

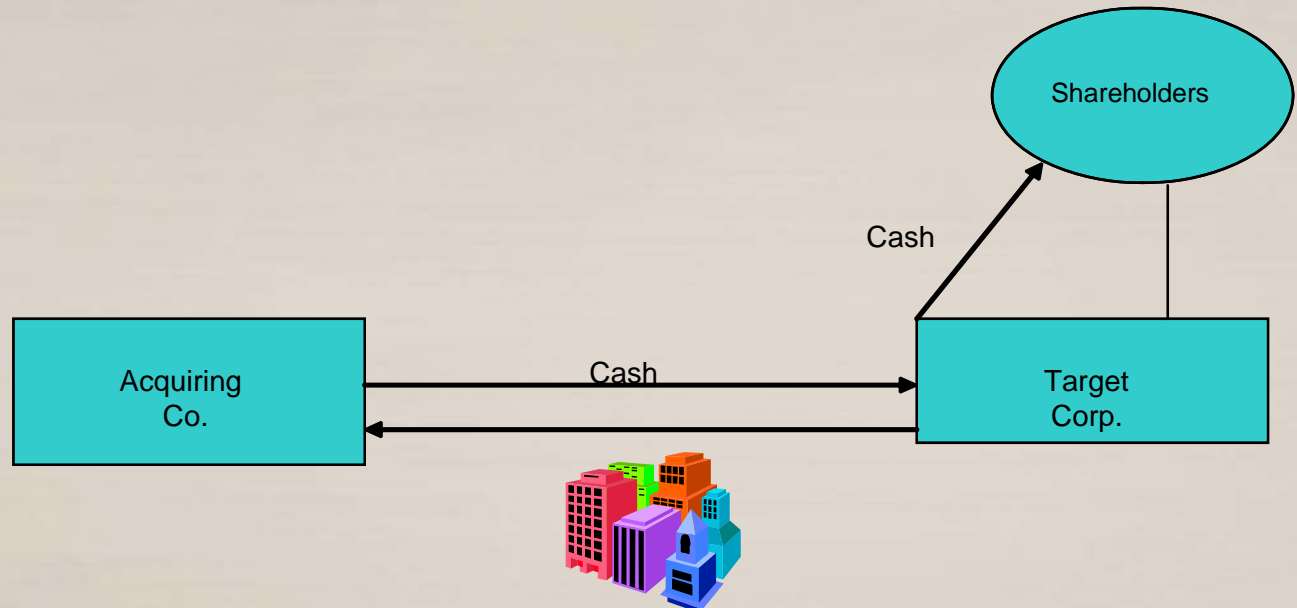
MILES &
STOCKBRIDGE P.C.

**THE TAX BASICS OF MERGERS
AND ACQUISITIONS**

Overview

- Choice of Entity for Acquisition
- Asset v. Equity Acquisition
- Cash or Equity Consideration
- Tax Consequences:
 - Tax Attributes
 - Basis of Acquired Property
 - State and Local Taxes

Asset Acquisition Assets for Cash C Corporation

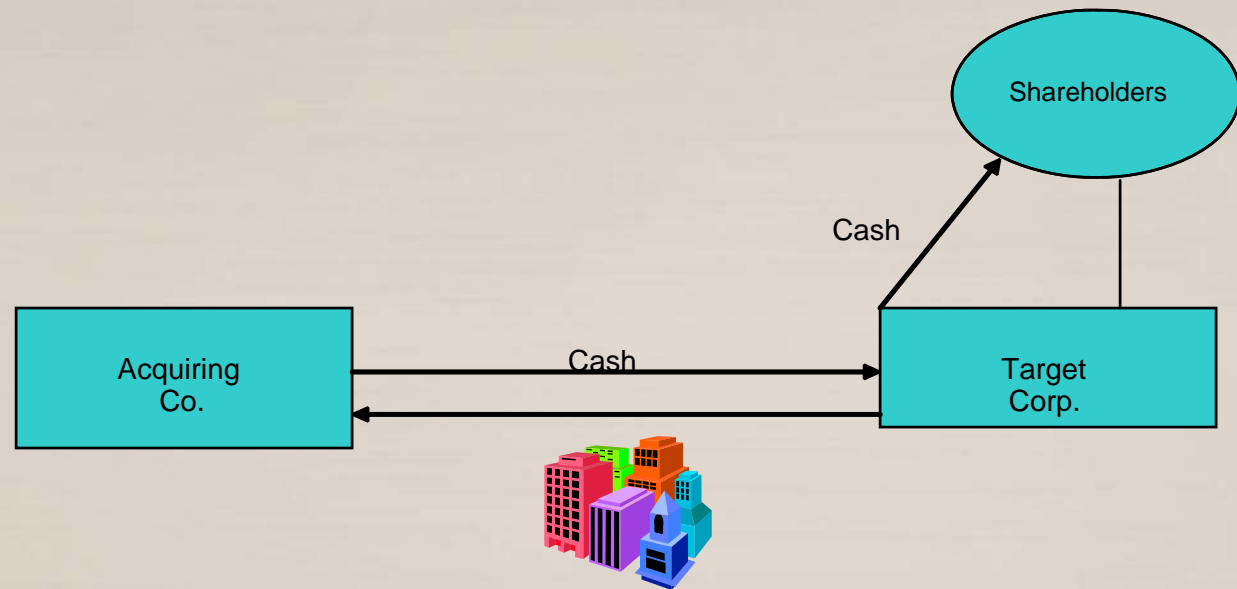


- Step 1 - Acquisition of Assets in Exchange for Cash
- Step 2 - Distribution of Cash to Shareholders

