

March 26, 2025

IPO and Public Company Readiness: Advance Planning for 2025 and 2026 IPOs

Structuring and Tax Issues

GIBSON DUNN

MCLE Certificate Information

The information in this presentation has been prepared for general informational purposes only. It is not provided in the course of an attorney-client relationship and is not intended to create, and receipt does not constitute, an attorney-client relationship or legal advice or to substitute for obtaining legal advice from an attorney licensed in the appropriate jurisdiction.

- This presentation has been approved for **1.0 General credit**
- Participants must submit the form by **Wednesday, April 2nd** in order to receive CLE credit

[CLE Form Link](#)

Most participants should anticipate receiving their certificate of attendance in 4-6 weeks following the webcast

All questions regarding MCLE Information should be directed to CLE@gibsondunn.com

Today's Panelists



Pamela Lawrence Endreny

Partner | Tax



Jennifer Sabin

Partner | Tax



Eric Scarazzo

Partner | Capital Markets

AGENDA FOR TODAY'S WEBINAR

01 Overview of IPO Structuring Issues

02 Scenario 1– Holdco Structure

03 Scenario 2– Conversion of LLC to Corporation

04 Scenario 3– UP-C Structure

05 Corporate Considerations

06 Dual Class Structures

OVERVIEW OF IPO STRUCTURING ISSUES

01

Overview of IPO Structuring Issues

Overview of IPO Structuring Issues

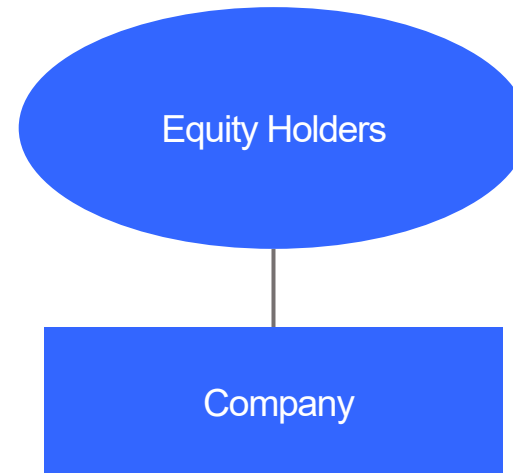
- **What is the current form of the business?**
- **Corporation vs. LLC/Partnership**
 - Tax rules require most publicly traded entities to be classified as corporations for tax purposes
 - Exceptions for certain oil and gas and real estate businesses
 - Capital markets investors generally prefer receiving IRS Form 1099 reporting vs. K-1s
- **Current capital structure**
 - Different classes of interests may be recapitalized
- **Pre-IPO restructuring steps**
 - If business is already in corporate form:
 - there may be no need for pre-IPO steps
 - sometimes a holding company will be put into place
 - If business is in LLC/partnership form:
 - conversion to corporation
 - UP-C structure

