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Stealth Aspect in Tax Package May Have Not So Stealthy Impact on Deals



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An insidious and underreported aspect of the tax legislation winding its way through Congress this week is a provision that likely will meaningfully and negatively impact private equity transactions, the after-tax results of entrepreneurial activities, and other public and private business transactions.

Under the latest version of the tax bill, debt financing of business activities will be substantially less attractive because of how the bill's provisions generally limit the deductibility of the enterprise's interest expense to 30 percent of "adjusted taxable income." Specifically, "adjusted taxable income" is defined in the bill as taxable income computed without regard to deductions allowable for depreciation, amortization or depletion.

Other key features of the legislation include:

- businesses with average annual gross receipts of \$25 million or less would be exempt;
- an affected business will be able to indefinitely carry forward its disallowed interest expense for use in future years; and,
- real estate businesses will be able to elect out of the rule, and the trade-off for the election out will be a lengthening of the depreciable lives of certain of the business' real property assets.

Adding insult to injury and meaningful complexity to Congress' tax simplification efforts: For partnerships and S corporations, the limitation would apply first at the entity level and then, a second time, at the partner or shareholder level.

If you would like to discuss the particulars of the proposed legislation or how it might affect the debt/equity structure of pending or existing transactions, our tax and transaction teams would be happy to help you make sense of the new bill, expected to be signed into law before Christmas.