The Tax Man Cometh…

It should come as no surprise that taxes are going up. With government spending directed to COVID 19 economic stimuli and vaccine deployment, as well as proposed infrastructure projects, a huge debt was created and inevitably the government will need to do something to repay it. The Biden administration has signaled that it intends to raise tax revenue through increases in corporate tax rate, generational wealth transfers (estate taxes) and capital gains. Depending on the capital structure, terms and conditions of the sale and the prevailing capital gains tax rates, sellers of business in 2022 and 2023 should expect to see increases that will eat away at the cash at closing. Sellers who put off selling will find that they will have to achieve either greater multiples and/or experience increases in EBITDA in order to replicate a 2021 deal metrics.

The chart below illustrates a hypothetical 2021 deal where the seller is able to collect $100M at close and $10M in rolled equity. As illustrated, under best- and worst-case scenarios for the Biden tax increases, the seller will naturally have to improve their performance and/or negotiate better than historical multiples in order to achieve the same levels they could have achieved if the closed a deal in 2021. Further, the illustration does not include the returns one could get from their investment of the proceeds of the sale. While not a profound revelation it is one worth taking note of if one's exit plan projected a sale in the next few years. Accordingly, we are encouraging business owners who have been vigilant in preparing their companies for a future sale to explore the possibility of accelerating their time frames. While the time frame is tight, doing a deal within 6 months is certainly achievable for companies that are prepared to go to market. Sellers should be mindful of the fact that buyers are aware of this cutoff and some will try to leverage this motivator to their advantage. Selecting the right acquirer and executing a well-drafted letter of intent is a must in this situation.

Federal Capital Gains Tax Rates	
Tax Year 2020	23.40%
Tax Year 2021 (Best Case)	31.40%
Tax Year 2021 (Worst Case)	43.40%

Offer			**Same Offer Next Year**					
Current Rate			*Best Case Tax Rate*			*Worst Case Tax Rate*		
2019 Adjusted EBITDA	$	11,000	2021 Adjusted EBITDA (no change)	$	11,000	2021 Adjusted EBITDA (no change)	$	11,000
Multiple		10x	Multiple		10x	Multiple		10x
Total Cash Offer	$	110,000	Total Cash Offer	$	110,000	Total Cash Offer	$	110,000
Equity Rolled	$	10,000	Equity Rolled	$	10,000	Equity Rolled	$	10,000
Pre-Tax Cash	$	100,000	Pre-Tax Cash	$	100,000	Pre-Tax Cash	$	100,000
Curent Cap Gains Rate		23.40%	Cap Gains Tax Rate		31.40%	Cap Gains Tax Rate		43.40%
Taxes	$	23,400	Taxes	$	31,400	Taxes	$	43,400
Cash Proceeds for Transaction	$	76,600	Cash Proceeds for Transaction	$	68,600	Cash Proceeds for Transaction	$	56,600
			Cash at Closing Decrease		($8,000)			($20,000)
			Offer Required to Match 2020 Deal (Best Case)			**Offer Required to Match 2020 Deal (Worst Case)**		
			~11x multiple or increase or ~$1.11M increase in EBITDA			~13.2x multiple or ~$3.5M increase in EBITDA		

Our team of investment bankers can provide further insight and guidance on this topic. Additionally, we encourage you to speak with a tax advisor before undertaking a sale of your business to ensure you fully understand all the tax implications of a potential transaction.