Tax
Mergers & Acquisitions

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Asian Taxation Guide 2010

Foreword

In the two years since our last edition of this publication, we have seen unprecedented fluctuations in the market economies on a global scale. Whilst we touched on the potential impact the credit crunch would have on the M&A market in our last edition, it would have been difficult at the time to foresee the impact the financial crises would have on the global economies, and correspondingly on the volume and size of the M&A deals made, or more aptly, the lack thereof.

Whilst a level of uncertainty remains, it appears the concerted massive government interventions have averted a global financial meltdown. Confidence is starting to return, credit taps are unlocked and the stock market is in recovery mode. The road to recovery is likely to be long and bumpy, however the cautious optimism of the current markets is presenting opportunities for M&A, particularly in the Asia Pacific region which is still the fastest growing and most economically attractive region in the world. In addition, Asian banks, with relatively unimpaired balance sheets, are taking this opportunity to intermediate the massive capital needs of a growing Asia.

M&A activity in the Asia Pacific region is holding up well compared to that in Europe and the United States. While both the volume and deal size in the region fell steeply in 2008 and early 2009 in step with those in the West, markets across the Asia Pacific region have been lifted in the second half of the year by the remarkable resilience of the Chinese economy, which has been buoyed by a series of fiscal and monetary stimulus measures.

Our research indicates that despite a sharp fall-off in the number of M&A activities, Asian financial institutions are actively exploring opportunities to expand. In this new environment however, firms are tending to adopt a more cautious approach, focusing on strengthening existing capabilities with attention to value drivers and operational details of the business being critical to success. Thus, whilst expansion is on the cards, restructuring will continue. There also remains the difficulty in valuing assets as a major obstacle to effecting deals.

The great public debt that was required to curtail the global financial crises will need to be reduced over time and given governments' limited ability to raise taxes during the long and slow economic recovery, there will be greater focus on plugging tax loopholes and increasing tax revenue under existing legislation. For example, China is currently undergoing a complete overhaul of its tax regime and constantly introducing legislation to plug any loopholes and implement policy.

China, Indonesia, Australia, Korea and India have all recently taken a particularly aggressive stance towards tackling perceived tax avoidance arrangements with holding company structures seeking to take advantage of double tax treaties where there is no or little substance in the holding company. Indonesia and China have issued regulations to effectively prevent persons other than "beneficial owners" of the income from claiming treaty protection under their respective treaty arrangements. It is becoming increasingly difficult

to structure arrangements to take advantage of favourable treaty rates, unless there is genuine substance in the relevant treaty countries. Korea and India have also had notable recent court cases that have addressed this substance issue and the Australian Tax Office has also recently taken a very hard line on the perceived use of holding companies.

Revenue authorities of various countries have also taken great interest in transfer pricing arrangements and activities of foreign corporations operating in their countries. The upshot of these developments is that tax structuring, due diligence and securing water-tight tax indemnities are more critical than ever in M&A, especially for cross-border transactions or those involving targets with multinational operations.

M&A transactions provide unique tax planning opportunities and it is also a time when potential tax risks need to be properly managed. In this "Mergers & Acquisitions Asian Taxation Guide 2010", our network of M&A tax professionals across Asia offer you valuable insights throughout the entire life cycle of the M&A process, from pre-deal negotiation, due diligence and tax structuring to post deal integration.

We have prepared a summary of 15 jurisdictions across Asia, highlighting key tax issues relevant to both purchasers and sellers in an M&A deal.

We trust that this publication provides you with some basic tools for understanding the typical tax implications for M&A deals, however we would strongly recommend you seek comprehensive tax advice from our applicable local PricewaterhouseCoopers (PwC) contact on your specific deals. We hope that you find it an essential read when contemplating M&A transactions in Asia.

This guide has been written using the extensive technical knowledge and practical deal experience gathered by the PwC M&A Tax Services practice in Asia.

I would like to express my sincere gratitude to the PwC M&A Tax Services country leaders and their teams from Australia, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Sri Lanka, Taiwan, Thailand and Vietnam and Greg James, Christy Wong and Danny Law of PwC Hong Kong.

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1. Introduction

1.1 General information on M&A in Australia

This chapter details the main issues that are relevant to both purchasers and sellers on a transfer of ownership of an Australian business or company.

The Australian taxation system continues to undergo significant reform. The Government has launched various taxation initiatives in recent years, including:

- the introduction of a tax consolidation regime;
- the introduction of a simplified imputation system;
- the proposed introduction of a new research and development (R&D) incentive;
- the proposed reform of Australia's tax treatment of employee share schemes;
- reform of Australia's international tax law; and
- reform of Australia's tax treatment of financial arrangements.

Broadly, the tax consolidation rules allow resident group companies to be treated as a single entity for income tax purposes, with transactions between such group members being disregarded for corporate tax purposes (e.g. payment of dividends and asset transfers).

These initiatives have created a complicated tax landscape for structuring M&A transactions. Particular care needs to be exercised whenever companies join or leave a consolidated group to ensure that tax attributes are known with certainty and that tax liabilities of the group members are properly dealt with. However, there are still many opportunities to structure a M&A transaction in a manner which delivers significant value to both the vendor and purchaser — particularly in terms of capital gains tax (CGT) planning, and optimising funding and repatriation arrangements.

The Government has taken a significant step towards the biggest reform to business innovation support for more than a decade by announcing the introduction of a new streamlined R&D Tax Credit incentive. The incentive, the details of which are currently being refined is proposed to replace the existing R&D tax concession with effect from 1 July 2010. Under the new incentive, companies will be entitled to a 40% R&D Tax Credit for undertaking eligible R&D activities which can be used to reduce their tax liability. This may be even greater for smaller companies. Draft legislation for the new R&D Tax Credit incentive was released for public comment on 18 December 2009. (See section 1.8 for further details).

On 26 March 2009 the final stages of reforms to the taxation of financial arrangements were enacted. The reform process which has been under way for approximately 18 years is intended to replace a patchwork of general principles and specific rules with a single coherent framework for the taxation of financial arrangements. The new regime applies to the first income year commencing on or after 1 July 2010, or, if the early start election is made, the first income year commencing on or after 1 July 2009. The changes introduced in the new regime may affect both the timing of income and deductions in relation to financial arrangements as well as the character of those income and deduction amounts. As the new law may have a significant impact on the Australian tax outcomes of funding arrangements for M&A activity, its impact will need to be considered in the structuring of any transaction.

Australia's international tax laws have continued to undergo significant reform. On 12 May 2009, the government announced its intention to implement most of the recommendations from the Board of Taxation's review of the current foreign source anti-tax deferral regimes. The majority of the new measures are expected to apply from 1 July 2010. Most significantly, the reforms will see the repeal of the foreign investment fund (FIF) provisions (and replacement of those provisions by a more narrowly focused anti-rollup measure) and a modernised rewrite of the controlled foreign company (CFC) provisions into the Income Tax Assessment Act 1997. On 18 December 2009, Treasury released draft legislation that will give effect to the decision to repeal the FIF and deemed present entitlement rules. On 5 January 2010, Treasury also released a consultation paper for public comment detailing the reforms to the CFC rules. (See section 1.4 for further details).

Companies that utilise employee share schemes will need to consider their incentive schemes in light of the new employee share scheme legislation which was enacted on 14 December 2009 and applies retrospectively from 1 July 2009. Broadly, under the new rules, the deferral of taxation will be dependent on the structure of the employee share scheme with a maximum deferral limit of 7 years. Participants will also lose the choice to be taxed upfront. (See section 1.5 for further details).

We should expect Australia's taxation system to continue to undergo significant reform in light of the current "Henry Review" which is examining the current tax system and will make recommendations to position Australia's tax laws to deal with demographic, social, economic and environmental changes. The "Henry Review" will be the most comprehensive review of the tax system undertaken in 50 years and is being carried out by Treasury's Dr Ken Henry. The review encompasses Australian Government and State taxes, except GST. The Henry tax review panel is due to deliver its final report to the Treasurer in December 2009.

1.2 Corporate tax

1.2.1 Income tax

The corporate tax rate in Australia is currently 30%. Australian resident companies are generally taxed on income derived directly or indirectly from all sources, whether in or out of Australia.

1.2.2 CGT

Capital gains derived by Australian companies are also generally taxed at 30%.

