

Getting the house in order

Legal and tax considerations in internal restructurings

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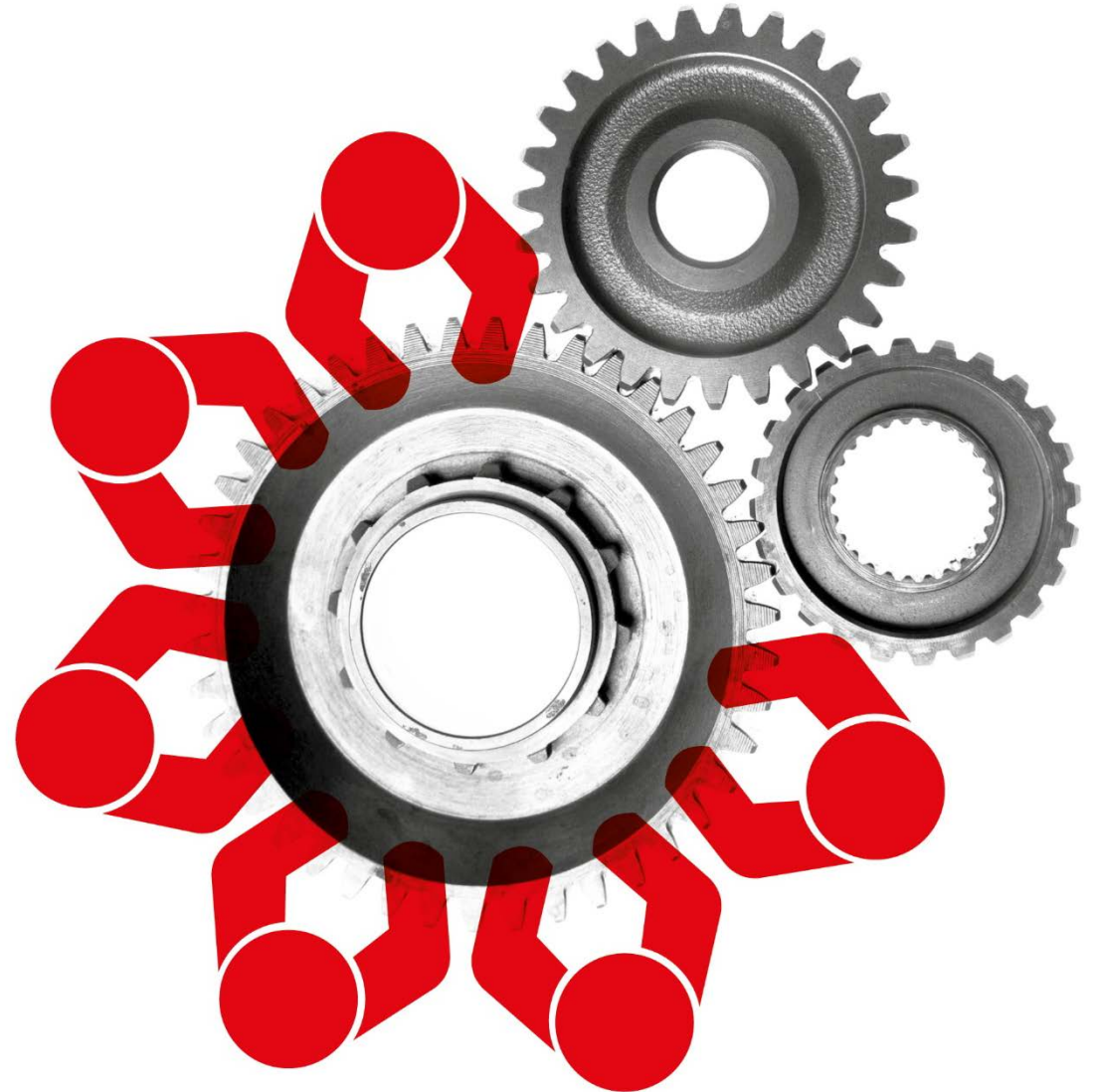
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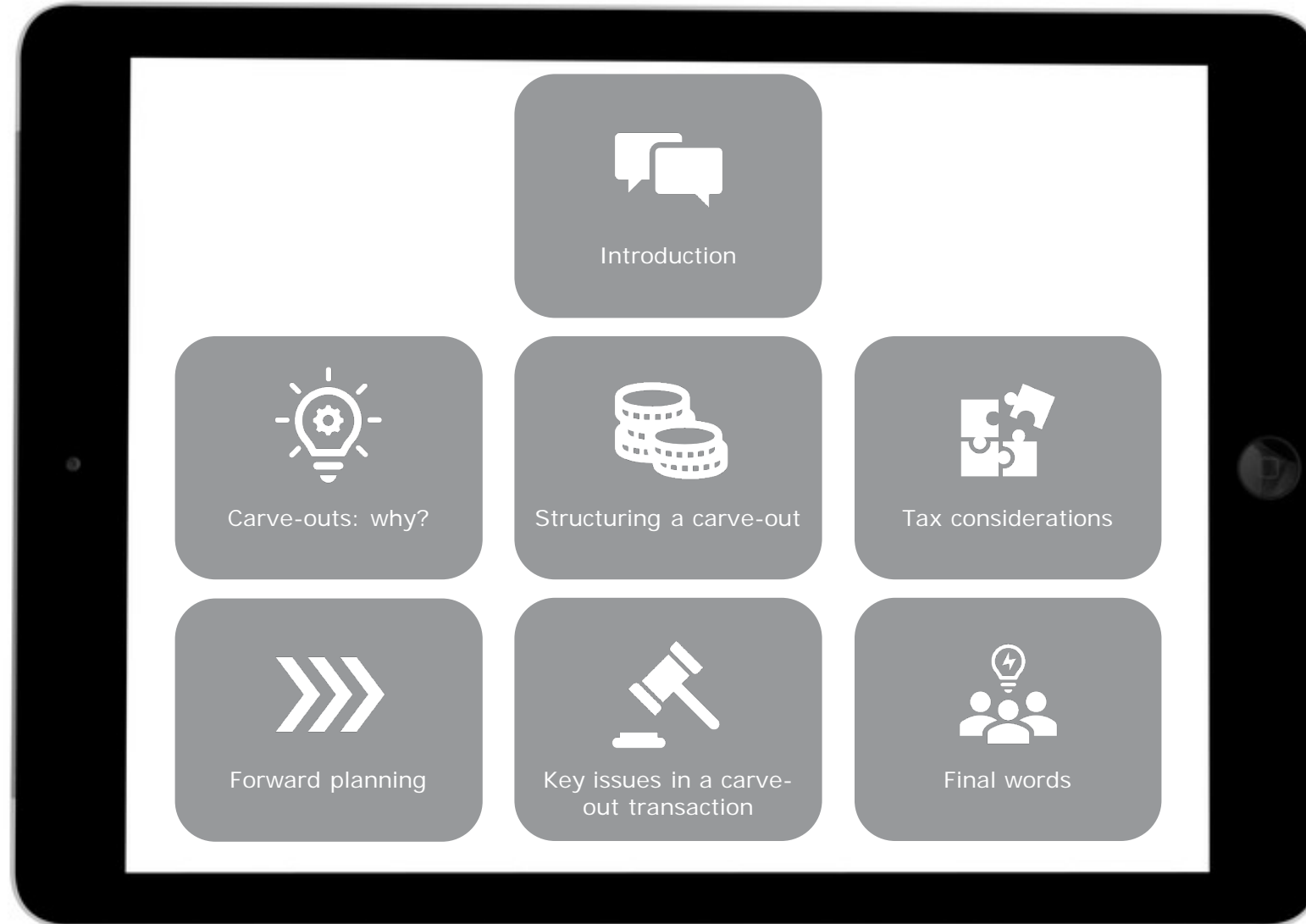


