

Mergers and Acquisitions Tax Services



Section 338(h)(10) Election Analysis

Minimize the future income taxes of an acquired corporation

Are you aware of and executing on tax opportunities associated with your pending transaction?

Are the differing goals of the purchaser and seller impacting your ability to optimize opportunities within the transaction?

Is your eligible transaction appropriately structured to realize the benefits of a section 338(h)(10) election?

Maximizing opportunities within a transaction can be difficult, given the differing goals of the seller and purchaser. The purchaser of a business may want to negotiate an asset acquisition of corporate assets, in order to mark up the tax basis of the acquired assets to their respective fair market values (FMV).

This step-up in the tax basis of the acquired assets may be depreciated or amortized over the life of the assets for tax purposes. In an asset acquisition, the FMV of intangibles and goodwill may typically be amortized straight-line over fifteen years. These amortization deductions may be used to offset the taxable income of the acquired business.

In a corporate stock acquisition, the amount paid for a business is embedded in the tax basis of the stock, and there is no step-up in the tax basis of the assets of the corporation. The amount paid for the stock may produce a tax benefit only upon disposition of the stock.

Tax costs and benefits of a section 338(h)(10) election

Some stock purchases may qualify for an election to treat the purchase as an asset acquisition for federal income tax purposes. If a corporation purchases an S corporation or a corporate subsidiary of a consolidated group in a qualified stock purchase, the buyers and sellers can make a joint section 338(h)(10) election to treat the

stock purchase as a deemed asset acquisition for federal income tax purposes. This election allows the buyer to step-up the basis of the acquired corporation's assets.

There are several scenarios, however, in which the seller may incur additional federal and state income tax costs in connection with making a section 338(h)(10) election. The seller may still be induced to make the election in these circumstances through an increase in the stock purchase price, designed to compensate the seller for the additional tax costs of the election.

It often makes sense for the purchaser to increase the purchase price because the net present value of the tax benefits to the purchaser of the depreciation and amortization deductions generated by a section 338(h)(10) election often significantly exceed the seller's additional section 338(h)(10) election tax costs.

McGladrey's mergers and acquisitions tax professionals can determine if a transaction will qualify for a section 338(h)(10) election, and appropriately structure transactions to benefit from this election. Our professionals can estimate the present value of the tax benefits that a buyer will realize from the depreciation and amortization of the step-up in tax basis that results from a section 338(h)(10) election. We can also estimate the additional tax costs a seller will realize as a result of the election.

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Our dedicated mergers and acquisitions tax professionals will take the time to truly understand the business you are acquiring, ask questions that can uncover opportunities, manage the acquisition process to maximize value and help you optimize the overall structure of your merger or acquisition transaction.

That's the power of McGladrey. The power of being understood.SM

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