Tax Integration

Managing tax implications during integration

By Mark Boyer and Gregg Nahass

July 2017

At a glance

The volume of tax work and activities to be completed as part of a deal can be overwhelming.

Planning early in the transaction can significantly impact the combined company's future effective tax rate, cost of tax compliance, and ability to utilize tax attributes.

Tax considerations are also the drivers that help shape legal entity integration, transfer pricing and operating model rationalization, and employee deployment.

© 2019 PwC. All rights reserved.

Introduction

Amid the excitement of a transaction, the tax aspects of integration are often viewed as overwhelming, overly complex, and “back-burnered” to the realm of post-deal business integration timelines. Having an aligned tax, business, and transaction strategy can help buyers focus their efforts on critical integration activities and avoid costly mistakes, as tax considerations are the drivers that help shape legal entity integration, transfer pricing and operating model rationalization, and employee deployment.

While executing a tax strategy and integration may be admittedly challenging, careful planning before and immediately following transaction close can have a significant impact on the combined company’s future effective tax rate, cost of tax compliance, and ability to utilize tax attributes.

Although the tax positions of a target company are carefully studied as part of the due diligence process, acquiring companies often fail to pay enough attention to the intricate requirements of integrating the operational aspects of the tax structure and tax department function to enable a smooth transition.

The early involvement of the tax department in integration decisions is critical because it enables the company to achieve desired pre-acquisition structuring while coordinating with other functional teams such as legal, finance, IT, and HR to prepare a plan for Day One and post-acquisition activities.

.

The issues our clients face, the actions we help them take

An effective integration process emphasizes the importance of getting the fundamentals of integration in place as quickly as possible during a deal to help minimize disruptions and achieve synergies. Rapidly launching integration efforts to Set the Course, Plan for and Execute Day One, and Design and Maximize Future-State Operations is a critical success factor. Figure 1 illustrates the integration process.

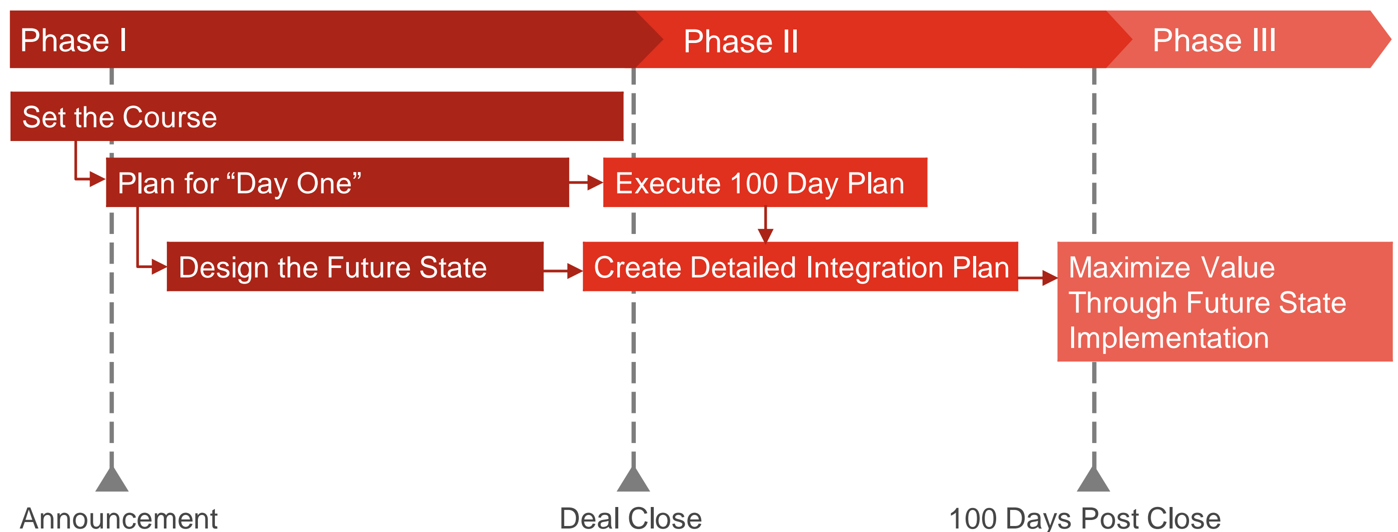

Figure 1. The PwC integration process follows a sequence of coordinated steps to focus resources and capital on the right activities at the right times.

