High Tech M&A Developments
Selected Topics

2015 High-Tech Tax Institute

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AGENDA

- High-Tech Spin-offs
- Inversion Update
- Developments for Integration Transactions
- Revisiting the Tax-Free Reorg

AGENDA

Section 355 Spin-Off Transactions

- Overview
- Comparison to Section 301 Distributions
- Monetization Strategies
- New 355 ATB Guidance – Rev. Proc. 2015-43, Notice 2015-59
- Other Considerations

SPIN-OFF TRANSACTIONS – OVERVIEW

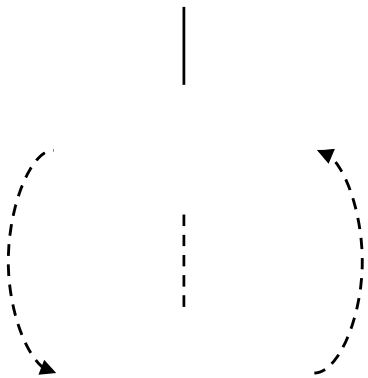
Section 355 Distributions

- Allows "Distributing" to make a tax free distribution of "Controlled" shares
  - Statutory Requirements
    - Control
    - Active trade or business
    - Distribution of all "Controlled" stock, or an amount constituting "Control"
    - Not a device for distribution of E&P
  - Judicial Requirements
    - Business purpose
    - Continuity of business enterprise
    - Continuity of interest
- May be a pro-rata "Spicbe a p[([(ra)-8r)0.5(68.1(i)-8..04r)7.6(o)]TJ

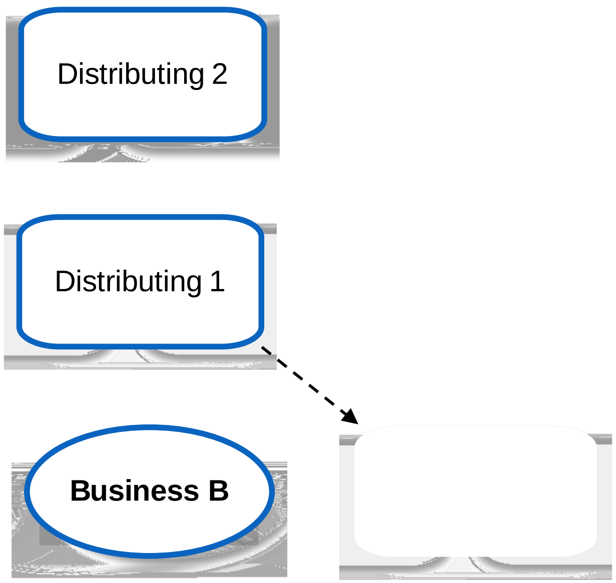
SPIN-OFF TRANSACTIONS - MONETIZATION STRATEGIES

- **Generally, there are five ways Distributing can extract value in connection with a spin-off:**
  - **Liability assumption:** Controlled assumes a liability of Distributing as part of a Section 368(a)(1)(D) reorganization.
  - **Cash distribution:** Controlled distributes cash to Distributing as part of a Section 368(a)(1)(D) reorganization.
  - **Securities-for-debt exchange:** Distributing transfers Business to Controlled in exchange for Controlled stock and Controlled securities (i.e., long-term debt).

