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# Mergers and Acquisitions: Deal Structuring

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## ABSTRACT

*Merger and acquisition deal structure is one of the merger or acquisition stages. The essential thing is to develop a fair agreement structure, taking into consideration the most significant priorities of the parties concerned. Mergers and acquisitions may be structured in three ways: buying assets, buying stock, or merging. It is essential to set up a suitable deal structure if you want a merger or acquisition to be successful and at the same time to look after all the Tax consequences and Accounting Issues to keep the transaction optimal.*

**Keywords:** Merger, Acquisition, Stock Purchase, Asset Purchase, Tax.

## I. INTRODUCTION

### (A) What do we understand from the term M&A Deal Structure?

There are an almost limitless amount of merger and acquisition structures to choose from when going through a business merger or acquisition. It is very likely that as many innovative and competent transaction attorneys and investment bankers exist as there are possible deal arrangements. To properly represent the buyer's and seller's aims and objectives, the structure must be as simple as possible. Every time there is a discussion and compromise, not all of the goals of either side will be fulfilled.<sup>2</sup>

An M&A deal structure is a formal agreement that specifies the rights and responsibilities of both parties involved in a merger or acquisition (M&A). It defines the rights and responsibilities of each side of the merger or acquisition. All deals fall into one of two categories: those in which the two sides establish terms and conditions, and those in which they just make offers and accept counteroffers.<sup>3</sup>

## II. BASIC OF THE DEAL STRUCTURE

In the case of mergers and acquisitions, two or more corporate entities join together to form

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<sup>2</sup> Sherman, A. (2011). Structuring the Deal. In <i>Mergers and Acquisitions from A to Z</i> (pp. 120-143). New York; Atlanta; Brussels; Chicago; Mexico City; San Francisco; Shanghai; Tokyo; Toronto; Washington, D.C.: AMACOM Division of American Management Association International. Retrieved August 23, 2021, from <http://www.jstor.org/stable/j.ctt1d2qzxj.11>

<sup>3</sup> M&A Deal Structure - Learn About How To Structure a Deal. (2020, October 2). Corporate Finance Institute. <https://corporatefinanceinstitute.com/resources/knowledge/deals/ma-acquisition-deal-structure/>.

one for many reasons, such as for economic, social, or other reasons. A merger or acquisition can only take place when both parties agree to it. When these parties are able to come together, the conditions that are negotiated are referred to as an M&A transaction structure.

A merger or acquisition is an extended and complex process that includes several stages, and deal structuring is one of them. In mergers and acquisitions, prioritising the goals of a merger or acquisition while simultaneously assessing the weight of risk each party bears is the process. For the appropriate structuring of the deal the parties need to present all the terms related to the mergers in a clear manner, which could be as follows:

- To have a strong view on the negotiating process,
- Identification of detectable latent dangers and how they might be dealt with.
- The extent to which they are willing to take on risk;
- The conditions under which talks may be terminated.

M&A deal structure development may be quite difficult due to the number of considerations that must be taken into account. A company owner has to consider the following aspects in order to keep their firm going: preferred funding methods, corporate control, business strategy, market circumstances, antitrust laws, accounting practises, and more. Fearing the complexities of the financial, investment, and legal procedure, you should use the appropriate financial, investment, and legal counsel.<sup>4</sup>

### **III. TYPES OF MERGERS AND ACQUISITION DEAL STRUCTURE**

For both sides, choosing the right merger or acquisition structure is crucial to the deal's success. One kind of arrangement may benefit one side more than the other. Because of these two reasons, all parties (and their lawyers) must take into consideration all of the legal, tax, and commercial concerns in drafting a transaction structure that benefits both parties.<sup>5</sup>

Generally, there are three options available for structuring the M&A deal, which are listed below as follows:

1. **Stock Purchase** - A stock acquisition involves purchasing stocks from the stockholders of the target business. There is no change in the target company's assets and obligations, but, a new owner is found. A stock purchase deal may only succeed if the buyer negotiates warranties

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<sup>4</sup> M&A Deal Structure - Learn About How to Structure a Deal. (2020, October 2). Corporate Finance Institute. <https://corporatefinanceinstitute.com/resources/knowledge/deals/ma-acquisition-deal-structure/>.

