Unlocking Value through Cross-border M&As

This technical commentary is written by *Felix Wong, Tax Manager, Singapore Institute of Accredited Tax Professionals (SIATP).* It is based on a SIATP's *Tax Excellence Decoded session* facilitated by *Accredited Tax Advisor (Income Tax & GST) Goh Bun Hiong, Tax Director, PKF-CAP Advisory Partners*.

As the world becomes increasingly globalised, more and more companies are looking to restructure through cross-borders mergers & acquisitions (M&As) to enhance shareholder value. Tax impact should be reviewed in totality with other business consideration for the restructuring project.

Unlocking Value through M&As

Companies typically have different motivations and drivers going into their restructuring projects. Some may be seeking to enter new markets while others may be increasing market share or intending to carve out non-core businesses to focus on key strengths; yet others may be consolidating for survival. Regardless of their motivations, the shared thread is that each company is trying to unlock value through its restructuring project.

Restructuring comes in many forms, and initial public offering, merger, acquisition, reverse takeover, consolidation, management buyout, spinoff and demerger are just some of the fancy terms associated with it. However, if we ignore the forms and go back to the basics, there are really only two types of transactions in restructuring projects – acquisition of shares and acquisition of assets.

The fundamental difference between acquiring the shares and the assets of a target company is that for the former, the target company continues to exist under the acquiring company (acquirer). In a share acquisition, the acquirer will inherit the existing licences and incentives of the target company which are often essential to the business, but it will also inherit any existing litigation and tax exposure of the target company. In an asset acquisition, however, the acquirer will not inherit any other assets or liabilities of the target company, other than the specific assets being acquired.

In addition, share acquisition and asset acquisition often have different tax implications and consequences. For example, stamp duty is applicable for the transfer of shares in private companies in Singapore but is not applicable for the transfer of assets. This gets much more complicated in cross-border M&A transactions. While a successful M&A can unlock value for an acquirer, its benefit may easily be eroded if the acquirer does not consider carefully the pros and cons of using a share acquisition versus using an asset acquisition prior to the actual M&A.

In addition to choosing the right types of acquisition (that is, shares or assets), it is also vital that the acquirer has a proper plan on how to hold the newly-acquired shares or assets. The acquirer should strategise and decide on a tax-efficient holding structure before effecting the M&A. In determining the efficient holding structure, the acquirer should have considered and be able to answer questions such as how many entities should be created to hold the newly-acquired shares or assets, what legal forms these entities should take, where these entitles should be created and what the final group holding structure should be. If the acquirer rushes into an M&A without a suitable holding structure in mind, it is likely that the potential value to be generated will be eroded even before the M&A is completed.

In a classic example, an acquirer purchases the shares of the target company before it has decided on the final holding structure. Subsequent to the purchase, the acquirer decides that the newly- acquired company is held under the wrong line of business, and hence carries out an internal sale to transfer the newly-acquired company to another line of business. The additional step of the internal sale may potentially trigger a taxable event and erode the value generated by the M&A.

The reality in many businesses is that group holding structures are driven by business needs and not by tax considerations. Notwithstanding this, an acquiring company should, as much as possible, take a global view and put in place an efficient group holding structure prior to an M&A.

Due Diligence

Before undertaking an M&A, an acquiring company will typically perform due diligence to evaluate the real value of the target company. To avoid unnecessary surprises at the advanced stages of the M&A, it is recommended that the acquiring company identify potential deal-killers early in the due diligence exercise.

Mr Goh shared that in his experience, a due diligence exercise involving the acquisition of shares is generally more time consuming than one involving the acquisition of assets. As discussed earlier, an acquirer will inherit any litigation and tax exposure of the target company in a share acquisition. In this regard, to minimise the risks, the acquirer should typically review multiple years of the target company's documents to identify possible issues and tax exposures. If any issue or tax exposure is identified, its potential impact will be quantified and factored in the sale price and/or the terms in the sale contract.

Conversely, due diligence exercises involving the acquisition of assets are generally less risky because the acquirer does not inherit the target company. For this reason, it is recommended that the acquirer consider acquiring the assets instead of the shares of the target company if it has limited time to complete its due diligence exercise.

Oft-Overlooked aspects of M&As

Be prepared for the sale before it happens

As M&A deals are often completed within a short timeframe, a company looking to sell part of its business should be prepared. This will ensure that the company will not have to "scramble to disentangle" and potentially miss the window of opportunity.

To prepare itself for the sale, a company may carve out part of its business where the company transfers the assets and/or shares that it wishes to sell to a specific group of entities. Through this process, the tax impact should be reviewed in totality with other business considerations. This is akin to an internal M&A process that takes place before the actual sale to the third-party buyer. This will ease the process for the potential buyer to acquire the specific part of the business.

Defending the group holding structure

Since the start of the Base Erosion and Profit Shifting (BEPS) project by the Organisation for Economic Co-operation and Development (OECD), companies around the world are increasingly being scrutinised by tax authorities over the legitimacy of their holding structures. In trying to reduce their taxable incomes, it is no longer enough for companies to create paper companies in exotic tax havens. Instead, the expectation now is for businesses to align their global holding structures with their global value chains.

Substance versus form

To avoid unnecessary disputes with local tax authorities, companies should be aware that different tax authorities may have different interpretations on business transactions. In some countries, the tax authorities may place emphasis on the form of the transactions where the focus is on the actual contracts, while tax authorities in other jurisdictions may be more concerned with the substance of the transactions. Due to this difference in interpretation, companies performing cross-border M&As should try to align the form and the substance of their transactions.

Regulatory approval

An acquiring company should also take note of the regulatory approvals such as foreign investment quotas, especially in developing countries. A target company in a particular sector may have previously entered into the local market when it was an encouraged industry. If there is a change in direction, the acquiring company may, for example, no longer be able to obtain a new licence to operate in the local market; thus, acquiring the assets of the target company may not be an option for the acquirer.

As the world continues to shrink and become increasingly globalised, it is now up to companies to adapt and continue unlocking value through cross-borders M&As. One thing is certain – there are tax implications galore. An awareness and review of possible hidden and overlooked tax considerations may just be the linchpin to a successful M&A.

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About Mr Goh Bun Hiong

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Bun Hiong's career started in 1994 with Arthur Andersen Singapore where he was involved in tax compliance and advisory work. Subsequently, he joined the Asia Pacific headquarters of the Philips Electronics Group and was part of the pioneer team supporting the conglomerate's growing interests in the region. In addition, Bun Hiong was also involved in various high profile merger, acquisition and spinoff deals with LG, Taiwan Semiconductors, and Lucent, amongst others.

Bun Hiong has been the Tax Director of PKF-CAP LLP since October 2011. With over 19 years' of experience, his diverse tax expertise spans many areas, including dispute resolution, incentive and investment negotiations, risk exposure management, and transfer pricing management.

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