SPIN-OFF TRANSACTIONS – CASH DISTRIBUTION

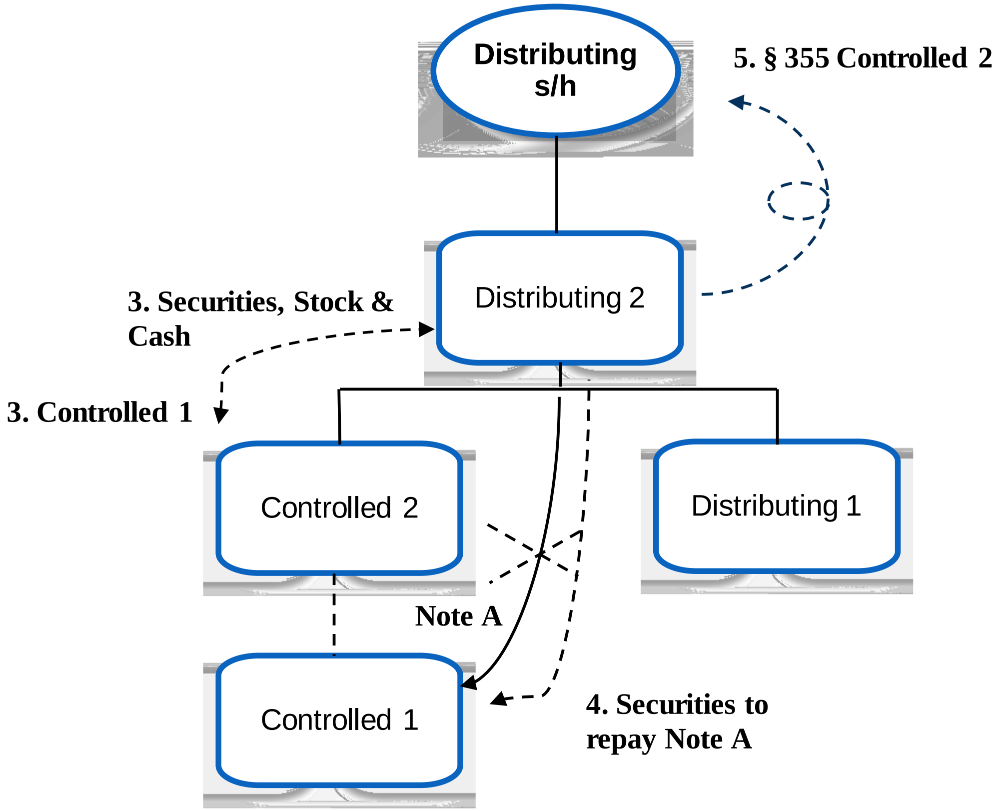


SPIN-OFF TRANSACTIONS – SECURITIES FOR INTERCO DEBT



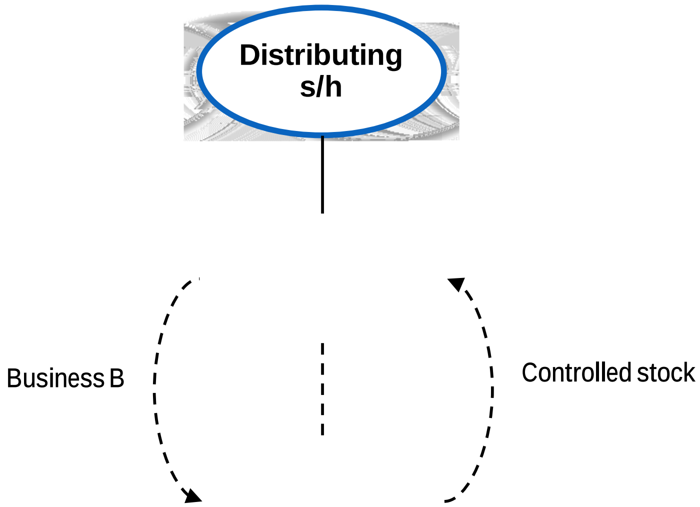
1. Distributing 1 transfers Business B & Note A to Controlled 1
2. Distributing 1 distributes Controlled 1 to Distributing 2

SPIN-OFF TRANSACTIONS – SECURITIES FOR INTERCO DEBT



3. Distributing 2 transfers Controlled 1 to Controlled 2 for Controlled 2 securities, cash, & Controlled 2 stock
4. Distributing 2 repays Note A with Controlled 2 Securities
5. Distributing 2 distributes Controlled 2 to its shareholders

