



HOULIHAN LOKEY



Consumer, Food, and Retail

# Potential Impact of the Biden Tax Plan:

What Every Owner and  
Investor Needs to Know



**Houlihan Lokey’s Consumer, Food & Retail Group is pleased to share this white paper that will explore the proposed Biden tax plan (the “Biden Plan”) against the backdrop of the M&A market and its near-term implications to founders, investors, and financial sponsors.** The decision to sell any business involves a complex set of dynamic and competing factors that ultimately influence a business’s underlying value and should be carefully considered by investors and owners alike. These competing forces include, but are not limited to, the health of the specific asset’s overall industry, the state of the capital markets, the buyers available, and the external environment. As an example, a shortage or excess of buyers for a specific asset will likely influence the demand curve and may resultantly increase or decrease the purchase price. During the next 12 to 24 months, we envision that capital gains taxes and ordinary income taxes will be the foremost factors on the minds of both buyers and sellers. Specifically, depending on the outcome of the 2020 presidential election, a significant overhaul of tax policy could result in undesirable, if not unforeseen, consequences for those considering a near-term sale of their business and may drive negative tax consequences to liquidity events in 2021 and beyond.



## The Key Tenets of the Biden Tax Plan

The Biden Plan, if enacted, will have a broad impact on both investors and business operators, and should be evaluated as people consider the timing of exit and liquidity strategies. While certain facets of the proposed plan would merely reverse components of the Tax Cuts and Jobs Act of 2017, other elements of the proposal are new and merit *immediate consideration* by our clients. The Biden Plan broadly targets both individuals and corporations by either eliminating tax benefits or implementing new tax obligations. Some of these primary elements include proposals to:

- Effectively *double the tax rate* on material long-term capital gains from 20.0% to 39.6% for those with adjusted gross income (AGI) exceeding \$1 million
- Eliminate the qualified income deduction for partnerships and S corporations
- Increase the corporate rate from 21.0% to 28.0%
- Add a new 12.4% “high-earner” payroll tax on all income above \$400,000
- Raise the top individual tax rate back up to 39.6% from 37.0%

## Summary Impact of the Proposed Biden Plan

Item	Current Law	The Biden Plan
Highest Individual Rate	37.0%	39.6%
Highest Capital Gains Rate	20.0%	39.6% on income above \$1 million
Corporate Income Tax Rate	21.0%	28.0%, reintroduction of alternative minimum tax (AMT)
Payroll Tax	Capped at wage base of \$137,700	Retain current tax, add an additional payroll tax for those earning above \$400,000
Qualified Business Income Deduction (Partnerships, S Corporations)	20.0%	20.0%, but phased out for income above \$400,000



## Potential Tax Impacts of the Biden Plan on M&A Transactions

The tax ramifications of the Biden Plan would meaningfully affect business operations for both founder-owned companies and portfolio holdings of private equity firms, with a significant impact on net proceeds from any potential M&A transaction. The following illustration demonstrates the potential federal tax difference between a transaction that closes under current tax law vs. a transaction that closes in 2021 or later under the Biden Plan (assuming any changes are retroactive to January 1, 2021).

Assume a company with \$50.0 million of EBITDA is sold for a 10.0x multiple with net debt of \$0:

### The Impact of Selling a Company Under the Biden Plan<sup>(1)</sup>

Timing of Sale	Proceeds	Tax Basis	Taxable Gain	Federal Tax Rate	Capital Gains Tax	After Tax Proceeds
Pre-Biden Plan	\$500M	\$0	\$500M	20.0%	\$100M	\$400M
Post-Biden Plan	\$500M	\$0	\$500M	39.6%	\$198M	\$302M

Even in this elementary illustration above,<sup>(2)</sup> the federal tax under the Biden Plan is *almost double* the capital gains tax that would have been due if the transaction occurred in 2020. Specifically, the seller in 2020 would have pocketed \$400 million net after tax but would receive only ~\$300 million if the same transaction occurred under the Biden Plan. In order to achieve the same level of after-tax proceeds, a seller would need to achieve a multiple 3.2x higher than in the first scenario, as demonstrated below:

### Meaningful Impact on Multiples Required for the Same Net Proceeds<sup>(3)</sup>

Timing of Sale	Proceeds	Tax Basis	Taxable Gain	Federal Tax Rate	Capital Gains Tax	After-Tax Proceeds	EBITDA Multiple
Pre-Biden Plan	\$500M	\$0	\$500M	20.0%	\$100M	\$400M	10.0x
Post-Biden Plan	\$662M	\$0	\$662M	39.6%	\$262M	\$400M	13.2x

<sup>(1)</sup> This article assumes that any legislation will be enacted swiftly if Biden is elected and all capital gains are long-term capital gains.

<sup>(2)</sup> Does not include current city and state taxes, which can be as high as 13.3% depending on residency, and other potential federal taxes, such as the Net Investment Income Tax of 3.8%.

