

AGENDA

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Board Considerations in the Face of Tax Reform Uncertainty

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While the drive by Republicans in Congress and President Donald Trump to make fundamental changes to the U.S. tax code creates substantial uncertainty, boards are faced with the ongoing need to make significant long-term capital allocation decisions.

While no director can predict the timing and terms of tax reform, directors would be well served to understand tax reform's range of implications for M&A or capital markets decisions. In gathering such information, directors will also create the kind of record that supports deference to their decision-making under Delaware's "business judgment rule," notwithstanding such substantial uncertainties.

Mergers and Acquisitions

Many commentators are expecting proposed reductions in corporate tax rates to result in substantial increases in company valuations. Similarly, changes in the implied values of a company's tax attributes, such as net operating losses or depreciation, can substantially impact value and deal structure. In these circumstances, directors — whether as sellers of an entire company or in considering a substantial acquisition — may be uncertain as to whether valuations being advanced fairly reflect the material implications of tax reform. Repatriating cash from overseas in the future, initially at a low tax cost and perhaps without any friction if a territorial tax regime is implemented, may also impact value and structure. Directors should ask management and outside advisors to:

- Provide sensitive data in valuation analyses tied to variability of tax factors, such as tax rates or the diminution in value of relevant tax attributes.
- Advise as to the strategic implications of material changes in the tax code, particularly for companies where the business model is linked closely with tax matters, e.g., those that monetize the value of tax attributes.

- Address the macro implications for the business operations, deal structure and capital allocation of proposed tax changes, such as for companies generating substantial cash flows outside the U.S. or as a consequence of implementation of a “border adjustment tax.”

These analyses may help the board bound the range of values that differing tax reform scenarios present, allowing it to thoughtfully approve deals in the face of uncertainty. However, the alternate scenarios may demonstrate fundamental variability in the financial benefits of certain deals, and some may not be viable in certain circumstances. In such situations, the board may consider terms allowing for termination of the transaction in the event that tax reform elements significantly affect the value of the deal.

Capital Markets

The proposed reforms would impact many factors boards consider when making material capital allocation decisions, including:

- Where to raise capital, such as if a territorial tax system enables no- or low-friction movement of capital across borders.
- Whether to deleverage or return capital to shareholders, if, for example, repatriation is enabled at lower cost and cash previously trapped offshore is now available to pay down debt or repurchase shares.
- Whether to raise capital by issuing debt or equity. In light of this uncertainty and its significant impact on decision-making as to capital allocation, much like with M&A, directors should seek management and banker advice as to the impact of various tax reform assumptions on optimizing capital structure from both market and operational perspectives and sensitivities around alternate financing scenarios.

Given the possible dramatic reductions in nominal rates for corporates and business pass-through entities, and the possible influx of substantial offshore cash for many global businesses, directors may encounter difficulties developing financing alternatives that are optimized for the multiple alternate scenarios that could arise under tax reform. In these circumstances, boards may be best advised to seek — wherever possible — redemption and similar terms that would enable material modifications, with the lowest friction, to the capital structure most desirable when the key elements of reform are finalized.