Choice of Entity for Acquisition

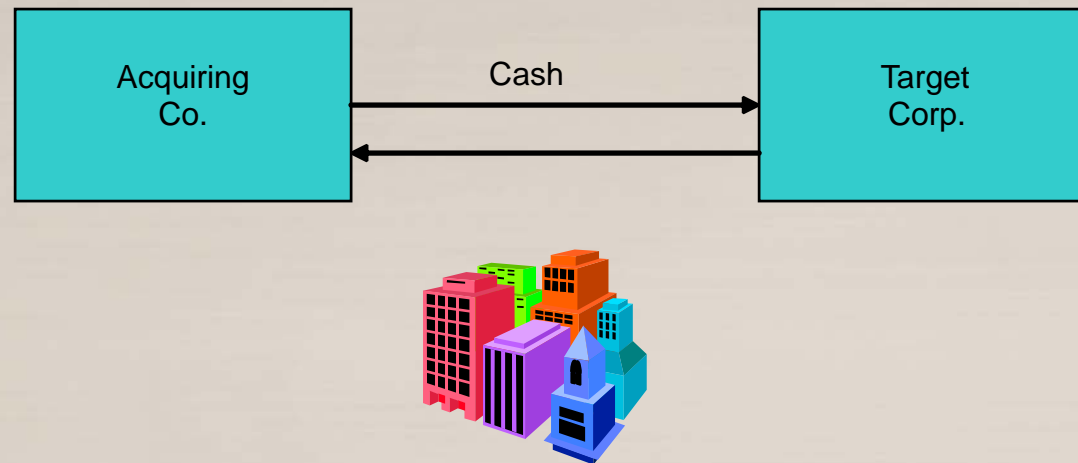
- Corporation
 - C Corporation (liability protection, double level of tax)
 - stand alone or member of Consolidated Group
 - Allow 338 Election (deemed asset purchase)
 - S Corporation (liability protection, single level of tax)
 - state considerations (all states do not recognize election)
 - Built-in-gains tax if acquiring stock of C corporation
 - Allow 338 Election
- Limited Liability Company or Limited Partnership
 - Preferred for privately held real estate
 - Better for use of losses
 - Tax -deferred distributions of refinancing proceeds

Asset Acquisition Assets for Cash C Corporation



- Step 1 - Acquisition of Assets in Exchange for Cash
- Step 2 - Distribution of Cash to Shareholders

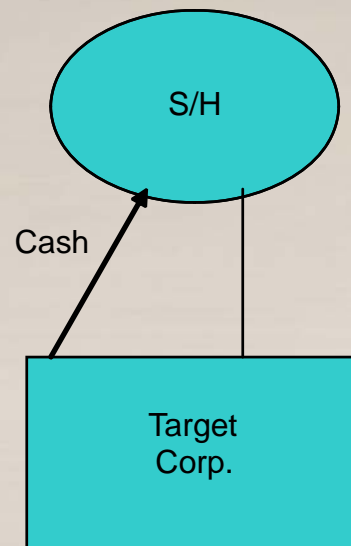
Step 1 - Acquisition of Assets in Exchange for Cash



Income Tax Consequences:

- Target recognizes gain subject to tax
- Acquiring receives a stepped up basis
- Assumption of liabilities treated like cash

Step 2: Distribution of Cash to Shareholders (assuming liquidation of Target)



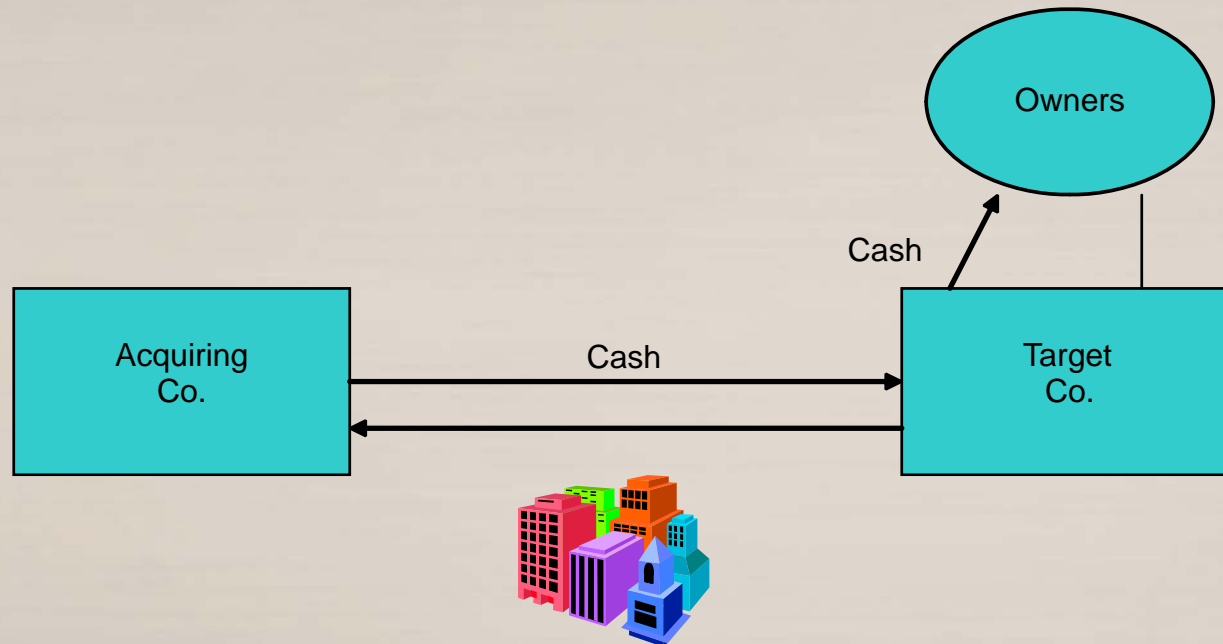
Income Tax Consequences

- Gain to Shareholders (probably capital gain)

Tax Consequences of Asset Acquisition (C Corporation)

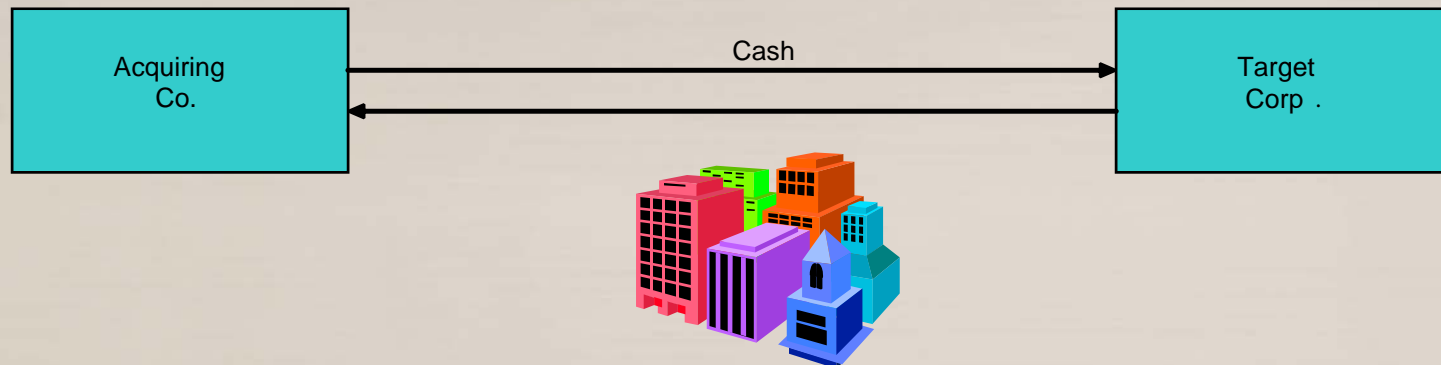
- To Seller:
 - Target Corporation – gain recognition on sale of assets
 - Shareholders – gain recognition on liquidation of Target
- To Buyer:
 - Step-up in basis
 - Potential assumption of all Target liabilities if substantially all assets purchased