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Session Overview





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Key issues in a
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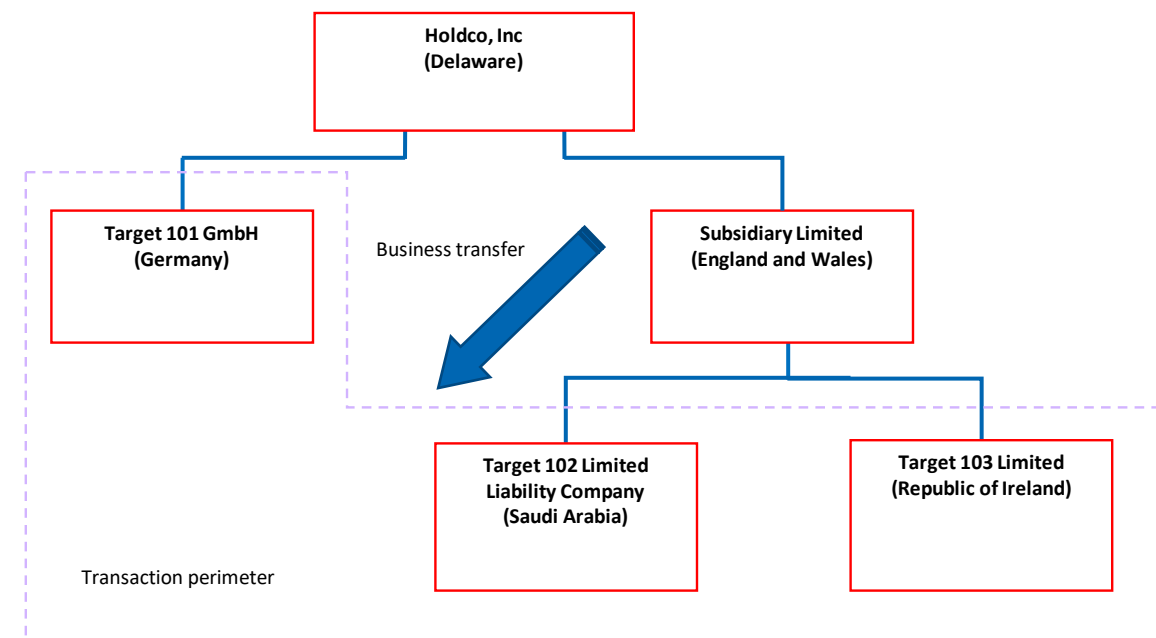
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Introduction

Corporate carve-outs

Why carve-out?

- Disposition of a subsidiary (or multiple subsidiaries) or portion of a business (business line, division, etc.)
 - Transactions are often to sell an underperforming business line or non-core asset or to list a business division in its own right; could be dual track
- Some of our largest recent transactions were sales of large divisions of clients:
 - G4S' disposal of its conventional cash handling business
 - Rolls Royce plc's sale of its Marine Engine division
 - Capita plc's disposal of Capita Asset Services





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Corporate carve-outs

Typical reorganization lifecycle

Legal implementation of any reorganization involves a number of workstreams, many of which run simultaneously. The carve-out is no different.





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Strategy of corporate carve-outs

Recent drivers and trends towards carve-out

NON-CORE business activities

- Products/services, plant(s) or cost centers not core to primary business
- Downward pressure on enterprise value
- Could realize full potential under new ownership

STRATEGIC DIRECTION shifting

- COVID-19 impact on broader corporate strategy impacting long-term business direction
- Limited expectations for carve-out value improvement if transaction shelved for 12-24 months

LIQUIDITY CRUNCH impending

- Ties up resources and capital that could be redeployed to primary business
- Generate cash via sale for other uses

EXTERNAL FACTORS other

- Write-down impact on overall fiscal year performance now vs. future periods
- Shareholder activism
- UK – Brexit



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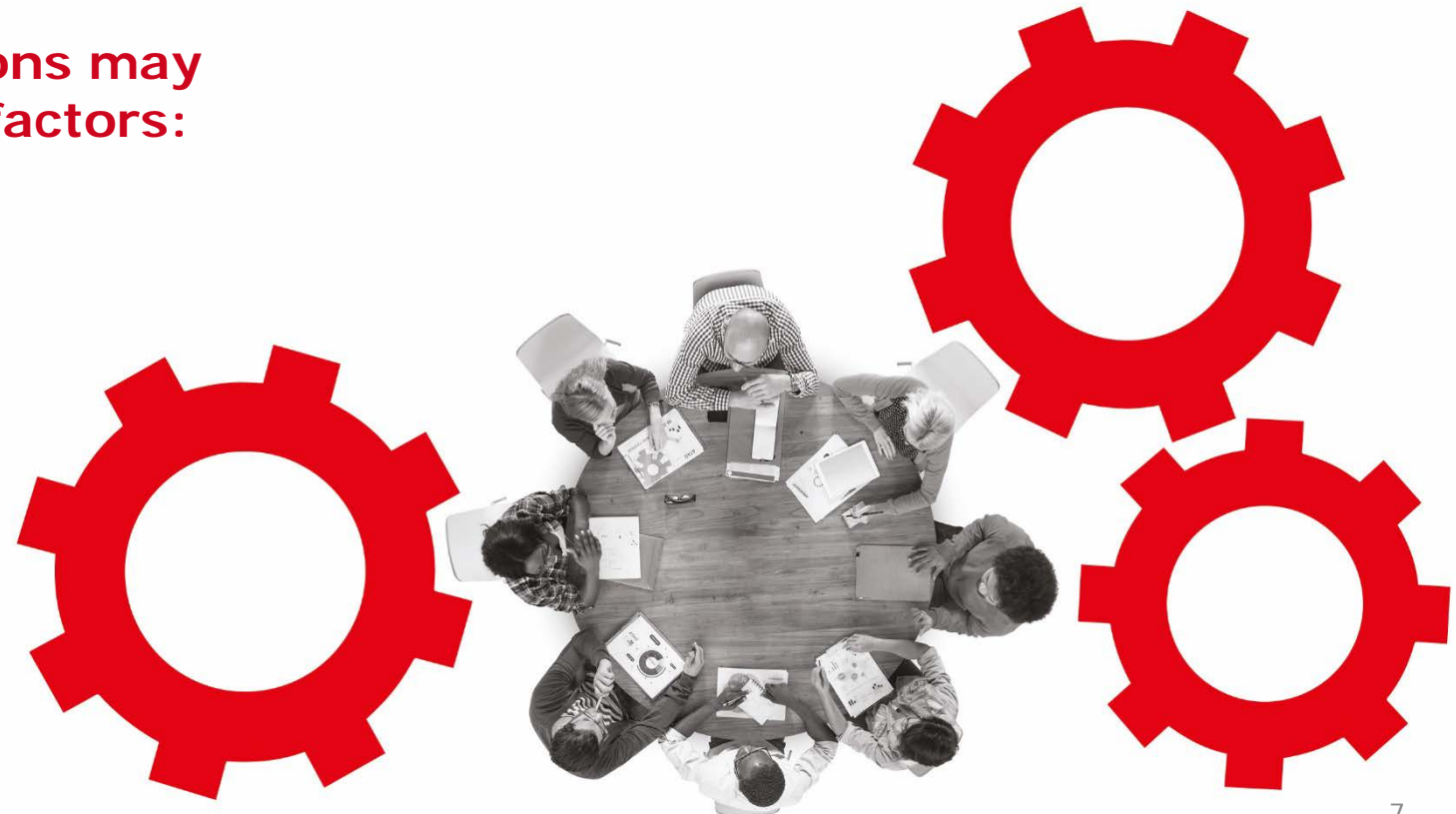
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Structuring carve-outs

