TAX AND ACCOUNTING CONSIDERATIONS WITH MERGERS AND ACQUISITIONS

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GENERAL OVERVIEW

- Merger, Acquisition, and Expansion Objectives
- Valuation
- Tax Considerations
- Accounting Considerations
- Integration
- Additional Considerations

DISCLAIMER

The information included in these slides is for discussion purposes only and should not be relied on without seeking individual legal, tax, and accounting advice from qualified professionals.

PRESENTERS

Mitchell McCoy, CPA
Audit Manager
Curtis Blakely & Co, PC

- Graduate of Stephen F. Austin State University with a Bachelor of Business Administration
- Holds a Master of Professional Accountancy
- Joined firm in 2013
- Active in firm's audit, tax and consulting services
    - Primarily telecommunication clients
    - Oil and gas companies
    - Non-profit organizations
    - Employment benefit plans
- Serves as Treasurer for the Texas State Racquetball Association
- Serves as a frequent guest lecturer for auditing classes at Stephen F. Austin State University

PRESENTERS

Rebecca VanNattan, CPA
Audit/Tax Manager
Curtis Blakely & Co, PC

- Graduate of LeTourneau University with a Bachelor of Science in Accounting
- Holds a Master of Business Administration
- Joined firm in 2014
- Active in firm's audit, consulting, and tax services provided to independent and cooperative telephone companies and non-regulated subsidiaries
- Active in firm's state tax compliance and planning
- Member Texas Society of CPA (TXCPA) and American Institute of CPAs (AICPA)
- Recurring speaker to accounting students at LeTourneau University
- Volunteer for the Greater Longview United Way - Volunteer Income Tax Assistance (VITA) program

IMPORTANCE OF CLEAR OBJECTIVES

- In a 2017 study by M&A experts, 92% of respondents said that their merger and/or acquisition fell short of expectations

  - Two most common disappointments and failures:
    - Failure to understand value drivers to generate a return
    - Inadequate merger integration

MERGER, ACQUISITION, AND EXPANSION OBJECTIVES

- Expansion of customer base within existing geographical markets
- Diversification of products and service
- Entry into additional geographical markets
- Talent acquisition or industry expertise

RESEARCH AND ANALYSIS

- Services currently offered
- Satisfaction levels with current provider
  - Typically performed via market research consultants
    - Customer surveys, research, etc.
- Financial strength of current provider
  - Profitability, cash reserves, and where they are in the business cycle
- Technology and capabilities
  - Compatible with existing technologies
  - Capacity, reliability, significant need for capital improvements

IMPORTANCE OF APPROPRIATE VALUATION

- Insures an accurate representation of value
- Provides basis for negotiations
- Protects members and/or shareholders from overpayment and unrealistic rate of return expectations

VALUATION TECHNIQUES

- Asset Based Approach
  - Directly measuring asset base and cost to replace productive capacity
- Market Approach
  - Based on sales of private and public entities of similar size and nature of operations
- Income Approach
  - Very detailed approach, present value of future economic benefit

TAX CONSIDERATIONS

- Tax Considerations are a Key Component of M&A Transactions

- Without proper planning and consideration, there can be unintended consequences and unexpected costs

- Tax implications can vary significantly depending on how a transaction is structured

PURCHASE STRUCTURES

- Two Most Common Avenues for Structuring Transactions:
  - **Asset Purchases:** Buyer typically creates a new entity that purchases individual assets from the target entity. Seller retains ownership in the selling entity and uses proceeds to pay-off debt
  - **Stock Purchases:** Buyer acquires Seller's ownership interest (stock, membership interest, partnership interest, etc.) in the target entity

ASSET PURCHASES

Advantages	Disadvantages
Step-up basis of assets to FMV	Tax cost to seller is generally higher
Depreciation and amortization deductions on assets with stepped-up basis	May need to re-title assets and renegotiate contracts
Selection of specific assets and liabilities	Potential sales tax due on asset purchases
Amortization of goodwill	Tax attributes such as NOLs do not carry over to purchaser
Selection of specific employees	

STOCK PURCHASES

Advantages	Disadvantages
Ease of administrative process	Assets and liabilities are transferred at carrying value
Assets do not need to be re-titled	No step-up in basis of assets to FMV
Seamless transfer of contracts and permits	Potential for unknown liabilities
No sales tax generated	More difficult to select specific assets and liabilities
Generally, capital gain tax rates for seller	Amortization of goodwill is not allowed
Seamless transfer of employees	

TAXATION SUMMARY

- Generally: **Buyers** prefer **Asset Purchases** and **Sellers** prefer **Stock Purchases**
- Certain stock acquisitions can be treated as the purchase of assets for tax purposes if the appropriate tax election is filed
- Every transaction is unique requiring a detailed review of applicable law
- Best practice for purchasers and sellers to both consult with tax advisors early in the process to fully understand the tax implications

ACCOUNTING CONSIDERATIONS: EQUITY PURCHASE

- Determination of "significant influence" is critical to determining appropriate accounting
  - 1% - 20% Ownership
    - Typically recorded as a cost basis investment
  - 20% - 50% Ownership
    - Can be cost or equity method, depending on level of "influence"
  - >50% Ownership
    - Consolidated

ACCOUNTING CONSIDERATIONS: ASSET PURCHASE

- Entities must determine fair market value of assets being purchased
  - Appraisals, similar sales in open markets, etc.
- If purchase price exceeds fair market value, goodwill is recorded
  - Goodwill is required to be assessed for impairment
    - Declines in revenues, increased competition, etc.
- Private company treatment elections are available
  - Allows goodwill to be amortized over 10 years

PART 32 GUIDANCE

Equity Purchase	Asset Purchase
Account 1401- Investment in Affiliated Companies	Assets recorded in normal part 32 account structure
Account 7300- Adjustment for Investment Earnings	Account 2005- Telephone Plant Acquisition Adjustment
	Account 2007- Goodwill
	Push down accounting election

INTEGRATION CONSIDERATIONS

- Financial operations
- Integrating accounting systems
- Internal controls and processes
- Operational procedures
- Company culture
- Organizational chart and reporting hierarchy
- Document retention
- Benefit coverage

INTEGRATION STRUCTURE AND BEST PRACTICES

- Involve various levels of management
  - Do not restrict only to senior management
- Divide into functional categories
  - Accounting, sales/marketing, technology, etc.
- Customer engagement
  - Notifications, assurances, establish credibility
- Strong communication internally and externally

ADDITIONAL CONSIDERATIONS

- RUS Borrowers
- NTCA R&S Participants
- Cooperative Membership

ADDITIONAL CONSIDERATIONS

- Organization Structures
  - Consider internal reorganization
    - Ways to accomplish merger tax free
    - Ways to liquate subsidiary into parent tax free
      - Parent must own at least 80% of subsidiary
      - Subsidiary must be solvent
      - Additional requirements
  - Consider moving subsidiary activities into Cooperative
    - Possible income and sales tax savings

QUESTIONS?

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