Tax Reform Impact on Private Equity Groups

Today's Agenda

- Tax Reform Impact at the Fund Level
- Tax Reform Impact at the Portfolio Level
- Centralized Partnership Audit Rules
- Tax Reform Impact at the State Level

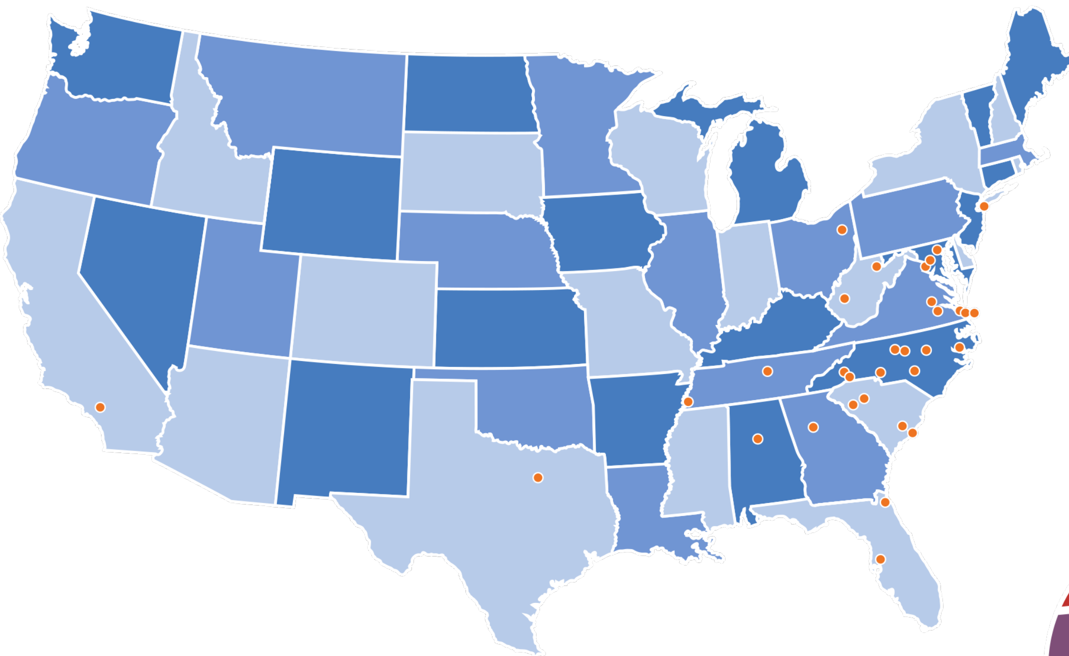
About DHG

2,000+ People, including 250 Partners / Principals

TOP 20 One of the top 20 largest accounting firms in the U.S.

13 States with resources serving clients across the U.S. and internationally

60+ SEC / Public Audit Clients



THERE WHEN IT COUNTS

- Experienced professionals who understand your industry
- Significant partner involvement
- Ongoing communication to avoid surprises
- Focused on business risks and their impact on your entity
- Accessible, responsive, hands-on style
- Customized service vs. one-size-fits-all approach
- Big Four alternative

Praxity MEMBER GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Member of Praxity, an international alliance of independent accounting firms that offers multinational clients access to resources around the world.

DHG Private Equity Overview

NAVIGATING COMPLICATED MARKET TRANSACTIONS

DHG Private Equity offers a dedicated group of professionals across multiple service lines to provide private equity firms and their portfolio companies a full array of services to meet their demanding needs in a challenging market.

FUND

- Fund Formation
- Tax Planning & Structuring
- Audit of Fund
- Valuation Services

TRANSACTION ADVISORY

- Financial/Accounting Due Diligence
- Tax Due Diligence
- IT Due Diligence
- Operations & Human Resources Due Diligence

PORTFOLIO COMPANY

- Annual Audit
- Tax Planning & Compliance
- IT Audits & Assessments
- Valuation Services

EXIT STRATEGY

- Sell-Side Due Diligence
- Initial Public Offering
- Tax Structuring
- Carve-Out Assistance

COMPREHENSIVE SERVICES

We provide comprehensive services tailored to meet the unique needs of our private equity portfolio company clients. Our breadth of services and resources give us great strength to address a wide variety of financial and operational issues for our private equity portfolio company clients. Our professionals have solid industry knowledge plus a multi-disciplined approach to financial, accounting and operational solutions by offering coordinated comprehensive services and strategies.