General

Structures of carve-out transactions may differ depending on a number of factors:

- Location of business within corporate structure
- Joint ventures/third-party partner considerations
- Tax implications – always key
- Ownership of material assets and liabilities





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Structuring carve-outs



Things to consider – top tips

- **Where early consideration can be vital**
 - Third-party shareholder/partner structures
 - Clear communications with all stakeholders (e.g., advisers and counterparties to contracts)
 - Early engagement
- **Strong project management is vital**
 - Set up good systems early!



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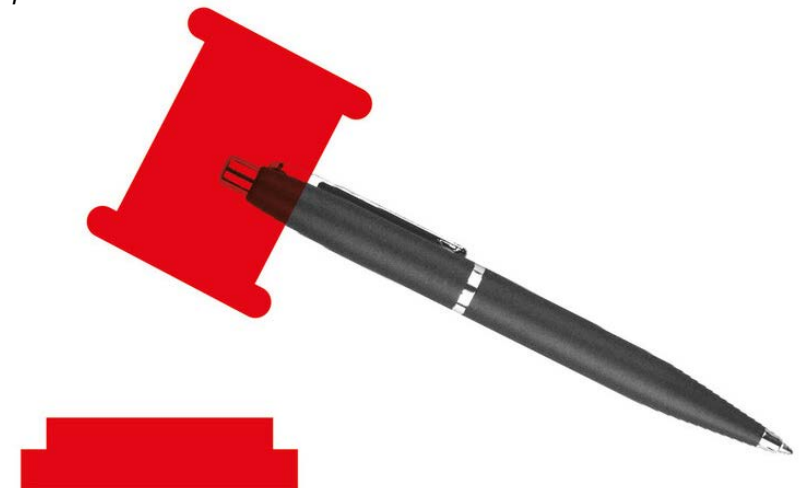
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Tax considerations

- What is being bought/sold?
 - Equity of an entity versus assets
 - If equity, what type is the tax classification of the entity (corporation, partnership, disregarded entity)?
- US vs. non-US
 - Purchase/sale of non-US subsidiary presents additional complexity
- Importance of modeling
 - What is the expected tax cost?
 - Will structure impact pricing (e.g., whether buyers will pay a premium for a deal that delivers a step up in the basis of the target assets)?
- Cash purchase/sale or open to alternatives?
 - Buyer equity or JV; IPO; or Spin-off
 - A spin-off may be tax-free, but if the applicable requirements are not satisfied, a spin-off will be taxable to both the distributing corporation and the shareholders receiving the distributed corporation