Where an Australian company disposes of shares in a foreign company in which it holds 10% or more of the voting rights, any resulting capital gain or capital loss is reduced by a percentage that reflects the degree to which the assets of the foreign company are broadly used in carrying on an “active business”. This percentage is broadly calculated as the level of active foreign assets of the foreign company divided by the foreign company’s total assets. Where this “active foreign business asset percentage” is less than 10%, there is no reduction to the capital gain or loss. Where this percentage is greater than 90%, there is no capital gain or loss to the Australian company. If the percentage is between 10% and 90%, the capital gain or loss is reduced by that percentage.

Non-resident taxpayers are generally only subject to Australian capital gains tax (CGT) on the disposal of ‘Taxable Australian Property’ (TAP). Broadly, assets which are TAP include interests in Australian real property, assets used in carrying on a business through a permanent establishment in Australia, and direct and indirect membership interests of at least 10% in an entity (resident or non-resident) where broadly, at least 50% of the relevant entity’s asset base is comprised of direct or indirect interests in Australian real property. TAP also includes any option or right to acquire such assets (see section 2.3.1).

Non residents making asset acquisitions on revenue account will need to carefully consider their position since Australian sourced gains on revenue account are generally assessable (even if CGT does not apply because the asset is not TAP) but subject to relief from Australian tax under a relevant double tax treaty (see section 7.2.1.1).

Where a gain is subject to CGT and also taxation on revenue account, special rules apply to ensure that broadly the gain is not taxed twice in Australia.

1.2.3 Dividends

To the extent that dividends are paid between resident companies that are members of a tax consolidated group, they will be ignored for calculating Australian taxable income of the group.

Where dividends are not paid within a tax consolidated group, dividends paid by a resident company will be fully taxable to the resident recipient company at the corporate tax rate. A “gross up and credit” system applies to the extent that dividends are franked (i.e. generally paid out of previously taxed profits by a company that is resident where tax credits are attached). The dividend is grossed up for the credits (being the tax paid on the underlying profits and attached to the dividend by the paying company) and this grossed up amount is assessable, with the receiving company being entitled to a non refundable tax offset for the credits attached to the dividend. To the extent that such tax offsets are not used at year end, they may convert into a tax loss of the recipient company, to be used by the company in future years, but subject to the rules governing the deductibility of tax losses.

Dividends paid by a resident, to the extent that they are unfranked (i.e. dividends effectively paid out of untaxed profits such that there are no tax credits attached) are fully taxable to the resident recipient company and no tax offsets are available.

Non-portfolio dividends received by a resident company from non-resident companies are excluded from tax, regardless of the country of origin of the dividend. To obtain this relief, broadly the recipient company must own shares (excluding certain finance shares) entitling the shareholder to more than 10% of the voting power in the non-resident company.

Other dividends received from non-resident companies may be assessable depending on the circumstances.

1.3 Withholding tax

1.3.1 Interest, dividends and royalties

Interest, dividends and royalties paid to non-residents are subject to Australian withholding tax except where the amounts are derived through an Australian permanent establishment (in which case they will generally be subject to taxation by assessment). Where withholding tax applies this is a final tax and is calculated as a percentage of the amount derived. In the case of dividends, withholding tax does not apply to the extent that the dividends are franked under the dividend imputation system (effectively these are dividends paid from taxed profits where credit for the tax paid is attached to the dividend) or conduit foreign income rules (see below) apply to exempt the dividend from withholding tax.

The rates of tax vary depending on whether Australia has a double tax agreement (DTA) with the recipient jurisdiction. In summary, the rates are usually as follows:

	Non treaty rate %	Treaty rate %
Interest	10	10
Royalties	30	10 — 15
Unfranked dividends (paid out of untaxed profits)	30	15
Franked dividends (paid out of taxed profits)	Nil	Nil

It should be noted that some Australian DTAs (such as the treaties with the United States, the United Kingdom, France, Finland, Norway, Japan and the yet to be ratified New Zealand treaty) feature lower withholding tax rates. For example, interest paid to a financial institution of one of these treaty countries by a resident of the other country may be subject to zero withholding, royalties are subject to a 5% withholding tax and dividends paid to corporate shareholders can, in some circumstances, attract a lower rate of withholding tax rate, including a zero rate where specified conditions are met.

Australia has a significant number of tax DTAs (in excess of 40), which cover Australia's largest trading partners.

Australia‘s conduit foreign income (CFI) regime came into effect on 1 July 2005. It applies to certain unfranked dividends paid out of foreign income which are distributed by Australian resident companies to non-resident shareholders. Such dividends are exempt from both income tax and dividend withholding tax. Broadly, the exemption applies to dividends paid from the following income:

- certain foreign sourced non-portfolio dividends;
- certain active foreign income and certain capital gains derived through a permanent establishment in a foreign country;
- capital gains from the disposal of a non-portfolio holding of shares in a foreign company which are not subject to Australian CGT; and
- foreign income and gains not subject to tax due to foreign income tax offsets.

1.3.2 Fees for services

Generally fees for services are not subject to non-resident withholding tax, provided the payments are not considered to be royalties.

However, foreign resident withholding tax rules apply to impose a non-final withholding tax on payments arising in Australia which are of a kind prescribed by Regulations and paid on or after 1 July 2004 to a foreign resident. One payment that has been prescribed by Regulation is a payment to foreign residents in respect of a contract for the construction, installation and upgrading of buildings, plant and fixtures and for associated activities. The rate of withholding tax for these payments is 5%.

1.3.3 Managed Investment Trust (MIT) and fund payments made to foreign resident beneficiaries

Effective from 1 July 2008, a reduced withholding tax rate applies to fund distributions from Australian MITs to certain eligible non-resident investors. The withholding tax rate which applies to the distribution depends on the residency of the recipient, or in some circumstances, the location of the place for payment.

Generally, the following withholding tax rates would apply where the recipient company is resident or receives the payment in a country with which Australia has an exchange of information agreement on tax matters (EOI) which meets certain government criteria e.g. Japan, UK, USA and Bermuda:

- 22.5% non-final withholding tax (being net of related deductions) for distributions paid in the first income year beginning on or after 1 July 2008;
- 15% final withholding tax for distributions paid in the next income year; and
- 7.5% final withholding tax for distributions paid in the later income years.

In any other case, a 30% final withholding tax rate will apply.

On 12 May 2009, as part of the 2009 Federal Budget, the Government announced proposals to allow MITs to elect (irrevocably) to apply CGT treatment to gains and losses on the disposal of certain investments. Subsequently, on 10 December 2009, Treasury released draft legislation for public comment. Such election is proposed to apply retrospectively from the 2008-2009 income year, or the first income year when the MIT is created.

The treatment of the gains on capital account may provide the following benefits:

- the trust and eligible beneficiaries may be able to apply the CGT discount to the capital gains in certain circumstances (refer to section 7.2.1.1 below); and
- non-resident investors who receive a distribution of capital gains which are not sourced from taxable Australian property would not be taxed in Australia on that distribution (refer to section 1.2.2 above), whilst withholding tax would have applied to the distribution to non-residents if the gains have been treated as revenue gains.

We note that the decision to make such election is a commercial decision which needs to be decided in light of the taxpayer's specific circumstances.

1.4 Anti-tax deferral rules / attribution regimes

Australia has a system of attributing to residents certain amounts (predominantly non-active (i.e. passive) and "tainted" (or base company) income) derived by foreign entities in which interests are held by Australian residents. This is to ensure that residents cannot accumulate income offshore and thereby defer / avoid Australian tax. Australia's attribution regimes include the controlled foreign companies (CFC), foreign investment fund (FIF), transferor trust and trust deemed present entitlement rules.

On 12 May 2009, the Government announced that significant changes will be made to the current attribution regimes following a lengthy review by the Board of Taxation into the operation of these rules. Most of the recommendations that came out of the review are intended to be implemented. However, we note that details of the changes have yet to be finalised.

Broadly, the major changes recommended in the report that are expected to be implemented are:

- Modernisation of the existing CFC provisions by updating the legal-based definitions of what constitutes "active" and "passive" income and excluding most "base company" income;
- Allowance of a (probably limited) group approach for applying the "active income test" (which can limit attribution where passive and tainted amounts fall below de minimis thresholds) in circumstances where CFC's are consolidated for accounting purposes;
- Exemption of complying superannuation entities from the CFC rules;
- Repeal of the FIF provisions and the deemed present entitlement rules for non-resident trusts and replacement of them with a specific narrow anti-avoidance rule; and

- Amendment of the transferor trust rules to “enhance their effectiveness and improve their integrity”. The transferor trust rules are designed to ensure no undue tax deferral benefit arises as a result of income accumulating in, generally, foreign discretionary trusts.

