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# Valuation Impact: Proposed Post-Election Tax Changes

## *A martinwolf Special Report*

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Every election year carries with it the potential for structural change—and with the ongoing economic crisis from the pandemic, there is a growing sense that this year may be ripe for bigger changes than normal.

- Currently, the highest-bracket tax structure includes a 20.0% capital gains tax plus a Net-Investment Income Tax (NIIT) of 3.8% for a total 23.8% federal tax rate when selling a business.
- The Democratic Party's campaign promises include bringing capital gains tax in line with federal income tax, which would be raised to the Obama-era level of 39.6% at the highest tax bracket. The existing NIIT of 3.8% will stay, **resulting in a total 43.4% federal tax rate** when selling a business.
- Assuming tax structure is changed to match the Democratic Party's campaign promises, there will need to be a **significant increase in valuation to achieve the same proceeds** business owners would get under the current tax structure.
- For example, to get the same after-tax transaction proceeds for a California-based business in the current tax structure at 7.0x EBITDA, business owners would need to sell the same business for 10.2x EBITDA in the proposed tax structure.

# High Income Tax State

## Summary

High income tax states, like California, Illinois, New York and New Jersey see the lowest post-tax returns. In some cases, if the proposed tax changes come into effect, combined state and federal tax would amount to more than 50% of transaction value. As an example:

- Under the current tax structure, sellers of CA-based businesses pay a 20% capital gains tax, 3.8% NIIT, and finally, the highest CA state income tax of 13.3%. In total, 37.1% of the transaction value is paid in taxes.
- Under the proposed tax structure, sellers of CA-based businesses would pay a 39.6% federal income tax, 3.8% NIIT, and finally, the highest CA state income tax of 13.3%. In total, 56.7% of the transaction value is paid in taxes.

As displayed below, the change in tax structure results in a 31.2% reduction in after-tax proceeds to business owners in CA.

	After-Tax Proceeds under Current Tax Structure																			
Transaction Value (\$M)	10	20	30	40	50	60	70	80	90	100	110	120	130	140	150	160	170	180	190	200
After-Tax Proceeds - Current (\$M)	7.6	15.2	22.9	30.5	38.1	45.7	53.3	61.0	68.6	76.2	83.8	91.4	99.1	106.7	114.3	121.9	129.5	137.2	144.8	152.4
After-Tax Proceeds - Proposed (\$M)	5.7	11.3	17.0	22.6	28.3	34.0	39.6	45.3	50.9	56.6	62.3	67.9	73.6	79.2	84.9	90.6	96.2	101.9	107.5	113.2

In order to achieve the same after-tax proceeds under the new proposed tax structure as they would get in the current tax structure, CA-based businesses would need to sell at a 45.3% higher transaction value.

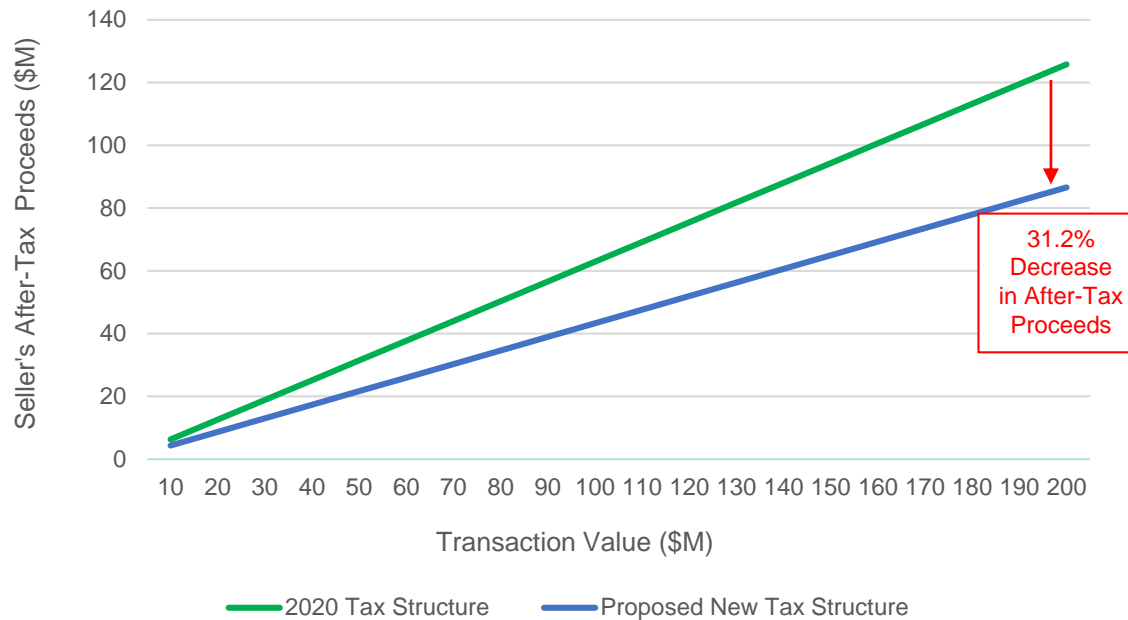
	New Transaction Value Needed to Achieve Same After-Tax Proceeds																			
After-Tax Proceeds (\$M)	6.3	12.6	18.9	25.2	31.5	37.7	44.0	50.3	56.6	62.9	69.2	75.5	81.8	88.1	94.4	100.6	106.9	113.2	119.5	125.8
Transaction Value - Current (\$M)	10.0	20.0	30.0	40.0	50.0	60.0	70.0	80.0	90.0	100.0	110.0	120.0	130.0	140.0	150.0	160.0	170.0	180.0	190.0	200.0
Transaction Value - Proposed (\$M)	14.5	29.1	43.6	58.1	72.6	87.2	101.7	116.2	130.7	145.3	159.8	174.3	188.8	203.4	217.9	232.4	247.0	261.5	276.0	290.5