SCENARIO 1— HOLDCO STRUCTURE

02

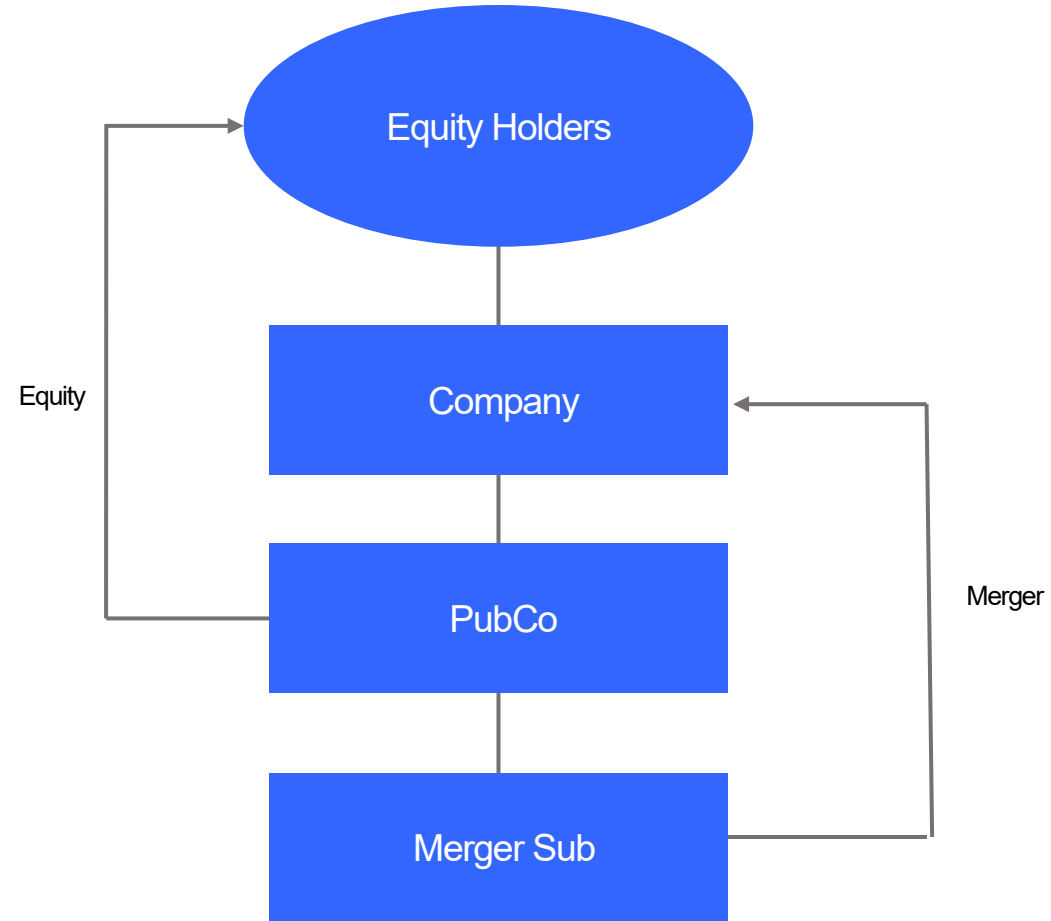
Pre-IPO Structure

- **Company is currently operated as a C corporation**
- **There may be reasons for putting a holding company in place for the IPO (e.g., regulatory, corporate finance)**



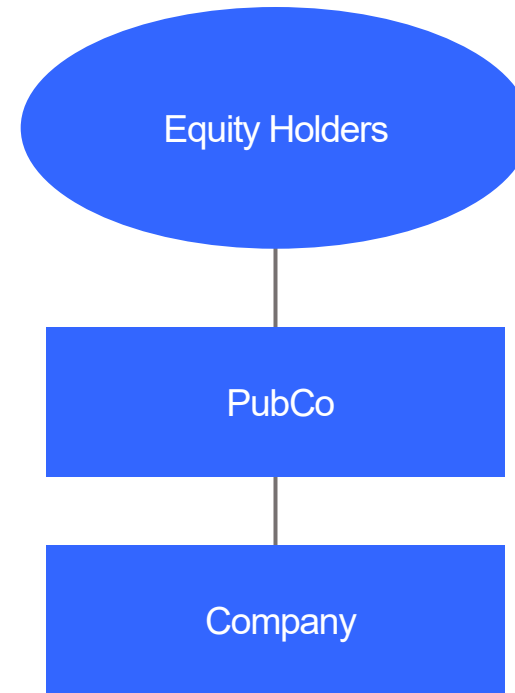
HoldCo Formation

- **Company forms a wholly owned corporate subsidiary (“PubCo”), which forms a wholly owned subsidiary (“Merger Sub”)**
- **Merger Sub merges into Company, with Company surviving**
- **Stockholders receive PubCo stock in exchange for Company stock**



