

M&A; EXECUTION PROGRAM

PART 01 OF 12 · PART 1: DEAL FOUNDATIONS & STRATEGY

PART 1

DEAL FOUNDATIONS & STRUCTURAL ENGINEERING

How the choice between Asset Purchase, Stock Purchase, and Merger determines who pays the taxes, who assumes the liabilities, and how much the deal is truly worth to each party.

IN THIS PART

- Stock vs. Asset vs. 338(h)(10) vs. Statutory Merger
- Depreciation step-up and its present value to the buyer
- Double taxation mechanics for C-Corp sellers
- Successor liability in asset vs. stock transactions
- Tax-free reorganization structures (Type A, B, C)
- The CFO's deal structure decision matrix

THREE CASE STUDIES

Each session includes one fully worked case study with detailed calculations, negotiating dynamics, and CFO-level decision frameworks.

■ SESSION 1: THE ARCHITECTURE OF A DEAL

Why Deal Structure Is the Most Important Decision You Make

Before a single due diligence document is exchanged, before the first LOI is drafted, before lawyers begin negotiating representations and warranties, the single most consequential decision in any M&A; transaction has already been framed: **how will this deal be structured?** The answer determines the tax consequences for both buyer and seller, the allocation of historical liabilities, the treatment of employee benefits and contracts, the accounting on Day 1, and in many cases, the difference between a deal that closes and one that falls apart.

As a CFO, you will encounter this question in every transaction, from a \$5 million bolt-on acquisition to a \$5 billion transformative merger. The vocabulary is the same. The math is the same. The stakes simply grow with the zeros. This session provides the complete conceptual and quantitative framework you need to advise your CEO and board

on structure — and to negotiate effectively with the other side.

The Four Primary Structures

There are four fundamental ways to acquire a business. Each has a distinct legal, tax, and accounting profile. Understanding all four — and the conditions under which each is preferred — is foundational CFO knowledge.

Structure	Legal Mechanism	Tax Treatment	Liability Transfer	Best For
Asset Purchase	Buyer acquires specific assets and assumes only designated liabilities	Buyer gets stepped-up basis; Seller taxed at asset level (double tax for C-Corps)	Buyer chooses which liabilities to assume; historical liabilities generally stay with seller	Buyers acquiring businesses with unknown liabilities; manufacturing, real estate
Stock Purchase	Buyer acquires shares of the target entity directly from shareholders	Seller pays capital gains on share appreciation; Buyer inherits carryover basis	Buyer assumes ALL historical liabilities, known and unknown	Sellers wanting capital gains treatment; service businesses with key contracts
338(h)(10) Election	Stock purchase treated as asset purchase for tax purposes only; entity continues legally	Deemed asset sale for tax; seller pays ordinary/capital gains; buyer gets step-up	Legal entity continues — contracts, licenses, permits stay intact	S-Corps, subsidiaries; buyer wants step-up but seller needs entity continuity
Statutory Merger	One entity absorbs another by operation of law; acquiree ceases to exist	Can be tax-free if structured as reorganization (stock-for-stock); taxable if cash	All assets and liabilities transfer by operation of law	Large public deals; tax-free reorganizations; combining equals

The Step-Up in Basis: Why Buyers Love Asset Purchases

The single biggest financial engineering lever in deal structure is the **step-up in depreciable basis** that an asset purchase provides to the buyer. When a buyer acquires assets, those assets are recorded on the buyer's books at fair market value — regardless of what the seller's historical cost basis was. This means that if the seller's equipment was fully depreciated (carrying value = \$0) but is still worth \$10 million at fair value, the buyer gets to depreciate that \$10 million all over again.

This has profound present-value implications. Each dollar of additional depreciation reduces taxable income. At a 21% federal corporate tax rate, \$10 million of additional depreciable basis creates \$2.1 million in tax savings over the depreciation life of the asset. The present value of those savings, discounted at the buyer's cost of capital, is real, hard cash — and it directly affects how much a buyer can justify paying for a business.