On 18 December 2009, Treasury released draft legislation that will give effect to the decision to repeal the FIF and deemed present entitlement rules. On 5 January 2010, Treasury also released a consultation paper for public comment detailing the reforms to the CFC rules. Treasury has indicated that the new measures will apply for income years commencing on or after the date of Royal Assent and will be targeting 1 July 2010 as the commencement date for the major amendments.

1.5 Employee share schemes

The Government announced in the May 2009 Budget that it will introduce legislation so that all discounts on shares and rights provided under an employee share scheme would be assessed in the income year in which the shares and rights are acquired. The existing treatment of employee share arrangements has been a cause of concern with a host of perceived compliance and integrity problems. The draft legislation setting out the new employee share rules was subsequently enacted on 14 December 2009. Generally, the key points from the legislation are:

- The structure of the employee share scheme will determine the tax treatment of the discount received on the shares or rights from the share scheme (i.e. tax upfront or tax deferred to a later point in time). Broadly speaking, a tax deferral on the discount received will only apply to schemes where there is a real risk of forfeiture;
- Participants will no longer have the choice to be taxed upfront, rather upfront tax will occur automatically when the conditions for deferring tax on the discount received are not met;
- Shares or rights to shares, acquired under a salary sacrifice arrangement will be capped at A$5,000 per annum;
- The maximum deferral of tax on the discount received under an eligible employee share scheme will be reduced from 10 years to 7 years;
- An annual reporting regime will be introduced which will require employers to provide details of the market value of shares and rights under an employee share scheme at the time when the employee is subject to tax on the discount;
- The tax refund rules will be extended to cover forfeited shares and not only rights. Broadly, the new tax refund laws provide for a refund of tax paid in relation to a discount received on a relevant share or right in circumstances where those interests are forfeited and the employee has been taxed on the discount; and
- A A$1,000 tax exemption is available to taxpayers participating in an employee share scheme, if the participant’s adjusted taxable income is A$180,000 or less.

In light of these developments, companies that utilise employee share schemes will need to review the structure of their schemes in order to determine the availability of the concessions under the new provisions which are to be effective retrospectively from 1 July 2009.

1.6 Goods and Services Tax

There are three types of supplies for Goods and Services Tax (GST) purposes:

- Taxable supplies, where the supplier charges GST on the supply and is entitled to claim input tax credits on its acquisitions relating to those taxable supplies;
- GST-free supplies, where the supplier does not charge GST on the supply and is entitled to claim input tax credits on its acquisitions relating to those GST-free supplies (an example of a GST-free supply is transfer of a "going concern" or a supply to a non-resident); and
- Input taxed supplies, where the supplier does not charge GST on the supply and is not entitled to claim input tax credits on its acquisitions relating to those input taxed supplies.

The GST rate for taxable supplies is currently 10%. Certain transactions such as the transfer of shares are input taxed supplies. In addition, a transfer of a business which satisfies certain conditions may be GST-free.

1.7 Stamp duty

Stamp duty is a State-based tax on transactions and documents. Duty is payable on certain transactions, such as transfers of "dutiable property". In general, "dutiable property" includes land and interests in land (e.g. fixtures, buildings, and leasehold interests), goodwill, intellectual property, plant and equipment, shares and units in unit trusts.

Duty is imposed at rates of up to 6.75% on the greater of the unencumbered value of the dutiable property, or the consideration paid. A transfer of shares is subject to duty at the rate of 0.6% in some States. However, higher rates of duty apply to dealings in shares (or units) in "land rich" or "landholder" entities. Secured financing can also attract a separate rate of duty (up to 0.4% on the amount secured).

Whilst Australia has moved toward a consolidated group tax regime, it is important to note that intra-group transactions may still be liable to stamp duty, even if there are no income tax implications for the transactions. Intra-group relief from stamp duty may be available in some states provided the relevant criteria are met. Relief is not automatic and must be obtained from the relevant revenue authorities.

As the stamp duty rules vary in each Australian jurisdiction, the stamp duty position on each transaction should be confirmed.

Duty law is constantly changing and we understand that significant new rules may be introduced shortly after this publication.

1.8 Research and development concessions

On 18 September 2009, the Minister for Innovation, Industry, Science and Research, and the Treasurer jointly announced the release of a Consultation Paper on the new research and development (R&D) tax incentive. Under the new rules, the current R&D Tax Concession will be replaced with a simplified R&D Tax Credit, with effect from 1 July 2010.

The three core components of the new incentives are:

- A non-refundable 40% Standard R&D Tax Credit for eligible R&D expenditure that can be carried forward;
- A 45% Refundable R&D Tax Credit for companies with a turnover of less than A$20 million for eligible R&D expenditure; and
- An increase of the R&D expenditure cap from A$1 million to A$2 million.

We note that the new rules will be accompanied by a tighter definition of “eligible R&D activity” to support only “genuine R&D”.

Subsequently, Treasury introduced draft legislation for public comment on 18 December 2009 and intends to apply the new rules for all income years commencing after 30 June 2010 in respect of both new and existing R&D activities.

1.9 Other relevant taxes

1.9.1 Branch profits tax

There are currently no taxes on the remittance of branch profits to the foreign head office of the entity. However, Australia has a peculiar law which seeks to levy tax on dividends paid by non-residents which are sourced from Australian profits. This means that if a foreign company on-pays Australian branch profits to its foreign shareholders as a dividend, the shareholder is technically liable to Australian tax (which may be limited under an applicable DTA). However, in practice the Australian Taxation Office (ATO) has encountered jurisdictional difficulties in collecting this liability.

1.9.2 Other taxes

Other taxes include:

- Fringe Benefits Tax (a tax on the employer) at 46.5% applicable to the grossed up value of certain non-cash benefits provided to employees;
- Payroll Tax (a State-based tax) paid by employers; and
- Land Tax (a State-based tax) paid by the owners of real property.

1.10 Foreign investment review board

Foreign investors (including Australian entities with direct or indirect foreign ownership) are required to obtain approval from the Foreign Investment Review Board for certain investments into Australia. In summary, the types of proposals currently requiring prior approval, and which therefore should be notified to the Government, include, amongst others:

- acquisitions of substantial interests in Australian businesses and companies, where the value of its gross assets exceeds A$219 million;
- investments in certain sensitive sectors irrespective of size (e.g. media, telecommunication, civil aviation);
- takeovers of offshore companies whose Australian subsidiaries or gross assets exceeds the value of A$219 million;
- direct investments by foreign governments and their agencies irrespective of size; and
- acquisitions of interests in Australian real estate or in entities holding Australian real estate in certain circumstances.

These above monetary thresholds are indexed to inflation in subsequent years.

Broadly, less stringent rules apply to certain direct and indirect investments (e.g. through an acquisition of an Asian holding company) made by US investors (as defined) into Australia. These include:

- higher thresholds for acquisition of substantial interests in Australian businesses and companies; and
- higher thresholds for takeovers of offshore companies.

The Government has recently announced changes to the FIRB notification thresholds for foreign investments into Australian businesses. In general, the notification thresholds will be increased and indexed on an annual basis, resulting in less transactions requiring FIRB approval. Legislation relating to these changes has not yet been introduced.

Also, legislation which widens the scope of the FIRB legislation has been introduced into Parliament (but not yet passed). Broadly, the changes will operate retrospectively from 12 February 2009, the date on which the Treasurer announced that changes would be made to ensure that the rules will apply to all foreign investments irrespective of the way they are structured. The amendments specifically include transactions or agreements that involve instruments which eventually convert into shares or share-like interests or voting power (e.g. convertible notes). In other words, if a foreign person acquires potential interests or potential voting power, FIRB may need to be notified and FIRB approval sought.

For any transaction that was entered into on or after 12 February 2009, the foreign investor will have 30 days from the date on which the amending legislation receives royal assent to notify the Treasurer and seek approval for the acquisition, to ensure that no offence is committed.

FIRB notification is required, not only for transactions between third-parties, but also for transactions between related / group companies.

2. Acquisitions

2.1 The preference of purchasers: stock vs assets deal

Whether a deal is structured as a stock (share) deal or acquisition of assets is typically driven by commercial considerations. Traditionally, there has been a preference in Australia for purchasers to acquire assets rather than shares, although sellers typically prefer to sell shares.