<sup>(3)</sup> A meaningful increase in the corporate tax rate from 21.0% to 28.0% will likely have a significant impact on public market trading multiples and therefore likely acquisition multiples paid to sellers.

## How Will This Impact Exit or Succession Planning?

Founders or families contemplating the sale of their business *within the next five years* should analyze the Biden Plan very carefully. Founders may only sell one business during their lifetime, which is often the most important transaction of their lives and for their families. The proceeds of the business sale could be disbursed to various family trusts and other vehicles for intergenerational wealth preservation.<sup>(4)</sup> Any founder or private equity firm considering the sale of a business must consider some variation of this impact if they are considering any exit or sale in the near future.

Additionally, even families or investment firms with no intention to sell their business may be concerned with the Biden Plan in terms of potential increases to annual taxes via increased payroll taxes and higher tax costs for both C corporations *and* S corporation shareholders or partners in partnerships. Hence, founders and private equity firms contemplating a transaction in the near future should be aware of the potential implications of the Biden Plan.

## Impact of a New Tax Plan on Exit Timing: The Double-Edged Sword

All business owners face a potential double-edged sword with the Biden Plan...*unfortunately, with both blades pointed at them.*

If they are mulling the sale of a portfolio company, they face the same scenario as described above with less cash after taxes in 2021 if the Biden Plan is enacted.<sup>(5)</sup>

Conversely, if they decide to hold the investment longer, they are now faced with the other side of the blade—a *higher ongoing tax bill under the Biden Plan*, which was likely not factored in to their original investment model.

If founders and private equity firms decide to hold on to their companies, they will be subject to increased operating taxes during the life of their investments, which consequently lowers the return on their investment. This is a fact for both pass-through entities as well as investments held in C corporation solutions. For instance, the 20.0% pass-through deduction under Section 199A would be phased out above \$400,000 under the Biden Plan. This materially affects limited partners with investments held in partnerships and S corporations. Utilizing C corporations would not be an appealing alternative, as their tax rates would increase to 28.0% from 21.0% under the Biden Plan and also be subject to a corporate alternative minimum tax. With an increase in these “tax costs,” companies will have materially decreased cash flow and fewer funds available to support leverage or capital investments in operations.

Any changes to federal tax legislation will also affect state income taxation, and those in high-tax states, such as New York and California, should take note. States are either “rolling conformity” states or “fixed conformity” states. Rolling conformity states will conform directly to the Internal Revenue Code (IRC) as it is amended; therefore, any changes imposed by the Biden administration would automatically change state tax law. By contrast, in fixed conformity states, any changes made to the IRC will generally be incorporated when the state legislatures enact legislation to conform to the IRC.

<sup>(4)</sup> There are also significant trust and estate tax law changes proposed under the Biden Plan that will impact intergenerational wealth transfer that are not discussed herein.

<sup>(5)</sup> If they decide to hold onto their portfolio companies, they will be subject to increased operating taxes during the life of their investments and, consequently, lower the return on investment. For example, the 20.0% pass-through deduction under Section 199A would be phased out above \$400,000 under the Biden Plan. This materially affects limited partners with investments held in partnerships and S corporations. Utilizing a C corporation would not be an appealing alternative, as their tax rates would increase to 28.0% from 21.0% under the Biden Plan. Furthermore, payroll taxes proposed under the Biden Plan may subsequently harm overall profitability.



## Final Considerations

Whether a portion or the entirety of the Biden Plan becomes law, the external environment that overlays the M&A markets may profoundly change over the next four years. Implementation of the Biden Plan will likely require not only a Biden election, but also a change in control in the U.S. Senate from Republicans to Democrats as well as Democrats maintaining control over the U.S. House of Representatives. In addition to the federal tax implications of the 2020 election, several states have proposed meaningful changes to their tax policy, including Illinois, Michigan, and Colorado, which will add to the increased tax burden on transaction proceeds.<sup>(6)</sup> The impact of the 2020 presidential election will be felt throughout the business world and will require a new microscope under which to evaluate, negotiate, and close transactions. We urge all of our current and potential clients to take note of the potential forthcoming changes, along with their associated consequences, as they consider an exit strategy for their business in the near future.



*(6) These states have proposed graduated income tax rates that would result in a higher state tax burden for high earners. Adoption of these proposals would be independent of the results of the 2020 presidential election. We note that certain states have already adopted graduated tax rates, including California, which has a 13.3% top marginal tax rate for individuals with income above \$1.0 million.*

# #1

## M&A Advisor for All U.S. Consumer, Food, and Retail Transactions

Refinitiv (formerly Thomson Reuters) ranks Houlihan Lokey as the top U.S. M&A advisor in the consumer, food, and retail space, based on number of transactions.

→ 2017 → 2018 → 2019 →

The Houlihan Lokey Consumer, Food & Retail (CFR) Group has earned a reputation for providing superior service and achieving outstanding results in M&A advisory, capital-raising, restructuring, and financial advisory services. The Consumer, Food & Retail Group is a trusted advisor to companies in the CFR industry and combines extensive market capabilities with in-depth industry knowledge to help maximize shareholder value for clients. In 2019, the group was ranked the No. 1 M&A advisor for all U.S. CFR transactions by Refinitiv (formerly Thomson Reuters).