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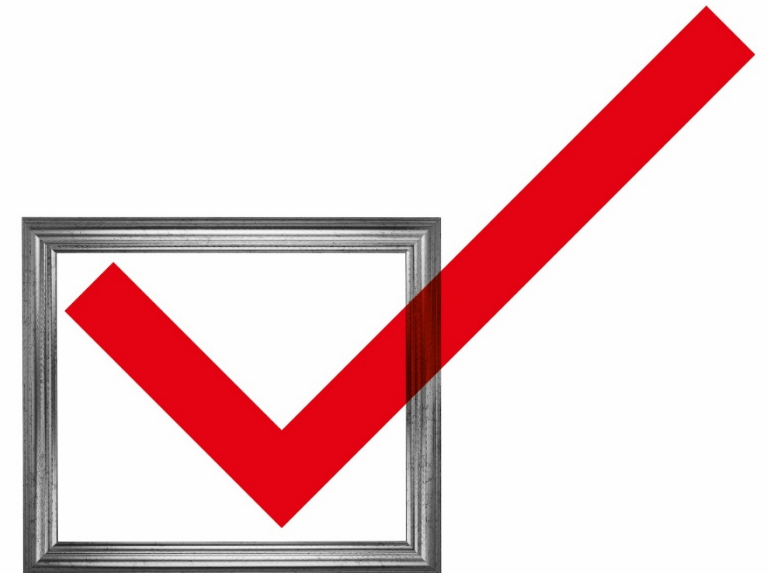
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Tax considerations

- Stock deal
 - Buyer gets cost basis in stock, no step-up in underlying assets
 - Seller likely has less gain – assuming a higher basis in stock
 - Target entity retains historic (tax and non-tax) liabilities
 - Seller will generally prefer to sell stock
- Asset deal
 - Buyer gets cost basis in assets which can be amortized
 - Seller likely has more gain – assuming a higher basis in stock
 - In case of corporate seller, may have two levels of tax
 - Buyer generally does not take historic (tax and non-tax) liabilities
 - Buyer will generally prefer to acquire assets





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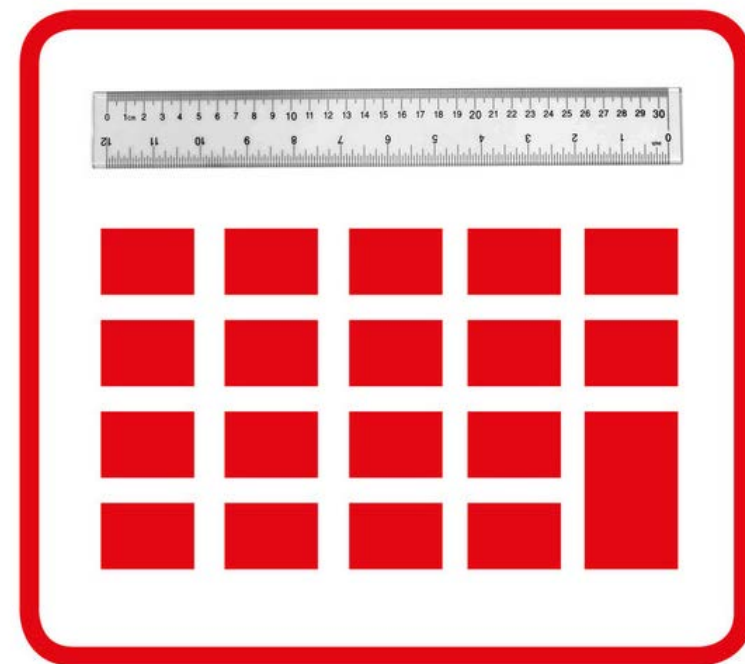
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Tax considerations

- The Tax Cuts and Jobs Act has had a significant impact on tax structuring considerations
 - The cut in the corporate tax rate from 35% to 21% was permanent
 - Many other provisions are temporary and will expire unless extended
- The Biden Administration has proposed a number of tax policy changes that would impact individuals and businesses, among them:
 - Increasing the corporate tax rate from 21% to 28%
 - Rolling back income tax reductions for individuals with incomes above \$400K (i.e., top marginal rate from 37% to 39.6%); taxing capital gains and dividends at the same rate as ordinary income for individuals with incomes above \$1M; and taxing unrealized gains at death





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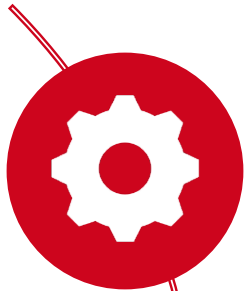
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Project Management: what can go wrong?



