Beat: Business

THE FRENCH LEGAL ACCOUNTING & TAX ISSUES RELATED TO ACQUIRE A US SUBSIDIARY

FRENCH AMERICAN PRIVILEGES

Paris, Washington DC, 09.04.2021, 00:30 Time

USPA NEWS - France and the United States maintain privileged economic relations. According to a study published by the French Embassy in the United States in 2019, France is the third largest foreign employer there with 730,000 jobs created by 4,800 subsidiaries of French companies. It is evident that the current coronavirus crisis makes the situation uncertain. Border closures and immigration-related suspension measures restrict opportunities for foreign companies to develop in the United States. However, this crisis is necessarily temporary and the American market and its 328 million inhabitants will undoubtedly remain a prime target for French and European companies seeking development. The entry of a company into the American market can in particular be effected through external growth through the takeover of an existing company. Therefore, it is possible to wonder about the legal, accounting and tax issues related to the acquisition of a subsidiary.

FRANCE VERSUS. USA: THE DIFFERENCE ACCOUNTING PRACTICES ACROSS THE ATLANTIC----------
The American accounting environment differs greatly from the French system. Unlisted American companies are not required to prepare accounts in accordance with American "US GAAP" accounting standards, nor to file these accounts with the clerk of the commercial court as French companies are required to do. Bookkeeping is nevertheless required for the preparation of the tax return. A company can therefore use an accounting method authorized by the US tax code, the Internal Revenue Code (or "IRC"): cash, accrual or even "hybrid" accounting which consists of a combination of the latter two. It is therefore essential to be attentive to the accounting framework used when reading financial statements prepared by an American target. The annual audit for unlisted companies is also not mandatory although it may be contractually required, as sometimes requested by certain financial institutions. As this is an unaudited target, the internal control procedures necessarily existing and without which no structure could function, can sometimes be closer to those of a family company compared to a French SME of equivalent size.

WHAT ARE THE TAX OF CHOOSING THE FORM OF ACQUISITION ?----------
Two options are possible for the acquisition of an American company, (i) by purchase of shares or shares ("stock deal"), or (ii) by repurchase of assets ("asset deal").During an asset acquisition, the acquirer acquires only the tangible and intangible assets - and only assumes the liabilities - specifically identified in the acquisition contract. The tax base of the assets, on which the future depreciation will be calculated, is re-evaluated at their market value on the date of the transaction. The difference between the cumulative value of the assets that have been identified and the overall price will be recorded as goodwill, depreciable for tax purposes over 15 years. This mechanism therefore presents a tax advantage for the purchaser. Conversely, this type of transaction can be inconvenient for the seller. The amount of the capital gain realized by the latter may be higher than that realized following a sale of securities due to the calculation methods and the taking into account of different tax bases. The seller may then have to negotiate compensation for this additional tax burden.----------
Sometimes it is not possible to buy back only assets for legal reasons, for example in the event that key contracts are not transferable. In the context of a transfer of securities, the transferred company retains its tax status. Pre-sales tax attributes are carried forward, such as accumulated losses and tax depreciation bases for fixed assets that are not revalued.
However, two elections provided for in Article 338 of the IRC allow the tax bases to be re-evaluated in a manner similar to an asset buyback, while retaining the legal nature of an acquisition of securities. Their condition of application and their potential benefit should be studied during the negotiation phases.

Regarding the transfer of the use of deficits, it is imperative for the investor to take into account the effects of Article 382 of the IRC. Indeed, following a change of control as defined by the IRC, the tax administration limits the use of losses carried forward on future profits. The maximum annual usage is equal to the market value of the target multiplied by a regularly updated rate published by the Internal Revenue Service (or "IRS"). In the case of the takeover of an international group, the American subsidiary often does not have a separate value reported in the global acquisition contract. This value must then be calculated for the reasons mentioned above. How

does the US federal system influence the acquisition of a subsidiary? From a legal standpoint, it's important to keep in mind that the United States is a country made up of 50 states and the District of Columbia. The acquisition of the subsidiary will therefore be subject to federal but also different state laws depending on the state (s) in question. The majority of companies are domiciled in the state of Delaware for generally legal and non-tax reasons as sometimes mistakenly perceived by some investors. Indeed, an American company must file a tax return and pay the corresponding tax in all states in which this company has a Nexus, defined differently by each state. A physical presence materialized by employees, business premises or other means will generally create a Nexus. The review of legal compliance prior to the acquisition will have to adapt to these specificities. For example, in social law, the drafting of an employment contract is not compulsory in most states. Rules of behavior, remuneration in the form of advantages in kind or "benefits" (health insurance, retirement plan, etc.) are generally provided for in the "Employee Handbook". This internal document may contain the human resources procedures applicable within the company. From an operational and workforce management perspective, it is essential to consider the "at will" character of labor relations, allowing them to be terminated without notice. US workers have the advantage of knowing the local market and passing on their experience, but may have the disadvantage of greater mobility. It is crucial to secure key employees with, for example, "stock option" type contracts and also to consider the expatriation of employees who will bring the group culture while finding the appropriate distribution between local and expatriate employees. The development of the coronavirus crisis and the restrictive immigration measures announced by President Trump in April 2020 will be of utmost importance in this regard." By Marc Trost, co-founder and partner of Orbiss Source; Orbiss/escale Consulting

Article online:
https://www.uspa24.com/bericht-18498/the-french-legal-accounting-und-tax-issues-related-to-acquire-a-us-subsidiary.html

Editorial office and responsibility:
V.i.S.d.P. & Sect. 6 MDStV (German Interstate Media Services Agreement): Jedi Foster and Rahma Sophia Rachdi

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Editorial program service of General News Agency:
UPA United Press Agency LTD
483 Green Lanes
UK, London N13NV 4BS
contact (at) unitedpressagency.com
Official Federal Reg. No. 7442619