Paul | Weiss

The Biden Administration: Considerations for Private Equity Firms and Portfolio Companies

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Key Factor – Control of the Senate

- With Democrats gaining control of the Senate, the Biden Administration will have an easier path to implementing their policies through legislation or other action (such as disapproving rules under the Congressional Review Act)
  - However, Democratic control of the Senate is by a tie-breaker margin, and legislative action would require either strict party-line votes or bipartisan support to pass
- In addition to new laws, the Biden Administration can also work through other mechanisms, including:
  - Executive powers, such as executive orders
  - Personnel changes at federal agencies, with new agency leaders introducing new policies and rulemaking, or otherwise affecting the policy and rulemaking agenda

Tax Proposals

Carried Interest	▪ All income from carried interest would be taxed at ordinary income rates (which would be increased as described below)
Corporations	▪ Increase corporate tax rate from 21% to 28% (which is still below the 35% rate that was in place before the Tax Cut and Jobs Act) ▪ Implement a 15% minimum tax on book income for companies with at least $100 million of income
International and Anti-Offshoring	▪ Double the tax rate on global intangible low-taxed income (GILTI) from 10.5% to 21% ▪ Establish a 10% Offshoring Penalty surtax on profits of goods produced by a U.S. company overseas for sale and consumption in the United States ▪ Offer a 10% "Made in America" advanceable tax credit for companies that make investments aimed at revitalizing U.S. manufacturing and creating jobs for U.S. workers
Individuals and Households	▪ Income from long-term capital gains and qualified dividends would be taxed at ordinary income rates for individuals with income of more than $1,000,000 (an increase from 20% to 39.6%) ▪ Increase the highest tax bracket from 37% to 39.6% (the highest tax bracket was cut by the Tax Cut and Jobs Acts but will return to 39.6% in 2025 in any event) ▪ Impose an additional 12.4% social security tax on wages above $400,000, split evenly between employers and employees. (The tax currently is capped at wages of $137,700, adjusted for inflation) ▪ Cap the tax benefit of itemized deductions to 28% of value for taxable incomes of more than $400,000, and restore the "Pease limitation" which reduces the value of itemized deductions by 3% for income above the relevant threshold

Tax Proposals (continued)

Environmental	▪ Offer businesses and residences tax credits for energy efficiency and solar investments ▪ Increase taxes on the fossil fuel industry
Pass-through Deduction	▪ Phase out "pass-through deductions" under Section 199A for taxpayers with income of more than $400,000
Impact on Private Equity	▪ The proposed changes to the carried interest regime (i.e., taxing carried interest at ordinary rates) and the proposal to tax other long-term capital gains (and qualified dividends) at ordinary income rates would particularly affect private equity professionals. The personal taxes they can expect to pay if Biden's proposals were enacted would be significantly higher ▪ Higher corporate rates would, in some cases, increase the value of tax attributes that PE sponsors may be able to monetize (e.g., in tax receivable agreements) ▪ The overall economic outlook may impact implementation - a struggling economy may delay changes (especially the proposed corporate tax increase) ▪ The possibility of tax credits for U.S. business and increased taxes on foreign income may drive business to rethink decisions to have certain operations overseas ▪ Higher corporate tax rate and possible minimum taxes on book income would affect portfolio companies and PE firms that have converted to corporate structures ▪ If these tax changes are implemented, it is unlikely, but possible that changes made in the future could apply retroactively (this rarely happens - however, 1993 and 2001 tax changes included examples of retroactivity)

International Trade and Crossborder M&A

International Trade and Tariffs

- Biden has yet to provide specific details regarding how his Administration will move forward on trade and tariffs, but is expected to announce his broad trade objectives soon after taking office
- Trade barriers imposed by the Trump Administration (including the tariffs on China) will be difficult to remove without "getting something in return"
- Biden has described his international priority as mending relationships with U.S. allies, which have been significantly frayed under the Trump Administration
- Sanctions are likely to remain a major element of U.S. foreign policy, but with less pushing into novel areas and greater coordination with U.S. allies