Set the course

A merger or acquisition, like other large scale corporate change, is an excellent opportunity to set a new course, both operationally and across the various support functions of the newly combined business. Setting the course involves defining clear objectives and establishing clear leadership and role clarity during the transition. This empowers members of the integration team—including Tax—to communicate effectively and take decisive action.

Setting the course for tax integration success requires a disciplined focus on key value drivers:

- Creating a tax efficient structure that produces an improved effective tax rate and allows for efficient cash movement and redeployment to where it is needed, both inside and outside the US
- Rationalizing the overall legal entity structure to improve compliance and administrative costs while preserving potential tax attributes
- Designing a reporting system and managing documentation that will allow for efficient tax accounting and compliance

Early stage cross-functional communication is critical to successful tax integration since tax planning can be significantly impacted by Legal, Finance, IT, HR and other functional decisions. For example, the decision to change a legal entity's structure or historical operations, adopt new general ledger systems, relocate material functions, or terminate employees can have a significant impact on the combined company's tax position and ability to comply with tax accounting and tax return deadlines. Leading practice is to identify a tax integration lead—a person who is responsible for identifying sub-teams and leaders for each tax area of interest.

The tax integration lead is primarily responsible for ensuring that tax matters are addressed by other functions and tax-related input is considered within other major workstreams, leading to seamless integration planning. Please see Figure 2 for key areas of tax integration focus.

	Phase I – Planning & Day One	Phase II – Interim	Phase III – End State
Global structuring	Legal entity and tax structure plan	Consolidate and rationalize entities	Execute and manage plan to final entity structure
US Federal tax planning	Conduct accounting methods study	Complete transaction cost analysis	Make elections and file, as applicable
Tax compliance	Identify jurisdictions and accounting changes	File pre- and post closing short-period tax returns	Compliance with statutory reporting requirements
State and local tax	Identify filing requirements due to change in control (CIC)	File pre- and post closing short-period tax returns	Compliance with reporting requirements
Purchase accounting	Prepare tax valuation	Record tax entries related to transaction purchase	Report as needed
Transfer pricing	Transfer pricing analysis with debt capacity	Implement transfer pricing policies and procedures	Monitor and document transfer pricing
	Announcement	Deal Close	100 Days Post Close

Figure 2. This chart outlines key areas of integration focus for Tax, along with their typical timing across the PwC integration process.

Plan for and execute Day One

Even if the best decisions are made as you Set the Course, much can go wrong at close without proper planning and execution. While Day One is a milestone for celebration, it is also the time for smooth transition of essential operations.

The goal for Day One is to have a plan in place to manage the combined company's tax function and meet the financial and compliance reporting obligations of the collective organization over the next nine to 12 months. Ideally, while setting the course, critical decisions have been made jointly with cross-functional teams, and now it is time to execute the plan.

While setting the course, many companies decide that duplicative legal entities within a jurisdiction will be eliminated post-close in an effort to reduce complexity and the cost of compliance (both for tax return and statutory account purposes). However, the need to reduce complexity must be balanced against whether there are any valuable tax attributes—such as tax losses, credit carryforwards, or high tax basis—which may be inadvertently eliminated in the absence of careful structuring.

For example, in some jurisdictions a merger of a legal entity with tax loss carryforwards may prohibit the use of the tax losses. In other jurisdictions, the ability to preserve tax losses depends on whether the buyer or target's legal entity survives the merger. It will be critical for the tax integration team to be involved in the decision about how best to eliminate legal entities.

Tax due diligence procedures may have been undertaken while setting the course to identify potential historic tax liabilities inherited in the transaction. It is critical that tax exposures identified during due diligence are further researched, properly documented, and recorded in purchase accounting. Note that under FAS 141R, liabilities not identified in purchase accounting (generally within one year of the close of the acquisition) and not accrued as part of purchase accounting will result in an adjustment directly to the provision for income taxes in the period incurred.

Additionally, the buyer should anticipate people attrition in the target company's tax and finance department. During this transition it is critical to quickly identify, secure, and understand the tax related documentation of the target company to ensure the combined entity will be able to comply with its tax accounting and tax compliance deadlines. The buyer may be required to defend the historic tax positions taken by the target company under examination long after the target company's personnel have left the company.

