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Resumption of Mergers and Acquisitions: What May Change After the Crisis

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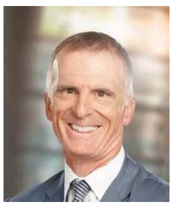

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The COVID-19 crisis has significantly slowed economic activity in all respects. The area of corporate mergers and acquisitions is no exception, and the level of activity, which was high before the crisis, has dropped significantly because of it.

It is difficult to predict when and at what pace such activity will resume, but we expect that, like many other sectors of the economy, this market will be different from what it was before the crisis. Among other things, we expect that the uncertainty regarding economic recovery will see vendors and purchasers increasingly rely on earnout clauses to reach agreements on the value of a business. Opportunities to obtain financing for the acquisition of a competitor or a complementary business are also likely to be limited, which will change how such transactions are financed.

The new behaviours made necessary by the post-crisis economic environment will certainly have considerable fiscal impacts. The tax rules applicable to earnout clauses can be complex, and parties to such transactions should learn about them before signing a letter of intent for a potential transaction. Those wishing to sell could get an unpleasant surprise in terms of the net result of the sale of their business if they aren’t properly advised from the outset.

In some cases, the sale of a business that would normally be expected to generate a capital gain with only 50% of such gain being included as taxable income could instead be 100% taxable as business income. Earnout clauses offer very interesting tax planning possibilities in some cases, such as the maximization of capital dividend accounts that corporations can use to pay tax-free dividends to their shareholders.

The same care should be applied by those wishing to acquire or sell a business with regard to the different methods of financing transactions that are likely to become popular after the crisis, such as partial financing by the vendor.

Poor tax planning in this regard could result in liquidity problems for vendors if payment of the balance of the sale price is spread out over too long a period. Purchasers will also want to maximize the tax benefits of this type of financing. The main way to do so involves banking on interest costs resulting from the financing of the purchase price, but to reap such benefits and others, the commercial agreements relating to the purchase must be carefully structured.

Tax complexities are numerous in M&A transactions, and those mentioned above are just two examples. The tax incidence of such transactions should be analysed as soon as they are contemplated. Parties to M&A transactions often wait too long before analyzing tax aspects. They thus greatly limit their opportunities to benefit from optimal tax planning.

For more information, our taxation team is available to help you.