CFIUS

- The Committee on Foreign Investment in the United States (CFIUS) will likely continue to aggressively evaluate foreign investment transactions, especially China-related investments
- But we can expect a return to the traditional CFIUS silence regarding its cases, with less White House meddling
- Although the Biden Administration is unlikely to relax scrutiny of Chinese investments in the United States, we can expect the Biden Administration to adopt a less abrasive approach
- CFIUS is likely to maintain a strong interest in recent areas of concern, including supply chain security (including for drugs and medical products), cyber security, emerging technologies (artificial intelligence, biometrics, robotics, etc.) and collection and use of personal data of U.S. citizens

Impact on Private Equity

- A Biden Administration can be expected to view international trade and investment in terms of the effect on U.S. jobs, U.S. infrastructure and U.S. technology development (including green energy)
- At the same time, a less scattershot approach to new trade barriers should make for easier business planning and forecasting
- CFIUS is likely to (i) remain a major impediment to Chinese investment in the United States and (ii) continue its interest in examining foreign elements in PE fund ownership/control structures (including the nature of LPs and co-investors)
- Like the Trump Administration, a Biden Administration can be expected to show a national security interest in U.S. investment in China and U.S.-China partnerships, especially where such activities appear to promote Chinese national security interests

Antitrust

Personnel	▪ The current Assistant Attorney General (AAG) of the DOJ Antitrust Division has indicated he will step down following the inauguration, in which case the most senior career official at the DOJ would likely become the Acting AAG until a new AAG is confirmed by the Senate ▪ Current Republican-appointed Chairman of the Federal Trade Commission (FTC), Joe Simons, will be resigning on January 29. Also, Democratic Commissioner Rohit Chopra will be appointed to the Consumer Financial Protection Bureau, opening the door for another Biden appointee. The result of these developments is that the FTC will be divided 2-2 for the near future, resulting in possible split votes and a more contentious environment ▪ Since FTC activity levels are already quite high, there is not much room to increase FTC enforcement levels, even with a Democratic majority
Enforcement	▪ Expect to see continued focus on big tech companies, including in respect of data portability and interoperability requirements, as well as a focus on pharmaceutical, healthcare and agriculture companies ▪ How active agencies can be is likely to be limited by budget - if there is no congressional support for increased funding, agencies will likely be unable to increase enforcement significantly ▪ The Unity Task Force (influenced by Bernie Sanders) calls on antitrust enforcement to consider the impact on job losses, racial equity and environment when reviewing mergers ▪ With a Democrat-controlled Congress, there may be renewed interest in New Deal-era style antitrust legislation as has been suggested by Elizabeth Warren. This legislation could heighten antitrust scrutiny through policy changes, such as the consideration of post-acquisition events (e.g., firm downsizing), to determine whether an antitrust issue is implicated
Impact on Private Equity	▪ Because the Acting AAG may unilaterally undertake official agency actions (unlike at the FTC), the DOJ's antitrust enforcement actions will not be subject to gridlock ▪ The Biden Administration's focus on certain industries and any Antitrust New Deal legislation may make transactions within those sectors challenging. For example, big pharmaceutical and big tech mergers might become more difficult ▪ Increased enforcement may impede transactions by portfolio companies that are looking to grow through acquisitions and consolidate their markets

Environmental, Social and Governance (ESG)

Policies

- A focus on climate change is a priority for the Biden Administration, which includes returning the United States to the Paris Climate Agreement and an ambitious Clean Energy Revolution plan
- The Biden Administration has announced its intent to rollback Trump Administration changes, including through executive order and legislation
- The Clean Energy Revolution includes, among other things, a goal of achieving economy-wide, net-zero emissions no later than 2050 through a combination of pushing pollution costs to polluters and investment in clean energy infrastructure and innovation
- Expect to see an increase in disclosure requirements surrounding companies' environmental impacts and a push to standardize disclosures by issuers and asset managers (see SEC Regulation and Enforcement below for more information)
- Likely to see efforts to reverse the anti-ESG investing rule established under the Trump Administration, which limits some fund managers from making investments based on environmental or social factors unless they can also show a financial reason for such investment
- The Biden Administration intends to establish a new Environmental and Climate Justice Division within the DOJ to complement the Environment and Natural Resources Division
- The Biden Administration has called for Congress to increase the federal minimum wage to $15, a legislative initiative that could pass given Democratic control
- Biden has also made addressing racial equity a priority for his administration; expect to see a push for more robust diversity disclosure