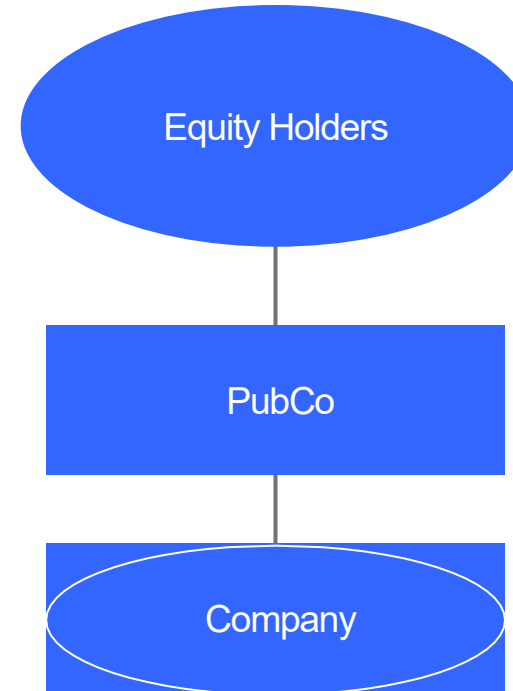
Resulting Structure

- **Transaction qualifies under Sections 351 and 368(a)(1)(B) of the tax Code**
- **No gain or loss recognized for tax purposes by PubCo or the stockholders**
- **PubCo and Company are members of an affiliated group filing a consolidated return**



Potential LLC Conversion

- **If Company converts into a limited liability company as part of the plan, transaction qualifies as a “F Reorganization” under Section 368(a)(1)(F) of the tax Code**
- **This may be desirable in some scenarios**
- **PubCo is treated as a continuation of Company for tax purposes and Company is a disregarded entity**
- **Company is treated as the same entity for legal purposes**