HOULIHAN LOKEY

# Contacts

## Consumer, Food, and Retail



**Jay Novak**  
*Managing Director*  
*Global Head of Consumer,*  
*Food & Retail Group*  
[JNovak@HL.com](mailto:JNovak@HL.com)  
312.456.4754



**Jason Abt**  
*Managing Director*  
[JAbt@HL.com](mailto:JAbt@HL.com)  
415.273.3606



**Mark Dufilho**  
*Managing Director*  
[MDufilho@HL.com](mailto:MDufilho@HL.com)  
214.220.8477



**Matthew Kaczmarek**  
*Managing Director*  
[MKaczmarek@HL.com](mailto:MKaczmarek@HL.com)  
312.456.4761



**Tim Larsen**  
*Managing Director*  
[TLarsen@HL.com](mailto:TLarsen@HL.com)  
312.456.4786



**Nate Pund**  
*Managing Director*  
[NPund@HL.com](mailto:NPund@HL.com)  
214.665.8680



**Susan Roddy**  
*Managing Director*  
[SRoddy@HL.com](mailto:SRoddy@HL.com)  
212.497.4195



**Jeremy Hirsch**  
*Vice President*  
[JHirsch@HL.com](mailto:JHirsch@HL.com)  
646.259.7432

## M&A Tax



**Winston Shows**  
*Senior Vice President*  
[WShows@HL.com](mailto:WShows@HL.com)  
214.665.8652



**Aninda Dhar**  
*Vice President*  
[ADhar@HL.com](mailto:ADhar@HL.com)  
212.497.4161

### About Houlihan Lokey

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in [mergers and acquisitions](#), [capital markets](#), [financial restructuring](#), and [valuation](#). The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm's commitment to client success across its advisory services. Houlihan Lokey is the No. 1 M&A advisor for the past five consecutive years in the U.S., the No. 1 global restructuring advisor for the past six consecutive years, and the No. 1 global M&A fairness opinion advisor over the past 20 years, all based on number of transactions and according to data provided by Refinitiv (formerly Thomson Reuters).





# HOULIHAN LOKEY

Houlihan Lokey is a trade name for Houlihan Lokey, Inc., and its subsidiaries and affiliates, which include those in (i) the United States: Houlihan Lokey Capital, Inc., an SEC-registered broker-dealer and member of FINRA ([www.finra.org](http://www.finra.org)) and SIPC ([www.sipc.org](http://www.sipc.org)) (investment banking services); Houlihan Lokey Financial Advisors, Inc. (financial advisory services); HL Finance, LLC (syndicated leveraged finance platform); and Houlihan Lokey Real Estate Group, Inc. (real estate advisory services); (ii) Europe: Houlihan Lokey EMEA, LLP, and Houlihan Lokey (Corporate Finance) Limited, authorized and regulated by the U.K. Financial Conduct Authority; Houlihan Lokey S.p.A.; Houlihan Lokey GmbH; Houlihan Lokey (Netherlands) B.V.; Houlihan Lokey (España), S.A.; and Houlihan Lokey (Corporate Finance), S.A.; (iii) the United Arab Emirates, Dubai International Financial Centre (Dubai): Houlihan Lokey (MEA Financial Advisory) Limited, regulated by the Dubai Financial Services Authority for the provision of advising on financial products, arranging deals in investments, and arranging credit and advising on credit to professional clients only; (iv) Singapore: Houlihan Lokey (Singapore) Private Limited, an "exempt corporate finance adviser" able to provide exempt corporate finance advisory services to accredited investors only; (v) Hong Kong SAR: Houlihan Lokey (China) Limited, licensed in Hong Kong by the Securities and Futures Commission to conduct Type 1, 4, and 6 regulated activities to professional investors only; (vi) China: Houlihan Lokey Howard & Zukin Investment Consulting (Beijing) Co., Limited (financial advisory services); (vii) Japan: Houlihan Lokey K.K. (financial advisory services); and (viii) Australia: Houlihan Lokey (Australia) Pty Limited (ABN 74 601 825 227), a company incorporated in Australia and licensed by the Australian Securities and Investments Commission (AFSL number 474953) in respect of financial services provided to wholesale clients only. In the European Economic Area (EEA), Dubai, Singapore, Hong Kong, and Australia, this communication is directed to intended recipients, including actual or potential professional clients (EEA and Dubai), accredited investors (Singapore), professional investors (Hong Kong), and wholesale clients (Australia), respectively. Other persons, such as retail clients, are NOT the intended recipients of our communications or services and should not act upon this communication.

This document has been prepared for informational purposes only and is not intended to provide, and should not be relied on, for tax, legal, or accounting advice. The reader should consult their own tax, legal, and accounting advisors before engaging in any transaction.