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Wayfair's implications for M&A

March 13, 2019

2:00 PM – 3:00PM ET

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Presenters

Chris Schenkenberg

National Managing Partner
M&A Tax Services
Chicago, IL

Trinh Tran

Experienced Manager

State and Local Tax
Los Angeles, CA

Rob Michaelis

Partner
State and Local Tax
Boston, MA

Michael Cronin

Senior Manager
State and Local Tax
Boston, MA

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Learning objectives

1. Cite the basic complexities and risks involved with Wayfair and M&A tax
2. Identify steps buyers and sellers must take to be Wayfair compliant
3. Describe aspects of how Wayfair is impacting other parts of the transaction life cycle, not just due diligence

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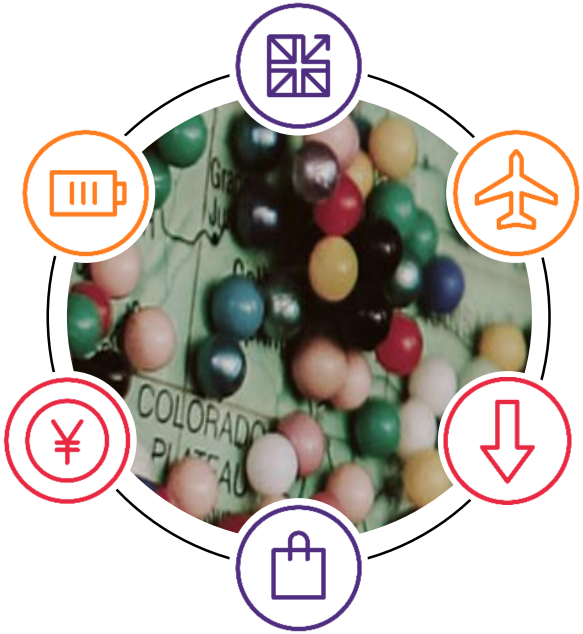
Agenda

- *Wayfair* background

- M&A lifecycle impacts
  - Target phase
  - Validate phase
  - Improve phase

- Questions

Wayfair background



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What were states doing pre-*Wayfair*?

Numerous states were stretching the concept of physical presence through a variety of ways:

Affiliate nexus

Click-through nexus ("Amazon laws")

Marketplace provider / facilitator laws

Cookie nexus (Massachusetts)

Information reporting rules for remote businesses

What were states doing pre-*Wayfair*?

Adoption of economic nexus statutes and policies

- Several states enacted economic nexus statutes that initially were relatively consistent with South Dakota's statute soon after *Wayfair* litigation began

- Other states waited until the last couple of months prior to the decision in *Wayfair* to enact legislation – in line with their regular legislative processes

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What happened in *Wayfair?*

South Dakota Law

- Direct legislative challenge to physical presence rule adopted in *Quill*
- Imposed tax collection obligations on certain remote sellers that sell tangible personal property, products transferred electronically, or services for delivery into South Dakota
- Remote sellers are subject to the provisions if they meet one of two thresholds in either the current or previous calendar year:
  - Gross revenue for such sales exceeds $100,000; or
  - Seller engages in 200 or more separate in-state transactions

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What happened in *Wayfair?*

South Dakota v. Wayfair, Inc. (June 21, 2018)

- Ruling: In a 5-4 decision, the U.S. Supreme Court held that the South Dakota statute satisfies the substantial nexus standard that is a component of determining whether a tax can survive Dormant Commerce Clause scrutiny
  - Expressly overruled *Quill* because the physical presence rule is "unsound and incorrect"

- Fundamental change in constitutional sales tax nexus standard that has been applied for over 50 years

What are states doing in response?

It varies…

In general:

- Varied responses
  - Legislation
  - Directives
  - Administrative Guidance
- Varied definitions
  - Taxable v. Gross Receipts
  - Wholesale/exempt sales
- Varied breadth
  - Sellers/Dealers
  - Marketplace Facilitators

What are states doing in response?