<sup>5</sup> Mergers And Acquisitions: Structuring a Deal | The Hartford. (n.d.). Mergers and Acquisitions: Structuring a Deal | The Hartford. <https://www.thehartford.com/business-insurance/strategy/mergers-acquisitions/deal-structure>.

and representations about the target company's operations, assets, and liabilities, since these details must be comprehensive and precise if the buyer hopes to comprehend the target firm.

Most of the assignment and third-party permission processes that may create difficulties or delays in an asset acquisition are avoided. To make a stock acquisition, you have to identify contracts that need approval. Another good example is that real estate contracts often include "change of control" clauses, which require the landlord to provide permission.<sup>6</sup>

Since most of the regular activities will remain with the seller after the closure, these agreements are generally arranged swiftly. Another major advantage of stock buying is that you won't pay any taxes.

An important consideration when creating a stock purchase agreement is to know that all of the company's financial and legal obligations will be passed to the acquirer. Stakeholders who express dissent may be included in this process as well.<sup>7</sup>

2. **Asset Purchase** - Only those physical and intangible assets (and only those liabilities) explicitly specified in the purchase agreement are acquired in an asset acquisition. Flexibility is a huge advantage when you use this kind of framework. Individuals have the freedom to choose just the assets and responsibilities they want, and the rest is left behind. This structure may enable a buyer to avoid contingent or unforeseen obligations, but other rules and principles of law (for example, environmental and tax) will still impose responsibility on the buyer.

To acquire a single division or business unit inside a corporation, the asset acquisition structure is often employed. Because of the work needed to identify and transfer every significant asset, it may be difficult and time-consuming. Even in the case of assets such as equipment, a bill of sale or other document of title may transfer ownership, but in the case of intellectual property and real estate, each requires an assignment or deed. Permits, for example, may only be transferred in certain circumstances.

Many contracts, for reasons of their own, will provide that they may only be transferred with the approval of the other party. The parties should identify all necessary third-party consents as early in the transaction as possible to help speed up the closing process.<sup>8</sup>

3. **Merger** - The business being acquired usually merges with another company to create a single legal entity. Stockholders of the target company will get stock, cash, or a mix of both

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<sup>6</sup> Choosing the Proper Transaction Structure: Asset Vs. Stock Vs. Merger - Lexology. (n.d.). Lexology. <https://www.lexology.com/library/detail.aspx?g=95557bae-e2a5-40d9-b23e-6ab72d2d52c8>.

<sup>7</sup> M&A Deal: Structure, Merger, Acquisition Explained in Simple Words. (2021, April 2). M&A Deal: Structure, Merger, Acquisition Explained in Simple Words. <https://dealroom.net/faq/what-is-m-a-deal#faq-5>.

<sup>8</sup> *Supra* note 6

from the buyer. Assets, rights, and obligations of the extinguished entity are transferred to the surviving entity by operation of law. Most mergers are “triangular,” in which the acquiring business forms a subsidiary, which is merged into the target firm (or into which the target firm merges) (a forward triangular merger). Triangular merger arrangement offers a safeguard against liabilities when the buyer acquires the target business.

The target company's assets, rights, and liabilities (known and unknown) are acquired in a merger deal, much like a stock acquisition. For these agreements, third-party consents are only needed when a change of control occurs.

In the vast majority of mergers, permission of just a majority of the shareholders is sufficient (although certain merger agreements may also need further shareholder approval). In these situations, merging is usually the only realistic option, even if many shareholders are opposed to the deal. A shareholder of a target business has the right to dissent from a transaction and also to demand a fair appraisal of their shares as assessed by a court. In almost all public business acquisitions, the target firm is acquired via a merger.<sup>9</sup>

While typically, mergers only need the support of a simple majority of shareholders, they often demand a supermajority. Fewer discussions take occur since all assets and liabilities are transferred to the purchaser upon the transaction's completion.

Another possible downside is that if due diligence was not complete and new obligations surfaced after the closing, this would be it.<sup>10</sup>

#### IV. ISSUE IN THE M&A DEAL STRUCTURE

To succeed in a negotiation, it is essential to identify and deal with problems related to the structure of the agreement. Basic principles that need to be kept in mind while considering transaction structuring include:

1. **Transferability of shares** - By law, as soon as a stock transaction is completed, the target's obligations are passed to the purchaser. When a merger is done, the surviving company takes on all of the obligations of the company that doesn't survive. Assumed liabilities in a sale of assets will be assigned to the acquirer, while other liabilities remain liabilities of the target.<sup>11</sup>