◆ STEP-UP PRESENT VALUE MATH

STEP-UP VALUE CALCULATION

Fully depreciated machinery (book value): \$0

Fair market value (appraised): \$10,000,000

New depreciable basis (step-up): \$10,000,000

Depreciation period (MACRS 7-year): 7 years

Annual incremental depreciation: \$1,428,571

Tax rate (corporate): 21%

Annual tax shield: \$300,000

Discount rate (buyer WACC): 10%

PV of tax shield (annuity, 7yr @ 10%): \$1,460,000

This \$1.46M is 'free money' – buyer can pay this much MORE for the asset than a stock purchase justifies.

Double Taxation: The Seller's Nightmare in an Asset Sale

For a C-Corporation seller, an asset purchase creates a devastating tax result called **double taxation**. The corporation pays tax once when it sells the assets (at the corporate level), and then the shareholders pay tax again when the after-tax proceeds are distributed as a liquidating dividend. This can result in a blended effective tax rate of 45% to 55% on the total gain — compared to roughly 23.8% (20% capital gains + 3.8% NIIT) in a stock sale.

◆ DOUBLE TAX TRAP

DOUBLE TAXATION ILLUSTRATION — C-CORP ASSET SALE

Asset sale proceeds: \$50,000,000

Tax basis in assets: \$10,000,000

Total gain: \$40,000,000

LEVEL 1: Corporate Tax

Ordinary income tax on asset gain (21%): \$8,400,000

Net proceeds available for distribution: \$41,600,000

LEVEL 2: Shareholder Tax

Liquidating dividend tax (23.8%): \$9,900,800

(on \$41.6M distribution; basis assumed ~\$10M)

TOTAL TAX PAID (both levels): \$18,300,800

EFFECTIVE TAX RATE ON GAIN: 45.75%

COMPARISON: Stock Sale Tax (23.8% cap gains):

Tax on \$40M gain: \$9,520,000

Effective rate: 23.8%

SELLER SAVES: \$8,780,800 in a stock vs. asset sale

This \$8.78 million difference explains why sellers almost always prefer stock purchases and buyers almost always prefer asset purchases. The negotiation between these two competing interests — and how to bridge it — is the heart of deal structure negotiation.

■ CFO INSIGHT

The 338(h)(10) election is the bridge. It allows both parties to get most of what they want: the buyer gets the depreciation step-up, and the seller (particularly in S-Corp or subsidiary transactions) avoids the double-tax trap. However, it only works for S-Corps and subsidiaries — not standalone C-Corps. Always run the 338(h)(10) analysis in any subsidiary or S-Corp acquisition.

Successor Liability: The Hidden Risk in Stock Purchases

When a buyer acquires stock, it acquires the entire legal entity — including every liability that entity has ever incurred, whether disclosed or not. This includes pending litigation, environmental contamination, employment claims, tax deficiencies from prior years, product liability, and regulatory violations. In an asset purchase, by contrast, the buyer typically only assumes the liabilities it specifically agrees to assume in writing.

The practical implication is that buyers in stock transactions must conduct more thorough legal and tax due diligence — because they are acquiring a black box of potential liability. Representations, warranties, and indemnification provisions in the purchase agreement become the contractual backstop for unknown liabilities. We will examine those

mechanisms in depth in Session 7.

Tax-Free Reorganizations: When Cash Is Not the Currency

Not every acquisition is a cash transaction. In large public-company deals, the buyer often pays with its own stock rather than cash. If the transaction meets specific IRS requirements, the target company's shareholders can receive the buyer's stock without recognizing taxable gain at the time of the exchange. This is called a **tax-free reorganization** under IRC Section 368, and it comes in several flavors.