Asset Acquisition Assets for Cash S Corporation or Partnership/LLC



- Step 1 – Acquisition of assets in exchange for cash
- Step 2 – Distribution of cash to owners

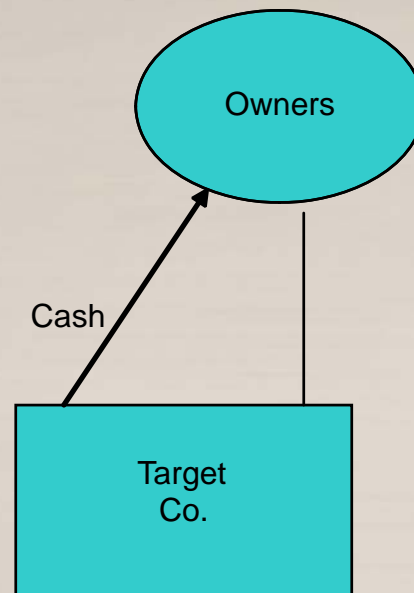
Step 1 - Acquisition of assets in exchange for cash



Income Tax Consequences

- Gain from sale of assets is passed through to Target Owners.
- Target Owners receive a step-up in basis of equity
 - Acquiring receives a stepped-up basis

Step 2: Distribution of Cash to Owners (assuming liquidation of Target)



Income Tax Consequences

- No gain to Owners unless amount distributed exceeds basis

Section 1060 Reporting Requirements

- Form 8594
- Applicable asset acquisition - acquire assets constituting a trade or business
- Seven asset classes for allocations
- Allocation among assets
 - Capital gain vs. ordinary income to seller
 - Depreciation time periods to buyer

Asset Allocation Classes

- Class I assets
 - Cash and General Deposit Accounts
- Class II assets
 - CD's, U.S. gov't securities, readily marketable stock and securities, and foreign currency
- Class III assets
 - accounts receivable, mortgages, and credit card receivables from customers which arise in the ordinary course of business
- Class IV assets
 - stock in trade or the taxpayer or other property of a kind which would be included in the taxpayer's inventory, or property held for sale to customers in the ordinary course of its trade or business

Asset Allocation Classes (continued)

- Class V assets
 - all assets other than Class I, II, III, IV, VI, VII assets
- Class VI assets
 - all section 197 intangibles, as defined by Section 197, except goodwill and going concern value
- Class VII assets
 - goodwill and going concern value

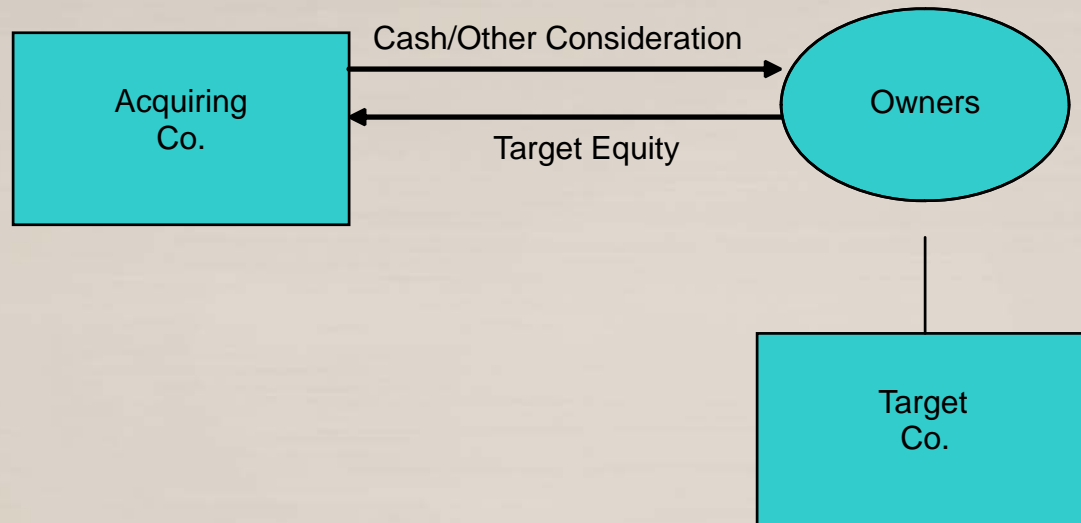
Asset Acquisition State Tax Consequences (other than income taxes)

- Sales and Use Taxes
- Transfer Taxes
- Property Taxes

Asset Acquisition Tax Attributes

- The Target Tax Attributes Do NOT Carryover (i.e., NOL's, basis, employment plans)
- No Successor Employer Reporting (W-2's) unless otherwise agree

Equity Acquisition



Income Tax Consequences:

- Owners receive gain subject to tax
- Acquiring keeps Target's basis in its assets – corporation
- Target taxed as partnership basis step-up

Income Tax Consequences of Direct Equity Acquisition

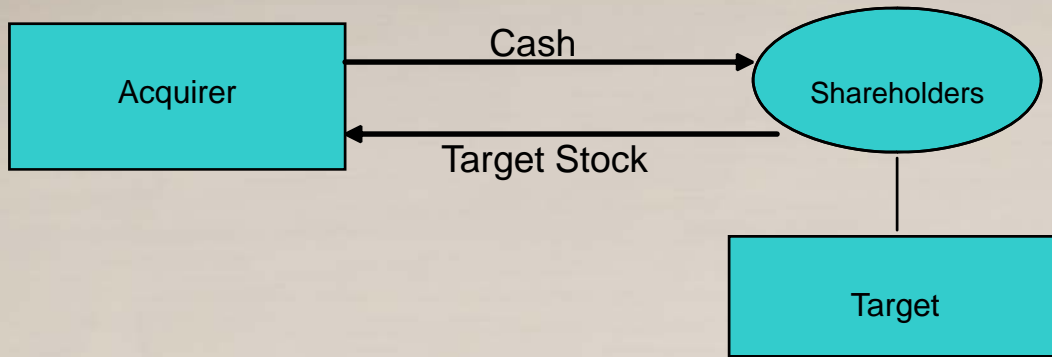
- To Seller:
 - Selling Owners recognize gain (generally capital gain, except “hot assets” if Partnership)
- To Buyer:
 - Receives carry-over basis in target assets on stock acquisition
 - Target liabilities remain in Target Company