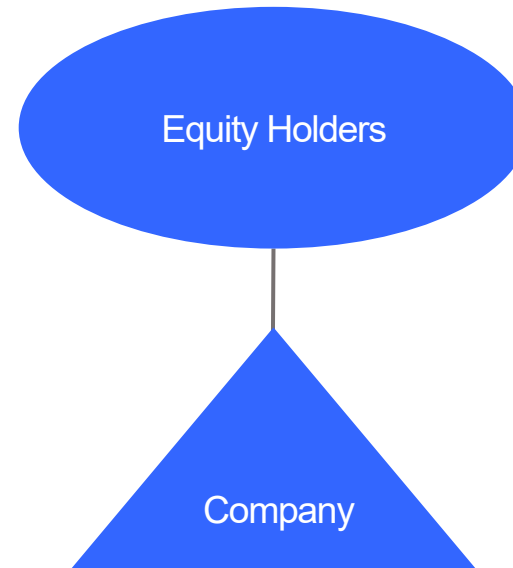


SCENARIO 2— CONVERSION TO CORPORATION

03

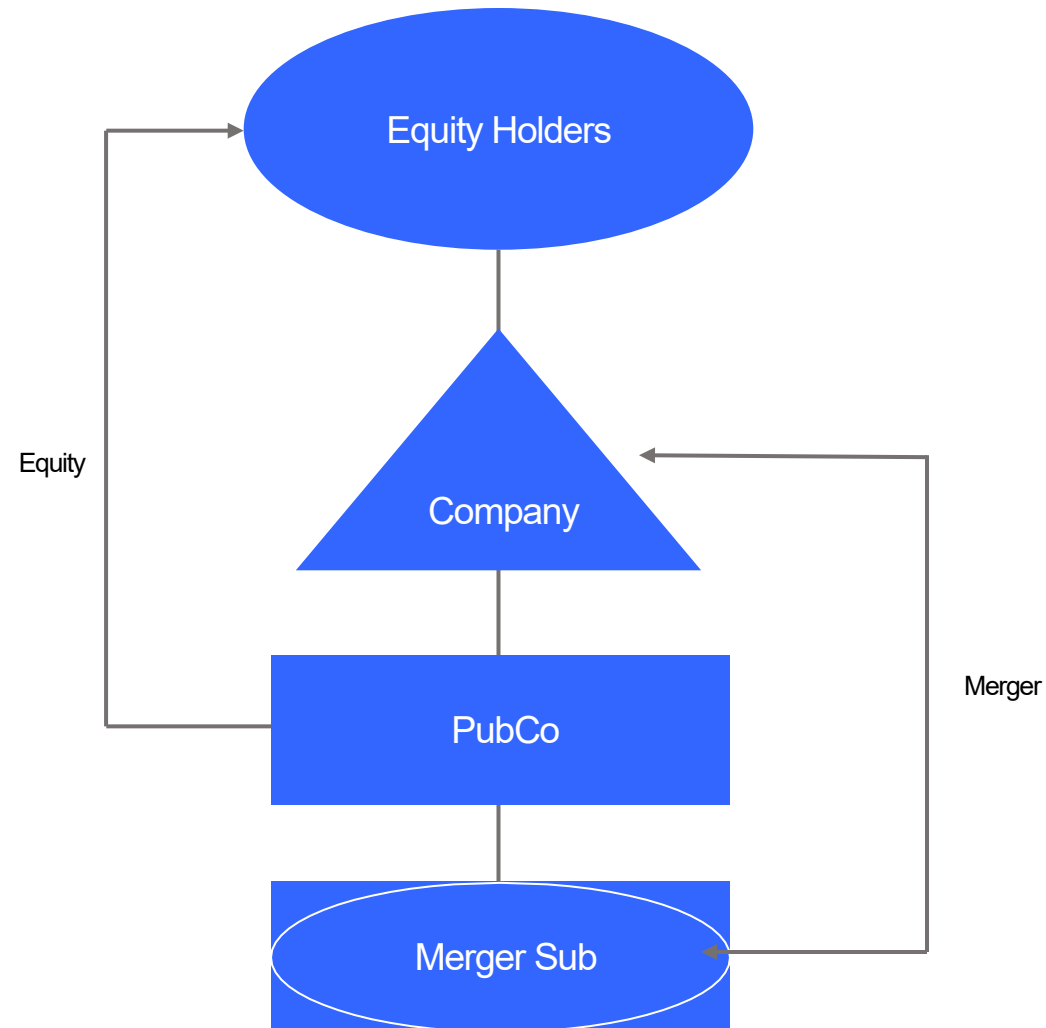
Pre-IPO Structure

- **Company is currently operated as an LLC (or LP) classified as a partnership for tax purposes**



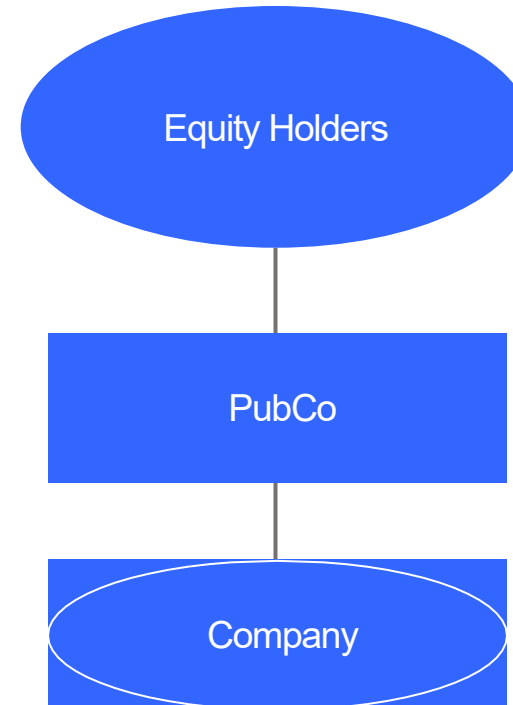
Conversion to Corporation

- **Company forms a wholly owned corporate subsidiary (“PubCo”), which forms a wholly owned subsidiary (“Merger Sub”)**
- **Merger Sub merges into Company, with Company surviving**
- **Equity holders receive PubCo stock in exchange for Company equity**