Impact on Private Equity

- A shift away from fossil fuels could lead to consolidation in the industry and growth in other green industries
- Pro-ESG investing policies could give fund managers continued latitude to consider ESG when making investment decisions
- Climate and environmentally-friendly rule changes could lead to greater ESG investing overall in the United States, which has lagged behind Europe
- A minimum wage increase could raise the operating costs of portfolio companies

Credit Markets

COVID-19 and Interest Rates

- Credit markets are likely to be driven more by COVID-19 than by specific changes brought on by the Biden Administration
- If Biden's COVID-19 policies are able to successfully contain the virus, we may see fewer market fluctuations tied to COVID uncertainties
- Interest rates are expected to remain low, which will allow for relatively cheap financing for acquisitions

Increased Regulatory Scrutiny

- Appointments to federal financial agencies will likely result in increased regulation and enforcement of financial regulation. Some appointees and Democrats have discussed reviving the 2013 Leveraged Lending Guidance. This could result in an increased ability for non-bank lenders to lend to highly-levered borrowers and may limit leverage available from regulated banks as well.
- Many federal financial agencies seek more extensive regulation of the "shadow banking sector". Some have discussed increasing the powers of the Financial Stability Oversight Council (FSOC) including by amending Dodd-Frank to expand the FSOC's authority to designate a nonbank financial institution for regulation based on both entity-specific criteria and activity-based criteria. If leveraged lending were determined to pose a threat to financial stability, any entity participating in leveraged lending could become subject to regulation by the Federal Reserve.

Impact on Private Equity

- The potential for increased regulation and enforcement activity around banks and other lending options may constrict the availability of credit for certain deals
- However, increased market stability from Biden's COVID-19 policies may increase lenders' confidence and willingness to extend credit

Securities Exchange Commission (SEC) Regulation and Enforcement

Personnel	▪ Former SEC Chairman Jay Clayton stepped down from his position at the end of 2020. Commissioner Elad Roisman replaced him as Acting Chairman of the SEC ▪ Reports indicate that the Biden Administration will nominate Gary Gensler, the former head of the Commodity Futures Trading Commission under President Obama, as the new Chairman and that he will likely lead the agency towards a more aggressive approach to enforcement and regulation
Regulation	▪ Will see some roll back of the regulatory easing under the Trump Administration ▪ The Biden Administration plans to issue an order on January 20, 2021 that may halt or delay SEC regulations that have not yet taken effect ▪ A Democrat-controlled Congress may be able to use the Congressional Review Act to expedite disapproval of SEC rules, including rules already effective that were published after August 21, 2020 ▪ Expect to see a Democrat-controlled SEC place greater focus on ESG disclosure ▪ For example, Democrats have been concerned with the lack of transparency regarding a company's climate change vulnerabilities, and Biden has pledged to make companies disclose their climate-related financial risks and greenhouse gas emissions in their operations and supply chains
Enforcement	▪ A change in leadership is likely to bring more robust enforcement and examinations, particularly in the investor protection arena ▪ For example, financial firms should expect to see a thorough review of Regulation Best Interest (Reg BI) compliance. Replacing Reg BI with another fiduciary rule for broker-dealers and registered investment advisors is less likely to occur in the immediate future

Securities Exchange Commission (SEC) Regulation and Enforcement (continued)

Impact on Private Equity

- Many changes in SEC regulation and enforcement could be implemented via personnel and policy shifts in addition to legislation passed by a Democrat-controlled Congress
- May see the SEC pursue more aggressive actions related to investor protection
- Although unlikely to occur anytime soon, an amendment to or replacement of Reg BI could subject broker-dealers to greater liability, requiring that they not only recommend products that are in their clients' best interest but also that they act as fiduciaries
- ESG investment industry is likely to continue to gain more strength under a Democrat-controlled SEC
- Increased standardization of disclosure requirements could allow investors to better compare ESG performance between funds and to more effectively seek out funds to invest in that have demonstrated a focus on ESG

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