SPIN-OFF TRANSACTIONS – RETAINED SHARES



Overview of Rev. Proc. 2015-43

- Rev. Proc. 2015-43 (released September 14, 2015)
- Adds 3 new, distinct no-rule policies:
  - RIC/REITS: IRS ordinarily will not rule distributions involving certain RIC or REIT elections for either D or C
  - Relative value: The IRS ordinarily will not rule where, immediately after the distribution, the FMV of the gross ATB Assets of D or C is less than 5 percent of the total FMV of the gross assets of such corporation.
  - Investment assets: The IRS w0.8(3o974 -(M)-5.16 n)74 -e2 32oe.ddsT752 32ole36 343.4495 <

SPIN-OFF TRANSACTIONS– Rev. Proc. 2015-43

- The no-rules prevent the IRS from ruling on "any issue relating to the qualification under Section 355 and related provisions".
- Section 4 of Rev. Proc. 2015-3 is a "ordinarily will not rule" list, which permits taxpayers to show the IRS "unique and compelling" circumstances to overcome a no-rule.
- The Notice identifies "unique and compelling" circumstances as

    (i) the presence of non-ATB Assets that would be ATB Assets but for the five-year requirement of Section 355(b)(2)(B), and

    (ii) a relationship between the business purpose for the distribution and the ATB Assets of D or C.

- Section 5 of Rev. Proc. 2015-3 is a "will not rule" list, and taxpayers' circumstances will not be considered.

SPIN-OFF TRANSACTIONS– NOTICE 2015-59

- Notice 2015-59 identifies four characteristics which, if present, are of concern to the IRS:
  - The distributing corporation or the controlled corporation owns investment assets with a substantial value in relation to (a) the value of all of the assets, and (b) the value of the assets of the ATB;
  - The ratio of investment assets to assets other than investment assets are significantly different between D and C;
  - D or C owns a small amount of ATB Assets in relation to all of its assets;
  - D or C (but not both) elect to become a RIC or a REIT.
- The IRS is concerned that a transaction with one or more of these characteristics may (i) present evidence of device, (ii) lack adequate business purpose, (iii) violate other Section 355 requirements (e.g., an implicit requirement that tax-free spin-offs are reserved for transactions effecting a genuine separation of two businesses), or (iv) circumvent Section 337(d)'s repeal of *General Utilities & Operating Company Co. v. Helvering*, 296 U.S. 200 (1935) ("GU Repeal").

SPIN-OFF TRANSACTIONS – OTHER CONSIDERATIONS

Continuing relationships and Tax Sharing Agreement

- Impact to business purpose
- Developing structure of IP rights between Distributing and Controlled
- Go forward treasury strategies
- Business infrastructure and systems

State Issues – What's tax free for federal purposes may not be for state

- California recently conformed with current active trade or business test ("SAG" rules)

Other acquisitions, dispositions and restructuring pre or post spin – Section 355(e)