2. **Third Party Consents** - It is critical that a pre-closing agreement to assignment be secured if the target's current contracts include a restriction against transfer. However, only if

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<sup>9</sup> *Supra* note 6

<sup>10</sup> *Supra* note 7

<sup>11</sup> Kerrigan, M. B. (2021, August 16). *Aug 2012 - Top Ten Issues in M&A Transactions - MBK*. Top Ten Issues in M&A Transactions - Mergers Acquisitions. <https://www.morse.law/news/issues-in-ma-transactions>.

the relevant contracts include explicit restrictions against assignment following a change of control or by operation of law, respectively, does there exist a permission need for a stock acquisition or merger.<sup>12</sup>

3. **Stockholder approval** - Since, the board of directors control the company, the target's board of directors may provide permission of an asset sale without having to ask each shareholder to give their consent. A sale of stock, however, must be approved by all shareholders, even if they don't sell any of their own shares. In the stock sale scenario, when unanimity is difficult to achieve, a merger may be used as an option, whereby the acquirer and target mutually agree on a threshold level of shareholder support to complete the transaction. Generally, non-consenting shareholders to an asset sale or merger will be granted appraisal rights under most other countries' corporate laws if they doubt the sufficiency of the value being offered.<sup>13</sup>

4. **Tax Consequences** - Taxability depends on transaction structure. Immediate tax implications are attached to asset sales and stock purchases, regardless of who does the selling or buying. Although some mergers and/or reorganizations/recapitalizations may be structured in such a way that at least a part of the sale proceeds (i.e. acquirer stock, often known as "boot") can be tax deferred, this is not the only manner in which such transactions can be structured.

An acquirer sees an asset sale as ideal since an increase in the acquirer's tax basis happens, and the acquisition price (fair market value) is equivalent to the acquirer's tax basis (fmv). Post-closing, this provides the purchaser with a large opportunity to depreciate assets and increase profitability. For any asset sale, the corporate tax would be charged as well as the shareholders' tax on dividends.

If you sell stock shares that you bought for more than a year, you'll have to pay long-term capital gains if you held onto the shares for at with that long. When the acquirer obtains just a cost basis in the shares acquired, the value of the assets is constant, and this results in a negative outcome for the company.

Alternatively, we may look to a merger/recapitalization to postpone the tax burden as long as possible.<sup>14</sup>

## **V. TAX AND ACCOUNTING ISSUES AFFECTING THE STRUCTURE OF THE TRANSACTION**

M&A may be fully tax free, partly tax free, or completely taxable to the seller depends on many

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<sup>12</sup> Ibid

<sup>13</sup> Ibid

<sup>14</sup> Ibid

factors, including the tax rate. Depending on the non-tax strategic goals of the buyer and seller, and their respective tax and financial positions, the transaction will be structured from a tax viewpoint in different ways for each party. Tax implications may drive a transaction in certain instances, while in other cases they are a non-issue. There will be tax considerations, including the tax basis of the assets purchased, that must be taken into account.<sup>15</sup>

A good way to demonstrate the degree to which tax concerns may get in the way of a transaction is to emphasise an example that presents a counter-example. During negotiations with his board, the CEO of the seller obtained a “carve-out” wherein a percentage of the new merged firm was granted to him as a personal gift.

Thus, the additional revenue produced almost \$1 million in cash tax obligation. Because of this tax obligation, the transaction was very difficult to accomplish. Once the CEO had a significant motive to keep the transaction from occurring, he earned credit for the deal. Remaining tax problems, like the one presented here, are essential in ensuring a smooth closing of a transaction.<sup>16</sup>

Generally, the seller's tax-related objectives involve:

- Counselling on when and when not to report profits in the event the seller.
- Identifying capital gains as regular income.
- To prevent a “double tax” (where corporations and shareholders are taxed twice), ensuring that cash is available to pay taxes when they become due.

Again, it is important to take into consideration the financial impacts as well. Non - taxable status may be difficult to obtain if the seller has no desire to obtain.

