

FountainBlue's High Tech Entrepreneurs' Forum

First Annual Trends in M&As Event



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TOPIC OVERVIEW

- Due Diligence & Cleanup
- IP Issues
- Tax and ERISA Issues
- Employment Issues
- Shareholder Planning – Individual and Estate Planning
- Basic Structures
- Transaction Process

DUE DILIGENCE & CLEANUP

- Organize company books and records
 - Organizational documents; check for good-standing and resolve any outstanding issues
 - Corporate minutes / board approvals; draft if necessary
 - Shareholder / member records and cap table; share certificates; draft documents if necessary
 - Regulatory Issues
 - Tax Returns and other government filings
 - Balance Sheet
 - Earnings Statements
 - Third Party Consents
- Resolve or quantify outstanding lawsuits and claims

INTELLECTUAL PROPERTY ISSUES

- Establish ownership of IP
 - File trademarks, patent applications, etc
 - Properly document transfers of IP to the company
 - Properly record transfers of IP to the company
 - Discuss any possible infringement
 - Retain executed confidentiality of information and invention assignment agreements for all employees
- IP documents
 - Review licenses of company-owned IP and licenses of IP used by the company; third party consents
- Resolve or quantify outstanding lawsuits and claims

TAX AND ERISA ISSUES

- 409A issues
 - Option valuation
 - Severance agreements
 - Deferred compensation
- 280G Golden Parachute Payments
- ERISA plan compliance
- State tax nexus
- Foreign tax compliance
- Transfer pricing

EMPLOYMENT ISSUES

- Employment Agreements
 - Offer letters; employment agreements of executives
 - Confidentiality of information and invention assignment agreements for all employees
 - Payments triggered by change of control / sale
- Stock, stock options, bonus plans, or other equity awards
- Identify Key Employees
- Compliance
 - Compliance with employee classification laws
 - Compliance with wage and hour laws
- Resolve or quantify outstanding lawsuits and claims

SHAREHOLDER PLANNING

- Sale to intentionally defective grantor trust
- Gifts of stock through family limited partnership
- Charitable trusts
- S corporation distributions
- Avoiding double taxation
- Capital gain versus ordinary income
- Installment sales
- Earn-outs

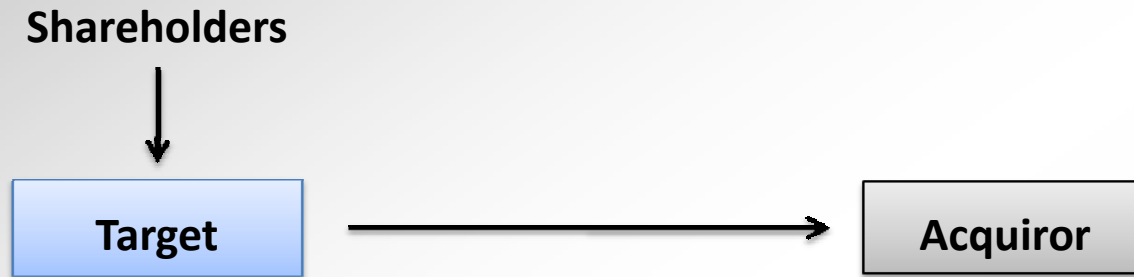
TRANSACTION PROCESS

- Negotiations
- Letter of Intent
- Due Diligence
- Purchase Agreement
- Ancillary Documents
- Closing

BASIC STRUCTURES

- Tax Free Reorganizations
 - Type A – Merger
 - Type B – Stock for Stock
 - Type C – Stock for Assets
 - Type D – Spin Off, Split Off, Split Up, and Type D Acquisitive Reorganizations
- Taxable Transactions
 - Stock Sale
 - Asset Sale
- Partnership Techniques
- S Corporation Strategies

TYPE A REORGANIZATIONS – SECTION 368(a)(1)(A) STATUTORY MERGER



- Statutory Merger – 2 or more corporations combined and only one survives (Rev. Rul. 2000-5)
- Requires strict compliance with statute
- Target can be foreign; Reg. 1.368-2(b)(1)(ii)
- No “substantially all” requirement
- No “solely for voting stock” requirement