Type	Structure	Key Requirement	Tax Result
Type A	Statutory merger or consolidation	Target merges into acquirer by operation of law	Tax-free to target shareholders if continuity of interest met
Type B	Stock-for-stock exchange	Buyer must acquire at least 80% of target stock with its own voting stock ONLY — no cash	Tax-free; target becomes subsidiary; no step-up in basis
Type C	Stock-for-assets exchange	Buyer acquires substantially all target assets in exchange for voting stock; target liquidates	Tax-free to target; similar to asset purchase but paid in stock
Reverse Triangular	Subsidiary merges into target; target survives as subsidiary	At least 80% of consideration must be buyer's voting stock	Most common structure for preserving target contracts/licenses

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CASE STUDY 1

Ironworks Industrial LLC

\$50M Manufacturing Acquisition — Asset vs. Stock Structure Negotiation

Background

Buyer: Consolidated Manufacturing Holdings (CMH), a private equity-backed roll-up acquiring industrial businesses. **Seller:** Ironworks Industrial LLC, a 28-year-old family-owned manufacturer of precision-machined metal components with \$42M in annual revenue. The business operates from a 120,000 sq ft owned facility with \$18M of heavy machinery and CNC equipment on its books — most of which is fully depreciated. The agreed enterprise value is \$50 million. The deal is being financed with 40% equity and 60% acquisition debt.

The Structural Conflict

CMH's CFO insists on an **asset purchase**. The reason is straightforward: the fully depreciated machinery, re-appraised at \$14 million of fair market value, creates a massive depreciation shield under an asset purchase. The seller's two family-owner shareholders insist on a **stock purchase** because as a C-Corporation with a low historical tax basis in their shares (around \$2M), an asset sale would trigger double taxation and cost them approximately \$9.2M more in combined taxes.

◆ STRUCTURAL COMPARISON – BUYER VS. SELLER ECONOMICS

IRONWORKS – STRUCTURAL COMPARISON

SCENARIO A: Asset Purchase

Agreed enterprise value: \$50,000,000
 Stepped-up depreciable basis (machinery): \$14,000,000
 PV of incremental tax shield (10yr/10%): \$1,790,000
 NET COST TO BUYER: \$50M - \$1.79M = \$48,210,000

SELLER – ASSET SALE TAX COST:

Corp-level gain (\$50M - \$8M basis): \$42,000,000
 Corporate tax (21%): \$8,820,000
 Distributable proceeds: \$41,180,000
 Shareholder cap gains tax (~23.8%): \$9,280,000
 Total tax burden on \$42M gain: \$18,100,000
 Effective rate: 43.1%

SCENARIO B: Stock Purchase

Buyer pays \$50M; no step-up; carryover basis

PV of step-up lost to buyer: (\$1,790,000)

COST TO BUYER: \$51,790,000

(equivalent – step-up is value buyer gives up)

SELLER – STOCK SALE TAX COST:

Gain on shares (\$50M - \$2M): \$48,000,000
 Capital gains tax (23.8%): \$11,424,000
 Effective rate: 23.8%

SELLER SAVES vs. ASSET SALE: \$6,676,000

The Bridge: A Price Adjustment

The CFO's job is to find the zone of agreement. In this case, the analysis reveals that the buyer's real cost advantage from the step-up is \$1.79 million in present value. The seller's incremental tax cost of an asset sale versus a stock sale is \$6.68 million. The buyer cannot fully bridge that gap through price alone — but a partial price increase combined with a 338(h)(10) structure (if applicable) or a gross-up payment can share the tax differential.

◆ IRONWORKS – FINAL NEGOTIATED STRUCTURE

NEGOTIATED RESOLUTION – PRICE GROSS-UP FRAMEWORK

Seller's incremental tax cost (asset vs. stock): \$6,676,000

Buyer's step-up benefit (PV): \$1,790,000

Net gap to bridge: \$4,886,000

NEGOTIATED OUTCOME:

Base purchase price (asset structure): \$50,000,000

Price increase to compensate seller: +\$3,500,000

Final asset purchase price: \$53,500,000

BUYER NET COST (after step-up PV credit):

\$53.5M - \$1.79M step-up PV = \$51,710,000

vs. straight stock at \$50M + lost step-up = \$51,790,000

BUYER IS EFFECTIVELY FLAT on this adjustment

SELLER NET IMPROVEMENT:

Additional proceeds: +\$3.5M gross

After additional tax on \$3.5M (~43%): +\$1,995,000 net

Seller still pays \$4.7M more in tax vs. stock sale

But gap narrows from \$6.7M to \$4.7M – deal happens

■ LESSON FROM IRONWORKS

In manufacturing deals with heavily depreciated equipment, the step-up negotiation is central to the price. The CFO must quantify both the step-up PV to the buyer AND the double-tax cost to the seller before the first LOI meeting. Without this analysis, negotiations stall. With it, you can propose specific price bridges that move both parties toward closing.

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CASE STUDY 2

SkyPath Software Corp.

S-Corp Acquisition — The 338(h)(10) Election in Action

Background

Buyer: TechHold Capital Group, a strategic acquirer building a vertical SaaS portfolio. **Seller:** SkyPath Software Corp., a 12-year-old S-Corp with three shareholders: the founder (70%), a strategic angel (20%), and a former employee (10%). SkyPath develops fleet management software with \$8.2M ARR and \$3.1M EBITDA. Agreed enterprise value: \$31M. Key asset: \$22M of intangible value in customer relationships, proprietary algorithms, and brand — none of which is capitalized

on the current balance sheet.

Why 338(h)(10) Is the Answer Here

SkyPath is an S-Corp — which means the 338(h)(10) election is available. The buyer wants the step-up to depreciate and amortize the \$22M of intangibles (which amortize over 15 years under IRC Section 197). The seller wants single-level capital gains taxation (no double tax, as S-Corp income flows through to individual shareholders anyway). The 338(h)(10) delivers both.

◆ 338(H)(10) ANALYSIS – SKYPATH SOFTWARE

SKYPATH – 338(h)(10) ECONOMICS

BUYER'S INTANGIBLE AMORTIZATION BENEFIT:

Customer relationships (15-yr IRC 197): \$14,000,000

Proprietary tech/algorithms (15-yr): \$5,000,000

Trade name (15-yr): \$3,000,000

Total Section 197 intangibles: \$22,000,000

Annual amortization: \$22M / 15 = \$1,466,667

Annual tax shield (21%): \$307,999

PV of 15-yr annuity @ 10% WACC: \$2,346,000

SELLER'S TAX UNDER 338(h)(10) vs. STRAIGHT STOCK:

Proceeds (deemed asset sale): \$31,000,000

S-Corp aggregate basis in assets: \$1,800,000

Total gain: \$29,200,000

Individual cap gains rate (23.8%): 23.8%

Tax at 23.8%: \$6,947,600

Straight stock sale tax (same rate, same gain): \$6,947,600

SELLER TAX DIFFERENCE: ZERO – 338(h)(10) costs

S-Corp sellers NOTHING extra vs. stock sale

(Unlike C-Corp, no entity-level tax for S-Corps)

NET RESULT: Buyer gets \$2.35M of free amortization value

Seller pays no additional tax. Both parties win.

■ THE 338(H)(10) RULE

For S-Corps and subsidiaries of consolidated groups, the 338(h)(10) election is almost always worth analyzing. The seller incurs no additional tax cost (flow-through entities have no entity-level tax), and the buyer receives a full step-up in basis for all acquired assets and intangibles. It is one of the few structures in tax planning where both parties can benefit simultaneously.

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CASE STUDY 3

MedCore Health Systems*Reverse Triangular Merger — Preserving Medicare & Medicaid Contracts***Background**

Buyer: RegionalHealth Corp (public). **Seller/Target:** MedCore Health Systems, a network of 14 outpatient clinics operating under Medicare and Medicaid provider agreements, state operating licenses, and 800+ individual physician contracts. Enterprise value: \$185M. The deal is structured with 70% stock and 30% cash. The fundamental problem: a simple asset purchase or statutory merger would trigger Medicare/Medicaid change-of-ownership (CHOW) proceedings that could take 18 months and result in billing interruptions costing \$2–4M per month.

