to be adjusted accordingly to factor in the liabilities. If they don't kill the deal beforehand, these kinds of issues can create havoc midway through the M&A deal process.

Take, for example, a software-as-a-service (SAAS) technology company selling licenses. If this company is selling a thousand licenses and no one advises it to pay sales tax, there is a limited ability to go back and charge the customer for the shortfall; and this then becomes a tax liability for the seller. The associated fees and expenses can compromise the bottom-line performance of the company. These tax liability expenses, if neglected, can often be extraordinary. If such a

large tax liability is caught early in the M&A due diligence process, it can be large enough to kill the deal. When tax burdens are discovered after closing, contentious issues can arise between M&A deal parties – underscoring the need for sufficient escrow and expense fund coverage.

Technology companies and pharmaceutical companies (primarily non-regulated supplements), often find sales tax issues difficult to navigate. Many technology solutions, such as cloud computing or online retailing, are relatively new. As such, U.S. sales taxes were often not collected in early growth phases, allowing the technology to take hold and flourish. Over time, some states began mandating sales tax collection. This caused confusion as to when state taxes did and did not apply. Pharmaceuticals have a similar challenge in distribution across state boundaries. Smaller sellers who may not have the advantage of sophisticated tax assistance may find themselves particularly at a disadvantage.

## How Often Do Tax-Related Issues Arise?

M&A tax issues arise in almost every transaction and at any point, pre- and post-close. If M&A deal parties have a strong legacy tax advisor, issues will usually be identified early during the pre-close tax due diligence process. If not, tax issues will arise post-close – often as a surprise to M&A deal parties – and can potentially create chaos for all involved.

Sometimes the issue is negligible and does not require remediation. In more challenging situations, sellers may find that they have escrowed too little, or that an expense fund is inadequate to cover potential tax liabilities, claims, and professional fees.

Sellers can voluntarily disclose unpaid tax liabilities through a Voluntary Disclosure Agreement (VDA) steering some states to reduce or abate penalties and limit the look-back period. However, this process costs time, money, and leads to potential delays in the M&A transaction at hand.

## What Should Deal Parties Look For when Choosing an M&A Tax Advisory Team?

With an estimated 30%-40% of total M&A deal finances affected by taxes – including federal, state, and local taxes – a team of M&A tax experts should offer depth of experience and a savvy set of skills that applies to all relevant taxation issues, inclusive of tax audits.

There are several specialties to be aware of when seeking tax assistance for your M&A transaction.

- **M&A Tax Experience**  
M&A deal parties should look for extensive, deep knowledge of the range of tax and accounting claims that can possibly emerge in an M&A transaction, and a specialty practice in M&A. Look for experience with tax dispute resolutions, state and local tax jurisdictions, U.S. and international tax interests, tax indemnification, and tax claims.
- **M&A Deal Process Experience**  
M&A tax advisors who are also deeply proficient in other aspects of the M&A deal process will innately possess a richer understanding of the transaction than a general-purpose tax firm.
- **M&A Deal Efficiencies**  
Using the same firm to support the M&A deal process and tax needs that may arise can also streamline third-party or multiple vendor inefficiencies. There are fewer delays and quicker analyses of information and documents, and faster paths to resolution of issues.

- **A Broad M&A Tax Purview**

A skillful M&A tax advisor should not only be able to help deal parties manage the tax issues at hand, but should also have a forward-thinking approach to help with the future direction of taxes and knowledge of proposed tax changes. Likewise, a historical knowledge of tax rules is equally critical should a deal require a review of a claim for liabilities that originated prior to the M&A transaction.

- **M&A Tax Cooperation**

M&A deal parties should consider outside tax expertise beyond their legacy tax advisors to ensure a specialized focus on M&A tax concerns. Working alongside legacy tax firms, an M&A tax specialist can assess potential liabilities and claims, as well as provide an in-depth review and analysis of a seller's corporate income tax returns where the sellers have a contractual right to review, comment and/or consent to the content and filing of the returns. Utilizing one firm for all elements of an M&A transaction that understands and consults with legacy advisors can streamline the experience, and can translate into an efficiently and fully synergized deal.

Having a solid grasp on tax implications is paramount to a successful M&A deal process and closing experience. Early identification and mitigation of tax liabilities – often unknown to selling parties – can help ensure that your M&A deal flows smoothly from the start.

Our M&A Tax Advisory team at SRS Acquiom possesses valuable perspective on tax documentation and issues, from identifying potential tax benefits to sellers to conducting in-depth analyses of potential problems that can arise before, during, and after closing.

Our in-house federal and state and local tax experts often work through complicated tax issues on an expedited time frame to facilitate post-closing deal matters and favorable tax claim resolutions.

## About the Authors



**Natalie Kleffman**

Director,  
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Natalie manages post-closing matters as a Director at SRS Acquiom. She works directly with key buyer and seller stakeholders to effectively resolve indemnification claims and disputes, with an emphasis on tax issues.

Prior to joining SRS Acquiom, Natalie gained experience at law firms, the United States Attorney's Office, and in-house at a late stage start-up. She also worked in the National Tax group at Ernst & Young (EY). Natalie's combined background as an attorney and tax professional provides her with a unique perspective in managing various tax disputes.

Natalie earned her JD from UC Berkeley School of Law (Boalt Hall) and her BA in Economics, cum laude, from UCLA. At Boalt, Natalie served as Co-Chair of the Berkeley Tax Law Clinic, which provides free tax guidance to low income individuals in the Bay Area.



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Seth Rabe is a Director of State and Local Tax Advisory. He provides guidance to shareholders regarding buyers' state and local tax claims.

Before joining SRS Acquiom, Seth worked at large multi-national accounting firms and in private practice representing companies. He has over 18 years of experience in all aspects of state and local tax. Seth represented companies in state and local tax disputes, planning, due diligence and structuring.

Seth received his B.A. from Washington University in St. Louis, his law degree from Cardozo School of Law at Yeshiva University and an LL.M. in Taxation from the University of Miami School of Law.