M&A Tax Talk
Tax Factbooks

We are seeing in the evolving M&A marketplace that Tax Factbooks are a pre-sale tax preparation option that may increase the efficiency of the tax diligence process.

What is a Tax Factbook?

A Tax Factbook is meant to summarize the tax profile of the target company and may include specific commentary such as background and history, legal entity structure, historical acquisitions, divestitures or restructurings, key operating jurisdictions, a tax filing calendar, cash tax rate, tax audit history, book-to-tax adjustments, tax attributes, an overview of other deferred tax assets and liabilities, intercompany transactions, and non-income tax compliance policies and procedures. Depending on the global footprint of the target business, Tax Factbooks may include specific summaries of the tax profile in each material jurisdiction.

During the preparation of the Tax Factbook, sellers may also work with sell-side tax advisers to determine whether pre-sale restructuring may be required or beneficial to a buyer. This may include the ability to provide step-up to a buyer by structuring the transaction as a deemed asset sale (e.g., contributing assets to a limited liability company prior to the sale or completing a cost/benefit analysis with respect to making section 338/336(e) elections, etc.). An analysis of the potential tax benefits associated with such pre-sale restructuring can be highlighted in the Tax Factbook in order to demonstrate potential tax-focused value drivers. Likewise, tax attributes (e.g., net operating losses, tax credits, or other incentives), if available and transferable, should be clearly summarized so that buyers can factor those benefits into the evaluation of their bid and/or purchase price.

Tax Factbooks are typically shared with prospective buyers during the tax diligence phase of the divestiture life cycle.

Where do we see Tax Factbooks in the marketplace?

A growing number of companies in the marketplace are pursuing Tax Factbooks as a pre-sale option to be more prepared. From stand-alone to private equity– owned companies of all sizes with various tax classifications (e.g., corporation, partnership, etc.), sellers are pursuing Tax Factbooks to better define the tax profile of the target entities and operations and streamline the due diligence process.

Note that in situations where there is likely only one buyer or where the tax profile and legal entity structure of the target is not complex, a Tax Factbook may not be as beneficial.

Benefits of the Tax Factbook

There are many benefits of preparing and having a Tax Factbook in place during a divestiture process, including:

- **Prepares sellers for buy-side tax diligence** – By virtue of gathering data that would be used to draft the Tax Factbook, sellers are also gathering key tax source documents that would likely be requested by buyers during their diligence process. These tax source documents will then be ready for upload to the online deal data room as the tax diligence phase kicks off and thus may help to expedite the overall deal timeline.

  The preparation of a Tax Factbook by a third-party adviser will typically require an interview with the seller's tax preparers and/or tax advisers (internal or external) that will closely mirror what sellers can expect from an interview by the buyer's due diligence team. Thus, the Tax Factbook process familiarizes sellers with the buyer's diligence process and can be helpful in anticipating questions from the buy-side team during a tax-focused diligence discussion.

- **Consolidates tax matters** – Tax Factbooks enable sellers to provide key information to buyers in a consolidated format (single document). This can also save management time, as foundational tax information is shared with all potential buyers at once and may even keep management out of initial "round 1"-type Q&A sessions with regard to tax requests.

- **Uncovers potential tax issues** – During the fact gathering process, sell-side tax advisers may uncover potential tax diligence issues and can advise sellers on how to proactively begin the process of resolving such tax issues before the buy-side diligence process begins. Taking corrective action prior to the buyer's due diligence may enable sellers to provide positive responses to questions raised and/or issues identified during the tax due diligence phase. For example, consider a situation where it was determined that a target was not compliant with sales and use tax filings in various states. Because the Tax Factbook process begins prior to buyer due diligence, the target has time to pursue voluntary disclosure agreements (VDAs) with material relevant states to limit the look-back period and avoid associated penalties. When the buyer asks about the potential exposure during their diligence, the seller will be able to demonstrate that the target has been proactive about addressing the potential issue by providing an estimate of the potential exposure and communicating the status of the VDA.

- **Carve-out transactions** – Consideration should be given to having a Tax Factbook in place for carve-out transactions, where a seller may be sensitive to uploading tax documentation, such as consolidated income tax returns, that would provide information on businesses that aren't included within the transaction perimeter. In practice, limited-source documents are shared on carve-out transactions, and a Tax Factbook can be an effective way of sharing only relevant tax information on the target with a potential buyer.

- **Levels the playing field** – Tax Factbooks, similar to quality of earnings (QoE) reports, provide the added benefit of sharing the same information with multiple bidders in an auction process. Because all bidders will have the same knowledge of the tax facts of the target, sellers may be in a better position to quickly evaluate multiple bids from buyers.

How is a Tax Factbook different than a Vendor Due Diligence (VDD) Report?

A VDD report is a sell-side tax due diligence report that identifies and quantifies potential tax exposures. These reports are more common in Europe, where such reports can be issued on a reliance basis. A Tax Factbook, on the other hand, is purely a summary of the tax profile of a business and does not highlight or quantify potential tax exposures.

Conclusion

Engaging experienced tax professionals to prepare a Tax Factbook early in the divestiture life cycle will typically enable sellers to be prepared for buy-side tax diligence by gathering the required underlying tax data, identifying potential tax issues, and, if applicable, initiating a remediation process. Tax Factbooks are also effective in highlighting valuable tax attributes or beneficial structures that may enhance a buyer's perception of value. In summary, Tax Factbooks can be effective in increasing the efficiency of the diligence process and enhancing returns for sellers.

Want to learn more?
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