\*Note: See Assumptions page for further detail.

# High Income Tax State

## Valuation Impact

**2020 vs Proposed After-Tax Proceeds Comparison**



If Current Multiple Is:	The New Necessary Multiple Is:
4x	5.8x
5x	7.3x
6x	8.7x
7x	10.2x
8x	11.6x
9x	13.1x
10x	14.5x
11x	16.0x
12x	17.4x

# Medium Income Tax State

## Summary

Medium income tax states, like Connecticut, Michigan, Ohio, and Missouri could also see over 50% of their transaction value paid in taxes. As an example:

- Under the current tax structure, sellers of Connecticut-based businesses pay a 20% capital gains tax, 3.8% NIIT, and finally, the highest Connecticut state income tax of 6.99%. In total, 30.8% of the transaction value is paid in taxes.
- Under the proposed tax structure, sellers of Connecticut-based businesses pay a 39.6% federal income tax, 3.8% NIIT, and finally, the highest Connecticut state income tax of 6.99%. In total, 50.4% of the transaction value is paid in taxes.

As displayed below, the change in tax structure results in a 28.3% reduction in after-tax proceeds to business owners in Connecticut.

	After-Tax Proceeds under Current Tax Structure																			
Transaction Value (\$M)	10	20	30	40	50	60	70	80	90	100	110	120	130	140	150	160	170	180	190	200
After-Tax Proceeds - Current (\$M)	6.9	13.8	20.8	27.7	34.6	41.5	48.4	55.4	62.3	69.2	76.1	83.1	90.0	96.9	103.8	110.7	117.7	124.6	131.5	138.4
After-Tax Proceeds - Proposed (\$M)	5.0	9.9	14.9	19.8	24.8	29.8	34.7	39.7	44.6	49.6	54.6	59.5	64.5	69.5	74.4	79.4	84.3	89.3	94.3	99.2

In order to achieve the same after-tax proceeds under the proposed tax structure as they would get in the current tax structure, Connecticut-based businesses would need to sell at a 39.5% higher transaction value.

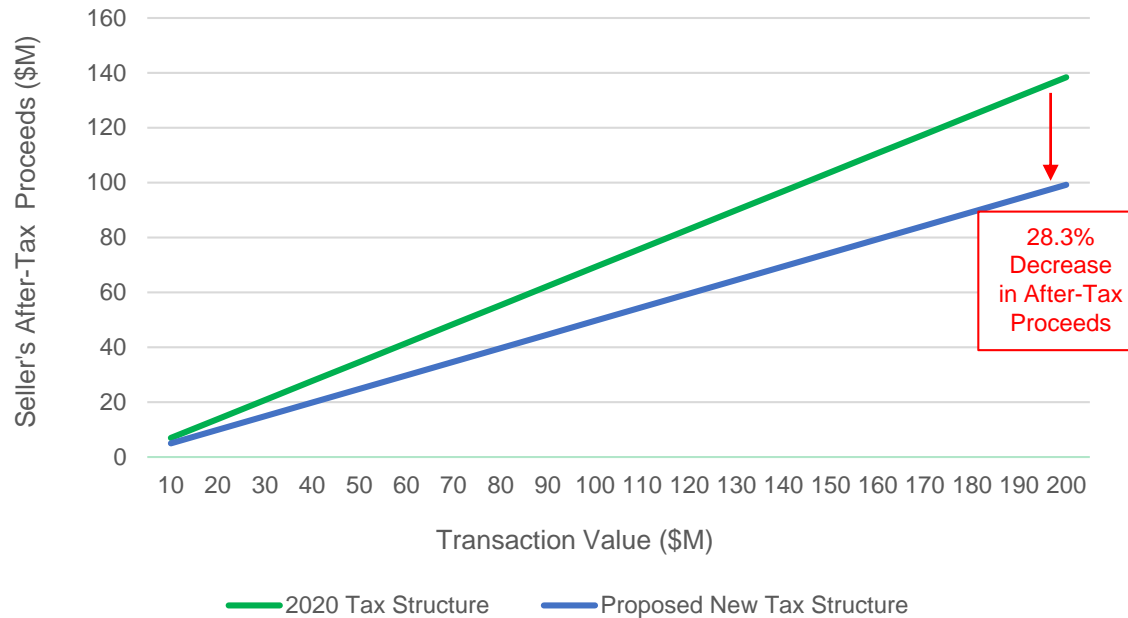
	New Transaction Value Needed to Achieve Same After-Tax Proceeds																			
After-Tax Proceeds (\$M)	6.9	13.8	20.8	27.7	34.6	41.5	48.4	55.4	62.3	69.2	76.1	83.1	90.0	96.9	103.8	110.7	117.7	124.6	131.5	138.4
Transaction Value - Current (\$M)	10.0	20.0	30.0	40.0	50.0	60.0	70.0	80.0	90.0	100.0	110.0	120.0	130.0	140.0	150.0	160.0	170.0	180.0	190.0	200.0
Transaction Value - Proposed (\$M)	14.0	27.9	41.9	55.8	69.8	83.7	97.7	111.6	125.6	139.5	153.5	167.4	181.4	195.3	209.3	223.2	237.2	251.1	265.1	279.0

