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THE LBO STRUCTURE

Have you foreseen to take over a company which is chargeable to corporate tax? Have you thought about another transaction more interesting than a simple corporate buyout: to create a takeover holding? Which benefits?

I. LBO : a common transaction

A. The buy-out by the holding company

Today, the usual way to buy-out a company, more precisely a SMEs (*"PME" or "Petites et Moyennes Entreprises*") is to adopt a plan that involves a holding, especially when the purchaser partly finances this acquisition.

In this plan, the purchaser doesn't buy directly the target company *("société cible")* but the buy-out is made by the intermediary of a holding, specially created for the acquisition.

B. The functioning

In order to buyout a company, a holding takes a bank loan.

The dividends shared out by the target company, allow the holding to be able to honor the loan due date.

This operation is known as LBO, “leverage buy out” which refers to the funding of the operation by the acquired company itself.

C. LBO into practice

It is common that the buyer bring into the acquired company business an asset of 25% to 30%.

Thus, thanks to this particular operation, a contribution of 250 000 to 300 000 euros will be enough to acquire a company whose value corresponds to 1M euros.

The remaining amount will be borrowed by the holding.

This kind of operation gives some obvious financing facilities but also significant tax breaks.

II. <u>The tax benefits derived from the LBO</u>

A. Interests exempted from tax levy

The classic buyout operation refers to the situation that the buyer as a natural person gains directly company issued equity.

The interests derived from the acquired company are taxed relatively heavily.

A progressive tax schedule based on 60% of the revenues distributed is applied.

Also, these dividends are subject to 15, 5% of social contributions.

By creating a holding for the buyout, the dividends shared out aren't subject to social contributions.

The dividends can be almost totally exempted from taxation (equivalent to 95%).

This tax benefit will not be applied if the holding keeps for two years the dividends and a parent subsidiary tax system is chosen.

Be aware that this option can be exercised in the cases where the holding (*parent company or "société mère"*) holds at least 5% of the share capital of the acquired company and those two companies are subject to corporation tax.

B. Another tax optimization

At the moment of the holding incorporation, it's important to provide for the option concerning the tax consolidation for the target company and the holding.

Indeed, about this tax consolidation, the taxation is made at the standard of algebraic sum of the tax results of the integrated group of companies.

The incorporation of a holding made in order to buyout the target company generates usually a deficit because of the annual carrying charges which will reduce the target company's tax result.

A corporate tax economy is reached but consequently it will increase the existing financial resources of the incorporated group.

C. Advices

The success of this transaction depends of the acquired company's power to share out adequately the dividends in order to guarantee the refund of the loan taken out by the holding.

Incorporated a takeover holding will fund the acquisition by the company that you want to buyout. By combining this transaction, the parent subsidiary tax system and the tax consolidation, you will be exempt 95% of the dividends collected by the holding. You will reduce the tax corporation of the acquired company.

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