Direct Stock Acquisition with Section 338(h)(10) election

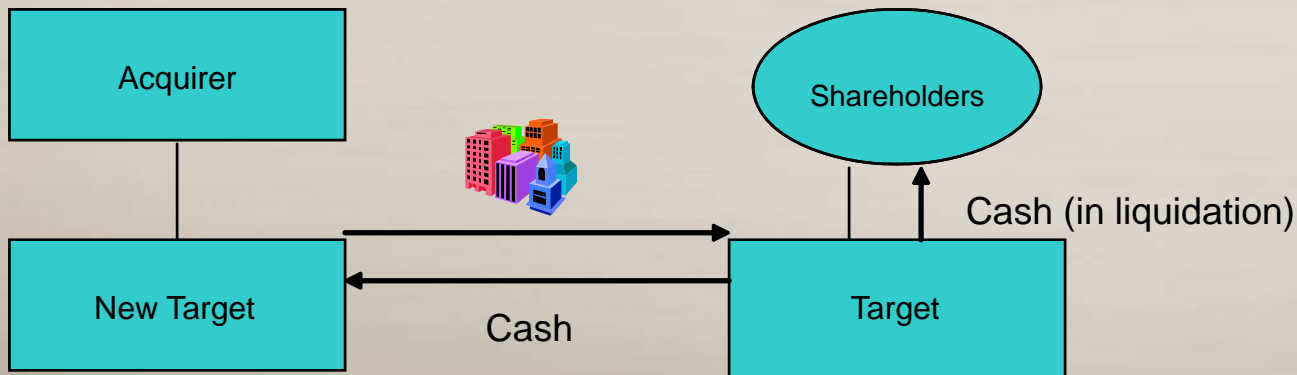
- Requirements:
 - Purchase 80% or more of Target stock
 - Target is either:
 - Member of a consolidated group or
 - S corporation
 - Buyer must be a corporation
- Consequences:
 - Deemed Asset Sale
 - Step-up in Basis
 - Tax based on asset basis

338(h)(10)

Reality



Tax Fiction



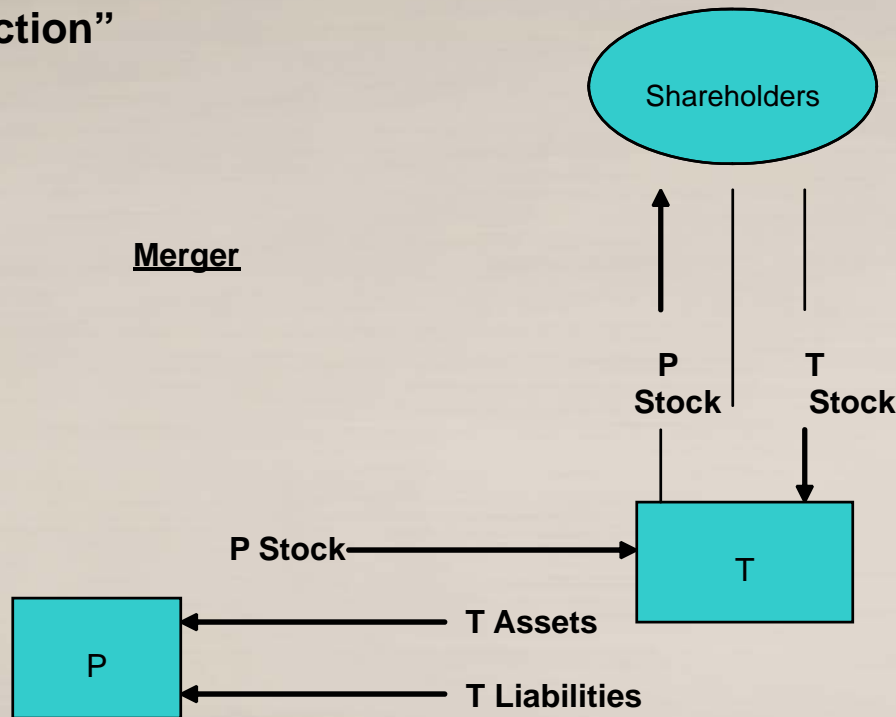
**THE BASICS OF TAX-FREE
REORGANIZATIONS**

"A" Reorganization

- Statutory Merger
- Flexible
 - Consideration for continuity of interest test is at least 38% stock
 - IRS Safe Harbor is at least 50% stock

Tax Free Merger Type “A” Reorganization

1. “Tax-Fiction”



No Gain or Loss to T Shareholders

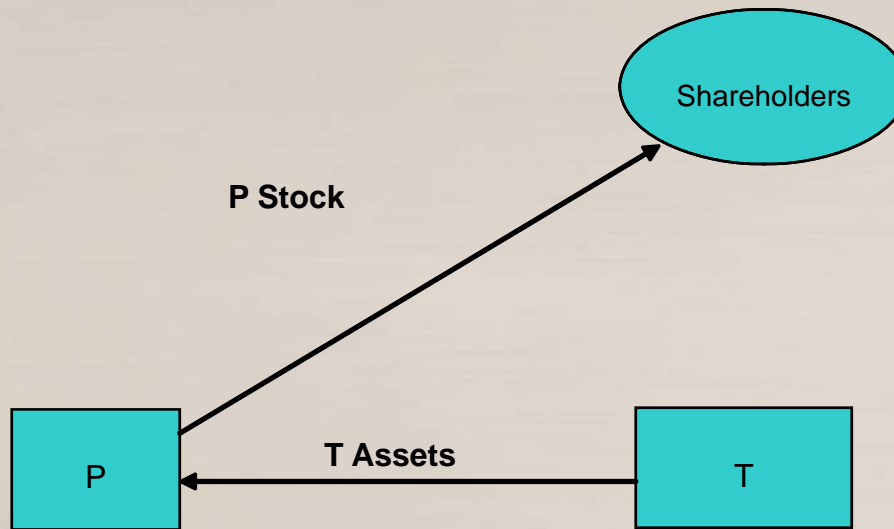
No Gain or Loss to P

No Gain or Loss to T

Liability Assumption – Not Treated as Money

Tax Free Merger Type “A” Reorganization (continued)