However, as a result of Australia's tax consolidation regime and other reforms, the differences between the tax treatment of an acquisition of assets versus a share deal have narrowed, such that a purchaser may not have a distinct preference for one over the other.

The acquisition of assets traditionally had a number of advantages over the acquisition of shares, including:

- freedom from any exposure to undisclosed tax liabilities;
- the tax effective allocation of purchase price, which may enable a step up in basis for depreciable assets and deductions for trading stock;
- valuable trademarks or other intangibles may be acquired and located outside Australia. In the absence of deductions being available in Australia for the amortisation of certain intangibles, this enables the licensing of the intangible to the Australian company, thereby generating allowable deductions to reduce the overall level of Australian tax; and
- providing an opportunity for tax effective employee termination payments.

Disadvantages of an asset purchase include that tax attributes (including losses and franking credits) of the vendor do not flow to the purchaser, and generally stamp duty on the acquisition of a business can be as high as 6.75%. This is significantly higher than the stamp duty on a private company share purchase (generally 0.6%, assuming that the company is not "land-rich", although some States no longer impose stamp duty on the transfer of shares in non-land rich private companies).

A non-resident buyer should consider a structure which takes into account future exit and repatriation plans and, where applicable, a push-down of debt into Australia as part of the acquisition. Tax effective funding structures may also be available depending upon the home jurisdiction. Acquiring shares in exchange for scrip may enable a merger without cashflow constraints. These points are all addressed in further detail throughout this chapter.

2.2 Stock acquisition

2.2.1 Acquisition structure

A non-resident buyer may be concerned with structuring a share acquisition to avoid CGT on future disposals.

Under the current CGT rules, non-residents are able to exit certain investments in Australia without being taxed on the capital gains made on those investments. Broadly, these investments include non-portfolio interests (held on the capital account) in an Australian resident company which has a value that is not "wholly or principally" attributable to Australian real property.

For companies holding shares on revenue account, which are not able to access the above CGT exemption, profits on the disposal of shares in an Australian company may be regarded as Australian sourced ordinary income and taxed at the corporate tax rate.

However, if the foreign company is resident in a country with which Australia has a DTA, relief under the business profits article may be available.

2.2.2 Basis step-up

A step-up in the tax basis of certain assets of the acquired company or group can be achieved under the tax consolidation regime, where the target company or group is acquired by an Australian tax consolidated group. Very broadly, the amount paid for the shares of the target company or group is "pushed down" to the tax basis of assets of the acquired company or group.

The benefits of obtaining step-up in the tax base of assets are:

- increased depreciation deductions (for depreciable assets); and
- reduced capital gains on the subsequent sale of a CGT asset.

On 26 March 2009, the CGT provisions and consolidation regime were modified to prevent step-up in the tax cost base of assets when shares and certain other interests in an entity (joining entity) are acquired by another entity following a scrip for scrip CGT roll-over under an arrangement that is taken to be a restructure.

This will have a significant impact on the structuring of acquisitions, particularly those which involve the acquisition of a group of related companies where it is proposed that some of the assets would be sold shortly after acquisition.

2.2.3 Tax losses and capital losses

Under the continuity of ownership test (COT), where shares carrying between them the rights to more than 50% of the voting power, dividends and capital distributions of a company, are not ultimately beneficially owned at all times during the period from the beginning of the loss year until the end of the income year by the same natural persons, losses of the company (being revenue or capital losses) cannot be utilised unless in respect of the income year the company satisfies the same business test (SBT). Generally under the SBT the company must carry on during the whole of the year of income, the same business (and no other business) as it carried on immediately before the time at which the COT could not be satisfied — such as at the date of change of ownership of shares. The SBT also includes a transaction test, and an anti avoidance provision designed to ensure that the SBT cannot be circumvented by commencing to carry on a business before a failure of the COT, where a purpose of commencement of the business is to satisfy the SBT.

The COT is complex to administer because of the requirement to trace beneficial ownership to natural person through interposed entities, although there are tracing concessions available for “widely held companies” which may alleviate this requirement to some extent. A requirement that only those same shares that are held during the test period by the same person can be taken into account in the numerator of the COT means that capital injections after the loss year may be problematic.

The SBT is facts and circumstances specific. The ATO has strictly interpreted what constitutes the “same business”. In addition, the tax consolidation regime will now make it even harder for consolidated groups to carry forward tax losses after a COT failure since any new business acquisition will not be able to be easily quarantined from the group.

Similar rules generally apply to unrealised losses of a company, with the quantum of such unrealised losses and the affected assets being determined when, by reference to ultimate beneficial ownership of the company at the date of commencement of the unrealised loss rules (in 1999) or any later “changeover time”, (i.e. the “reference time”) there is a changeover time of the company. A changeover time occurs generally, where, by reference to the reference time, shares carrying between them the rights to more than 50% of the voting power, dividends and capital distributions of a company cease to be ultimately beneficially owned by the same natural persons. The “push down” of the acquisition price under the tax consolidation regime will generally eliminate the application of these unrealised rules until there is a subsequent changeover time.

Special COT rules dealing with the deductibility of bad debts claimed by companies also need to be considered.

2.2.4 Tax incentives

Depending on the nature and size of the investment project, State governments have given rebates from payroll tax, stamp duty and land tax on an ad hoc basis and for limited periods.

The major tax incentives / grants provided in Australia are outlined in section 12 below.

2.3 Asset acquisition

2.3.1 Acquisition structure

Similar structuring issues apply to the acquisition of assets as they do for shares.

If the assets are held directly by an offshore entity, the assets will nevertheless form part of the Australian CGT net in relation to future disposals of Taxable Australian Property (TAP). In the context of an asset acquisition, TAP would broadly include direct or indirect interests in real property situated in Australia (Taxable Australia Real Property) and assets used in carrying on a business through a permanent establishment in Australia together with rights or options to acquire such Taxable Australian Real Property or assets (see section 1.2.2). The Commissioner of Taxation has expressed his view that real property for this purpose should include a leasehold interest in land and the definition of real property has now been amended to include such an interest. Accordingly, setting up through a foreign holding jurisdiction to minimise CGT on exit continues to be relevant in the context of an asset acquisition where the asset falls into one of the categories above.

With the current CGT rules exempting non-residents from CGT on the sale of non-portfolio interests in Australian companies (where the value of the company is not "wholly or principally" attributable to real property situated in Australia), an asset acquisition may be less attractive than a share deal for a foreign seller.

See also section 7.2.1 below.

2.3.2 Cost base step-up

Where parties are dealing at arm's length, the basis of acquired assets will generally be the market price negotiated between them. A buyer will typically try to allocate purchase price to depreciable assets rather than goodwill in order to maximise deductions post-acquisition (there is no tax amortisation of goodwill in Australia).

There are more aggressive techniques available to step-up the cost base of an asset to market value prior to sale, but due consideration should be given to Australia's general anti-tax avoidance rules.

Non-deductible expenses of acquisition or sale of an asset may typically be included in the cost base of that asset.

2.3.3 Treatment of goodwill

Under current taxation laws, there are no deductions available for the acquisition of goodwill.

The capital allowance provisions provide for amortisation deductions for certain types of intangible property. While this will not extend to goodwill, a purchaser should focus on identifying the value of specific intangibles (which may be eligible for amortisation deductions) rather than treating all intangibles as goodwill. For example, allocating purchase price to copyright, patents or industrial designs (or a licence in respect of any such item) could result in obtaining amortisation deductions.

2.4 Transaction costs

The following sections summarise the GST and stamp duty costs associated with a transaction, as well as the tax deductibility of these and other transaction costs.

2.4.1 GST

(a) Acquisition of shares

The supply of shares by an Australian entity to an Australian counter-party is an input taxed financial supply and no GST is due on the supply of those shares. However, under Australian law, the acquisition of the shares by a company will also be regarded as a financial supply by that company.

In these circumstances, the company acquiring the shares will be unable to claim all the GST charged to it on expenses relating to the acquisition of the shares if the company exceeds the Financial Acquisitions Threshold (FAT) (a company breaches the FAT if the acquisitions that are made for the purpose of making financial supplies exceeded either A$50,000 or 10% of the entities total input tax credits in any twelve month period).

Nevertheless, in some circumstances, a company that makes input taxed financial supplies may be entitled to claim 75% of the GST incurred on acquisitions relating to those supplies as a reduced input tax credit (RITC), where such acquisitions qualify for a Reduced Credit Acquisition (RCA).