- Implications of pre-spin activity
- Implications of post-spin activity

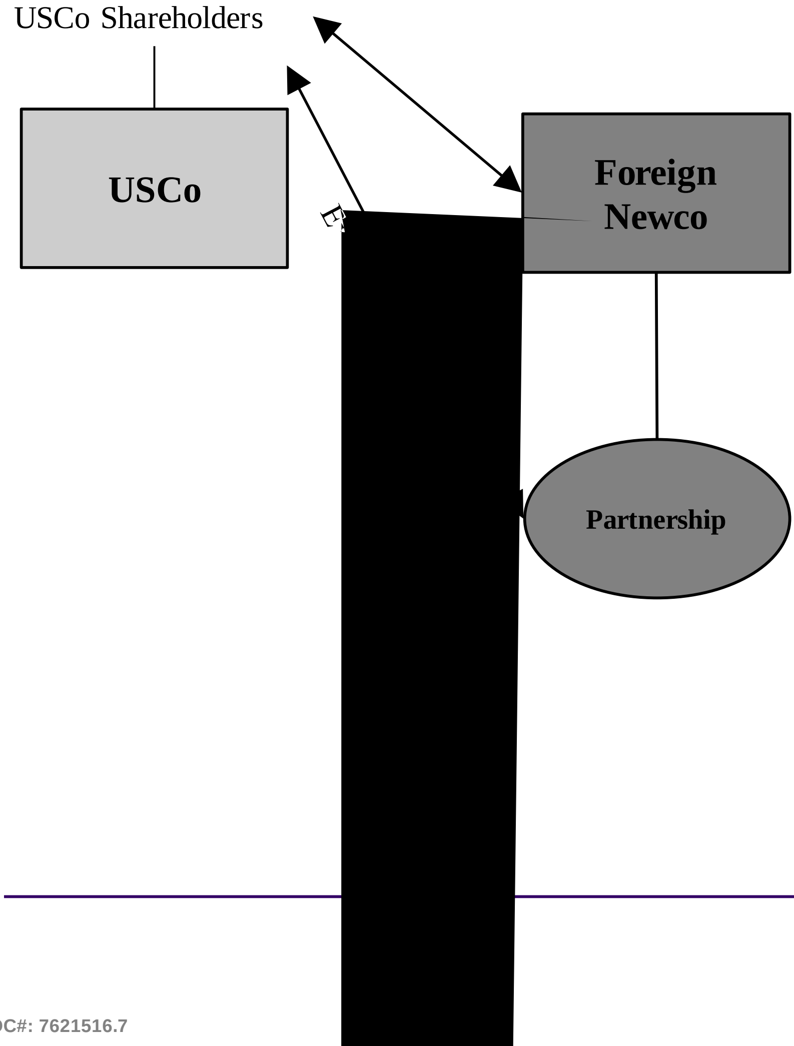
Inversion Update

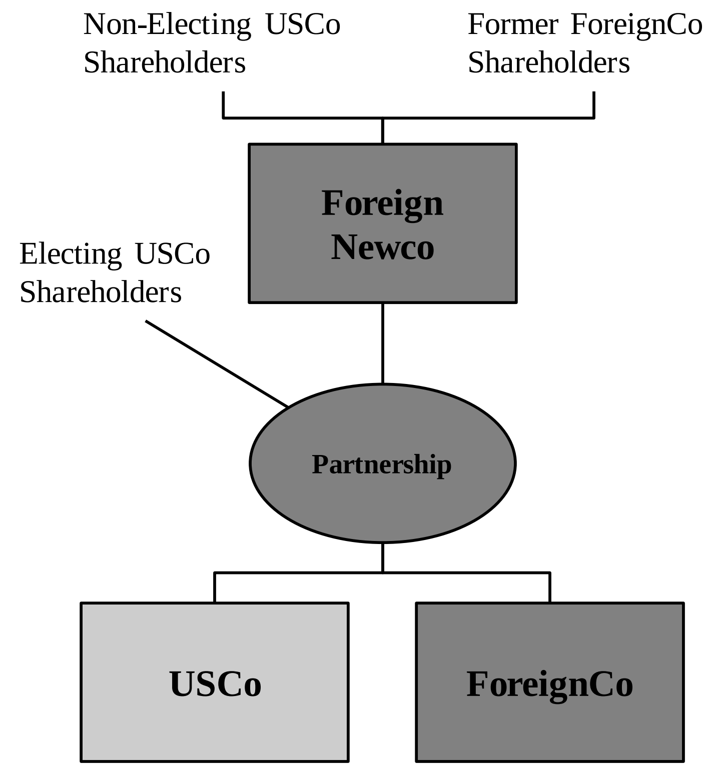
BENEFITS OF BEING ACQUIRED BY A FOREIGN

RECENT DEVELOPMENTS

- Notice 2014-52. In Fall 2014, IRS Notice issued describing regulations that will:
  - Limit ability to access “trapped cash” in 60+% inversions
  - Make qualification as a foreign corporation more difficult for certain transaction
  - Limit certain post-

ILLUSTRATIVE STRUCTURE (SIMPLIFIED)





CONSIDERATIONS

- Limitations on availability of partnership units?
  - Tag, Drag and “Clean-up” provisions?