1. “Real World”



STATUTORY MERGER

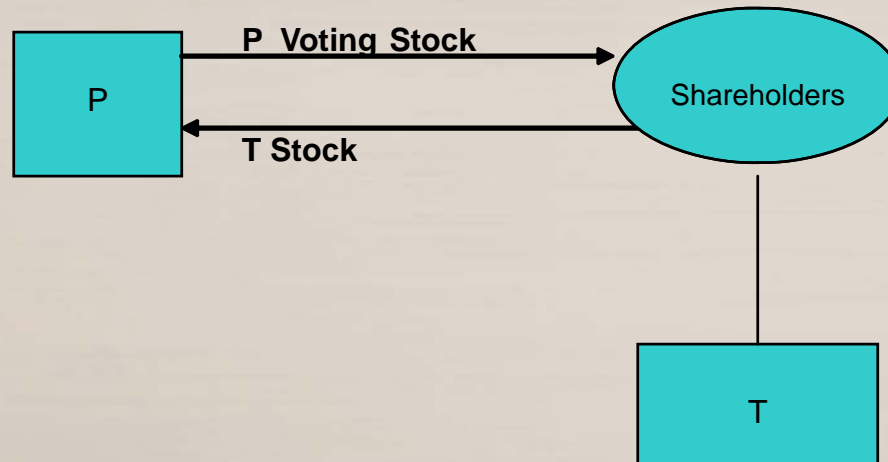
Most Flexible
Only need 38% of consideration to be stock

“B Reorganization”

- Exchange of Target stock
- Solely for Acquirer's voting stock
- Immediately after, the Acquiring corporation is in "control" (80%) of Target

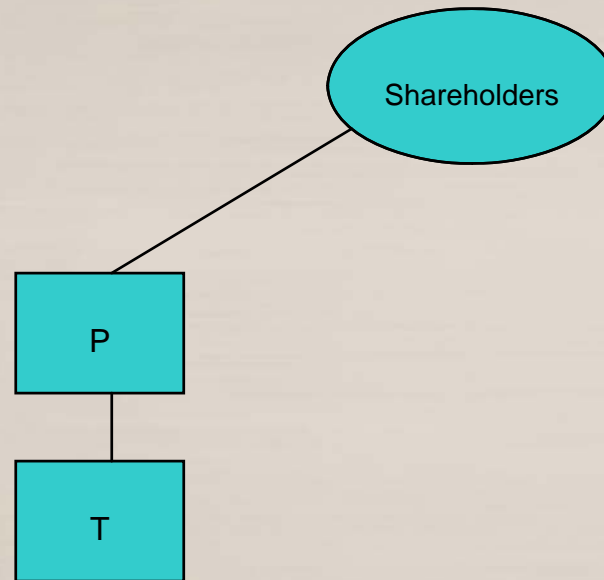
TYPE "B" REORGANIZATION STOCK FOR STOCK

1.



TYPE “B” REORGANIZATION STOCK FOR STOCK (continued)

2.



Solely for Voting Stock

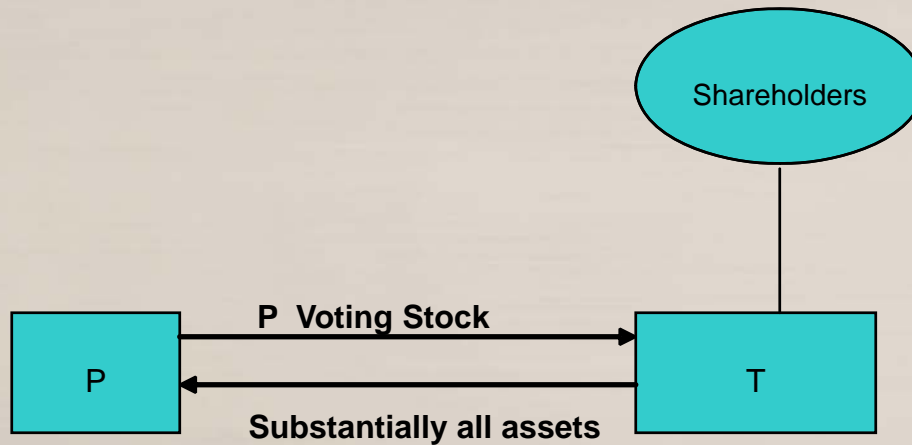
P must have “Control” of (80%) T immediately after exchange

"C" Reorganization Exchange of Assets for Voting Stock

- Acquisition of "**substantially all**" of the Targets properties (70% gross/90% net of Target's historic assets)
- Solely in exchange for Acquirer's voting stock

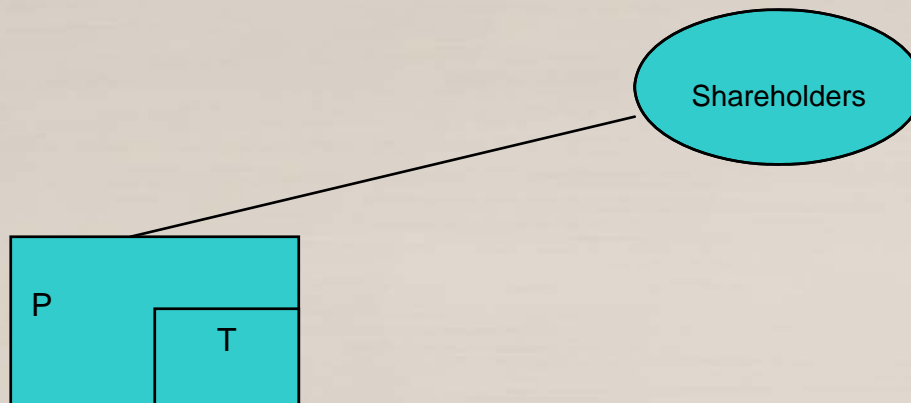
TYPE "C" REORGANIZATION STOCK FOR ASSETS

1.



TYPE “C” REORGANIZATION STOCK FOR ASSETS (continued)

2.