Some things to remember when integrating Tax functions

- **Proactively manage cross-functional dependencies between Tax and other back-office functions, including Legal, Finance, IT, and HR.**
  The decisions made by other functional areas may have an adverse impact on the combined company's tax position without proper tax input. Be sure there is a clear process for identifying and escalating tax review of cross-enterprise integration activities.
- **Understand what's in and what's out.**
  It is critical to identify which tasks are owned by the tax function. Areas such as Section 280G (i.e., golden parachute provisions) and Section 409A (i.e., deferred compensation) are often handled by HR or Legal, and cash redeployment is often handled by Treasury.
- **Work with advisors that have appropriate global reach.**
  The more globally dispersed your operations, the more you will need to depend on local legal and tax advisors to deliver on plans that are carefully tailored to the local taxation system complexities.
- **Develop an integration schedule that meets the ongoing financial reporting and compliance obligations.**
  Quarterly tax accounting and tax return deadlines will still need to be met while the integration process is underway. Be sure that accounting and tax information required to meet these deadlines continues to be accessible during the integration process. Additionally, the complexity of reporting for the combined operations must be considered.
- **Design a tax organization structure with an optimal number of people with the right skills in the right positions to support the integration.**
  The integration process and resulting tax structure may require tax personnel to transition to new roles, or may require the hiring of personnel with the optimal skill sets to support the new organization. Another approach may be to outsource tax planning to a third party.

Design and maximize future state operations

A critical post Day One tax integration activity is to develop a strategic plan for the combined function. The goal is not simply to select leadership, reduce headcount and enable continued operations, but to improve tax-related activities — positioning the new department to be effective in the future. The integration strategy should be aimed at establishing proper controls, increasing efficiency, and reducing risk.

Proper planning for Tax integration should address each of the following matters, and more

Purchase accounting

- Ensure potential tax exposures are properly identified and recorded, where appropriate
- Assess the need to record or release a valuation allowance on acquired tax attributes
- Evaluate IP ownership to ensure appropriate deferred tax accounting
- Assess stock option plan assumptions to ensure that appropriate deferred tax accounting is applied
- Establish appropriate APB 23 assertions (cash permanently invested off-shore)

Tax compliance

- Identify jurisdictions where combined or stand-alone returns must be filed going-forward (US federal and state, foreign jurisdictions)
- Identify requirements to file pre- and post-closing short-period tax returns
- Assign responsibility for the tax compliance function of the combined business in the various jurisdictions

Legal entity simplification

- Review combined legal entities by jurisdiction
- Assess potential elimination of legal entities and analysis of any adverse tax consequences associated with their elimination (e.g., triggering of tax, loss of tax attributes, etc.)
- Coordinate with other functional areas to confirm proper documentation of legal entity rationalization and ensure intended tax treatment
- Identify local country filings and other requirements

US Federal tax planning

- Prepare additional documentation to support future attribute utilization (i.e., Section 382 analysis), and identification of planning opportunities to more effectively utilize existing tax attributes going-forward
- Conduct accounting methods study and execute advantageous accounting methods changes where relevant
- Complete transaction costs analysis and cost segregation studies, as applicable
- Make tax elections related to the completed transaction as applicable (Section 338 elections, election to waive NOLs, new election to file a consolidated return, etc.)

Global structuring

- Develop tax efficient value chain (e.g., consider U.S. versus foreign sourcing of income, location and profitability of manufacturing operations, use of principal distribution companies)
- Plan business alignment of non-US intellectual property (IP)
- Ensure IT platforms are equipped for additional compliance burdens
- Consider global treasury strategies such as the use of internal leverage, intermediate holding companies, financing entities, etc.
- Identify whether off-shore cash can be redeployed and at what cost
- Pursue planning opportunities to more effectively utilize foreign tax credits
- Examine implications of new post-acquisition structure of current and proposed transaction flows on indirect tax (e.g., VAT, customs or duties)
- Identify and assess foreign currency issues

Transfer pricing

- Conduct transfer pricing analysis to ensure appropriate pricing of various related party transactions
- Assess debt capacity and supportability of inserted leverage and interest rates
- Consider how new IP platform, global financing structure and combined operations of legacy business and acquired company's business will change transfer pricing policies going-forward
- Support transfer pricing methodologies with contemporaneous transfer pricing documentation

State and local tax

- Identify and complete tax elections necessary due to change in ownership (e.g., water's-edge elections, state consolidated return elections)
- Assess impact of change in ownership on credit and/or incentive packages of acquired entities, including need to terminate/recertify credits
- Assess sales and use tax filing requirements under new integrated structure, and need to collect additional documentation (i.e., exemption certificates) to strengthen compliance of acquired business
- Consider need for additional state registrations (e.g., sales/use tax, payroll/unemployment tax, historic wage base)

Conclusion

Consolidating tax functions is often an important part of two companies coming together, and it often has a high impact on the overall integration plan of the entire transaction.