Existing guidance	Generally similar dollar/transaction threshold	Some different states	Dollar threshold only	The "and" versus "or" test
• Forty states have issued guidance regarding *Wayfair* application • All but a few are already effective and being enforced • Some large states aren't live yet (e.g., CA, FL, PA, and TX). All of these but FL have clarified an intent to be live by a certain date	Following the Supreme Court's decision, the majority of states have enacted legislation or issued guidance following SD's \$100,000/200+ transaction thresholds	AL, CT, GA, MA, MS, NY, OH, TN and TX A few states have issued or proposed higher dollar thresholds	CA, MS, OH, OK, PA, SC, TN, TX A handful of states have issued only dollar thresholds, not transaction volume	Most states that have both dollar and transaction lines indicate you have to cross one, but AL, CT and NY indicate *both* lines have to be crossed

Understanding *Wayfair*

Clearing up the 9 common misconceptions on *Wayfair*

1. The decision only applies to internet retailers
2. The decision doesn't apply to my business because I don’t sell taxable products or services
3. I perform services for customers in just one state, and I only need to be worried about the tax implications in the state where the services are performed
4. The economic nexus thresholds only apply to taxable sales
5. The nexus rules only apply prospectively, and I don't need to be concerned about prior periods
6. I have treaty protection on my inbound sales
7. The decision only impacts sales tax
8. This decision does not have an impact on my financial statements
9. My staff, systems, and sales tax process are able to handle the increased compliance and administrative burden

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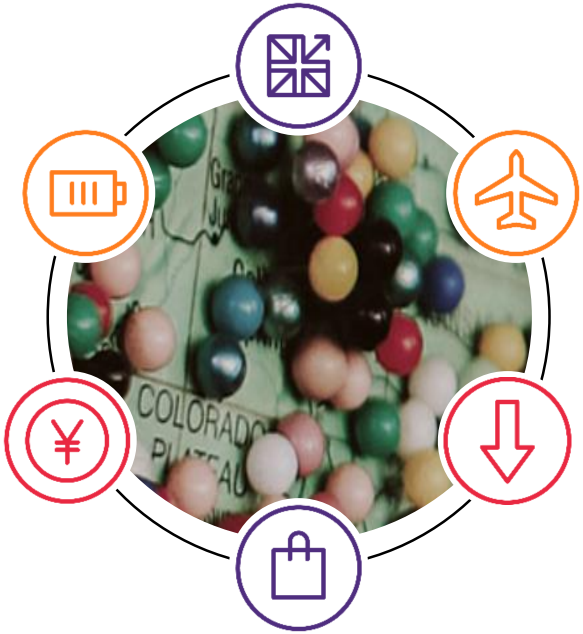
M&A lifecycle impacts



M&A lifecycle impacts

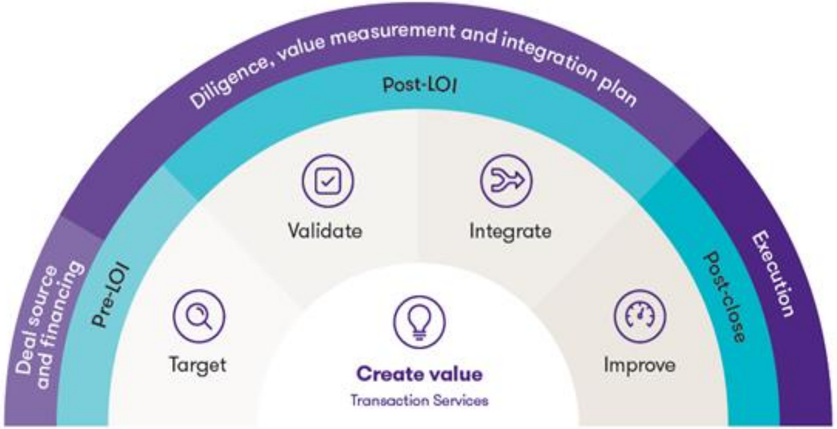
Wayfair creates new complexities for those conducting tax due diligence in transactions

Target
- Board services and solutions
- Capital asset solutions
- Strategic M&A advisory
- Capital Markets(GTCF LLC)
- Tax value solutions
- Corporate value consulting

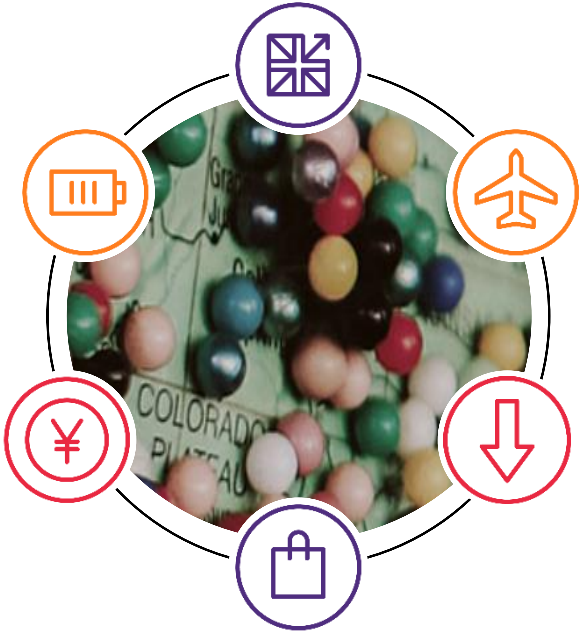
Integrate or Divest
- Transaction integration
- Cultural alignment
- Information technology effectiveness
- Human capital alignment
- Change leadership
- Tax merger integration
- Divestitures
- Interim leadership
- Transaction Accounting Services

