

Tax reform and private companies
Is now the time to sell?

February 2018



Executive summary

The passage of US tax reform legislation, formally referred to as “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” (the “Act”), may benefit US private companies and their owners more than just the possible reduction in their US tax liability. US private companies are likely to be viewed as more attractive takeover targets by foreign buyers. The competitive landscape has shifted now that the new law has significantly reduced the US corporate tax rate, along with other related provisions that could spur additional M&A interest. The law’s passage comes at a time when the strong US economy was already attracting more inbound investment to the United States, and private companies may benefit the most because of recent deal dynamics, strategic priorities and current valuations.

A global tax shake-up

On December 22, 2017, President Trump signed into law a US tax reform package that significantly lowered tax rates on corporations, pass-through entities, individuals and estates. The Act replaced the country's graduated corporate rate structure, and its 35 percent average overall rate, with a flat 21 percent rate.

Overnight, the law transformed the United States from the highest corporate-tax jurisdiction among the 35 developed nations in the Organisation for Economic Co-operation and Development (OECD) to the 13th highest.¹ After adding in corporate income taxes levied by individual states, US corporations will now pay an average of about 25.75 percent, compared to 38.91 percent before the Act (see chart at left).

That's a significant drop in tax liability by any measure, and one that is likely to spur additional interest in US companies. While tax isn't always the main driver of value determinations, any material reductions in a country's tax obligations tends to improve the target market's value proposition and can lead buyers to offer companies in that market more attractive terms. When comparing opportunities in various geographies, buyers have been known to tip the scales in favor of those with lower tax profiles.

Other provisions of the new law could provide further incentive for US-inbound deals. One reduces the income tax that companies pay on royalties as well as the sale of goods and service payments from the overseas use of intellectual property or intangible assets such as licenses and patents. This effectively reduces the tax on foreign income from goods and services produced in the United States to 13.125

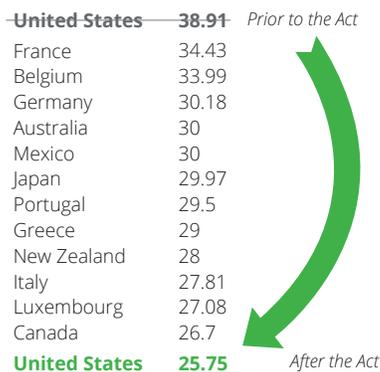
percent until the end of 2025, far below the old system that taxed such income at the corporate tax rate of 35 percent.²

In addition, in an asset acquisition, buyers are now able to immediately expense 100 percent of certain business assets acquired through 2022, thanks to the new law's capital expensing provisions. That means that companies will likely have more free cash-flows available for operations or to fund additional strategic acquisitions.