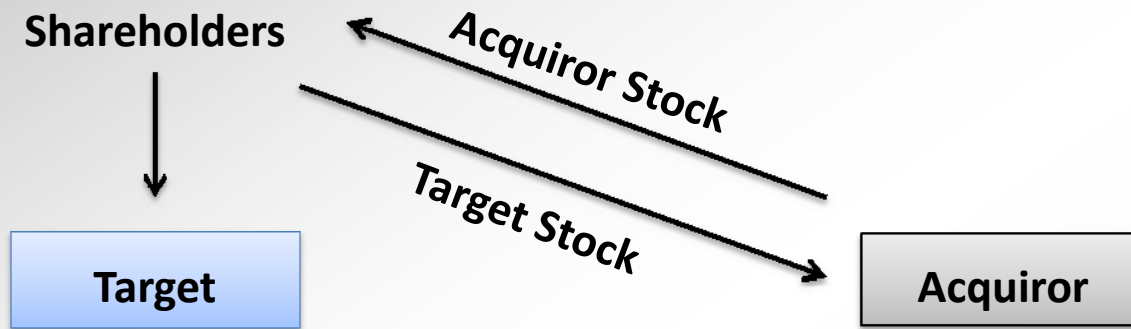
Requirements:

- Necessary Continuity of Interest
- Business Purpose
- Continuity of Business Enterprise
- Plan of Reorganization

Tax Effect:

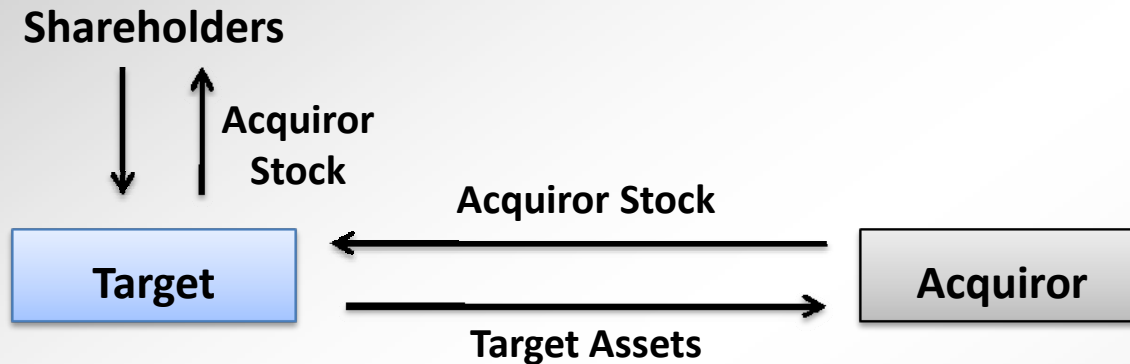
- Shareholders – Gain recognized to the extent of boot
- Target – No gain recognition
- Acquiror takes Target’s basis in assets plus gain recognized by Shareholders
- Busted Merger – taxable asset sale followed by liquidation

TYPE B REORGANIZATIONS – SECTION 368(a)(1)(B) STOCK FOR STOCK



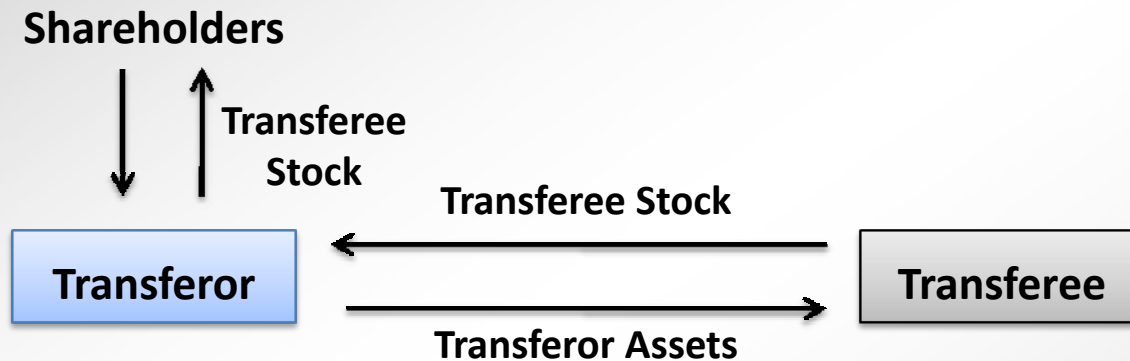
- Acquisition of stock of Target, by Acquiror in exchange for Acquiror voting stock
- Acquiror needs control of Target immediately after the acquisition
- Control = 80% by vote and 80% of each class
- Acquiror's basis in Target stock is the same as the Shareholder's basis prior to the acquisition
- Solely for voting stock
- No Boot in a B
- Reorganization Expenses – distinguish between Target expenses and Target Shareholder expenses (Rev. Rul. 73-54)
- Creeping B – old and cold stock purchased for cash should not be integrated with stock exchange

