

Stradling Attorneys at Law

The Up-C IPO: Strange name, Bankable structure

by Ryan C. Gaglio and Parker A. Schweich

The “UP-C” is one of the many reasons tax lawyers should not be allowed to name things, but, despite its strange name, the UP-C can be a useful structure for taking your tax partnership (likely your limited liability company, or LLC) public, while still maintaining some of the LLC’s tax benefits – for both you and the public shareholders.

“Up-what?”

Even though the name is easy to mock, the UP-C has become a viable path for LLCs to access the public markets. For numerous reasons, LLCs have not traditionally been good candidates for initial public offerings (IPOs) of most operating businesses. The UP-C, which is shorthand for “Umbrella Partnership-Corporation”, allows the historic owners of an LLC to participate in an IPO while preserving many of the tax benefits that an LLC affords. In an UP-C, a newly formed corporation (“PubCo”) undertakes an IPO and uses the proceeds to buy interests in the LLC. After the IPO, the public shareholders own Class A stock of PubCo, the historic owners of the LLC own voting-only Class B stock of PubCo, and PubCo owns an economic interest in the LLC equal to the public’s economic interest in PubCo. PubCo also has all of the voting power in the LLC, which continues to operate the pre-IPO business. The historic owners of the LLC have voting-only interests in PubCo and solely economic interests in the LLC. This concentrates control of the LLC in PubCo while allowing the historic owners to maintain their traditional LLC pass through tax treatment until they are ready to exchange their divided PubCo and LLC interests for Class A stock of PubCo. An Exchange Agreement with PubCo allows for this exchange. The public disclosures required by the Securities and Exchange Commission in the registration statement for the UP-C IPO, and the ongoing accounting and compliance work, are more complicated (and, therefore, somewhat more expensive) than a standard IPO, but this is often outweighed by the benefits.

That sounds complicated. Why would anyone do it?

Because LLCs have useful tax benefits – namely the potential for “basis step up.” You have tax basis in your LLC’s assets. This tax basis (i) allows for depreciation or amortization of those assets and (ii) reduces gain (or increases loss) on the sale of those assets. When you (or a corporation) acquire additional interests in the LLC (assuming it makes an election under Internal Revenue Code Section 754), your basis in those assets increases by what you paid (or exchanged) for the interests – the “basis step up.” This means your depreciation and amortization increases, and your gain on a sale of those assets decreases (or your loss increases). The same is true for PubCo. Every time PubCo exchanges its Class A stock for a historic owner’s divided PubCo

and LLC interests, PubCo gets a basis step up in the LLC assets and the resulting tax benefits. This basis step up could significantly increase PubCo’s valuation in any proposed sale of the company.

The UP-C structure also supports the growth of the business because the company will be able to compensate its employees with publicly tradeable Class A stock of PubCo and will have the option to issue either equity in PubCo or economic interests in the LLC when entering into strategic partnerships or acquiring other businesses.

Additionally, if you are a private equity group that owns portfolio companies structured as LLCs, the UP-C structure may be the most efficient way to attain liquidity (if an IPO is more preferable to you than a company sale) without having to reorganize the portfolio company and while still maintaining many of the tax benefits of an LLC and the ability to exercise some control over the LLC’s business through the Class B voting stock of PubCo.

But I’m a founder. What’s in it for me?

PubCo – and thus the public shareholders – get the benefits of increased tax basis in the business you built. In exchange, PubCo shares these tax benefits with you – typically 85 percent to 90 percent, in your favor – under a “Tax Receivables Agreement.” As a historic owner of the LLC, you also continue to enjoy being subject to only one layer of tax for as long as you maintain ownership of your economic interests in the LLC. Whenever you desire liquidity for your ownership interests in the LLC, you can exchange those LLC interests for Class A stock of PubCo and resell the Class A stock in the public markets. Thanks to favorable UP-C interpretive guidance in 2016 from the Securities and Exchange Commission which (subject to certain conditions) allows the historic owners of the LLC to tack their holding period requirement for reselling stock under Rule 144 back to the date they originally acquired their LLC interests (rather than the date they exchanged those interests for Class A stock), this process of achieving liquidity has become easier. With the UP-C structure, you can reap the capital benefits of an IPO and the tax benefits of an LLC.

Additional contribution by
Shelly Teleoglou
Associate, Tax
(949) 725-4171
steleoglou@sycr.com

Ryan Charles Gaglio

Ryan Charles Gaglio is a shareholder in Stradling’s Corporate and Tax practice groups. Ryan focuses on tax planning, tax controversy and transactional matters. He advises clients on the federal, state and local tax consequences of mergers and acquisitions, bankruptcies and workouts, and executive compensation, as well as on sales, use and property tax matters. Contact him at 949-725-4042 or rgaglio@sycr.com



Parker Schweich

Parker Schweich is a shareholder in Stradling’s Corporate and Securities practice group and is a member of the firm’s Public Company, Mergers & Acquisitions and Emerging Growth practice groups. Parker helps clients raise capital, invest in or acquire businesses, achieve successful exits and navigate the complexities of corporate and securities laws. Contact him at 949-725-4241 or pschweich@sycr.com.