Resulting Structure

- **Equity holders treated as contributing partnership interests to PubCo, followed by a deemed liquidation of Company, for tax purposes (see Rev. Rul. 84-111)**
- **No gain or loss except to the extent liabilities exceed tax basis**
- **Company is a disregarded entity**

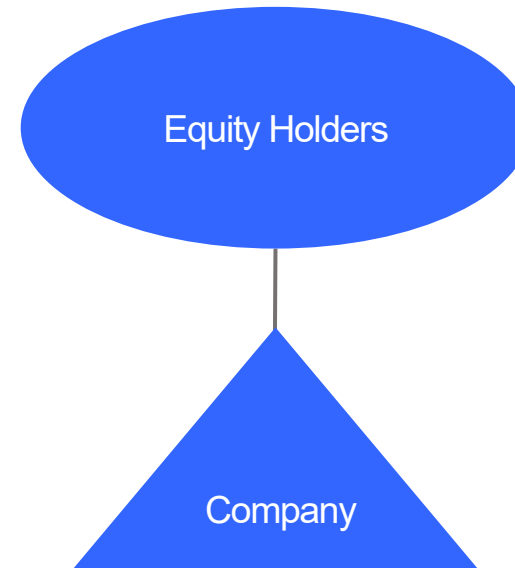


SCENARIO 3— UP-C STRUCTURE

04

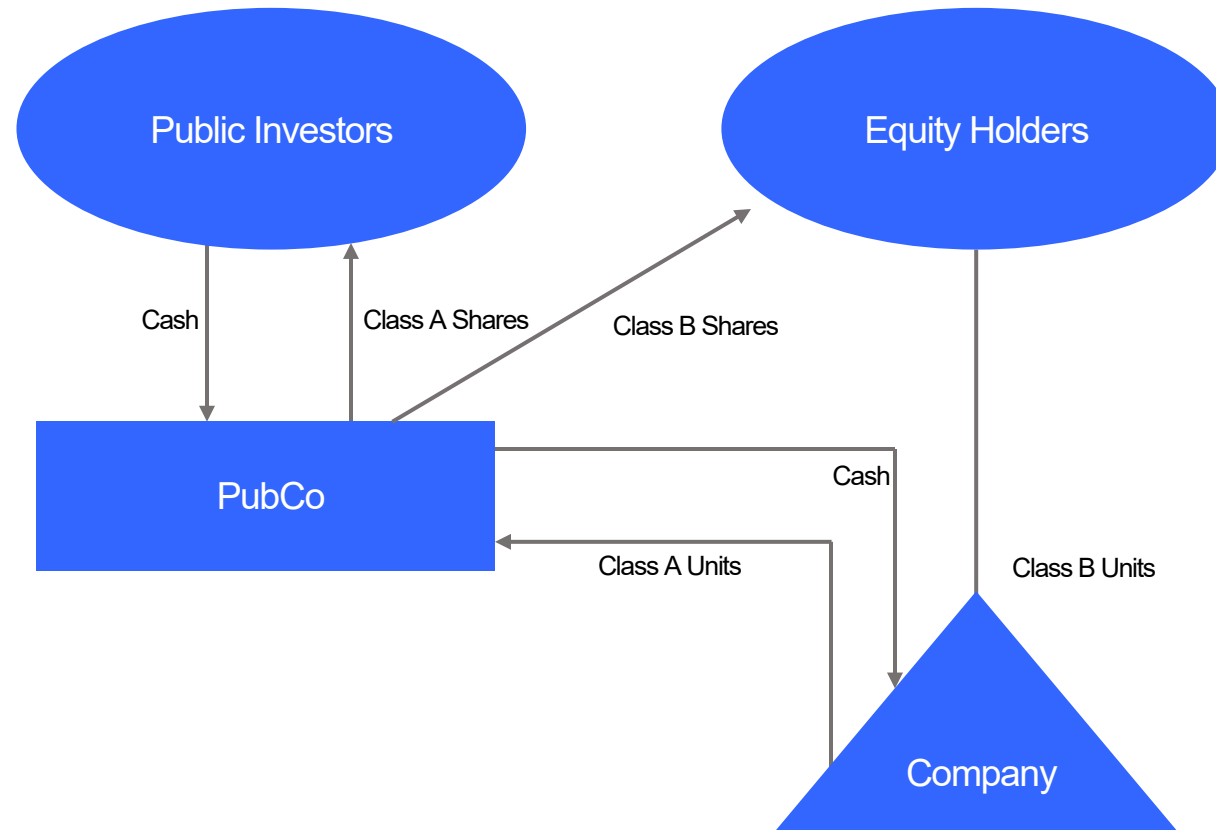
Pre-IPO Structure

- **Company is currently operated as an LLC (or LP) classified as a partnership for tax purposes**
- **Equity holders wish to preserve benefits of flow-through tax treatment (e.g., one level of tax, allows for tax-deferred acquisitions)**