TYPE C REORGANIZATIONS – SECTION 368(a)(1)(C) STOCK FOR ASSETS



- Acquisition of substantially all of the assets of Target, by Acquiror in exchange for Acquiror voting stock
- “Substantially All” – at least 90% of FMV of Net Assets and at least 70% of FMV of Gross Assets
- Target must liquidate in the reorganization
- 20% Boot Exception – Acquiror can pay boot (non-stock) for Target assets, up to 20% of total consideration; liabilities assumed are not considered boot unless other boot exists
- Reorganization Expenses – Acquiror may assume expenses (Rev. Rul. 73-54)
- Assumption of stock options not boot
- Bridge loans by Acquiror are boot
- Redemptions and Dividends – who pays and source of funds

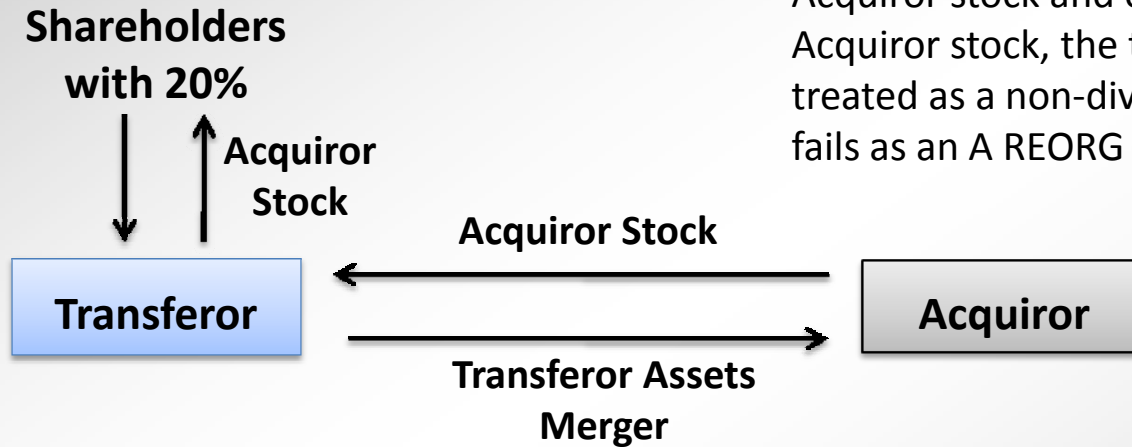
TYPE D REORGANIZATIONS – SECTION 368(a)(1)(D) DIVISIVE SPIN OFF, SPLIT OFF, SPLIT UP



- Divisive – transfer by a corporation of all or part of its assets to another corporation if, immediately after the transfer, the transferor or its shareholders are in control of the transferee corporation. Stock or securities of the transferee must be distributed under the plan in a transaction that qualifies under Section 354, 355, or 356.

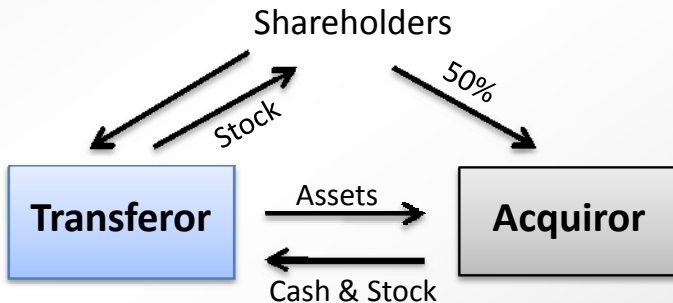
TYPE D REORGANIZATIONS – SECTION 368(a)(1)(D) NON-DIVISIVE

Merger Treated as Acquisitive D

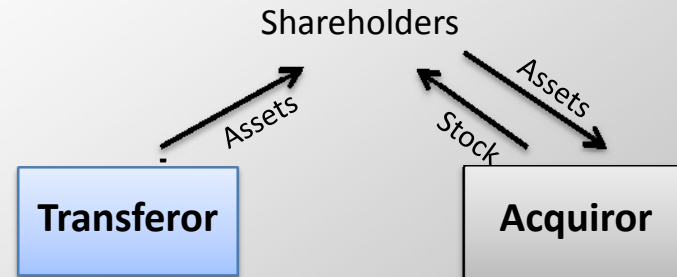


- If shareholders of Transferor stock receive Acquiror stock and own at least 50% of Acquiror stock, the transaction may be treated as a non-divisive D REORG even if it fails as an A REORG for lack of continuity

