



MERGERS AND ACQUISITIONS

Introduction

Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Introduction

Mergers and acquisitions (M&A) activity is often assumed to vary with the general level of economic activity. A high level of activity, sometimes called M&A fever, is often seen as pathological; as evidence of economic over-heating; as a sign that opportunities for organic growth are becoming harder to find, and companies are having to eat or be eaten to maintain their momentum.

But as a collection of techniques and systems for buying and selling companies and productive assets, M&A is for all seasons.

M&A activity tables focus on acquisitions involving listed companies. This is the glamorous, high-ticket end of the business, but it is a small proportion of the total. M&A-type transactions are the means by which companies of all kinds, in all industries, and every region of the world are re-structuring themselves, and generally adapting to the new, post-crisis environment. Selling a division, or some non-core assets here; buying assets from an erstwhile, but now bankrupt rival there; swapping debt for new equity in a hard-pressed subsidiary; quitting some markets altogether; shifting capital and resources to where they are most needed – actions such as these are the stuff of re-structuring and corporate adaptation to changed circumstances.

Re-structuring of this kind is big business. It accounts for a third of the M&A deal volume at some of KPMG member firms, and there is little sign that the process of post-crisis consolidation is nearing completion.

There were signs, at the time of writing in February 2010, that private equity funds, attracted by favorable conditions for bottom-fishing (picking up troubled companies on the cheap), were staging something of a come-back after their period of retrenchment. But they too are adapting to the new realities. Their leverage model tends to be far less aggressive these days and the average flip rate – the time invested in each portfolio company – is lengthening. In retrospect the high flip rates in 2006/7 seem to have been anomalous and that despite historically low interest rates private equity is now returning to its long-term average holding period of five to seven years.

There is light at the end of the private equity tunnel (let's hope it isn't an oncoming train in the form of a second wave of debt defaults). Private equity continue to do deals, albeit at lower leverage – more like 50:50 nowadays – and reduced return on investment expectations. Analysts are even suggesting it may be a good time to invest in listed private equity funds. Investing now may generate greater returns on investment on exit than on funds raised at the peak of the private equity boom.

There were suggestions in the immediate aftermath of the credit crisis that sovereign wealth funds (SWFs) might make common cause with private equity funds that were clearly struggling to replenish their coffers. It did not happen. SWFs have been quite active on their own accounts in the financial sector in the past two years or so, but they haven't teamed up with private equity funds and have not done as much equity investing as expected in other sectors. This may be partly to do with their equivocal position in double taxation treaties as a consequence of their putative sovereign immunity.

This issue is being actively discussed by the Organisation for Economic Co-operation and Development's (OECD) Committee on Fiscal Affairs, through its Working Party 1 on Tax Conventions and Related Questions. New draft clauses in the OECD Model Tax Convention are proposed to clarify and harmonize the application of double taxation treaties to SWFs. The OECD invites comments on the draft changes.

Elsewhere megadeals, such as Kraft's acquisition of Cadbury, are back in industries not so much affected by the crisis, and there is still plenty of consolidation to be done in hard-pressed industries, such as automotive and banking, much of which is being effected through M&A-type deals.

Emerging markets are still attracting acquisitive interest. KPMG in Brazil's team expects M&A activity to significantly increase in 2010. Heightened M&A activity is evident throughout Latin America, Turkey, India, and China, but less so in

Russia. The direction of deal flow is changing. There is more north to south activity as interest in, and also from, emerging markets grows. Africa is more active, and the whole global M&A market is becoming more multi-dimensional. These are long-term trends that have little to do with the crisis, and are unlikely to be reversed. The days when the acquirers in almost all cross-border M&A deals were European or North American companies appear to be numbered. European or North American companies still dominate global M&A activity of course, but many have been weakened by the crisis and made vulnerable to acquirers wearing a wider variety of national flags.

For their part tax authorities are also adapting to changed circumstances. A year or two ago, when global M&A activity was at its peak, many were busy removing tax obstacles to cross-border acquisitions, in the knowledge that in-bound M&A could be a potent instrument of economic growth and development. At the same time they were trying to ensure, with transfer pricing, thin-capitalization, and earnings-stripping rules, that they retained as much as possible of the value created by foreign investment.

These days they are even more eager for foreign investment, but less concerned about value leakage. They are relaxing change of control rules, because companies burdened with distressed debt need new investors, and the previous interest in thin-capitalization and earnings-stripping rules is more muted now. They were designed for better times when leverage was high, and the private equity funds were on the rampage. Now that high leverage is out of fashion, thin capitalization is less of a concern.

But as the chapters that follow show, longer-term trends in tax administration have not been brought to a halt by the global crisis. If anything, the shift from direct to indirect taxation, and the corresponding trend towards lower head-line corporate income rates have been given added impetus by the interesting times the world economy and the world's financial markets have been experiencing.

It remains to be seen whether M&A activity regains its heady, pre-crisis heights. It seems unlikely that the role of debt in M&A financing will resume its previous prominence any time soon, but there is still plenty of consolidation and restructuring work to be done, and the integration of the global economy, although it has been a major M&A theme for many years now, is likely to be seen in retrospect to have been still in its early stages on the eve of the second decade of the third millennium.

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All information current as of February 2010

About KPMG's M&A Tax Practice

KPMG's Mergers & Acquisitions Tax practice can help ensure acquisitions create shareholder value

At a time like the present of extreme pressure on balance sheets all over the world mergers, de-mergers, disposals, and re-financing have vital roles to play in the re-allocation of corporate assets and the re-configuration of corporate finances.