Why the Structure Drives the Deal

MedCore's government contracts and provider agreements contain **anti-assignment clauses**. In an asset purchase or forward merger, these contracts are legally transferred — which triggers the CHOW process and all associated costs. In a **reverse triangular merger**, however, MedCore remains the surviving legal entity (it absorbs RegionalHealth's acquisition subsidiary). The contracts never technically transfer — they stay with MedCore, now a wholly owned subsidiary. The CHOW process is avoided entirely.

◆ MEDCORE — REVERSE TRIANGULAR ECONOMIC ANALYSIS

MEDCORE — STRUCTURE COMPARISON: ASSET PURCHASE vs. REV. TRIANGULAR

OPTION A: ASSET PURCHASE — CHOW COST ANALYSIS

Medicare billing interruption (18 months × \$900K/mo): \$16,200,000

Medicaid rebilling/reprocessing costs: \$1,200,000

Legal/compliance fees (CHOW proceedings): \$1,800,000

Contract re-execution (800+ physicians × \$500 avg): \$400,000

Total CHOW-related cost: \$19,600,000

Effective cost to buyer (PV, already in year 1): \$19,600,000

OPTION B: REVERSE TRIANGULAR MERGER — CHOW COST:

CHOW triggered: NO (MedCore survives as entity)

Contracts re-executed: NO (no change of legal holder)

Medicare/Medicaid interruption: NONE

Incremental cost vs. asset purchase: \$0

STRUCTURAL SAVINGS: \$19,600,000

NOTE: 70% stock consideration = partially tax-free to sellers

30% cash = taxable in year of receipt; stock deferred

Sellers pay tax only on the \$55.5M cash portion initially

Accounting Implications

Because RegionalHealth is a public company and the consideration is 70% stock, this transaction qualifies as a tax-free reorganization under IRC 368(a)(2)(E). From an accounting perspective, the acquisition is recorded under ASC 805 (Business Combinations) using the acquisition method. RegionalHealth records \$185M of consideration at fair value, allocates it to MedCore's identifiable assets and liabilities at fair value, and records the excess as goodwill. The tax-free status to sellers does not affect the accounting.

■ THE STRUCTURAL IMPERATIVE IN HEALTHCARE M&A;

In any acquisition of a business that holds government licenses, permits, Medicare/Medicaid provider agreements, FAA certificates, or other non-assignable regulatory approvals, the transaction structure must be engineered around the regulatory change-of-ownership rules from the very beginning. The CFO and regulatory counsel must be in the room together before the LOI is signed. The structural decision is not a legal technicality — it is a \$19.6 million financial decision.

■ SESSION 1 KEY TAKEAWAYS

- 01 Quantify the Step-Up First**
Before any structural negotiation, calculate the present value of the depreciation step-up in an asset purchase. This is the buyer's primary financial argument for an asset deal.
- 02 Model the Double-Tax Gap for C-Corp Sellers**
For C-Corp sellers, the additional tax cost of an asset sale vs. a stock sale can be 20+ percentage points of effective rate. This gap defines the negotiation envelope.
- 03 338(h)(10) Is the Structural Solution for S-Corps and Subsidiaries**
Always run this analysis. S-Corp sellers pay no additional tax, and buyers receive a full step-up. It is the most efficient structure when available.
- 04 Regulatory Contracts Drive Structure in Licensed Businesses**
In healthcare, financial services, transportation, and government contracting, the anti-assignment rules of key permits can make the structural choice for you. Model the CHOW/license transfer cost explicitly.
- 05 Tax Structure and Accounting Are Separate Questions**
The tax treatment of a deal (taxable vs. tax-free) does not determine the accounting treatment. All business combinations use ASC 805 acquisition method regardless of tax form.

Next: Part 2 — The Letter of Intent, Valuation Frameworks, and How to Negotiate the LOI Without Giving Away the Deal Before Due Diligence Begins.