(b) Acquisition of assets

Where assets transferred are “all things necessary” for the continued operation of a business, the supply of those business assets may be a transfer of a “going concern” (provided that certain conditions are met) and will be GST-free. In these circumstances, the company acquiring the assets of the business will not be required to pay GST on the supply.

Alternatively, where insufficient assets to continue to operate a business are transferred, the requirements for the “going concern” provisions will not be met and the liability of supplies will depend on the GST liability of the individual assets.

In relation to the GST costs incurred by the company acquiring the assets (including any GST incurred on the actual acquisition of the assets), GST input tax credits (i.e. a recovery of GST paid) will be available where the assets purchased are used by the acquiring company for a creditable purpose. GST input tax credits may not be available where the acquiring company intends to ultimately make input taxed supplies from the acquisition of such assets. An adjustment of input tax credits initially claimed may be required if the company later commences making input taxed supplies.

2.4.2 Stamp duty

2.4.2.1 Acquisition of stock

Broadly speaking, where there is a transfer of shares in a NSW, South Australia or ACT registered company, stamp duty will be imposed at the rate of 0.6%, calculated on the greater of the unencumbered value of the shares or the consideration paid for the shares. Queensland, Victoria, Western Australia, the Northern Territory and Tasmania have abolished share transfer duty.

If the company directly or indirectly (through downstream entities) owns land (e.g. buildings, fixtures and interests in land such as leasehold interests), the land-rich / land holder rules need to be considered. Land-rich duty is imposed at rates of up to 6.75% on the value of land (and in some states, goods / chattels) deemed to be acquired.

Further, corporate trustee rules need to be considered if the target company is a trustee of a discretionary trust (or owns shares in a company that is a trustee of a discretionary trust).

It should be noted that the land-rich / landholder and corporate trustee rules may apply to any transfer of shares, regardless of where the company is registered — i.e. can apply to the transfer of shares in a foreign entity that, directly or indirectly through downstream entities, holds Australian property / assets.

2.4.2.2 Acquisition of assets

Whether the acquisition of assets / property will be liable to duty will depend upon the types of assets / property being transferred and their location. Where there is a transfer of a business, the transfer of land, goods, goodwill and intellectual property, amongst other things, is subject to duty. If there is no transfer of a business (i.e. there is no goodwill), some categories of property may not be dutiable in certain jurisdictions.

The rate of duty varies between jurisdictions and can be as high as 6.75% on the greater of the consideration paid or the unencumbered market value of the property being transferred. The consideration payable for stamp duty purposes may include non-cash amounts such as an assumption of liabilities.

2.4.3 Concessions relating to M&A

Australian income tax, GST and stamp duty law offer some concessions when a company or a corporate group is being reorganised.

2.4.3.1 Income tax

Where assets are transferred within a tax consolidated group, the transaction is ignored for Australian income tax purposes. However, stamp duty may still apply to transfers of dutiable property even if the transfer occurs within a tax consolidated group.

2.4.3.2 GST

The GST "going concern" concession is discussed above.

Eligible companies may also form a GST group, with the effect that transfers of assets (or shares) within the GST group are disregarded. However, stamp duty may still apply to transfers of dutiable property even if the transfer occurs within a GST group.

2.4.3.3 Stamp duty

Exemptions from stamp duty are available for certain qualifying reorganisations in most States and Territories. These exemptions typically feature a "clawback" provision, which seeks to enforce the exempted stamp duty liability (plus interest and penalties) where certain "de-grouping" transactions subsequently occur (such as a subsequent sale of particular assets or entities).

2.4.4 Tax deductibility of transaction costs

Acquisition expenses (including stamp duty) are typically non-deductible, but form part of the capital cost base for calculating the gain or loss on future disposals and in some cases for calculating depreciation on depreciable assets.

However, certain capital expenditure costs incurred in relation to an existing, past or prospective business may be deductible over five years. To be eligible for this deduction a taxpayer must incur the costs for a taxable purpose (i.e. for the purpose of deriving income that is subject to Australian tax on an assessment basis) and this cost must not be otherwise deductible under any other provision of the Act nor included in the CGT cost base of an asset. The cost of assets acquired (including goodwill) cannot therefore be deducted under this measure.

Costs of borrowing money used for a taxable purpose are deductible over five years, or over the life of the loan if shorter than five years. Where the borrowing relates to certain overseas investments the costs may be deductible on another basis (see section 4.2 below). The return provided to the financier (such as an amount of interest) is not a borrowing cost and is deductible as mentioned in section 4.2 below.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

A stock acquisition can result in a step-up in the tax basis of assets of the acquired company or group of companies where:

- the resulting group of companies elects to form a tax consolidated group for the first time;
- the acquirer of a company is a tax consolidated group; or
- the acquirer of a group of companies is a tax consolidated group.

The specific treatments of common types of acquired assets are considered in section 3.2 "Asset acquisition" below.

3.2 Asset acquisition

Where parties are dealing at arm's length, the cost base of an asset will be the market price negotiated between them. A buyer will typically try to allocate the purchase price to depreciable assets rather than goodwill, in order to step up the cost base and maximise deductions post-acquisition.

There are more aggressive techniques available to step-up the cost base of an asset to market value prior to sale, but these must have due consideration to Australia's general anti-tax avoidance rules.

The cost of plant and equipment used as part of a business is generally tax depreciable over the effective life using either a diminishing value or straight line method. Amounts paid for computer software may also be tax depreciable.

Companies are able to deduct tax amortisation amounts for certain types of intellectual property (copyright, patents and industrial designs). However, no tax deduction is available in Australia for goodwill.

Non-deductible expenses of acquisition or sale may typically be included in the cost base of an asset.

4. Financing of acquisitions

4.1 Thin capitalisation and debt / equity distinction

4.1.1 Thin capitalisation

Australia has a thin capitalisation regime which potentially restricts the amount of tax deductible interest (or like costs) which any multinational (whether Australian or foreign based) may allocate to its Australian operations. Allied to this measure is the tax distinction between debt and corporate equity as discussed below.

Broadly, the thin capitalisation rules apply to outbound investors (i.e. Australian entities with certain controlled foreign investments or foreign branch operations) and also to inbound investors (i.e. non residents with assets in Australia and also foreign controlled Australian residents).

Importantly, the rules limit tax deductions for costs incurred in respect of debt interests (deductible debt) issued by the taxpayer. Typically the cost will be interest on monies borrowed and associated costs of borrowing. Returns paid to investors on equity interests issued by companies (even if the form of the investment is a legal form loan) will not be tax deductible.

Generally a "safe harbour" level of total debt of 75% of net Australian assets (excluding the deductible debt itself and with certain adjustments) is available. A higher ratio is allowed for certain financial entities. An alternative arm's length test requires the taxpayer to demonstrate that, having regard to certain factors and assumptions, the actual debt level could have been obtained from an independent lender. One of the assumptions is that any credit support actually provided is to be ignored but not so the actual terms and conditions applying to the actual debt. These factors and assumptions make the arm's length test difficult to apply. A further test for solely outbound investors is available and allows debt to be calculated by reference to the actual debt of the worldwide group of which the entity is a part.

Modified rules apply to (non-bank) financial institutions, Australian banks and Australian branches of foreign banks.

In addition, the Australian Revenue released a discussion paper on 3 June 2008 in relation to the pricing of cross border financing and guarantees, and the interaction of the transfer pricing provisions with both the debt / equity and the thin capitalisation rules. The paper contends that the Australian Revenue may adjust the pricing of the intra-group guarantees and loans where the price of the financial transaction (e.g. guarantee fees and interest rate) was not set at arm's length. This paper is not finalised and is not binding law, however it represents the Australian Revenue's current views and should therefore be considered when structuring acquisitions.

4.1.2 Debt / equity distinction

There are statutory tests to characterise instruments as debt or equity for tax purposes enacted in 2001. Distributions may have different tax implications depending on the classification of the underlying instrument.

The distinction between debt and equity is based on a "substance over form" approach. This means that in some circumstances, legal form debt may be treated as equity, and legal form equity may be treated as debt for Australian tax purposes.

Generally, under these rules, an instrument will be classified as debt, rather than equity, if there is an effectively non-contingent obligation (ENCO) for the issuer to return the initial outlay (i.e. the original investment) to the investor (excluding through the issue of equity). This calculation is based on nominal values for arrangements where the ENCO's must be met within 10 years, otherwise present values are used. In general terms, returns on instruments classified as debt are deductible where the debt is used for a "taxable purpose" or to make certain overseas investments (see section 4.2 below), although a deduction cap may apply in some cases. A return on debt may not be franked under the imputation system, and is taxable to the recipient. In the case of a non-resident, the returns are treated as interest for withholding tax purposes.