Early involvement of the tax department in integration decisions is critical to managing the tax implications of the deal, managing the effective tax rate, ensuring compliance with regulatory laws, and maximizing the deal value.

Aligning the tax strategy to the business strategy helps to enable the combined businesses improve the company's long term tax position. Aligning tax strategies and creating an integration plan to sync a tax-efficient legal entity structure with the target operating model of the combined businesses should be done in conjunction with other cross-functional activities of the company. M&A transactions place a significant burden on tax functions due to the volume of deal related activity occurring from diligence through post transaction close. As a result, the tax function should plan early for the myriad of activities across the enterprise requiring tax input and review. The tax function should be prepared to staff appropriately for managing the volume of work.

Contact information

For more information, please contact one of our practice leaders or your local PwC partner.

Gregg Nahass, Partner
US and Global Leader,
M&A Integration
310 200 2797
gnahass@pwc.com

Consumer Markets

Boston	Derek Townsend Michael Ross	derek.b.townsend@pwc.com michael.d.ross@pwc.com
Dallas	**Mike Giguere (US Leader)** Sushil Ahuja	**mike.giguere@pwc.com** sushil.ahuja@pwc.com
New York	Jim Smith Ali Furman Mike Pokorski Tony Filipe*	jim.smith@pwc.com alison.furman@pwc.com michael.pokorski@pwc.com tony.filipe@pwc.com

Financial Services

Boston	**Paul Kennedy (US Leader)**	**paul.g.kennedy@pwc.com**
Chicago	Josh Carter	joshua.carter@pwc.com
Denver	Vitaly Vishnitsky	vitaly.vishnitsky@pwc.com
New Orleans	Andrew Wooten	andrew.k.wooten@pwc.com
New York	Jay Remis*	jay.l.remis@pwc.com

Health Services

Atlanta	Robert Shuman	robert.g.shuman@pwc,com
Chicago	Angus Buchanan	angus.buchanan@pwc.com
Dallas	Matamba Austin	matamba.austin@pwc.com
New York	**Michael Wright (US Leader)** Sky Milch	**michael.r.wright@pwc.com** sky.milch@pwc.com

* Managing Director

Contact information (continued)

Industrial Products and Services

Atlanta	Joe Balog Marcus Simms	joesph.p.balog@pwc.com marcus.s.simms@pwc.com
Boston	Conrad Balejko Daniel O’Neill	conrad.balejko@pwc.com daniel.a.oneill@pwc.com
Chicago	**Lev Holubec (US Leader)** Lawrena Colombo Jennifer Farkas Manish Kumar Matthew McCurdy*	**lev.w.holubec@pwc.com** lawrena.clombo@pwc.com Jennifer.a.farkas@pwc.com manishk@pwc.com matthew.d.mccurdy@pwc.com
New York	Mike Fiore Kevin Kloske	michael.fiore@pwc.com kevin.kloske@pwc.com

Technology, Media, and Telecommunications

Austin	Barrett Shipman	barrett.j.shipman@pwc.com
Boston	Ed Jasaitis	ed.jasaitis@pwc.com
Los Angeles	**Gregg Nahass (US Leader)** Dries Bredenkamp Nitin Lalwani Ryan Keefer Amit Verma Chris Cook*	**gnahass@pwc.com** dries.bredenkamp@pwc.com nitin.lalwani@pwc.com ryan.keefer@pwc.com amit.j.verma@pwc.com chris.w.cook@pwc.com
New York	Christina Scherma Shungu Chigariro David Baral*	christina.r.scherma@pwc.com shungu.chigariro@pwc.com david.baral@pwc.com
San Jose	Marc Suidan Paul Hollinger	marc.suidan@pwc.com paul.j.hollinger@pwc.com

* Managing Director

www.pwc.com/us/deals

© 2019 PwC. All rights reserved. Not for further distribution without the permission of PwC. “PwC” refers to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL), or, as the context requires, individual member firms of the PwC network. Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm’s professional judgment or bind another member firm or PwCIL in any way.