- Qualification as a partnership?
  - Lock-up period
  - Cash vs. stock exchange
  - Economic rights

- PTP status?
  - Actual market?
  - Permitted transfers?
  - Redemption/exchange mechanics?
  - Qualifying income?

- Qualified dividend income?

Developments for Integration Transactions

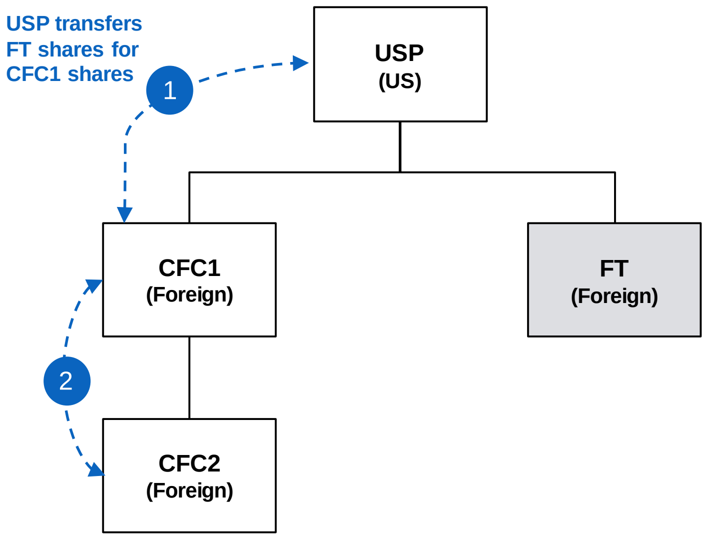
Developments for Integration Transactions

- Revenue Rulings 2015-9 and 2015-10 on Step Transaction
  - Revoking Rev. Rul. 78-130 on triangular § 368(a)(1)(C) reorganizations
  - Clarifying treatment of "triple drop and check" transactions

- Proposed Regulations under § 367
  - Taxing "outbound" transfers of foreign goodwill and going concern value under either § 367(a) or § 367(d)
  - Immediate effective date

- Notice 2015-54 on Contributions to Certain Partnerships
  - Requiring either (i) recognition of gain on contribution or (ii) election of the "remedial allocation method" under section 704(c)

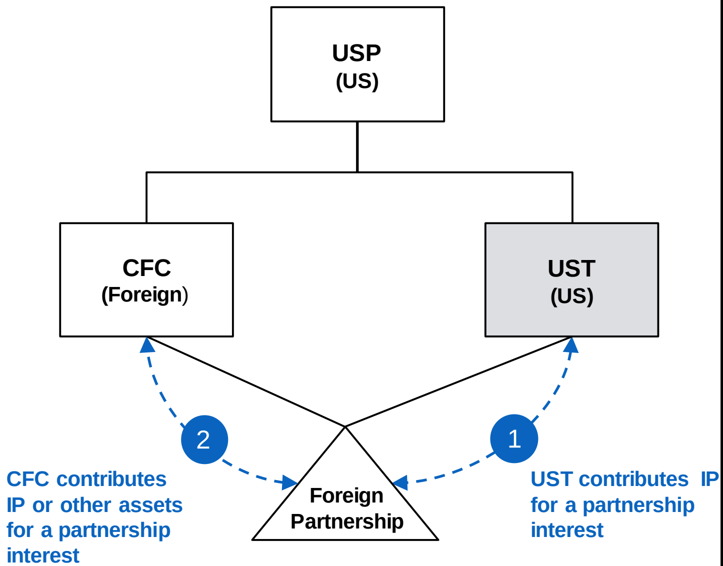
Rev. Rul. 2015-10 (“Triple Drop and Check”)



US Target Integration

New CFC
(Foreign)

Partnership for IP Integration



Transaction Description

Step 1: UST contributes the foreign rights to its IP to Foreign Partnership in exchange for a partnership interest

Step 2: CFC contributes its IP, operating assets, foreign subsidiaries, or cash to Foreign Partnership in exchange for a partnership interest

