5 KEY TAKEAWAYS

State and Local Tax Issues in Corporate M&A Transactions

On November 15, David Hughes presented at the Practicing Law Institute's three-day conference on **"Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2024"** held in Chicago and on-line. David's presentation, **"State and Local Tax Issues in Corporate M&A Transactions"**, concerned common state and local tax (SALT) problems that arise in an M&A transaction.

Here are five key takeaways:

1

Timing. Get the tax department (or outside tax advisors) involved early! While SALT issues might not be the focal point of a transaction, they can easily derail a deal if they are left unaddressed until the eleventh hour. At the same time, the tax department and tax advisors should be proactive about finding a role in the deal to begin the tax due diligence process sooner rather than later.

2

Sales and Use Tax on the Deal. The tax department should be involved in a transaction to determine whether the deal is subject to state sales and use tax. Stock sales – including stock sales treated as asset sales for tax purposes - are not subject to sales tax because stock is an intangible. While a sale of assets is generally subject to sales tax, several exemptions and exclusions – including sale for resale, "occasional sales" and sales of machinery/equipment – will likely apply when all the assets of a business are sold. But watch out for titled property – including real estate and vehicles – that might be subject to special transfer taxes even if otherwise exempt from a traditional sales/use tax.

3

Income Tax on the Deal. Most states conform to federal income tax so a transaction or reorganization that is tax-free for federal purposes will likely also be tax-free for state income tax purposes. Sellers should be especially mindful of stock sales that are treated as asset sales for tax purposes (such as a 338(h)(10) transaction). Any taxable gain will likely be treated as "business income" for state income tax purposes and will be subject to tax wherever the company/target is taxable, which will flow through to the owners of a pass-through entity. By contrast, if the sale is treated as a sale of stock/equity for tax purposes, then the shareholders are arguably taxed only in their state of residency (if that state levies an individual income tax).

4

Impact of Consolidated/Combined Reporting. Corporations that file consolidated federal income tax returns often file separate returns in one or more states or file on a combined basis with different group members. This can result in dramatic differences between the federal and state taxation of transactions. It can also mean that the target has joint and several liability for taxes of other entities that are not involved in the transaction.

5

Due Diligence. Due diligence is an important part of any transaction and the tax department should be involved to assist with tax due diligence. There are three primary areas of interest for SALT due diligence: **a)** identify and quantify potential buyer exposure for unpaid taxes by seller; **b)** minimize state and local taxes on the transaction as well as future taxes for the buyer; **c)** identify post-acquisition integration issues (such as "instant unity")and impact on state returns.

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