Today's Panelists

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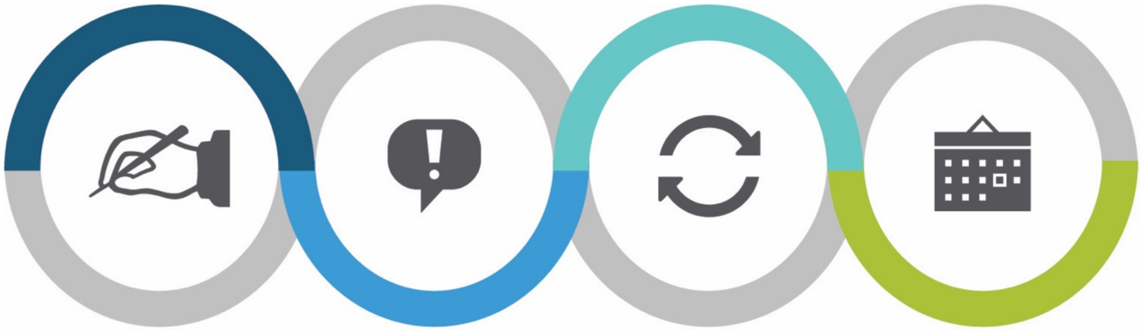
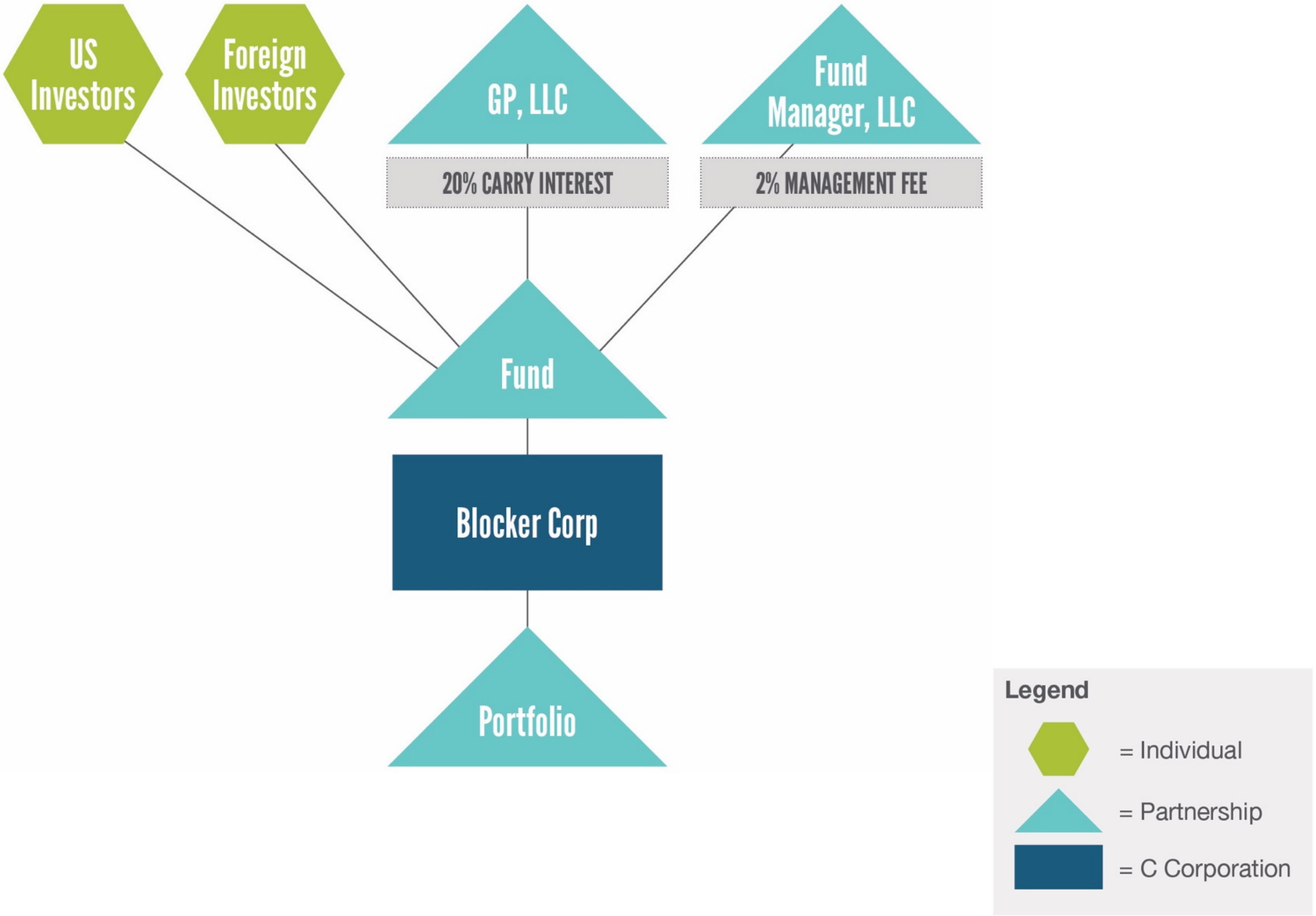
Tax Cuts and Jobs Act H.R. 1 ("Act")