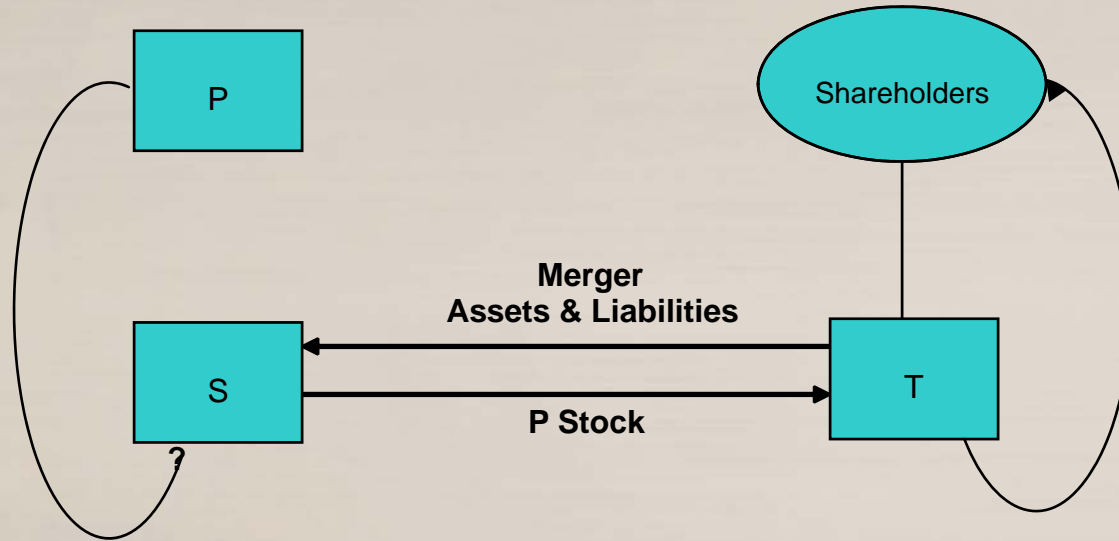
P acquires “substantially all” T assets
Solely P voting stock EXCEPT:
20% other property
If other property, liabilities assumed count

Forward Triangular Merger Merger of Target into Sub with Sub Surviving

- Sub acquires "**substantially all**" of T's assets
- Only Parent's stock can be used to effect the exchange
- A merger of T into Parent would have qualified as an "A" reorganization

FORWARD TRIANGULAR MERGER

1.



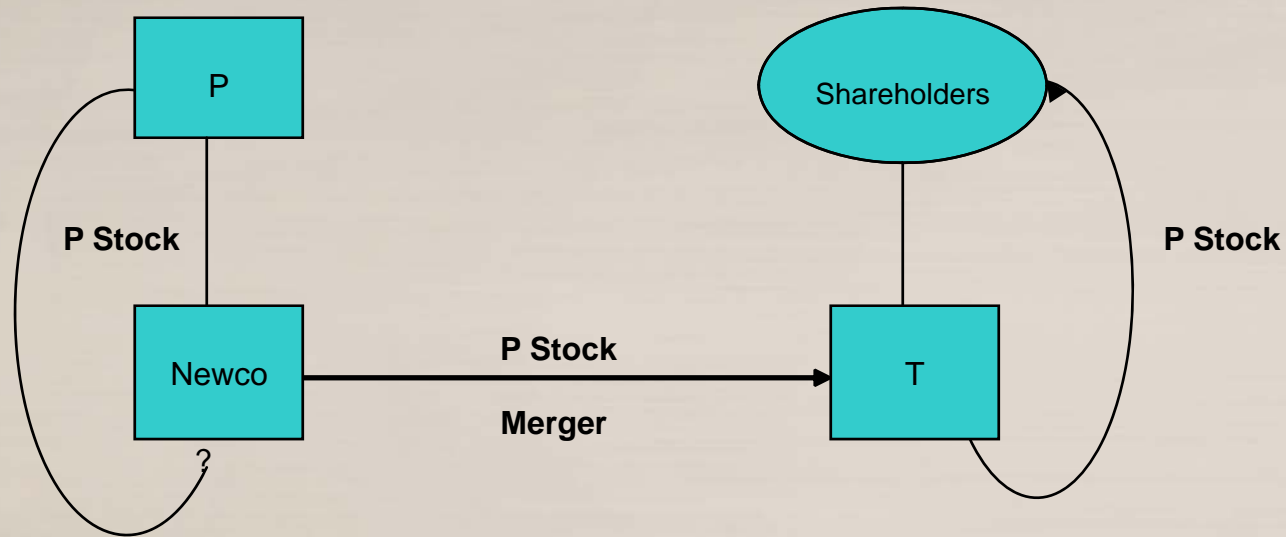
REVERSE TRIANGULAR MERGER

Merger of Sub into Target with Target Surviving

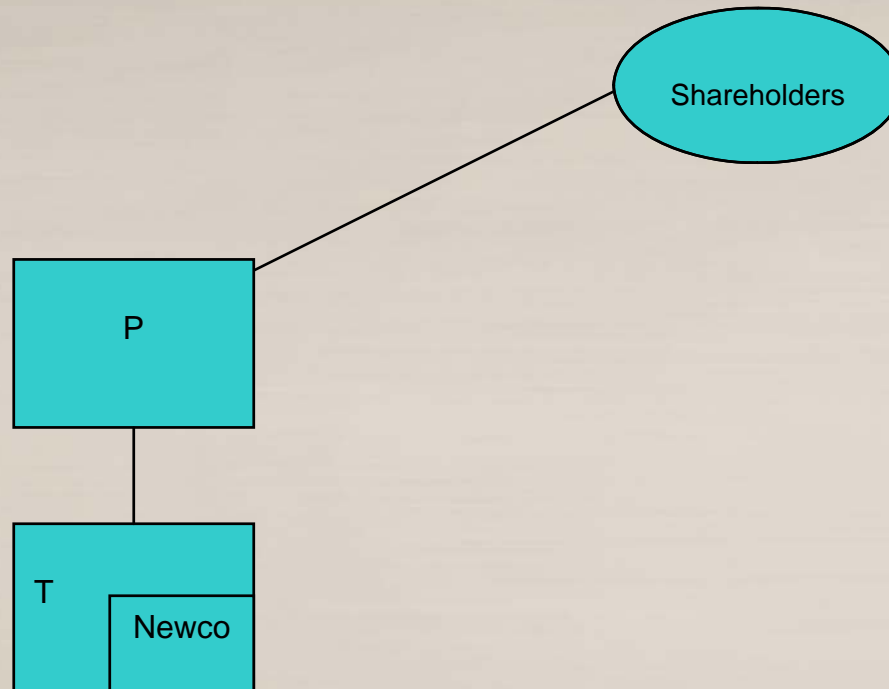
- After merger Target holds "**substantially all**" of its properties AND "**substantially all**" of Sub's properties
- Target's shareholders surrender in the merger Target stock representing "**control**" of Target **in exchange for Parent voting stock**

REVERSE TRIANGULAR MERGER

1.