Signatories may be missed



Deliverables may be missed



Deadlines may be missed



Signing and closing may be
delayed



Employee consultations or
works council approvals may
be missed



POA may need to be re-executive
if expiry dates are not long
enough or approval authority is
inadequate



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The importance of additional planning during COVID-19

Gathering the underlying information

- Consider 'working from home' implications in the planning process
- Have a clear, uniform request list in to which key stakeholders have input, and which is used globally and is clearly managed by identified points of contact/project managers with clear responsibility
- Have lawyers and accountants work together to avoid duplication of requests/multiple pieces of paper
- Consider what internal corporate restructuring is necessary
- Consider need for new corporate entities to house business line or if existing structure suffices





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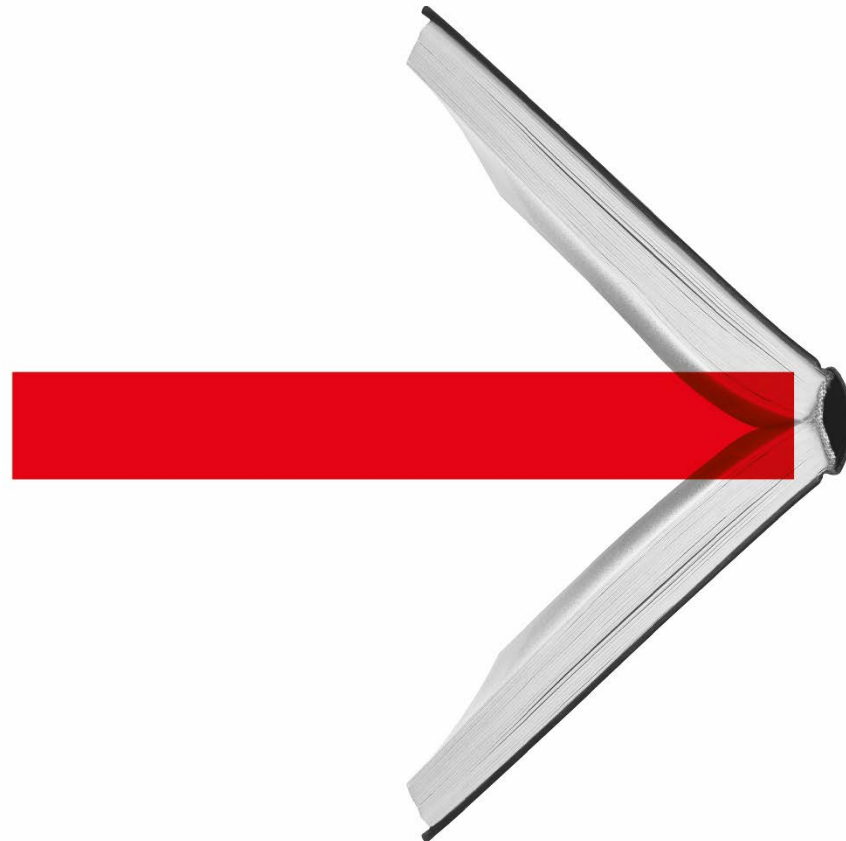
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The importance of additional planning during COVID-19



Traditional challenges become more challenging during COVID-19:

- Delivering
- Project management
- Data volume
- Execution issues
 - Logistics
 - Powers of attorney
 - Notaries/apostille
 - Electronic execution



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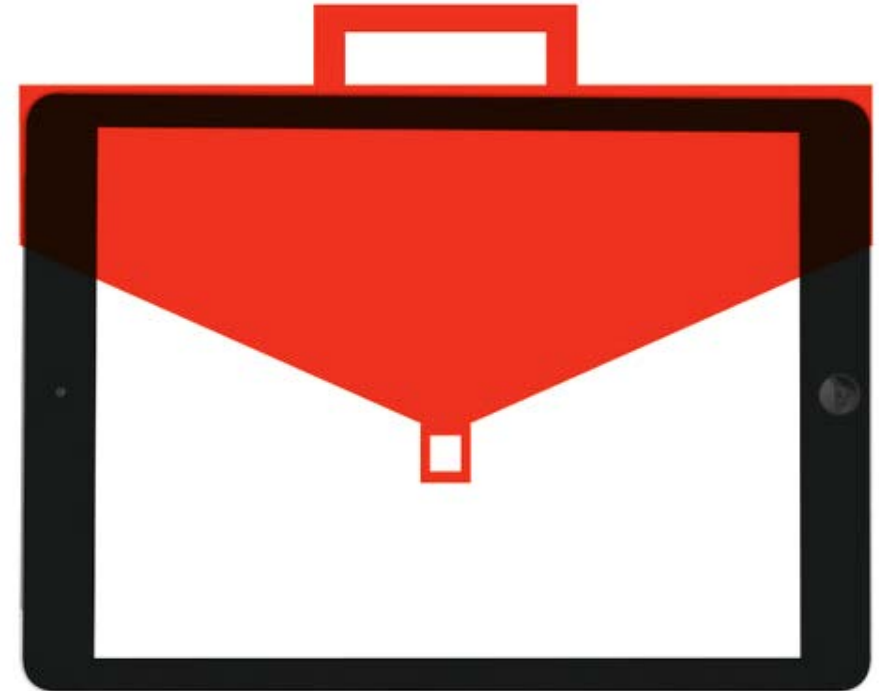