Discussion Points

- Foreign Partnership should be treated as a "Section 721(c) Partnership" under Notice 2015-54:
  - CFC as a "related foreign person" (determined under §§ 267(b) or 707(b)(1)) is a direct or indirect partner; and
  - UST and CFC as a "related person" own more than 50% of the interests in partnership capital, profits, deductions, or losses
- Notice 2015-54 provides that future treasury regulations will require:
  - UST to recognize the built-in gain in its IP on contribution to Foreign Partnership (§ 721(a) will not apply, subject to a *de minimis* exception); unless
  - Foreign Partnership elects to apply the "remedial allocation method" under Treas. Reg. 1.704-3(d) with respect to all built-in gain property contributed by UST (and the other requirements of the "Gain Deferral Method" are satisfied)
    ,

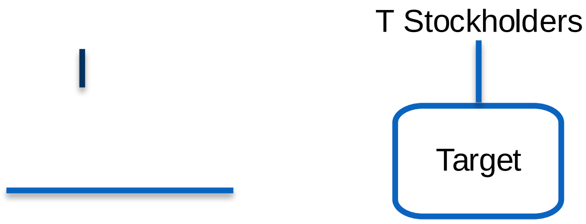
Revisiting the Tax-Free Reorg

VALLEY M&A PRACTICE

- Notwithstanding the range of options available under Section 368, the vast majority of tax-free reorganizations are structured as mergers, and within that fall into 2 categories
- All stock transactions are usually accomplished as reverse triangular mergers under Section 368(a)(2)(E)
- Part stock, part cash transactions are usually accomplished as so-called “2-step” transactions under Section 368(a)(1)(A)
  - First step is usually acquisition of target in reverse triangular merger
  - Second step is merger of target into acquirer or sub of acquirer, with sub often an LLC.

TWO-STEP “A” REORGANIZATIONS

- Rev. Rul. 2001-46 – reverse triangular merger followed by a direct (usually upstream) merger as part of an integrated plan characterized as an “A” reorganization
- Typically only real technical issue is 40% continuity of interest test
- If fails to qualify as a reorganization, taxed as a stock sale rather than an asset sale – Rev. Rul. 2008-25
- Second step is often a forward merger into an LLC, with the LLC surviving since this avoids the “substantially all” test of Section 368(a)(2)(D), provides a liability shield and allows for maximum restructuring flexibility post-closing



FACTORS INFLUENCING TAX-DEFERRED DECISION

CONS

- Calculation mechanics of Section 356 reduce benefits of tax-deferred treatment in transactions with significant cash, since cash is taxed up to the gain realized
  - In forward merger with 40% stock component, only stockholders with basis equal to less than 40% of deal price receive any benefit from gain deferral.
  - Often, only founders may benefit from deferral of gain.
- Buyer may want to step up basis of target stock to reflect value paid
  - May aid in restructuring or in the event of future sale
  - Some transactions are structured under Section 351 rather than Section 368 in order to achieve a higher basis in the target stock attributable to the cash paid.
- Reverse triangular merger is simpler than a 2-step merger and is favored by corporate lawyers, even if taxable
  - Minimizes contract assignment issues arising from forward merger
  - However, since "signing date" rule does not apply for purpose of Section 368(a)(2)(E) 80% "control" test, may be difficult to guarantee tax-deferred status if any cash in transaction

FACTORS INFLUENCING TAX-DEFERRED DECISION

- Even in 2-step merger, if “signing date” rule does not apply, may be difficult to guarantee tax-deferred treatment.
  - NYSE and Nasdaq limits on stock issuances may make it impossible to guarantee that 40% continuity test will be met.
  - Rules limit stock issuances to 20% of current stock outstanding in the absence of a stockholder vote
- Several recent deals have been structured with no guarantee of tax-deferred status.
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IMPACT OF QUALIFIED SMALL BUSINESS STOCK

- Reduced federal income tax on capital gains from QSBS held for more than 5 years

* Unless extended through 2015 QSBS acquired after 12/31/14 taxed at rates effective for QSBS acquired before 2/8/09

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