An equity interest in a company will generally be characterised by returns that are contingent on the economic performance i.e. profitability of the issuer or part of the issuer's activities. Returns on equity are non-deductible to the paying company and generally taxable to the recipient. The returns may generally be franked (where there are profits) under the imputation system and are treated as dividends for withholding tax purposes. A simple return of the amount invested may itself be treated as a dividend to the extent that the amount is not debited to the company's share capital or non-share capital account.

A financing arrangement that satisfies the debt test will generally be classified as debt even though it would otherwise be classified as equity. In other words, there is a tie breaker rule that favours classification of a financing arrangement as debt. It may therefore be possible for mandatorily redeemable shares with a less than 10 year term to be structured as debt.

Particular care will need to be taken when considering how the acquisition of Australian assets will be funded. For example, where the acquisition is to be partly funded by shareholder loans, there is a risk that the "related arrangement" provisions may apply to deem the shareholder loans, which otherwise pass the debt test, to be treated as a non-share equity interest. Unforeseen tax consequences may therefore result in the absence of any planning.

4.2 Deductibility of interest (and similar costs)

Interest costs on debt interest loans and other costs incurred in obtaining or maintaining a debt interest ("debt deductions") are generally deductible in Australia where, ignoring any specific provision which may apply to deny, limit or spread deductibility, the underlying debt is used in producing income which is taxable in Australia on an assessment basis (i.e. for a "taxable purpose").

In addition, a deduction for costs incurred in obtaining or maintaining a debt interest may be available to Australian residents where the costs are incurred in earning "non-assessable non-exempt" foreign income (e.g. in the case of an Australian resident company, certain non-portfolio dividends from foreign countries).

Expenses associated with the derivation of exempt foreign branch income by an Australian company are, however, not deductible.

4.2.1 Stock deal

4.2.1.1 Funding cost

Purchasers will typically use a mixture of debt and equity to fund an acquisition and the activities of the target. For non-residents, maximising debt in the Australian target has several advantages. Interest paid offshore is only subject to 10% withholding tax, but is generally deductible in Australia at 30% (subject to thin capitalisation constraints). General comments on deductibility of interest are set out in section 4.2 above. Repayment of debt principal is also an effective method of repatriating surplus cash without a withholding tax or CGT cost.

With the introduction of the consolidation regime, acquisition structuring has become simpler with intra-group dividends (i.e. within the Australian consolidated group being ignored for tax purposes.) This simplifies the repatriation of cash from operating companies to holding companies in the Australian group to service debt commitments.

4.2.1.2 Acquisition expenses

Acquisition expenses (including stamp duty) are typically non-deductible, but form part of the capital cost base for calculating gain or loss on future disposals.

However, certain capital costs that would not otherwise be deductible under any other provision of the Act may be claimed for tax purposes over 5 years. These include capital expenditure incurred in relation to an existing, past or prospective business. These costs must be incurred for a taxable purpose (i.e. incurred for the purpose of deriving income that is subject to Australian tax on an assessment basis), must not otherwise be deductible nor included the in CGT cost base of an asset. The cost of assets acquired (including goodwill and interests in Australian companies or Australian businesses) cannot therefore be deducted under this measure.

Borrowing costs are deductible over five years, or over the life of the loan if this is shorter than five years. The return provided to the financier (such as an amount of interest) is not a borrowing cost and is deductible as mentioned in section 4.2 above.

4.2.2 Asset deal

4.2.2.1 Debt deductions

Debt deductions (being costs of obtaining or maintaining debt interests) are typically deductible, subject to thin capitalisation constraints and a statutory cap in some situations.

The deductibility of other borrowing costs is referred to in section 2.4.4.

4.2.2.2 Acquisition expenses

See comments on “Acquisition expenses” in section 4.2.1.2 above.

5. Mergers

There is no legal concept of a merger in Australia as it exists in other countries. The effect of a merger can be achieved by acquiring the target company and then liquidating that company and transferring its assets to the acquisition vehicle.

This can generally be achieved without any income tax or CGT, where the target company becomes a member of a tax consolidated group followed by liquidation of the target company. However, the transfer of property from the target company to the acquiring company within the tax consolidated group may be subject to stamp duty. Exemptions from such stamp duty exist in some States, and therefore the ultimate stamp duty liability will depend on the location of the assets.

A cross-border merger can also be achieved in a similar way, though the relief from income tax, CGT and stamp duty is not likely to be available and therefore there will be a more significant tax cost.

6. Other structuring and post deal issues

6.1 Repatriation of profits

6.1.1 Taxation of dividends

To the extent that dividends are paid between companies that are members of a tax consolidated group, they will be ignored for calculating Australian taxable income of the group.

Where dividends are not paid within a tax consolidated group, dividend paid by a resident company will be fully taxable to a resident recipient company at the corporate tax rate. A “gross up and credit” system applies for dividends to the extent that they are franked (i.e. effectively paid out of previously taxed profits by a company that is resident where tax credits are attached to the dividend by the payer). The dividend is grossed up for the tax credits attached to the dividend and this grossed up amount is assessable, with the receiving company being entitled to a non refundable tax offset for the credits attached to the dividend. To the extent that such tax offsets are not used at year end, they may convert into a tax loss of the recipient company, to be used by the company in future years, but subject to the rules governing the deductibility of tax losses.

To the extent that dividends paid to an Australian resident (not being a member of the paying company’s tax consolidated group) are unfranked (i.e. effectively paid out of untaxed profits with no tax credits attached by the paying company) the dividend is fully taxable to the resident recipient and there is no tax offset (i.e. as there are no credits attached to the dividend under the dividend imputation system).

Non-portfolio dividends received by a resident company from non-resident companies are excluded from tax, regardless of the country of origin of the dividend. To obtain this relief, broadly the recipient company must own shares (excluding certain finance shares) entitling the shareholder to more than 10% of the voting power in the non-resident company.

Other dividends received from non-resident companies may be assessable depending on the circumstances.

Where dividends are paid by a resident company to a non-resident, they will generally be subject to withholding tax to the extent that the dividends are not franked or exempt under the conduit foreign income rules (see section 1.3.1 above).

6.1.2 Interest and royalties

Interest and royalties are common and efficient methods of repatriating profits, because they are typically deductible in Australia. The withholding tax cost is usually lower than the corporate tax saved.

Strategies to repatriate profits using interest or royalties will need to take into account thin capitalisation constraints for interest, and transfer pricing provisions generally. Australia's transfer pricing regime is broadly consistent with OECD guidelines, but comparatively strict and effectively policed by the ATO.

Interest withholding tax is imposed at a rate of 10%, with royalty withholding tax being imposed at 30% (unless a lower rate is available under a DTA).

6.1.3 Capital return

A capital return on shares debited to the company's 'share capital account' is generally not assessable to a non-resident where the shares in question do not cease to exist. However there are special requirements that need to be complied with and these need to be considered carefully at the time of subscribing the capital and also at the time of repatriation including the 'share capital tainting' rules and the anti streaming rules (see below) that each can result in the repatriation being treated as a dividend.

Anti streaming rules can apply to treat a return of capital as the payment of a dividend where generally, the capital is returned to the shareholder instead of the repatriation of monies to the shareholder as a dividend that would have been assessable or subject to withholding tax. In practice it is common to request a ruling from the ATO before making a capital return to ensure that these rules do not apply.

A distribution of capital which is not a dividend and does not involve a cancellation or buyback of the shares will cause a reduction in basis of the shares in the Australian company for CGT purposes. To the extent the distribution exceeds the CGT cost base (reduced by any such previous capital distributions), a capital gain equal to the excess will be realised. However, the CGT territorial nexus rules (described in section 2.2.1), may operate to disregard this capital gain for non-residents receiving such a return.

Share buy-backs can also be an effective method to return capital, although a deemed dividend component would often arise.

6.1.4 Government approval requirements

Australia requires each currency transaction over A$10,000, including international telegraphic and electronic transfers, to be reported to the Australian Transaction Reports and Analysis Centre. However, this is not an approval requirement, but merely a notification issue.

6.1.5 Repatriation of profits in an asset deal

If the assets are acquired directly by a foreign entity (i.e. through an Australian branch), no branch profits tax will apply on cash paid offshore. Refer to section 1.6.1 which addresses the taxation of Australian sourced profits.