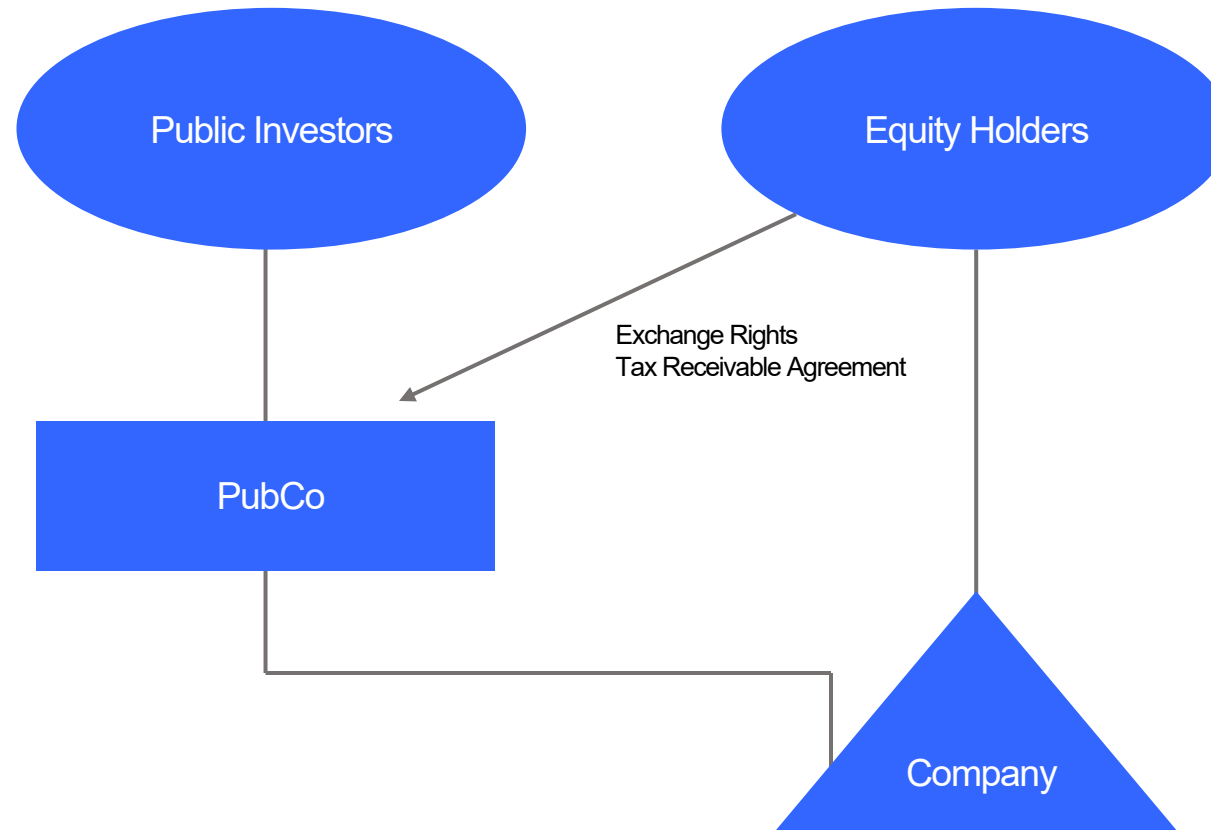
UP-C Steps

- PubCo formed as a corporation
- Raises cash from capital markets investors
- PubCo contributes cash to Company in exchange for equity interests in Company
- Typically Company equity is recapitalized in connection with the IPO
- Equity holders receive non-economic voting shares in PubCo
- Equity holders may sell some of their Company equity to PubCo in connection with the IPO



Resulting Structure

- PubCo is pure holding company
- Equity Holders have rights to exchange their Company equity for PubCo stock (or cash)
- Exchanges are taxable and give rise to future tax benefits for PubCo (e.g., amortizable tax basis)
- PubCo enters into a Tax Receivable Agreement in connection with the IPO to share cash tax savings with equity holders



CORPORATE CONSIDERATIONS

05

Up-C Transactions – Corporate Considerations

Registration statement disclosure. The registration statement for an Up-C IPO will ordinarily contain disclosure related to:

- A plain English description of the Up-C organizational structure, including a description of the ownership interests to be held by the pre-IPO owners and by the public stockholders investing in the IPO
- A diagram describing the relationship of the “upstairs” public company and “downstairs” LLC/partnership, including the relative percentage ownership of each class of shares and interests
- The terms of the TRA and a description of the estimated payments expected to be paid to the pre-IPO owners
- A description of how pre-IPO owners can exchange their LLC units for shares of the public company’s listed class of shares
- Whether the public company will be considered a “controlled company” pursuant to applicable Nasdaq or NYSE rules, and the impact on corporate governance matters

Up-C Transactions – Marketing Considerations

Although the Up-C structure has become increasingly common, the issuer and underwriters should consider how the structure may affect marketing of the IPO. In particular:

- How comfortable the targeted IPO investors will be with the complexity of the structure
- Will IPO investors be concerned about holding only indirect ownership of the operating business (via the LLC) and, in most cases, the pre-IPO owners maintaining control over both the issuer and the LLC.
- Potential negative perception of a TRA in light of pre-IPO owners receiving a majority of the tax benefit

Up-C Transactions – Additional Considerations

- The IPO issuer should conclude that the LLC is consolidated into its financial statements
- Ongoing tax, accounting, legal and compliance costs for administrative of the Up-C structure are likely to be higher than for an ordinary IPO
- Pre-IPO owners may be
 - subject to logistical limitations on their ability to exchange into public company shares and liquidate such shares
 - experience tax realization events for an exchange in circumstances where they are unable to sell shares in a timely manner or at prices consistent with their tax liability
- The company needs to plan for ongoing tax distributions, as well as TRA payments
- There appears to be a recent increase in litigation risk around TRAs

Up-C Transactions – Additional Considerations

- Need to consider interaction between (1) open trading windows at PubCo / MNPI and (2) the exchange policy and exchange date, particularly if holders want to raise cash to pay tax liability arising from the exchange
- Planning around Section 16 (i.e., Form 4 filings) in connection with exchanges
- Potential HSR filings:
 - By PubCo to the extent that it acquires additional shares in the LLC
 - By pre-IPO owners, to the extent they are exchanging upward and acquire additional shares of PubCo
- Interaction of Up-C structure and credit agreement provisions, particularly:
 - Covenant testing at the LLC level versus PubCo level
 - Acquisition/disposition of interests in LLC
 - Current and future treatment of LLC as VIE versus subsidiary

