How to Take Advantage of the ‘New Golden Age’ of Private Equity

We are living in another golden age of private equity according to many experts. Private equity managers raised $453 billion from investors in 2017—breaking the record set in 2007—and the trend in 2018 has been more of the same. Based on the growth of the past few years, and assuming a conservative 8% annual compound growth rate, private equity is projected to overtake hedge funds in assets under management within five years.

Private equity largely owes its rise to an extended period of historically low interest rates. Impatient with low yields in the public space, investors increasingly have turned to debt funds, buyouts and other private assets for stronger potential returns. The influx of cash in the private space, coupled with the benefits of private ownership such as more efficient board meetings and executives with a greater personal stake in profitability, has fed the trend of large companies being acquired by private equity firms. However, private equity’s growth has attracted the attention of federal regulators, who are concerned about the shrinking of public markets. For example, earlier this year the Committee on Foreign Investment in the United States spoke out against Broadcom’s prospective takeover of Qualcomm, citing its fear that Broadcom would run the company in a “private equity style” that emphasized short-term profits over long-term research and development investment.

Buyers and sellers in private equity also must reckon with changes brought by the Tax Cuts and Jobs Act of 2017. The sweeping tax overhaul includes several provisions relevant to private equity investment strategies, such as an increase in the holding period for long-term capital gains with carried interest, restrictions on some deductions and the expansion of others.

What opportunities does this evolving market offer for investors, lenders and recipients of private capital, and how are firms adapting to the prevailing trend? Crain’s Custom turned to two seasoned private equity professionals to learn what the changes mean, and whether the TCJA has been a net positive or negative for the industry:

**John Ruckstuhl**, managing director in the transaction advisory services group of EisnerAmper LLP. For more than 20 years, he has advised private equity and venture capital firms on their domestic and international transactions.

**Matthew McNally**, managing director in the asset management tax practice group in the New York office of True Partners Consulting LLC. He works with private equity firms, portfolio companies, hedge funds and venture capital firms.

**Crain’s**: What are some of the more significant challenges facing private equity buyers looking to complete transactions before the end of the year?

**Ruckstuhl**: We’ve seen a recent spike in the volume of transactions looking to close before year-end. In order to expedite the process, all of the transaction professionals involved on both sides of the deal—including lawyers, accountants, lenders and investment bankers—need to be fully committed to the various deadlines in order to meet closing deadlines. It is crucial to understand the lead times required for the various parties to complete credit and investment committee reviews.

**McNally**: The Tax Cuts and Jobs Act of 2017 has certainly had a significant impact on current and future deals, especially on both debt funds and buyout transactions due to the new limitations on interest expense deductions. Currently, I do not see debt funds or buyout transactions becoming less alluring as long as interest rates remain at historically low levels. If interest rates begin to rise ever more sharply, investment appetites for these funds may begin to wane. The reform has already begun to disrupt how potential buyout targets are valued and how buyout transactions may have to remove some of the leverage. However, the corporate tax cuts may help bolster returns in the future and may offset any adverse consequences the tax reform may have had.

**Crain’s**: What are some factors that are either holding up or terminating deals?

**Ruckstuhl**: The primary factors that hold up or terminate deals are the financial performance of the target and the language in the purchase agreement. It is not unusual for sellers to take their focus off the operations during the sales process. Sellers need to stay committed to delivering on the near-term projections they provided at the beginning of the process. Sellers also get a first view of the purchase agreement and have to make decisions on the terms. We also see sellers getting their tax advisers involved late in the process, resulting in proposed changes to the structure as the sellers start to focus on the net cash they anticipate from the deal.
Client Approach:
advice and innovative approaches.
our dedicated team understands client needs and provides strategic
companies. From start-up funds to large and complex financial entities,
audit, tax, and advisory services to private equity firms and their portfolio
EisnerAmper is among the nation's largest accounting firms with a
Understanding Your Business

Prior to the law change, there was no limitation and private equity firms had unregulated public utilities and real property businesses.

The TCJA also limits deductions for losses and recharacterization provisions. Higher leverage multiples are contributing to the overall increase in purchase prices.

We continue to see an abundance of credit in the market. Traditional banks continue to lend into the middle market. Alternative lenders are also very active and have a lot of dry powder. Lenders looking to sign deals are getting aggressive with pricing and covenant provisions. Higher leverage multiples are contributing to the overall increase in purchase prices.

“...the cost of debt will effectively increase, because firms no longer get the full benefit of what can be a massive tax write-off. Borrowers should contemplate repaying existing debt, and companies accessing capital markets might want to consider issuing new debt capitalization
compared to their debt.”

Ruckstuhl: We continue to see an abundance of credit in the market. Traditional banks continue to lend into the middle market. Alternative lenders are also very active and have a lot of dry powder. Lenders looking to sign deals are getting aggressive with pricing and covenant provisions. Higher leverage multiples are contributing to the overall increase in purchase prices.

“...the cost of debt will effectively increase, because firms no longer get the full benefit of what can be a massive tax write-off. Borrowers should contemplate repaying existing debt, and companies accessing capital markets might want to consider issuing new debt capitalization
compared to their debt.”

McNally: The private equity fund managers will have to consider their specific circumstances and the impact to the specific portfolio companies. Under the new tax regulations, the co-investment vehicles and control of portfolio companies could cause an increase in reporting and income pickup at the fund level, even before investment returns are ever distributed. The portfolio companies will become increasingly reliant on PE fund managers to help them with the tax implications of these issues to make the right decisions. The TCJA has far-reaching implications for almost every U.S. partnership.

Crain’s: How has the TCJA affected the interplay between private equity-owned companies and the PE firms themselves?

McNally: The private equity fund managers will have to consider their specific circumstances and the impact to the specific portfolio companies. Under the new tax regulations, the co-investment vehicles and control of portfolio companies could cause an increase in reporting and income pickup at the fund level, even before investment returns are ever distributed. The portfolio companies will become increasingly reliant on PE fund managers to help them with the tax implications of these issues to make the right decisions. The TCJA has far-reaching implications for almost every U.S. partnership.

Crain’s: How are longer holding periods for private equity investments affecting the marketplace?

McNally: The TCJA added a requirement for the acquirer (buyer) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (seller) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withhold the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What are the implications of the new rules regarding the sale of partnership interest by a foreign partner?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the transferor stating that the seller is not subject to withholding. If the buyer does not withhold the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withhold the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withhold the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withhold a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withhold from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?

McNally: The TCJA added a requirement for the acquiree (seller) of a partnership interest to withholding a 10% tax on the amount realized on the transfer unless the transferor (buyer) gives a certificate (typically Form 8313 or 8332) to the buyer stating that the seller is not subject to withholding. If the buyer does not withholding the tax, the partnership must withholding from distributions to the buyer, which can significantly reduce the proceeds to the seller.

Crain’s: What opportunities has it created?