Assets acquired by an Australian acquisition entity will have similar repatriation issues as described above for shares.

6.2 Losses

6.2.1 Tax losses, capital losses and foreign losses

Tax losses on revenue account can be carried forward indefinitely, although they may not be carried back. However, utilisation of these carried forward losses is subject to satisfying the continuity of ownership test (COT) or same business test (SBT). Section 2.2.3 above deals with these issues. Complex rules apply to losses carried forward by trusts.

Under the tax consolidation regime, subject to satisfying the COT or SBT at the 'joining time', losses of a new group member may be transferred into a consolidated tax group. Losses transferred into a consolidated group may have additional restrictions imposed on the rate at which they may be used.

Capital losses may only be used to offset capital gains. Capital losses may be carried forward (but not carried back) indefinitely, subject to the COT and SBT requirements, as for tax losses i.e. losses on revenue account.

Broadly, 'foreign losses' (i.e. losses or deductions other than debt deductions incurred in deriving assessable foreign sourced income) may be used to offset income which is assessable to an Australian resident company. For income year commencing prior to 1 July 2008, the foreign loss rules required foreign losses to be quarantined into four separate classes, only to be used against assessable foreign income of the same class. New rules, effective for income years commencing on or after 1 July 2008, have removed this requirement to quarantine amounts and thus enable a company to deduct foreign losses referable to the derivation of assessable foreign income from assessable income generally. The new rules also allow the progressive conversion of previously quarantined foreign losses into generally deductible losses.

6.3 Continuity of tax incentives

Certain tax incentives may be lost when a business is transferred, particularly where the transfer is in the form of a sale of business assets. The terms of the relevant tax incentive should be reviewed to confirm the availability of the incentive post-deal.

6.4 Group relief

The tax consolidation regime allows wholly-owned groups of companies, together with eligible trusts and partnerships, to consolidate for income tax purposes.

Under the current tax consolidation regime, only the head company of the group is subject to income tax on assessment (but see comments below regarding the liability of group members for the tax assessed). The head company of a consolidated group may obtain relief with respect to the use of available losses of the group. This relief may relate to losses created by existing companies within the group or joining the group (i.e. losses created before the companies joined are transferred to the group) or losses generated by the head company while within the consolidation regime. Certain restrictions may be placed on the rate at which losses generated by an entity which joins the group (including the head company itself), may be used.

Whilst it is only the head company of a consolidated group that is subject to income tax on assessment, all members of the group may be jointly and severally liable for the tax in the event of a default unless a proper tax sharing agreement applies. Where a proper tax sharing agreement is in place each member is generally liable for the share of the liability allocated under the agreement. Companies leaving a consolidated group must make a payment to the head company to discharge their obligation under a tax sharing agreement so as to obtain a clear exit from their responsibility to pay tax.

7. Disposals

7.1 The preference of seller: stock vs assets deal

A non-resident seller will generally prefer to sell shares rather than assets. This is due to the new CGT exemption available to non-residents holding interests in non land-rich Australian companies.

7.2 Share disposal

7.2.1 Gain on sale of stock

7.2.1.1 Capital gains tax

CGT generally applies to the disposal of shares acquired on or after 20 September 1985. Individuals or trusts who have held shares for more than twelve months may be entitled to a 50% CGT discount when calculating their taxable income. The sale of an asset acquired for the purpose of profit making by resale will generally be taxable as income (subject to any Tax Treaty relief). In this case the CGT rules will effectively adjust the capital gain so that there is no double Australian tax i.e. both as income and as a capital gain.

A seller's main concern will usually be CGT upon the disposal of its shares. Commercially, a seller may prefer to sell shares so as to not be left with a structure requiring liquidation or ongoing maintenance.

In the case where a shareholder other than an individual makes a capital loss on sale of such interest, the capital loss may be reduced in certain circumstances where the company in which the interest is held (directly or indirectly) was a "loss company".

The current territorial nexus rules in relation to taxation of capital gains derived by non-residents became effective on 12 December 2006. Broadly, those rules restrict the application of the Australian CGT rules to non-residents holding direct interests in Taxable Australian Real Property (TARP), business assets of Australian permanent establishments and indirect interests in TARP. Rights or options held by a non-resident to acquire direct or indirect interests is TARP or business assets of a permanent establishment are also subject to CGT. Generally, TARP refers to land, leasehold interests in land, and rights to exploit or explore for minerals, oil, gas or other natural resources.

The provisions defining indirect interests in TARP contain a "long-arm" rule under which, generally, a non-resident will be subject to CGT on the disposal of a greater than 10% ownership interest in an interposed Australian or foreign entity, where the value of the interposed entity is wholly or principally (and tracing through any interposed entities) attributable to TARP (i.e. more than 50%).

See also our comments at section 2.2.1 above.

It is important to note that these CGT rules will not apply to limit Australian taxation where the relevant assets are held on revenue account. Where assets are held on revenue account, any profits or gains made which have an Australian source will be assessable to the non-resident unless exempt under a relevant DTA. However, the ATO has recently released two draft taxation determinations in relation to certain inbound investors into Australia. The first draft determination focuses on whether the ATO would seek to apply the anti-tax avoidance rules where a treaty shopping structure has been established to alter the intended effects of Australia's international tax agreement's network. The second draft determination focuses on whether a private equity fund holds their investments on revenue or capital account. These determinations are in draft and are not yet legally binding, however they should be considered in light of any transaction that is contemplated.

7.2.1.2 Scrip for scrip CGT rollover

The "scrip for scrip" provisions provide rollover relief from CGT where an acquirer issues shares to the vendor to acquire a target company. This allows a vendor to defer any CGT liability by receiving shares in the acquiring entity as consideration for the transfer. This allows takeovers or "mergers" to occur without an immediate tax liability to the vendor.

The provisions are complex, and the benefits conferred are largely limited to widely held entities.

As discussed in section 2.2.2, the new CGT roll-over measures may restrict certain entities (joining a consolidated group) from obtaining a step-up in tax base of assets.

7.2.1.3 Shareholder loans

Care needs to be taken when the target company has debts due to related parties which are unlikely to be repaid prior to the completion of the sale.

If the debts are simply forgiven, the Australian debt forgiveness rules may operate to deny the future utilisation of certain tax attributes of the target company (e.g. carried forward losses — both revenue and capital — and the tax base of certain depreciable and capital assets). Similar issues may arise if the outstanding debt is capitalised.

A commonly adopted alternative is to adjust the final purchase price by the amount of the outstanding debt with the acquirer providing loan funds to the target company to enable the debt to be repaid.

7.2.1.4 Unwanted assets

Assets held by the target company which are not to be included within the sale may be transferred prior to the acquisition to other members of the vendor's wholly-owned consolidated group, without giving rise to an immediate tax liability. However, a tax liability may crystallise if the transferred asset subsequently leaves the vendor's group. This is therefore a factor to consider on any future reorganisation of the vendor's group. Also, stamp duty may apply to the transfer of assets within a consolidated group, even if there are no income tax implications.

7.2.2 Distribution of profits

Generally, dividends paid to non-resident investors are subject to withholding tax except to the extent that the dividends are franked (see sections 1.3.1 and 6.1.1). Where dividends are subject to withholding tax, or exempt from withholding tax because the dividends are franked, there is no tax payable by the non-resident on an assessment basis. In other words withholding tax is a final tax imposed on the non-resident.

Refer to section 6.1 above for further details.

7.3 Asset disposal

7.3.1 Profits on sale of assets

As for shares, a seller's main concern will be CGT upon the disposal of its assets. In the case of 'depreciating assets', generally CGT will not apply, but the disposal will result in an assessable amount (on revenue account) to the extent that the proceeds from disposal exceed the asset's tax written down value (i.e. the cost of the asset less depreciation amounts claimed).

Unwinding, liquidating or maintaining the structure post-sale has commercial complications which a vendor may wish to avoid.

7.3.2 Distribution of profits

Refer to sections 1.3.1 and 6.1 above for further details.

Dividends paid to non-resident investors by a resident company are subject to withholding tax except to the extent that they are franked under the dividend imputation system (i.e. effectively paid from after tax profits with tax credits attached by the paying company) or are covered by the conduit foreign income rules. However where the relevant shares are assets of a permanent establishment of the non-resident shareholder in Australia, the dividends paid on those shares will be assessable to the non-resident (and thus the withholding tax rules will not apply).