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Key issues in a carve-out transaction

IP and IT issues

- Perhaps the most important category to consider in your sector
- Who owns the IP? Does it need to be assigned?
- IP licenses that need to be terminated?
- Shared IP
- Is new IP required as part of sale? (re-branding?)





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Third-party consents and notices

Business contracts

- Material customers/suppliers
- Change of control; assignment; novation
- Assigning contracts to fit within transaction perimeter?
- Partial assignment of contracts?

Finance

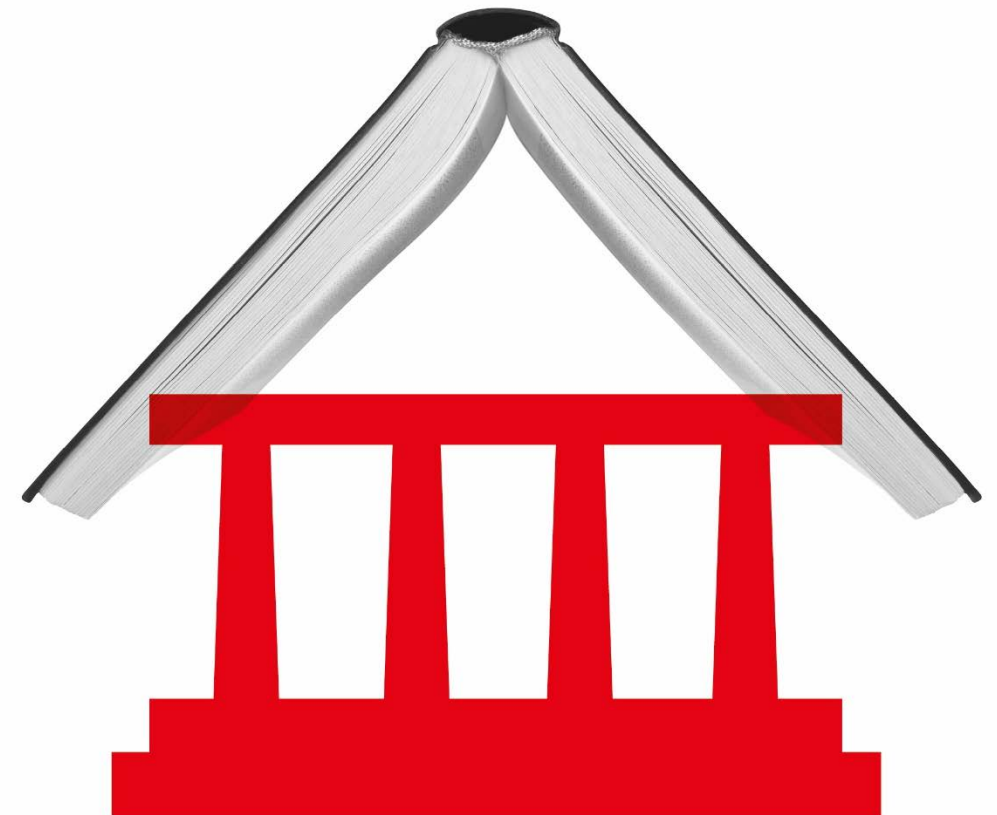
- Lenders

Real property

- Landlords

Regulatory

- Regulatory (e.g., permits, operating licenses)