REVERSE TRIANGULAR MERGER (continued)



P Voting Stock

T Shareholders transfer "control"

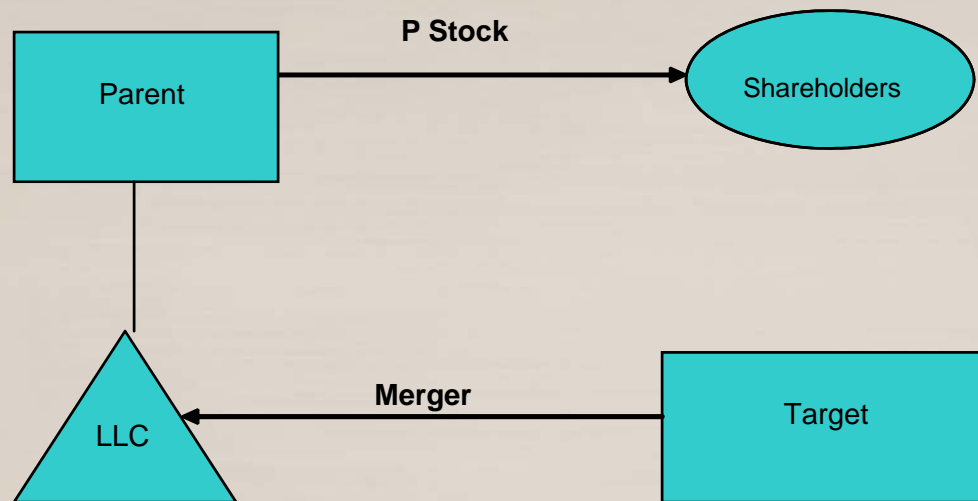
T must hold "substantially all" of Newco and T assets

GENERAL REQUIREMENTS

- Continuity of Interest (COI) = At least 38%
- Continuity of Business Enterprise (COBE)
 - the historic business test
 - the historic asset test
- Business Purpose

SECTION 368 AND LLC's

Merger Into Single Member LLC



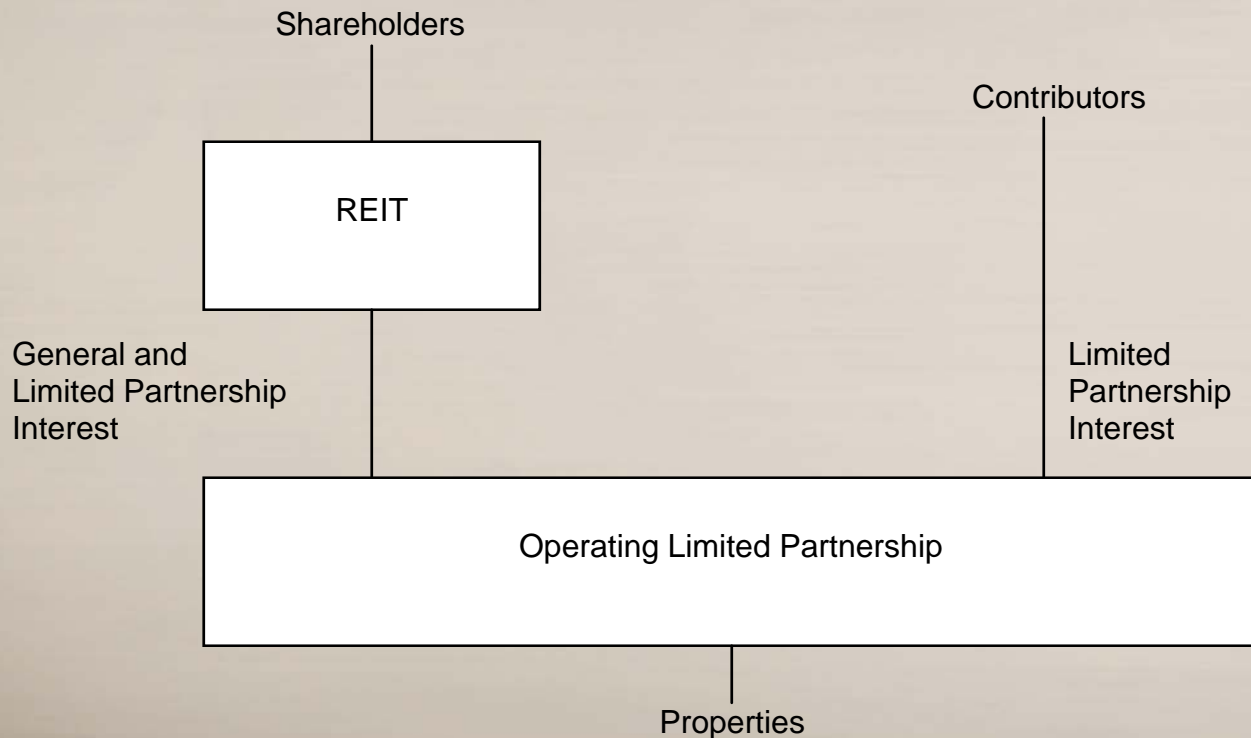
"A" Reorganization

COMBINING PARTNERSHIPS AND CORPORATIONS (REITS)