- Signed into law on December 22, 2017
- The most significant federal tax legislation in the past 30 years
- Lowers corporate tax rates and overhauls individual income taxes
- Generally effective for tax years after December 31, 2017[1]

[1] *Effective dates vary. Some provisions are permanent and some expire.*

Typical Subsidiary Blocker PEG Structure



Common Federal Tax Classifications

	C Corporation	S Corporation (C Corporation with a Subchapter S Election)	Multi-Member LLC and Partnership	Sole Proprietorship and Single Member LLCs
Taxation	Double Taxation	Pass-Through	Pass-Through (Can Elect Corporate Tax)	Entity Not Taxed (Individual Taxed)
Tax Rate	Flat 21% Tax Rate	Owners' Marginal Tax Rates	Owners' Marginal Tax Rates	Owners' Marginal Tax Rates
Management	Board and Officers	Board and Officers	Members or Appointed Managers	Owner
Limited Liability	Yes	Yes	Yes	No

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Tax Reform Impact at the Fund Level

Tax Reform Impact at the Fund Level

- **Carried Interest**
- **Deduction for Business Income From Passthroughs**
- **Gain/Loss on the Disposition of a Partnership Interest by Foreign Partner**

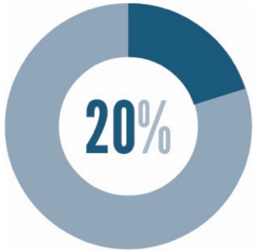
Carried Interest

	BEFORE	AFTER
Holding Period for Long Term Capital Gain Rate	1 Year	3 Years
Short Term Capital Gain Rate	10% - 39.6%	10% - 37%
Long Term Capital Gain Rate	0% - 15% - 20%	No Change
Long Term Capital Gain Rate Limited To	Capital Assets or Partnership Interests	"Applicable Partnership Interests"

PE IMPACT

Broad but minimal since the average investment holding period > 3 years.

Deduction for Business Income From Passthroughs



- Deduction for qualified business income ("QBI")
- For sole proprietorships, partnerships and S corporations
- QBI generally relates to the conduct of a qualified trade or business that is ***not*** a specified trade or business (i.e., ***not*** accounting, law, health, consulting, investing and investment management)
- May be limited based on W-2 wages and capital related to QBI

- New top individual income tax rate
- Reduced from top rate of 39.6%
- 3.8% Net Investment Income Tax may still apply

- Combined effective top individual income tax rate
- 3.8% Net Investment Income Tax may still apply

PE IMPACT

The net effect of a 29.6% tax rate will cause taxpayers to reconsider the choice of entity. *NOTE:* PEGS should consider various factors, such as the need for a blocker corporation, W-2 wage limitation, Medicare and self-employment taxes.

Gain/Loss on the Disposition of a Partnership Interest by Foreign Partner

CHANGE	EFFECTIVE ON/AFTER
Treated as Effectively Connected Income ("ECI") and subject to U.S. income tax	November 27, 2017
A new 10% withholding tax for purchaser/transferee	December 31, 2017

PE IMPACT

Foreign investment may decrease and additional compliance burden may increase with respect to withholding and reporting of foreign investors.

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Tax Reform Impact at the Portfolio Level

Tax Reform Impact at the Portfolio Level

- **Corporate Tax**
- **Net Operating Loss (“NOL”) Deduction**
- **Expensing for Certain Qualified Property**
- **Limited Deductibility of Interest**

Corporate Tax

	BEFORE	AFTER
Rate	35%	21!
Alternative Minimum Tax (“AMT”)	Required – 20% Rate	Repealed

PE IMPACT

- **Corporate portfolio companies and blocker companies may have lower federal income tax liabilities.**
- **Financial reporting impact related to the revaluation of deferred tax assets and liabilities.**
- **Small business accounting methods reforms (i.e. cash method, IRC §263A, inventory, long-term contracts, interest deduction limitation exception).**
- **Corporate dividends received deduction.**
- **C Corporations should maximize 2017 deductions because there is a 14% permanent rate arbitrage.**
- **Potential entity reclassification opportunities.**

Net Operating Loss ("NOL") Deduction

	BEFORE	AFTER
Utilization	100%	80%
Carryback[1]	Allowed for 2 Years	Not Allowed
Carryforward[1]	20 Years	Indefinitely

[1] New Carryback and carryforward rules apply to any NOLs generated in 2018 taxable year and beyond.