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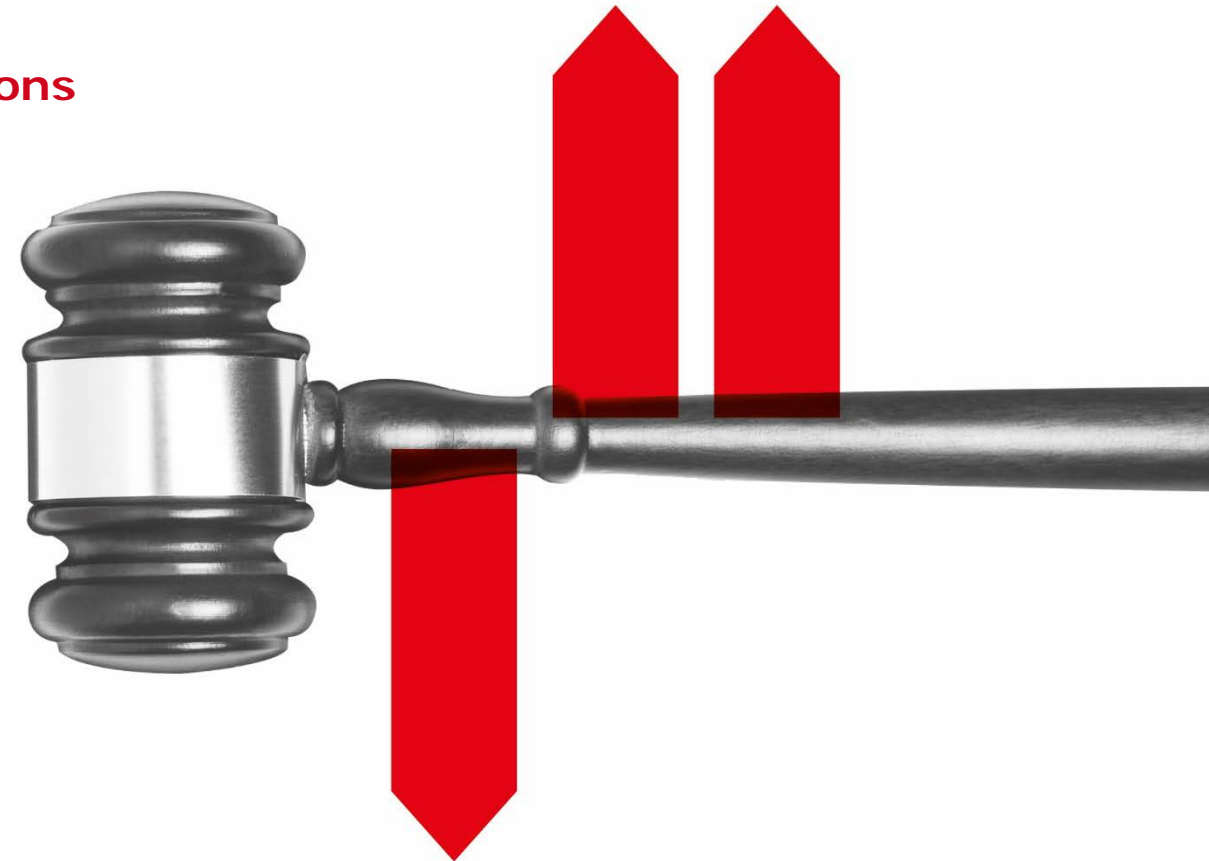
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Key issues in a carve-out transaction

Shared assets

Shared agreements and intercompany considerations

- Global and shared agreements
- Intercompany agreements and intercompany debt
- Shared “back-office” support services
- Shared productions/distribution operations
- Shared employees
- Shared real estate
- Insurance policies
- Treasury and finance support





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Key issues in a carve-out transaction

Historical liabilities



Ongoing
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support



Retention of
certain
liabilities?



Retention of
liabilities of
shared assets



Consider how
historic
liabilities
impact
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Indebtedness and encumbrances

- Separation of bank accounts?
- Parties to credit facilities? Capital leases?
- Lien releases
- Intra-group financing
 - Allocation of debt
 - Repayment
 - Waiver (noting potential tax downsides to the same)
 - Assigning/transferring the debt/notes receivable





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Key issues in a carve-out transaction

Employees

- Confirming which entity(ies) employs employees of business
- Shared employees
- Employees carved-out of transaction
- Are all benefits centralized? Are there any benefits that are not centralized?
- Are there any outstanding employment claims?
- Timing and messaging (non-US)
 - Re-deployment where no TUPE transfer
 - Works councils/unions
 - Redundancies
 - Pensions/benefits





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Conclusion

- Do not underestimate the time that a transaction can take. The more time you can give yourself (and advisors) the better
- Prior planning and establishment of systems can be the differentiator between a well-managed process and timetable extensions, particularly where transitional services are required
- Validate and interrogate the steps/plan from every angle
- Collate information in a uniform, coordinated manner
- Be alive to employee consultation and people dynamics
- Curve-balls will arise, but can typically be dealt with provided they are identified with sufficient time



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Q&A



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