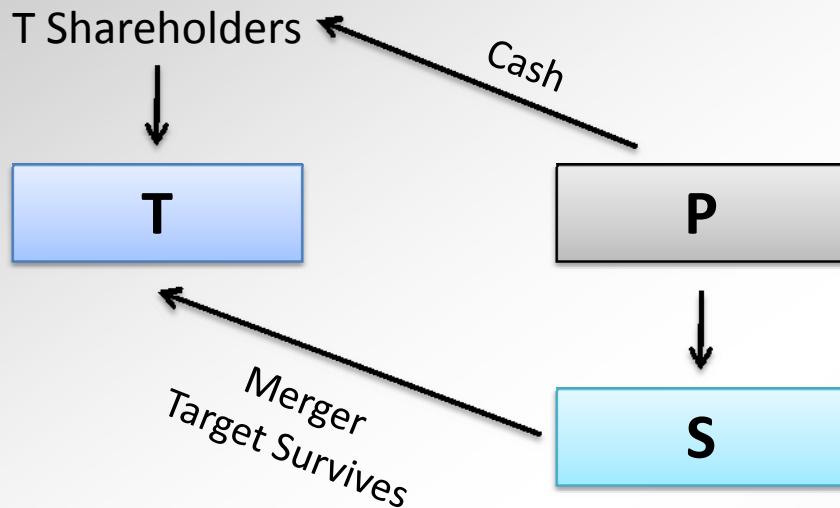
Failed Type C Treated as D



Liquidation / Reincorporation



TAXABLE STOCK PURCHASES



Cash Reverse
Triangular Merger

Treated as Stock Sale

- Shareholders have gain or loss
- P takes cost basis in Target shares

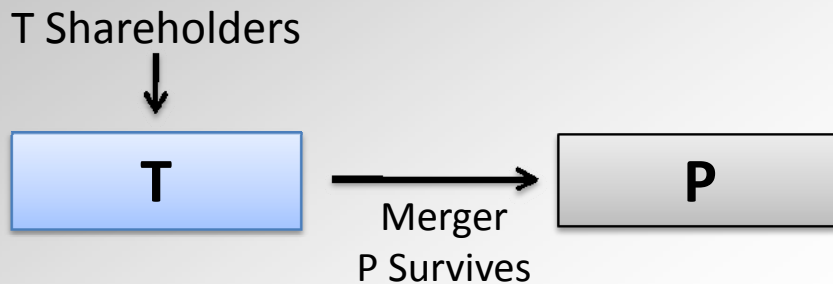
Key:

T = Target

P = Acquiror

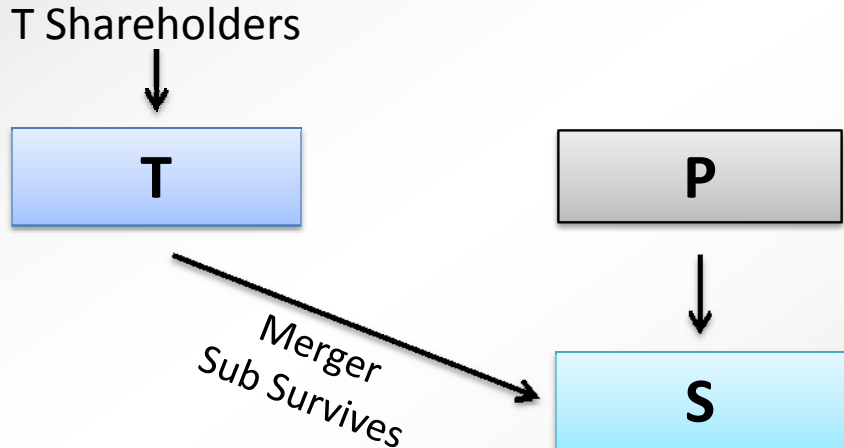
S = Merger Sub

CASH FORWARD MERGER



Asset sale followed by liquidation of Target

Variation with Merger Sub:



- Target has gain on sale
- Target shareholders have gain on liquidation (unless 332 applies)
- P takes cost basis in Target assets

Key:

T = Target

P = Acquiror

S = Merger Sub