DUAL CLASS STRUCTURES

06

Overview

- Dual class structures are ordinarily used to provide specific shareholders (most often a company's founders or other insiders) additional rights that are not offered to the class of stock that is publicly listed
 - For example, a second class of stock may have voting rights that are outsized relative to their economic interest in the company
 - Because a dual class structure is already inherent in Up-C transactions, the class owned by pre-IPO owners tend to have increased voting rights per share
- When dual class structures exist:
 - The class with additional rights (referred to as "Class B" for ease of reference) is typically convertible into or exchangeable for the publicly traded class of shares (referred to as "Class A" for ease of reference)
 - The issuance of additional Class B shares is typically limited or prohibited

Typical Features of Dual Class Structures

- Voting ratios vary and are often set at 10 to 1 or even higher. In these cases, the Class B holders receive 10 votes for each Class B share, while the Class A holders receive only 1 vote for each Class A share
- It also is possible to have one class that is voting and another class that is non-voting or, as is the case in Up-C transactions, to have one class that has economic and voting rights and another with only voting rights
- Classes typically vote together whenever there is a shareholder vote, which means the Class B holders can control or at least influence the outcome
- The dual class structure may be eliminated, or the special rights of the Class B shares may be eliminated, upon specified triggers:
 - Certain investors may push for a sunset as of a specific date (i.e., five years after IPO)
 - Sunset might occur upon the death or resignation of a specific founder
 - When transferred to anyone that is not a permitted transferee

Pros and Cons of Dual Structure

- Benefits of dual class structures include:
 - Founders and other pre-IPO owners can retain strong control of an IPO company, while obtaining access to the liquidity and breadth of the equity markets
 - For some IPOs, a dual class structure can reassure investors because it allows insiders to implement their strategy for the company while limiting the influence of other shareholders
 - Prevents hostile takeovers, particularly ones that are not in the long-term interests of shareholders
- Dual class structures are subject to criticisms:
 - Does not align with a one-share, one-vote principle that is typical in public companies
 - High vote shareholders are subject to fewer checks on their decisions, which means Class A holders may not be able to effectively protect their interests
- Institutional investors and proxy advisory firms generally favor a single class with equal voting rights. Some have pushed for a sunset on dual class structures

U.S. Stock Exchange Considerations

- Both NYSE and Nasdaq have rules that are designed to prevent coercive implementation of dual class structures
- The exchanges are generally comfortable with a dual class structure that is implemented as part of an IPO because IPO investors are given an opportunity to understand the ways the ways in which their rights will be limited and then choose whether to invest
- Implementation of a dual class structure after IPO is generally disallowed

The background features a series of dark blue, curved lines that sweep across the frame from the top left towards the bottom right, creating a sense of motion and depth. The lines are more densely packed on the left and become more sparse towards the right. The overall color palette is a gradient of blues, from a very dark, almost black blue on the left to a light, airy sky blue on the right.

GIBSON DUNN

Attorney Advertising: These materials were prepared for general informational purposes only based on information available at the time of publication and are not intended as, do not constitute, and should not be relied upon as, legal advice or a legal opinion on any specific facts or circumstances. Gibson Dunn (and its affiliates, attorneys, and employees) shall not have any liability in connection with any use of these materials. The sharing of these materials does not establish an attorney-client relationship with the recipient and should not be relied upon as an alternative for advice from qualified counsel. Please note that facts and circumstances may vary, and prior results do not guarantee a similar outcome. © 2024 Gibson, Dunn & Crutcher LLP. All rights reserved. For contact and other information, please visit us at [gibsondunn.com](https://www.gibsondunn.com).