To get at the transaction's fair market value, one should double the seller's cost basis. The buyer is allowed to carry over the seller's tax basis to its own financial statements if the transaction is non-taxable. The buyer will want to hold these assets on the balance sheet at their stepped-up tax basis (for example, if the buyer is paying more than the seller's tax basis). Settling the tax problems between the parties is very essential based on our findings. This affects the transaction's pricing and each party's view of fair value.<sup>17</sup>

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<sup>15</sup> Sherman, A. (2011). Structuring the Deal. In *Mergers and Acquisitions from A to Z* (pp. 120-143). New York; Atlanta; Brussels; Chicago; Mexico City; San Francisco; Shanghai; Tokyo; Toronto; Washington, D.C.: AMACOM Division of American Management Association International. Retrieved August 23, 2021, from <http://www.jstor.org/stable/j.ctt1d2qzxj.11>

<sup>16</sup> CUSTÓDIO, C. (2014). Mergers and Acquisitions Accounting and the Diversification Discount. *The Journal of Finance*, 69(1), 219-240. Retrieved August 23, 2021, from <http://www.jstor.org/stable/43611060>

<sup>17</sup> *Supra* note 15

## VI. TIME DURATION FOR M&A DEAL

Mergers and acquisitions (M&A) deals may take anything from one month to over a year to conclude. An M&A deal is seldom completed quickly. The time needed depends on both the size of the transaction and the level of engagement of the companies involved. The company is able to provide final terms and transaction structure in just a few weeks when the buyer is eager to move the process forward as quickly as feasible.<sup>18</sup>

While words are easy to define, doing business may be difficult, and a lot of information and effort are required.

Once you've come to an agreement on the terminology, stakeholders must undertake comprehensive due diligence, including a planning phase and an executive post-close process. Gathering and processing the data needed to execute these procedures is accomplished using data rooms, project management tools, or a specialised M&A software that combines the two features. There are a number of unknown variables that may slow down the timeframe.

The closer a transaction gets to closing, the more cautious and laborious all the M&A processes have to be.<sup>19</sup>

## VII. SOME OF THE BIGGEST MERGERS IN UNITED STATES<sup>20</sup>

1. Verizon and Vodafone - The Verizon Communications and Vodafone formed Verizon Wireless to create the Verizon Wireless network. In July 2011, Verizon completed the \$130 billion acquisition of Vodafone's 45 percent share. At this point, Verizon Wireless is owned entirely by Verizon Communications.

2. Pfizer and Warner – Lambert - The two pharmaceutical firms Warner-Lambert and Pfizer Inc entered into a merger in 2000 when Pfizer bought out Warner-Lambert. It was a \$90 billion transaction, and it took three months to complete.

3. Exxon and Mobil - When Exxon Corporation and Mobil Corporation combined following a \$80 billion transaction, the new corporation was named ExxonMobil Corporation. During the transaction, Exxon and Mobil were the most prominent oil producers in the United States, and now they have distinguished themselves from the rest of the pack.

4. Travelers Group and Citicorp - When Citicorp was about to form a merger with Travelers Group in 1998, they organised a major event.

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<sup>18</sup> Weaver, S., Harris, R., Bielinski, D., & MacKenzie, K. (1991). Merger and Acquisition Valuation. *Financial Management*, 20(2), 85-96. doi:10.2307/3665732

<sup>19</sup> *Supra note 7*

<sup>20</sup> *Supra note 7*



With the \$70 billion merger, the financial services sector was greatly affected in the nation, and the creation of Citigroup was a result of the merger.

5. America Online and Time Warner - In 2000, one of the largest corporate mergers of all time occurred when AOL joined forces with Time Warner. By merging with Time Warner, AOL, an internet service provider, became AOL Time Warner, a major media behemoth.

The transaction was estimated to be \$165 billion and is seen as a watershed moment in the merger and acquisition industry. But this combination fizzled out after just a short time.

### **VIII. CONCLUSION**

We don't all wear the same size. In order to get to the top, many businesses choose to make acquisitions. For others, there are several benefits to splitting a subsidiary or company division such that it is owned by the public. In principle, mergers generate synergies and economies of scale, which increases the amount of work and results in a savings in the cost of doing business. The thought that a merger would provide more market dominance is reassuring for investors.

De-merged businesses are more likely to benefit from redesigning management incentives since they frequently have better operational performance. Increasing capital is used to finance expansion via organic methods or through acquisition. At the same time, investors profit from the increased flow of relevant information resulting from de-merged businesses.

The important part of every M&A deal is choosing the proper structure to execute it. The structure may be difficult to understand, and the advantages to one side may come at the expense of the other. It follows that both parties and their lawyers must examine all of the different legal, tax, and commercial issues and come up with a structure that is beneficial to both sides

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