PE IMPACT

A greater focus on Transaction Cost Analysis ("TCA") and financial reporting related to the valuation allowance of NOLs.

Expensing for Certain Qualified Property

CHANGE	TIMING
100%	September 27, 2017 – December 31, 2022
80%	2023
60%	2024
40%	2025
20%	2026
MODIFIED: The definition of property eligible for bonus appreciation ("Qualified Property")	January 1, 2018
ELIMINATED: The qualified leasehold improvement, qualified restaurant and qualified retail improvement property asset types	January 1, 2018
INTRODUCED: A broadly-encompassing asset type called "qualified improvement property" which generally includes all improvements made to the interior of a nonresidential building after the year in which the building was originally placed in service	January 1, 2018

Expensing for Certain Qualified Property

PE IMPACT

- Asset acquisitions could be deemed more attractive due to immediate expensing provisions.
- Sellers may be inclined to negotiate a favorable sales price in exchange for an asset sale.
- Cost segregation studies on existing companies becomes much more important than previously because there is a 14% permanent rate arbitrage if completed before 2017 tax return is finished.
- Greater importance to valuation and purchase price allocation.

Limited Deductibility of Interest

CHANGE	TIMING
EBITDA Based Calculation used to determine "ATI" up to 30%	2018 – 2021
EBIT Based Calculation used to determine "ATI" up to 30%	2022+
Applied at the entity level for Partnerships and S Corporations	2018
Disallowed interest may carryforward indefinitely	2018

PE IMPACT

- **An estimated $250B of taxes will be raised over the next 10 years.[1]**
- **Portfolio company leverage becomes less attractive at higher leverage levels / the cost of capital will increase.**
- **Will the interest deduction limitation apply to a private equity fund? Will a private equity fund be considered not a trade or business or an IRC 212 activity not subject to the interest deduction limitation at the fund level?**

[1]Congressional Joint Committee on Taxation's Estimated Budget Effects of the Conference Agreement For H.R 1 (dated December 18, 2017)

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Centralized Partnership Audit Rules

Centralized Partnership Audit Rules

CHANGE	TIMING
The new rules replace the audit procedures enacted by TEFRA	2018
Assess and collect taxes at the partnership level	2018
A "partnership representative" now replaces the tax matters partner	2018

PE IMPACT

- **Amendments to the partnership agreement.**
- **Additional tax due diligence and indemnification needed during an acquisition.**

Tax Reform Impact at the State Level

State and Local Taxes

Expensing for Certain Qualified Property

- State conformity?
- New investments may lead to state credits and incentive opportunities
- Making sure fixed asset systems calculate state depreciation on assets expensed for federal tax purposes

Limited Deductibility of Interest

- States may decouple
- Applied at the entity level? If so, there may impact on:
  - Entity level taxes
  - Nonresident withholding
  - Composite returns
  - Carryforward if excess interest expense at the partner level and related prospective planning

Deduction for Business Income From Passthroughs

- Does not reduce AGI of owners
- Some states may decouple from this provision
- Because the deduction is at the partner level, it should not impact:
  - Entity level taxes
  - Nonresident withholding
  - Composite returns
  - Carryforward if excess interest expense at the partner level and related prospective planning

S Corporation to C Corporation Conversions

- In certain states the difference between the corporate rate and the individual rate can be significant. When clients ask us if they should convert from S to C we should consider the states in which they file.

Next Steps

- Review all portfolio investments as soon as possible to maximize 2017 tax deductions.

- Review all portfolio companies for tax opportunities to offset new NOL and interest expense limits – such as R&D credits.

- Pay greater attention to purchase price allocation in acquisitions and strongly consider IRC §§338(h)(10) and 336(e) transactions.

- Model potential entity classification, interest deduction limitation and debt structures, passthrough deduction and the changes to NOLs.

- Review portfolio company partnership investments to consider new partnership audit rules. Partnership agreements may need to be amended.

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