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TAX STRUCTURING AND THE VALUE OF THE FIRM

Utilization of affiliated financial intermediary Special Purpose Entities (SPEs) and hybrid instruments in investment banking

From a German perspective this paper investigates the role of Tax Structuring (financial intermediary SPEs/utilization of mezzanine capital) in the investment banking sector to improve the overall investment performance. In this regard, the invention and implementation of a tax-effective investment structure is a key factor to derive excess risk-free returns from (financial) investments (additional tax shield). Establishing a tax-optimized investment structure has to be an integral part of the investment strategy. This means, Tax Structuring as a part of the investment management process enables to optimize the Net Present Value (NPV) and Adjusted Present Value (APV) of an investment project. Moreover, Tax Structuring can also be used as an investment management tool or new investment management approach to enhance the value of the whole firm.

The research results of this paper can be summarized as follows:

1. Tax Structuring is an important instrument in investment planning to increase the investment project's NPV level, the IRR and the overall investment performance.
2. The APV method/approach (Adjusted Present Value) is not sufficient caused by the fact that the APV does not reflect the value contribution generated by Tax Structuring (periodic cash tax savings). Therefore, the APV method has to be extended by a new third component which considers the "Tax Structuring Tax Shield". Concerning this matter, this paper develops and demonstrates a new APV formula/approach as a solution.
3. Tax Structuring and the value of the firm: From the background of the "Value Additivity Theorem" the value of the whole firm can be enhanced if each major investment project will be wrapped and realized in a specific developed and fine-tuned tax structure (tax optimized investment structure). From the perspective of this new investment management approach, the firm can be understood as a "cluster" of various (major) investment projects. Tax optimized Investment management can increase the value of the firm by applying specific developed tax structures to each major investment project.
4. Since Tax Structuring enables to derive excess risk-free investment returns (periodic cash tax savings), investment managers should consider Tax Structuring as an integral part of the investment management process (tax engineering). Therefore, developing a tax optimized investment structure in which the investment project can be wrapped should be utilized as a general investment management tool.

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