Validate
- Diligence Buy & Sell Side
- Financial
- Tax
- Operational
- Value chain
- Technology
- Human Capital
- Commercial
- Culture
- Quality of earnings
- Working capital analysis
- Fair value advisory

Improve
- Transaction performance improvement
- IPO Readiness
- Restructuring
- Event led advisory
- Tax structuring
- Cash-tax optimization
- Tax attribute analysis



M&A lifecycle impacts - target



M&A lifecycle impacts

Target phase - *Historic nexus determinations*

Nexus application is a complex issue that businesses have always dealt with

- Business has historic nexus, but has not been compliant
- Target companies are generally not compliant in all states where it should be
- Reasons for non-compliance vary

  - ✓ Management not understanding true breadth of target's operating footprint and/or third-party relationships
  - ✓ Management not understanding historic nexus standards (which may include misapplication of income tax standards to other taxes)
  - ✓ Management belief that activity was minimal or sporadic in some states
  - ✓ Management view of materiality
  - ✓ Management risk tolerance level
  - ✓ Management's tax advisor doesn't provide the proper guidance

M&A lifecycle impacts

Target phase – *The Wayfair pinch-point*

- Application of the *Wayfair* “economic nexus” standard is more expansive
- Bright line is provided to clear uncertainties
- If you have sales and/or transaction volume beyond a certain threshold, you have to register to collect and remit tax on taxable sales
- Buyer has a broader tax filing footprint than prior owner
- Target that had historic nexus and exposures

Marrying the Buyer’s responsibility going forward with Seller’s historic exposure creates the pinch-point.

M&A lifecycle impacts

Target phase – *Practical Advice*

A well-intended buyer's registration to become compliant going forward may trigger a state to start asking questions

- Unintended consequences if not properly vetted
- Buyer being open to historical exposures for several tax years, including penalties and interest

Some sellers and even buyers think they don't have to worry about the past, which is simply not true

- Fiduciary relationship between a customer and a state for sales tax
- Successor liability should always be a consideration
- Ill-advised structuring to get around past liabilities

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M&A lifecycle impacts

Target phase – *What about income tax*

- If you really look at the bare bones, *Wayfair* addressed a constitutional right to tax issue. As a result, there is good reason to find it to be applicable to income tax.

  - Seven states (AL, CA, CO, CT, MI, NY and TN) already had bright-line type thresholds for income tax nexus purposes, as had OH for CAT purposes.
  - “Income derived from sources” language equals economic nexus without a bright-line threshold amount

- Retroactive application?
- Management has to make a decision on whether it’s applicable, and if so, whether they have exposure.

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M&A lifecycle impacts

Target phase – *How diligence changes*

- More detailed financial data needs to be analyzed for income and/or sales tax
- More thorough diligence procedures and testing may be required than before
- Representations and warranties insurance coverage and potential exclusions based on *Wayfair*
- Strategic buyer or private equity entity – differences in knowledge regarding the issues may drive differences in approach

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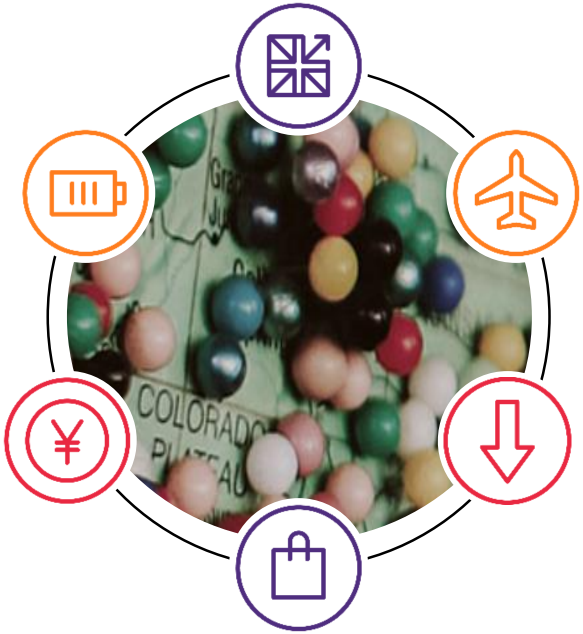
M&A lifecycle impacts - validate



M&A lifecycle impacts

Validate phase – *earnings, target valuation & purchase price*

Could *Wayfair* application impact purchase price?

