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

Primer on Trusts
What is a Trust?
How are they structured?

Non-Tax Structures
Revocable Life Time Trusts
Uniform Transfer to Minors Act Accounts

Tax Focused Structures
Family Limited Partnerships
Irrevocable Trusts (various types)
Primer on Trusts

- Trusts are not legal entities; trusts are agency relationship
- Grantor/Settlor establishes a trust
- Trust Agreement names trustee and confers powers
- Trust Agreement names the beneficiaries of the trust
- Trustee has legal title; beneficiaries have beneficial title
- Taxation of trusts varies
Revocable Lifetime Trusts

• Many names, same concept
  – Management Trusts
  – Lifetime Trusts
  – Living Trusts
  – Loving Trust

• Grantor usually trustee

• Revocable by the grantor

• Taxed to the grantor

• Management Trust v. “Will Substitute”
Family Limited Partnerships

• FLPs are holding companies owned by two or more family members

• FLPs generally are created for the following purposes:
  – consolidate business interests, real estate, publicly and privately held securities, and other assets of the family
  – efficiency of management
  – retain assets in the family
  – creditor protection
  – retain community or separate property nature of underlying assets
  – avoid expenses and publicity of litigation
  – promote education and communication within the family
  – tax planning
Intentionally Defective Grantor Trusts

**Benefit**

- Grantor treated as owner of trust for Federal income tax purposes
- No gift by grantor when income tax paid
- Trust Agreement usually has one of the following features:
  - Power of Substitution
  - Power to enable borrowing without adequate security
  - Power to add beneficiaries
- Caution: benefit can turn into a crippling cost

**Support**

- Rev. Rul. 2004-64
- Rev. Rul. 85-13
Installment Sales to IDGTs

• Common “freeze” technique

• Grantor can sell assets to the trust with no income tax consequences

• Common terms of sale:
  – 9-year interest only note with a balloon payment at the end
  – Interest set at the applicable federal rate
  – Seller retains security interest in the assets
Formula Transfers

• Assignment agreements (whether by gift or sale) may contain formula transfers
  – Gift/sale is of an asset that is hard to value
  – Formula transfers allow the transferor to define the dollar value of the asset passing to taxable transfer

• Types of formula clauses:
  – Defined value clause based on values “as finally determined”
  – Defined value clause
  – Price adjustment clauses
  – Price adjustment clauses
Grantor Retained Annuity Trusts

• Short-term trust for grantor’s benefit with remainder to descendants
  – Objective is to transfer growth assets to GRAT that beat the "hurdle rate"
  – Hurdle rate is the 7520 rate (based on the applicable federal rate)
  – Taxable gift based on value of initial gift to GRAT, minus present value of annuity retained
  – Growth in excess of hurdle rate = tax-free gift to remainder beneficiaries

• Annuity expressed as percentage of initial value given to the GRAT
  – Annuity payments increase if value is adjusted upward on audit, and vice versa
  – Payment of the annuity may be in-kind
  – IRS will usually challenge the valuation of the in-kind annuity payments as well as the initial value of the trust

• Similar to formula clauses, creates uncertainty of ownership percentages
Philanthropic Structures

- Charities can be used as the non-taxable transferee in formula transfers

- Donor Advised Funds
  - Assets owned by public charity
  - Assets managed by public charity
  - Donor (or other appointed people) can suggest donees and amounts
  - Public charity is not required to follow suggestions

- Private Foundations
  - Less common due to excess business holdings rules
  - Very complex rules govern private foundations
  - Penalties can be excessive