\*Note: See Assumptions page for further detail.

# Medium Income Tax State

## Valuation Impact

**2020 vs Proposed After-Tax Proceeds Comparison**



If Current Multiple Is:	The New Necessary Multiple Is:
4x	5.6x
5x	7.0x
6x	8.4x
7x	9.8x
8x	11.2x
9x	12.6x
10x	14.0x
11x	15.3x
12x	16.7x

# Low/No Income Tax State

## Summary

Even in low/no income tax states, like Texas, Tennessee, Florida and Washington, taxes on M&A transactions will exceed 40% under the proposed tax structure. As an example:

- Under the current tax structure, sellers of Texas-based businesses pay a 20% capital gains tax, and a 3.8% NIIT. Texas does not have state income tax. In total, 23.8% of the transaction value is paid in taxes.
- Under the proposed tax structure, sellers of Texas-based businesses pay a 39.6% federal income tax and a 3.8% NIIT. In total, 43.4% of the transaction value is paid in taxes.

As displayed below, the change in tax structure results in a 25.7% reduction in after-tax proceeds to business owners in Texas.

After-Tax Proceeds under Current Tax Structure																				
Transaction Value (\$M)	10	20	30	40	50	60	70	80	90	100	110	120	130	140	150	160	170	180	190	200
After-Tax Proceeds - Current (\$M)	7.6	15.2	22.9	30.5	38.1	45.7	53.3	61.0	68.6	76.2	83.8	91.4	99.1	106.7	114.3	121.9	129.5	137.2	144.8	152.4
After-Tax Proceeds - Proposed (\$M)	5.7	11.3	17.0	22.6	28.3	34.0	39.6	45.3	50.9	56.6	62.3	67.9	73.6	79.2	84.9	90.6	96.2	101.9	107.5	113.2

In order to achieve the same after-tax proceeds under the proposed tax structure as they would get in the current tax structure, Texas-based businesses would need to sell at a 34.6% higher transaction value.

New Transaction Value Needed to Achieve Same After-Tax Proceeds																				
After-Tax Proceeds (\$M)	7.6	15.2	22.9	30.5	38.1	45.7	53.3	61.0	68.6	76.2	83.8	91.4	99.1	106.7	114.3	121.9	129.5	137.2	144.8	152.4
Transaction Value - Current (\$M)	10.0	20.0	30.0	40.0	50.0	60.0	70.0	80.0	90.0	100.0	110.0	120.0	130.0	140.0	150.0	160.0	170.0	180.0	190.0	200.0
Transaction Value - Proposed (\$M)	13.5	26.9	40.4	53.9	67.3	80.8	94.2	107.7	121.2	134.6	148.1	161.6	175.0	188.5	201.9	215.4	228.9	242.3	255.8	269.3

\*Note: See Assumptions page for further detail.