- Historic exposure versus recurring expenses impacting earnings
- Proper handling of sales/use tax collection/remittance should have zero impact on earnings, other than administrative costs
- Charging sales tax may risk relationships with customers and impact overall sales and profitability
- Increased tax costs from vendor compliance – caution some tax expenses are capitalized

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M&A lifecycle impacts

Validate phase – *How to deal with historic exposure*

- Historic exposure amounts versus ongoing items which impact profitability for valuation
- Ensure that purchase agreement adequately addresses *Wayfair* exposures
  - Is an indemnity clause strong enough?
  - What about use of an escrow amount? How much should be set aside and how long should the escrow stay open?
  - How does R&W coverage impact how this is dealt with?
  - Purchase price adjustment for historical exposures?
- Historic exposures not limited to just the tax – agreement should also address consulting and compliance fees, penalties, interest, etc.

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M&A lifecycle impacts

Validate phase – *seller concerns v. buyer concerns*

Understand proposed deal structure and income tax on gain consequences

- Does *Wayfair* application result in taxation of gain for the target entity and/or its ultimate owners in additional states?
- Potential impact for gain inclusion, apportionment and payment of state withholding and/or income taxes
- Private equity companies and potential investor relation issues

Understand and plan to most optimal post-acquisition operating structure

- Potential additional state filings and overall impact on the state tax benefits of acquisition debt and stepped-up asset basis?
- More post-acquisition organizational structures?

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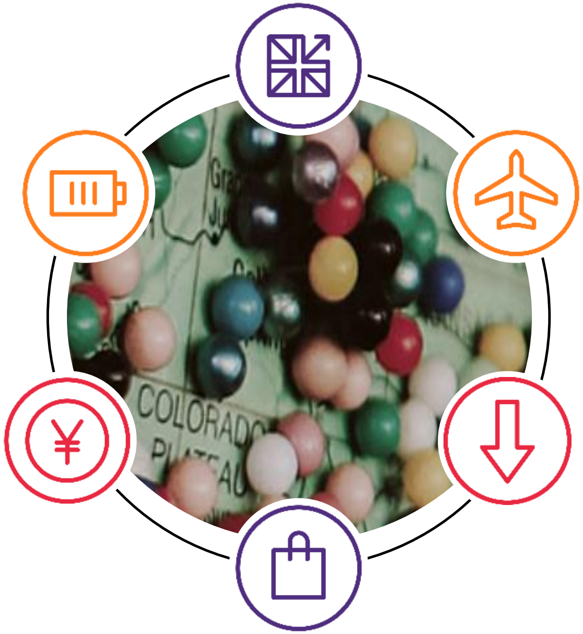
M&A lifecycle impacts - improve



M&A lifecycle impacts

Improve phase – *Define the remediation needs*

The target could have several remediation needs:

- Coverage for sales/use and income/franchise taxes
- Product mapping, taxability research, sales factor sourcing research performed to determine where and how much tax to remit
- Voluntary Disclosure Agreements or simple prospective registrations?
- Private equity seller or buyer with multiple portfolio companies having similar issues?

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M&A transaction impacts

Improve phase – *fine-tune the exposure*

Mitigating factors must be exhausted

- Potential industry specific exemptions, resale exemptions, direct pay permits
- Collecting exemption documentation to lessen tax
- Customers already remitted use tax
- Income tax planning and considerations to reduce apportionment or refund opportunities

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M&A lifecycle impacts

Improve phase – *Do proper internal controls exist?*

Does target have internal controls to be compliant in the *Wayfair* world? Be able to answer the following:

- Consider impact on administrative compliance and management
- Consider possible fixes
- Consider what services are needed? Is outsourcing an option?
- Consider what happens if there are no internal controls in place?

M&A transaction impacts

Improve phase – *Summary of key considerations*

Wayfair brings complex issues that have been historically ignored into the deal, which makes the deal more complicated to negotiate and close

Key considerations we have seen as a result of *Wayfair:*

- Sales and use tax compliance outsourcing
- Sales tax consulting to evaluate taxability
- Sales tax system and implementation

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Q & A

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M&A Tax Services
Chicago, IL

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State and Local Tax
Los Angeles, CA

Rob Michaelis

Partner
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State and Local Tax
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