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November 16, 2020

The 2020 Election, Capital Gains Taxes and the M&A Marketplace

To our friends and clients,

One of the many storylines emerging from the general election held earlier this month is this: the projected Blue Wave failed to materialize. Vice President Biden has been announced as the president-elect, but the Congressional composition is yet to be determined. Republicans are in position to potentially retain control of the Senate and the Democrat majority in the House has been narrowed, suggesting the bolder elements of the Biden campaign platform may be less likely to survive the legislative process than they appeared pre-election.

Among these bolder elements is the plan for tax reform. Specifically, the Biden plan calls for capital gains to be taxed as ordinary income for individuals with adjusted gross income exceeding \$1 million, effectively doubling the tax rate from 20% to 39.6%. Adding to the angst around this issue is a lack of clarity on a potential effective date, leaving open the possibility it could be made retroactive to January 1, 2021.

potential for a retroactive effective date and (3) the pre-election expectation of a Blue Wave that could facilitate the plan's swift passage into law, many prospective sellers took action. Agency principals engaged in discussions around a third party sale began pushing for an accelerated timeline. The objective was to secure a 2020 transaction date, thereby eliminating exposure to any new tax law passed next year. But without the Blue Wave, will there still be a push for a 2020 close?

The legislative realities of tax reform will likely be settled by two Senatorial runoff elections in Georgia, now making the state the epicenter of the political universe with control of the Senate on the line. A Republican-controlled Senate means any tax increases are likely dead on arrival. Conversely, a Democrat-controlled Senate (even 50-50 with the Vice President serving as a tiebreaker) puts the Biden tax plan back on the table. But because these two runoffs won't occur until January 5th, we expect sellers to continue pushing for a 2020 transaction date. The betting odds for a retroactive capital gains tax increase may have dropped, but the prospective impact is significant enough that most sellers won't want the exposure.

Another possibility is an increase in capital gains tax rates passed next year, but with an effective date of January 1, 2022 (rather than retroactive). This too would likely require a Democrat-controlled Senate. But if passed, agency principals considering a sale over the next few years may consider accelerating their timeline into 2021. The result could be an even more pronounced push for year-end closings next year, potentially making 2021 a record year for deal activity.

All eyes now turn to Georgia.

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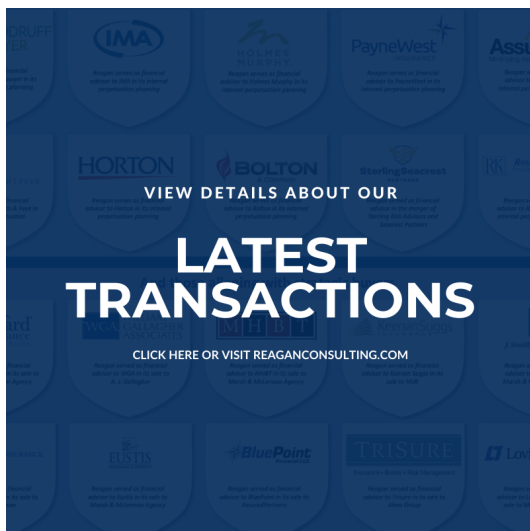


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