In an increasingly integrated world economy much of the reassignment of assets and re-structuring of capital necessarily involves cross-border transactions where differences in laws, regulations, cultures and language multiply the risks that miscalculations, misconceptions and misunderstandings will deny to shareholders a transaction's full value-adding potential. This is particularly true in situations in which high debt levels come up against the ever tighter restrictions in tax regimes the world over on the tax-deductibility of interest.

To realize the potential of acquisitions and disposals of assets and reallocations of capital and resources within global businesses to forge more robust and tax-efficient companies, better adapted to world economic conditions, it's vital to understand and take the tax implications of each transaction into account at the outset.

Understanding the Deal

In today's highly professional and competitive deal environment most transactions are auctions. Understanding how these work is essential for strategic investors. To assess the value of your target you must understand its tax risks and to win the auction you have to quantify its post-tax upside potential.

Timing is crucial. In auction processes don't expect any flexibility on deadlines. In managing tax due diligence, international acquisition structuring and modeling tax in the target business, everything must be examined on day one.

The Mergers & Acquisitions Tax practice (M&A Tax), a network of professionals located in KPMG member firms throughout the world, helps companies avoid fiscal pitfalls and unpleasant, post-transaction surprises. In addition to identifying potential tax costs/risks and proposing actions or strategies to mitigate their negative effects on deal value, we also try to identify potential tax saving opportunities to increase the deal value and propose actions or strategies to capture those opportunities. We combine a global focus supported by an M&A network of people with regular working relationships with our intimate local knowledge to help our member firms' clients extract full value from cross-border transactions and restructurings. Our commercially-minded, deal-hardened professionals help clients identify and manage material tax exposures, look beyond the immediate impact, and design deal structures that enhance post-tax returns.

A Range of Services

In conjunction with KPMG's Transaction Services team we offer a wide range of M&A Tax services covering the many phases of domestic and cross-border transactions. The following can be adapted to suit your needs and business objectives:

Tax Due Diligence

Our tax due diligence service can track down the tax information the acquirer or vendor needs to answer the four vital questions; where's the tax exposure and what can be done about it, and where are the tax opportunities and how can they be captured? The answers can help deal-makers plan and structure their transactions tax-effectively in ways that support the acquirer's post-deal integration plans.

We have conducted due diligence reviews for all kinds of transactions, from large privatizations to confidential private equity deals. With our well-tested methodology we help to identify and resolve material tax exposures in multi-faceted, multi-jurisdictional transactions.

Structuring Acquisitions and Disposals

With our technical structuring know-how and our understanding of each party's business priorities, we can help to design robust deals that take account of exposures and opportunities revealed during tax due diligence. We offer a range of services, from reviewing documents from a tax point of view, to providing opinions and obtaining tax authority rulings.

We assess the financial and commercial, as well as the tax positions of the parties, so that our member firms' clients can place due emphasis on the deal's tax risks and opportunities, and we can also help during negotiation and deal execution, by focusing on the tax efficiency of contractual arrangements and the value of warranties and indemnities in contracts.

In due diligence and deal structuring, we assess the value of the target's tax attributes, identify contingent tax liabilities and address other important, but often overlooked issues, such as asset retention, debt placement, separation agreements and exit plans.

In the case of disposals we can help our member firms' clients ensure that portfolio companies are ready for sale and as free as they can be from price-reducing tax issues.

Acquisition Cost Recovery Analysis

We can help clients who are planning or have just completed a deal to mitigate after-tax deal costs. We focus mainly on identifying investigatory fees, such as investment banking and broker fees for finding the target, and due diligence, legal, and other pre-completion fees or costs that can be deducted or depreciated, or claimed for indirect tax credits.

The service covers both direct and indirect tax and is best provided during a deal's preliminary stages. When involved in shaping a deal, we will help identify eligible expenses and reduce costs that cannot be deducted, depreciated or credited. In other cases, we may be able to amend the previous years' tax returns to secure a refund.

Post-Transaction Integration Services

A key to deal success is the swift resolution of issues created by a transaction, from duplicate programs, to conflicting tax positions. We can help clients reconcile the tax positions of their own and the acquired, or soon-to-be acquired, business, and identify and capture synergies in such areas as compensation and benefits, international assignment programs, disposals and joint ventures.

Our post-transaction integration team includes professionals in KPMG practices such as International Executive Services, Transfer Pricing Services, and People Services.

Tax Restructuring Services

Even the most successful business is vulnerable to changing market forces and hard times. Sudden financial challenges may require an organization to rework its financial structure or even file for bankruptcy. We can help companies manage tax effectively during a contraction as well as growth. We can find ways for companies in financial trouble or bankruptcy proceedings to reduce cash outlays for taxes at a time when they can least afford them and increase their value, by helping them preserve tax assets, such as tax losses and credits.

We can help at the many stages of a business contraction, from shut-downs and sales, to restructuring, liquidation and debt negotiations. By helping a company to extract value from its tax attributes during a restructuring the M&A Tax practice can contribute to its return to financial health.

The KPMG Difference

KPMG's global network of member firms gives us access to a large number of talented and experienced people who understand how tax affects M&A, and M&A-type, transactions in tax jurisdictions across the world. Their experience in numerous transactions means they are familiar with the processes and necessities of auctions and can provide the right focus to support a successful acquisition or disposal. No two transactions are the same of course, but there are similarities and common themes. Our collective knowledge has helped us to develop procedures that enable us to coordinate the tax aspects of all kinds of transaction, from large, multi-jurisdictional to small domestic deals. As this book demonstrates our global network of member firms keeps us in regular contact with tax and related developments in all significant economies and markets, and allows us to offer value-adding services at all stages of the transaction process.

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