# Low Income Tax State

## Valuation Impact

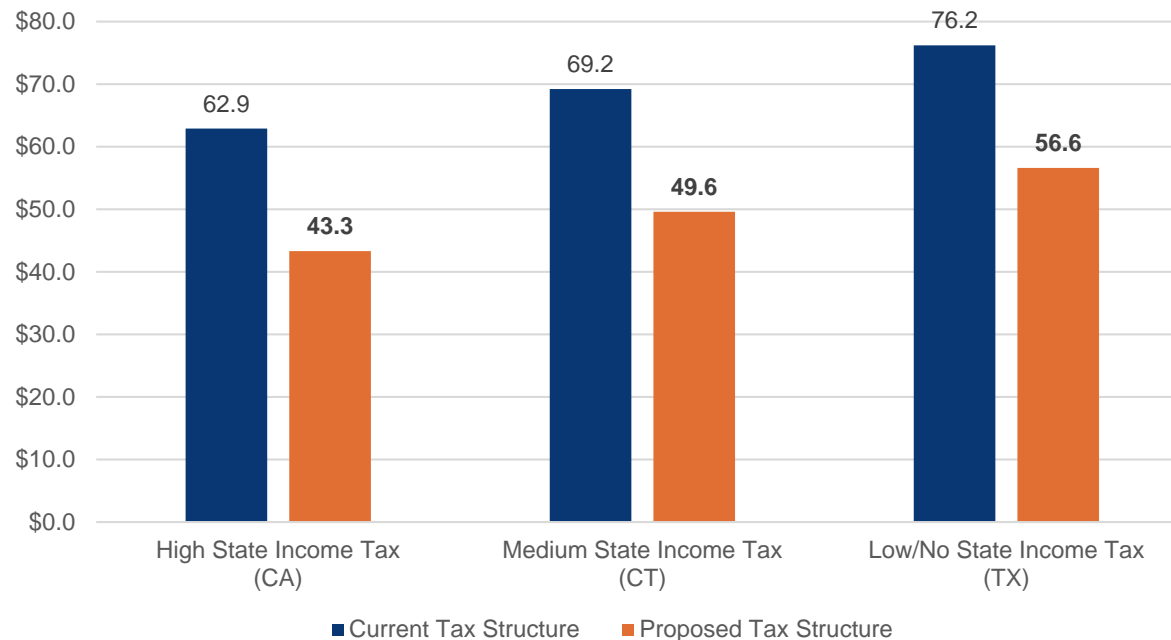
**2020 vs Proposed After-Tax Proceeds Comparison**



If Current Multiple Is:	The New Necessary Multiple Is:
4x	5.4x
5x	6.7x
6x	8.1x
7x	9.4x
8x	10.8x
9x	12.1x
10x	13.5x
11x	14.8x
12x	16.2x

- Potential changes to tax policy may have a dramatic impact on exit proceeds
- Today's economic and regulatory climate is more open to broad structural change than in a typical election year
- Sellers should carefully consider after-tax proceeds when determining exit timing

**Current vs Proposed After-Tax Proceeds**  
*\$100M Transaction*



# Assumptions

## High Income Tax State: California

2020 Tax Structure		
Tax	Percentage	Source
CA State Income Tax <sup>1</sup>	13.30%	<a href="#">Link</a>
Cap Gains Tax <sup>2</sup>	20.0%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	37.1%	

Proposed Tax Structure		
Tax	Percentage	Source
CA State Income Tax <sup>1</sup>	13.30%	<a href="#">Link</a>
Federal Income Tax <sup>2</sup>	39.60%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	56.7%	

## Medium Income Tax State: Connecticut

2020 Tax Structure		
Tax	Percentage	Source
CT State Income Tax <sup>1</sup>	6.99%	<a href="#">Link</a>
Cap Gains Tax <sup>2</sup>	20.00%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	30.8%	

Proposed Tax Structure		
Tax	Percentage	Source
CT State Income Tax <sup>1</sup>	6.99%	<a href="#">Link</a>
Federal Income Tax <sup>2</sup>	39.60%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	50.4%	

## Low/No Income Tax State: Texas

2020 Tax Structure		
Tax	Percentage	Source
TX State Income Tax <sup>1</sup>	0.00%	<a href="#">Link</a>
Cap Gains Tax <sup>2</sup>	20.0%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	23.8%	

Proposed Tax Structure		
Tax	Percentage	Source
TX State Income Tax <sup>1</sup>	0.00%	<a href="#">Link</a>
Federal Income Tax <sup>2</sup>	39.60%	<a href="#">Link</a>
NIIT <sup>3</sup>	3.80%	<a href="#">Link</a>
Total	43.4%	

<sup>1</sup> Assumes highest tax bracket for state income tax

<sup>2</sup> Assumed highest bracket for long-term capital gains (Based on marital status, income, and length of investment)

<sup>3</sup> Net Investment Income Tax (NIIT) is applied to investors with incomes over \$250k, regardless of investment horizon

<sup>1</sup> Assumes highest tax bracket for state income tax

<sup>2</sup> Proposed federal income tax at highest tax bracket

<sup>3</sup> Net Investment Income Tax (NIIT) is applied to investors with incomes over \$250k, regardless of investment horizon

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