T&E Issues in M&A Transactions
American Bar Association, 2019 Fall Tax Meeting
Employee Benefits Mergers & Acquisitions Update

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The “Secret Estate Tax Lien”

- LLC Hypothetical
- Estate Tax Lien
  - Not recorded
  - No bona fide purchaser protection for probate property
      - Reps and warranties will not work
      - Even reviewing the Form 706 may not have worked
- The Secret Estate Tax Lien can be hard to spot as an issue
  - Transferee as seller
  - Disregarded entity
  - An old trust included in the estate of a beneficiary

- Dealing with the Secret Estate Tax Lien
  - Proceeds used to pay charges or administration expenses, and the payments are allowed by a court
  - Discharge under Code § 2204
  - BFP exception for non-probate property
  - Exception for purchaser of “security” or for holder of “security interest”
  - Certificate from IRS under Code § 6325 – note that all proceeds may need to be placed in escrow

- Practical considerations
  - Identified late in the deal?
  - Multiple sets of advisors
  - Privacy and securities law issues
The “Secret Estate Tax Lien”

- Planning considerations
  - Use a revocable trust
    - Non-probate property so BFP protection
    - But note that lien placed on all trust assets, and trustee is personally liable for unpaid estate taxes (Code § 6324(a)(2))
Dealing with Fiduciaries

- Historical
  - Duty to Inquire vs. Bona Fide Purchaser
  - Potential for third party liability
  - Opinion of counsel

- Current statutory framework
  - Uniform Trustee Powers Act - § 7
  - Uniform Trust Code - § 1012.
    - Note the issue of being protected from liability vs. being able to rely upon apparent authority.
    - Certification of trust – UTC § 1013
  - “Normal” deal powers common – powers to sell, mortgage, lease, borrow and take action with respect to securities
  - Other deal powers:
    - Indemnify
    - Guarantee
    - Agree to joint and several liability
    - Certification of trust
    - Power to delegate?

- Prudence – having the power vs. agreeing to exercise it
  - Representations and/or warranties as to the operation of a business?
  - Agreeing to indemnify third parties?

- Good faith reason to review a trust instrument
  - Distribution provisions that could impact post-closing terms, such as indemnification obligations
  - Confirm subchapter S status
Dealing with Fiduciaries

- Individual trustees –
  - Consider capacity and succession issues
  - Delegation considerations
- Institutional trustees
  - Sophistication but internal approvals
  - Financial wherewithal
- Modern trust provisions
  - Investment advisor and directed trustee
  - Trust committee
  - Trust protector
Dealing with Fiduciaries

- Practical approach
  - Determine the governing law – *this may require an opinion, especially if the situation is complicated*
  - Does governing law protect third parties from the duty of inquiry?
  - Does governing law provide trustees with broad powers?
  - Can a third party *rely on* a certification of trust?
  - Are there other reasons (post-closing obligations) to review the trust instrument?
- Legal opinions:
  - If possibly needed, start the process early
  - Anticipate problems/hurdles with counsel providing an opinion
  - What is the value of an opinion in relation to the firm providing it?
- Court approval
- Drafting:
  - Choice of governing law (and making same clear)
  - Draft to include transactional powers
  - Consider the use of entities within a trust
  - Anticipate how the trust structure (a short-term GRAT, for example) might impact a transaction
    - Outright to children
    - Continuing trust
    - Pour over to another trust
S Corporation Issues

- Trusts as eligible shareholders
  - Easy to determine if *ineligible*, vs. determining if eligible
  - Grantor trust *on the face of the document*
    - Need to confirm no terms have been altered, directly or indirectly, such as waiving or releasing a power of substitution
    - Identity of *current* trustee, and relationship to the grantor
    - Grantor still alive?
- Foreign trusts – be careful of court and control tests
- Electing small business trust (ESBT) – watch for nonresident alien beneficiaries
- Drafting for S corporation issues:
  - Specify how a trust is intended to qualify – including with an obvious caption
  - Include provisions to eliminate or mitigate pitfalls
    - Prohibit impermissible beneficiaries of an ESBT
    - Require administration solely within the US
    - Prohibit non-US persons from serving as trustee, or from exercising any substantial decisions