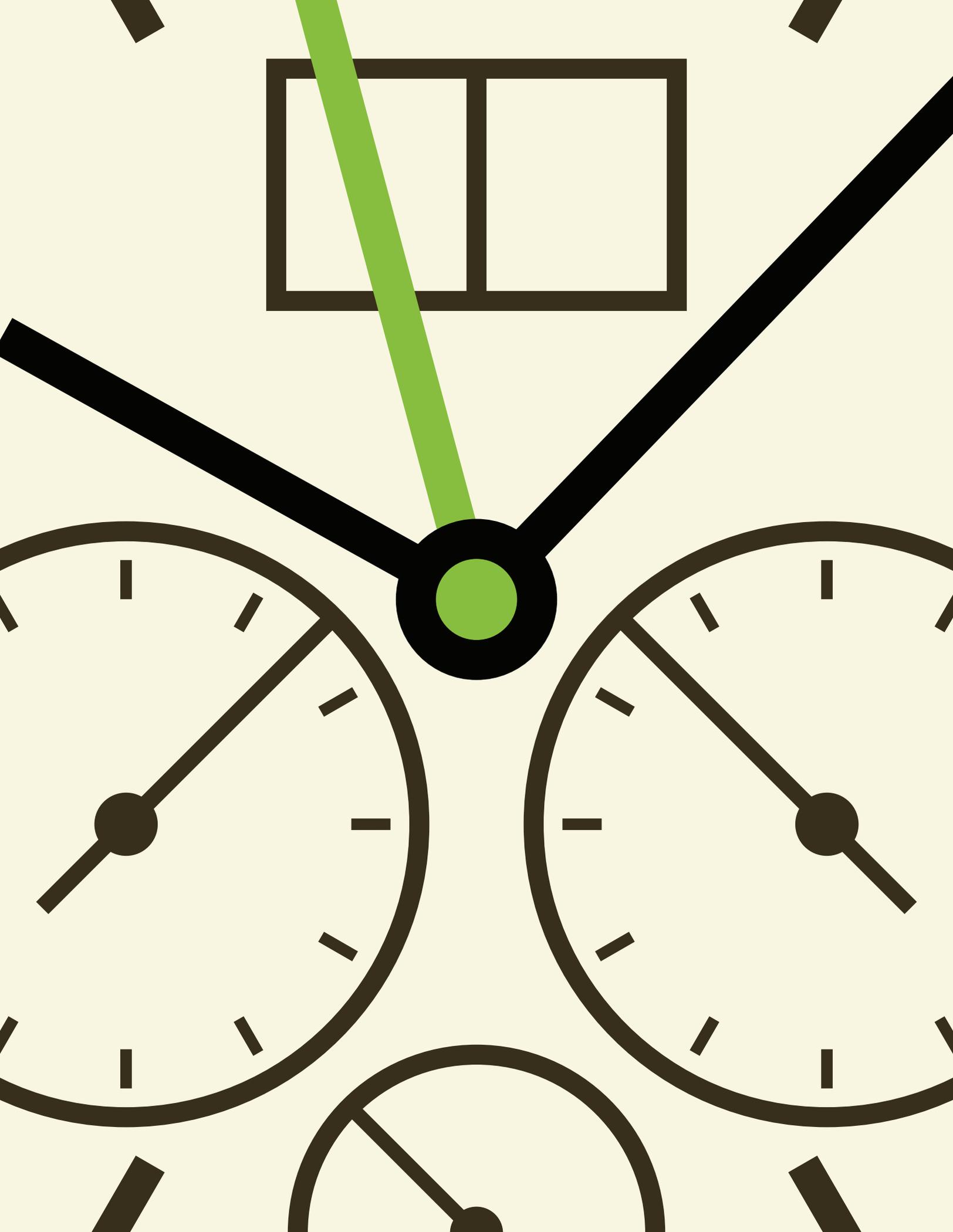
One indicator of the Act's potential to shift investment flows is the number of countries announcing plans to take measures in response to its passage. For example, Japan, which was already in the process of cutting its main corporate tax rate to just under 30 percent, is now considering going as low as 20 percent for some companies.³ And a range of European countries are promising to reduce certain taxes businesses are required to pay there.⁴

While these nations may appear to be contemplating leveling the field of global competitiveness as well as an investment shift to the United States, it is unknown whether they will pass tax or other policy reforms in the near term that would counter the impact of the new lower US tax rates. Already, some companies headquartered overseas have reported the favorable impact of the new US tax law for boosting their growth plans and profits. Associated British Foods PLC, for example, said in mid-January that the tax law's passage will benefit its US expansion plans for Primark, its fast-fashion retail subsidiary.⁵ Then there's German automaker Daimler, which said in December 2017 it expected the Act to boost its net income for the year by 1.7 billion euros.⁶

Highest corporate income tax rates of developed countries



Note: New US corporate tax rate reflects 21% federal rate, plus 4.75% effective state tax rate, for a total of 25.75%.



More cross-border deals

Global deal-making has already jumped in the first three weeks of the year, though the talks leading to those transactions likely predated the new law's passage. Deals closed during that period totaled \$207 billion, the highest amount since the same period of January 2000, according to Dealogic.⁷

Even before the tax law was passed, US-domiciled companies were receiving increased attention from global buyers looking to tap into a strong and steady economy. US gross domestic product grew last year at a 2.5 percent clip, its fastest pace in three years,⁸ and the jobless rate matched its lowest level since late 2000.⁹ After averaging 1,333 purchases of US companies per annum from 2008 to 2012, foreign buyers closed on an average of 1,778 deals per year between 2013 and 2017, according to Thomson Reuters. What's more, the annual volume of inbound transactions has increased for five consecutive years, topping out at 2,394 last year.¹⁰

Global buyers may face even greater competition going forward, as they will have to contend not just with other foreign rivals but also with US multinational companies that are now bringing cash home that was historically pooled in overseas companies. The one-time repatriation of overseas cash permitted by the Act is going to give such organizations more spending fuel, and strategic acquisitions inside US borders could soon follow.

Private companies, in particular, may be primed to benefit from foreign buyers' increased appetites. That's because more merger competition has led them to set their sights on smaller targets. In 2016, a few mega deals led to a surge in the deal value of US-purchased companies. But, in the main, deal values on inbound transactions have declined in recent years even as volumes have risen.¹¹ That trend is working in favor of US private companies, particularly those who have a smaller deal price compared to the mega deals.