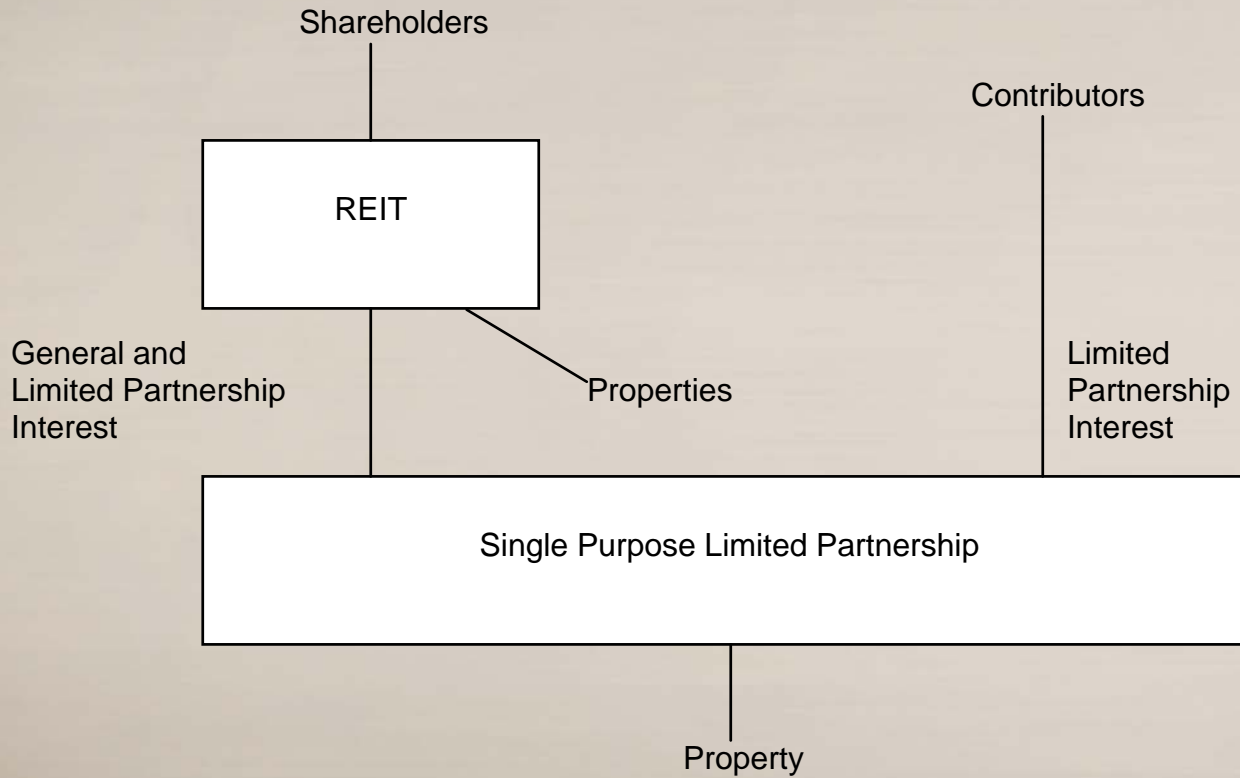
- Tax-free reorganization provisions do not apply to partnerships
- Contributions to partnerships are generally tax-free
- UPREIT structure designed to combine partnership property with REIT on tax-deferred basis
- Contributors get partnership interests exchangeable for REIT shares
- Tax concerns:
 - Disguised sale
 - 704(c) (built-in) gain
 - Relief of liabilities

TAX-FREE REAL ESTATE COMBINATION INVOLVING PARTNERSHIPS

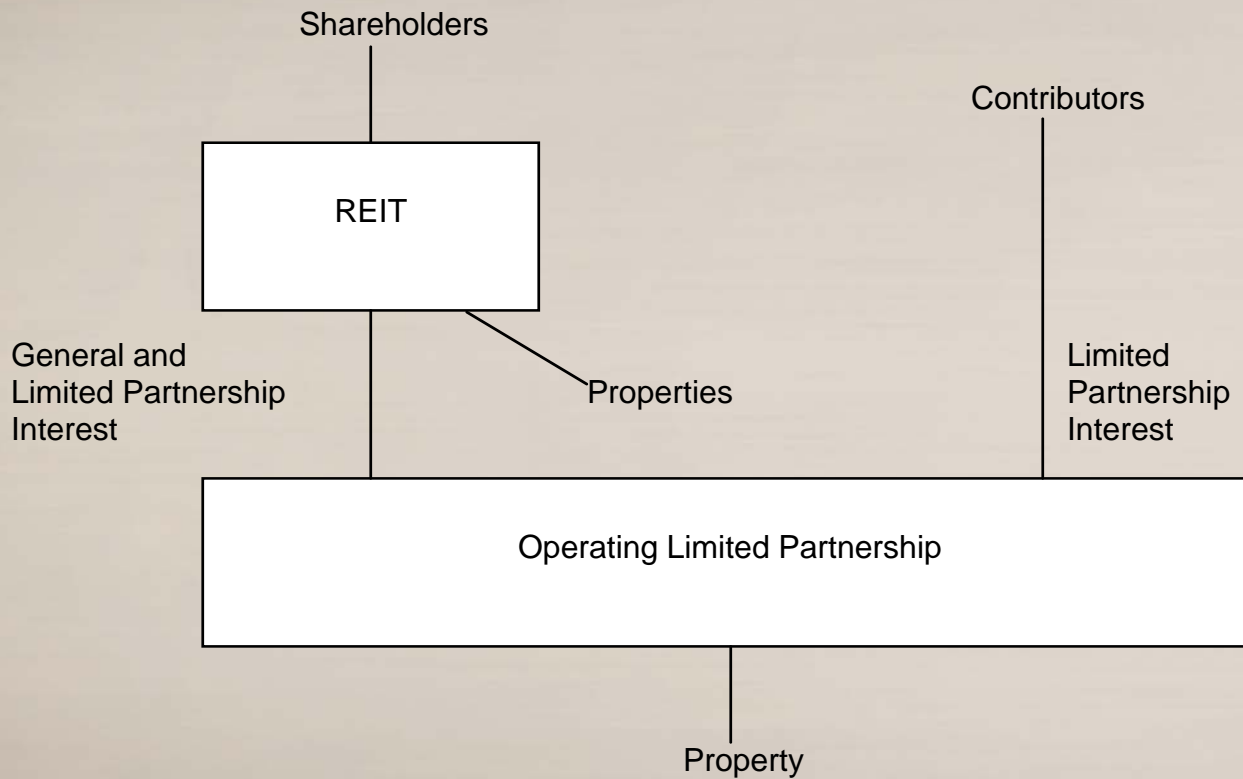
Umbrella Partnership REIT (UPREIT)



DownREIT



Hybrid Structure



Jeffrey A. Markowitz, Esquire

Miles & Stockbridge P.C.

10 Light Street

Baltimore, MD 21202

jmarkowitz@milesstockbridge.com

FIRM OVERVIEW

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10 Light Street
Baltimore, MD 21202

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