A recent Deloitte survey of nearly 1,900 global private companies supports the notion that cross-border merger activity is poised to rise in the months ahead. Some 42 percent of those surveyed anticipate that their company is likely or very likely to make an acquisition in 2018, and 26 percent expect their company to be acquired. The top two reasons cited for a deal were the opportunity to enter new global markets, and expanding or diversifying their customer base.¹² Importantly, the global survey was conducted before the Act's passage.

European companies, in particular, could be at the head of the pack. After several years of slow earnings growth and overleveraged balance sheets, many companies on the continent have rationalized their operating expenses and boosted productivity while significantly reducing their financial leverage. Most that have come through this process now enjoy a stronger competitive position and could look to the United States as a way to tap a very large market and realize new economies of scale. Europe was the leading region of origin for US-inbound deals in 2017 by a more than two-to-one margin over the Americas (excluding United States) and nearly three-to-one difference over Asia-Pacific.¹³

To be sure, some companies based overseas believe some of the new costs attached to the Act may outweigh the benefits of a lower corporate US tax rate. One such measure could mean new taxes on payments that US subsidiaries make to their international affiliates under the Base Erosion and Anti-Abuse Tax.

Preparing for a nibble

The passage of the Act is likely adding pressure to companies that were already asking tough questions about their path to growth in the global economy. Boundaries are blurring, and those that have not considered M&A in the past may be more likely to do so as part of their growth strategy.

For US private company leaders, now is an opportune time to strengthen their own corporate development capabilities so they are prepared to field and evaluate an increased interest in their businesses. With the passage of the Act, every private company should reassess what it is worth—in whole or in part. They should also make sure that their business is “M&A ready”: in possession of a clear strategy, an optimal corporate and tax structure, and best-in-class reporting and governance.

It also makes sense to actively assess the competitive M&A landscape, taking note of who’s buying, who’s selling, and the prices they’re realizing. Different industries and geographies will see varying levels of interest. As such, it’s important to partner with M&A specialists who understand your specific sector dynamics and can provide access to potential buyers who may not have historically been interested in owning US assets.

With big pieces of legislation such as the Act, the ripples can often be felt far and wide. It behooves US private companies to get ahead of the new law’s potential repercussions before those waves start bouncing back.

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Notes

- 1 Organisation for Economic Co-operation and Development, Table II.1. 2017 Statutory corporate income tax rate, https://stats.oecd.org/index.aspx?DataSetCode=Table_II1#.
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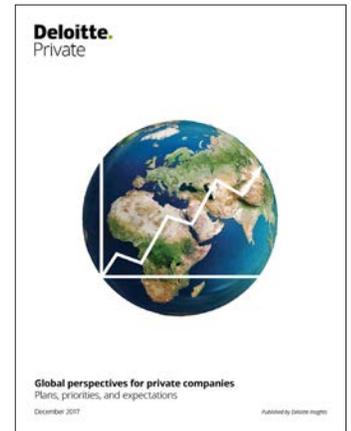
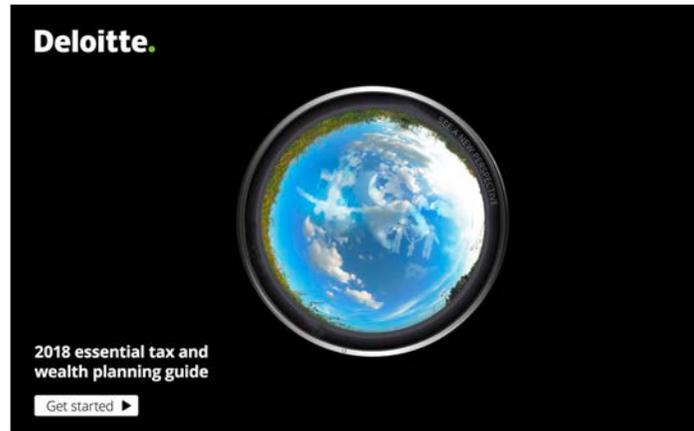
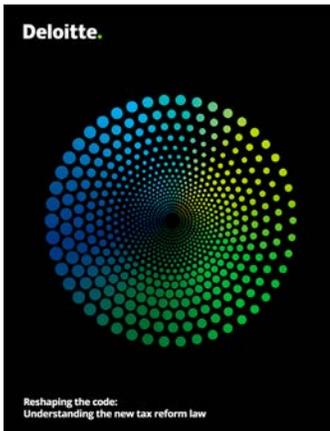
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Additional resources



[Reshaping the code: Understanding the new tax reform law](https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-reform-report.pdf)

<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-reform-report.pdf>

[2018 essential tax and wealth planning guide](https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-2018-essential-tax-and-wealth-planning-guide.pdf)

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