Accordingly, where the shares are not assets of a permanent establishment in Australia, any withholding tax payable on the dividend will be imposed as a final tax i.e. no further Australian tax will be payable on repatriated franked or unfranked dividends received by the non-resident.

Where a non-resident company operates an Australian branch, there is no tax payable on the remittance of branch profits to the foreign head office of the company. However, Australia has a peculiar law which seeks to levy tax on an assessment basis on dividends paid by a non-resident company which are sourced from Australian profits. This means that if a foreign (i.e. non-resident) company on-pays Australian branch profits to its foreign (i.e. non-resident) shareholders as a dividend, the shareholder is technically liable to Australian tax (which may be limited under an applicable DTA). In practice the ATO has jurisdictional difficulties in collecting this liability.

8. Transaction costs for sellers

8.1 GST

GST is paid at a rate of 10% in Australia by purchasers of most goods and services. However, it is the seller's responsibility to correctly account for GST on the supplies made.

The sale of shares between Australian entities is an input taxed financial supply (and not subject to GST). GST costs incurred by the seller in relation to the sale of the shares may not be recoverable in full.

Where a supply of assets satisfies the requirements for a sale of a "going concern", the supply will be GST-free. However, where the going concern requirements are not satisfied, the GST liability of the supply will depend on the nature of the individual assets.

The seller will be entitled to a full GST input tax credit on the GST costs incurred where the sale is a "going concern" or where the individual assets are all either subject to GST at a rate of 10% or are GST-free.

8.2 Stamp duty

Stamp duty is generally payable by the purchaser, with the exception of South Australia and Queensland where the liability may fall on all parties to the transaction. However, the parties to the transaction may contractually agree as to who will bear the stamp duty costs (e.g. paid by the buyer).

8.3 Concessions relating to M&A

Certain concessions in relation to Australian income tax, GST and stamp duty may be available for the reorganisation of a company prior to sale.

8.3.1 Income tax

The transfer of assets within a tax consolidated group is ignored for Australian income tax purposes. However, stamp duty may still apply.

8.3.2 GST

As mentioned above, there is a GST concession for the acquisition of a going concern. It is also possible for eligible companies to form a GST group. This effectively allows transfers of assets within the group to be disregarded. However, as discussed above, stamp duty may still apply.

8.3.3 Stamp duty

Exemptions from stamp duty are available for certain qualifying reorganisations in most States and Territories. These exemptions typically feature a “clawback” provision, which seeks to enforce the stamp duty liability (plus interest and penalties) where certain transactions subsequently occur (such as a subsequent sale of particular assets or entities).

8.4 Tax deductibility of transaction costs

Transaction costs incurred by a seller are typically included in the seller’s basis for the purpose of calculating the gain or loss on the transaction (per section 2.4.4).

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

In relation to the transfer of assets within a group, different rules apply for consolidated groups and non-consolidated groups. Consolidated groups are able to ignore the transfer of assets between members of the group under the “single entity rule” (although stamp duty may still apply).

Transfers within non-consolidated groups may trigger a CGT gain or loss — when transferring assets between entities and the consideration is not what would be regarded as arm's length, a deemed market value is used to determine the gain or loss and provide the new cost base to the recipient company.

9.2 Declaration of dividend prior to sale

Before the sale of a company, dividends may be paid in order to extract surplus cash. Where these dividends are paid to non-residents, withholding tax will generally be required to be paid if the dividends are not fully franked (see sections 1.3.1 and 6.1 above). Where the surplus cash represents repatriated foreign source income of the Australian company, conduit foreign income relief may be available in respect of Australian withholding tax (see section 6.1.1 above).

10. De-mergers

Australian tax law offers de-merger rollover relief from CGT to tax consolidated groups and their shareholders. The key conditions are:

- at least 80% of the de-merger group's ownership interest in the de-merged entity must be acquired by the group's shareholders;
- each shareholder must receive an equal corresponding proportion of interests in the de-merged entity (and no other consideration) equal to their interest in the group prior to the de-merger; and
- the total market value of each shareholder's interests in the de-merger entity and the group entity must at least equal the total market value of their interests in the group prior to the de-merger.

Non-resident shareholders can only obtain rollover benefits to the extent that interests in the de-merged entity are TAP (i.e. satisfy the nexus rules in respect f the application of CGT to non-residents) immediately after the de-merger.

De-merger dividends arising as a result of a de-merger may be able to relieved from Australian tax.

Shareholders of the group apportion their basis across their existing shares plus the additional shares in the de-merged entity.

11. Trade sale or listing

After acquiring a target, a financial buyer generally looks for an exit route either through a trade sale or an initial public listing (IPO). The Australian tax treatment will depend upon the residence of the acquirer and whether the acquirer holds the target on revenue or capital account.

Where an Australian resident holds the target on capital account, gains on disposal will be assessed as capital gains. A 50% CGT discount may be available to individuals or trusts if they have held the target for a period greater than twelve months. Where a resident is considered to hold the target on revenue account, proceeds from an IPO or other disposal will be assessed as ordinary income.

Currently, where a non-resident holds an interest in an Australian company on capital account, the non resident is subject to Australian CGT on any gain made on IPO or other disposal if the disposal was of non-portfolio indirect or direct interests in TAP or the shares comprise the business assets of an Australian permanent establishment (see section 7.2.1.1 above).

Where a non-resident shareholder holds shares in a target company on revenue account, the shareholder is currently subject to tax on any gain made to the extent that such gain is considered to be Australian sourced, although the relevant DTA may override the domestic law. The status of the company and the level of shareholding are not relevant when the shares are held on revenue account. Whilst CGT may also apply to the disposal, there is generally a mechanism which seeks to avoid double tax.

In relation to GST, the supply of securities is treated as a "financial supply", meaning GST is not charged but a credit for GST paid on related expenses may not be available. However, where the supply is made to a non-resident, it may be "GST-free", which would allow a credit to be claimed for GST paid on related expenses.

If a company is seeking to be listed on the Australian Stock Exchange, the listed vehicle, which can also be the acquisition vehicle, should be incorporated in Australia.

12. Tax incentives

Depending on the nature and size of the investment project, State Governments have given rebates from payroll tax, stamp duty and land tax on an ad hoc basis and for limited periods.

The major tax incentives / grants provided in Australia include:

- an outright deduction for certain relocation costs incurred in establishing a regional headquarters;
- accelerated deductions for capital expenditure on the exploration for and extraction of petroleum and other minerals and certain quarrying operations;
- certain tax-exempt non-resident investors that satisfy Australian registration requirements are exempt from income tax on the disposal of investments in certain Australian venture capital equity held for more than twelve months;
- taxable income derived from pure offshore banking transactions by an authorised offshore banking unit in Australia is taxed at a rate of 10%;
- Export Market Development Grant program which provides funding of up to A$200,000 for expenditure in the development of eligible export markets;
- a 125% deduction (increased to 175% for certain qualifying companies) for eligible research and development (R&D) expenditure. A cash rebate may be available for small companies. However under the recently proposed changes to the R&D incentive, this is expected to change to a non-refundable 40% Standard R&D Tax Credit or a 45% refundable R&D Tax Credit for certain companies with a turnover less than A$20 million; and
- a refundable tax offset of 20-40% for Australian expenditure incurred in the production of Australian films (the producer offset); a refundable tax offset of 15% for production expenditure on a film that was filmed in Australia (the location offset); and a refundable tax offset of 15% for post-production, digital and visual effects production for a film irrespective of where the film was shot (the PDV offset). A taxpayer may only claim one of these tax offsets.

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1. Introduction

1.1 General comments on M&A in People's Republic of China

This chapter details the main issues that are relevant to both purchasers and sellers on a transfer of ownership of a company in the People's Republic of China (PRC or China). It is generally assumed that all sellers are PRC companies and that all purchases are made either by a foreign enterprise (FE) or through a foreign-invested enterprise (FIE) in PRC, unless otherwise indicated. A transfer of ownership of a PRC company may take the form of a disposal of shares or assets.

The relevant taxes to be considered in the context of a M&A transaction are detailed as follows.

1.2 Corporate tax

Corporate Income Tax (CIT): Generally, PRC companies are taxed on a stand-alone basis. Previously, taxation of a FIE was governed by the Foreign Enterprise Income Tax (FEIT) Law to separate from domestic enterprises, but is now covered by a unified new CIT Law effective 1 January 2008. The profits earned by a company are taxed at the CIT rate of 25% (or lower where tax incentives apply).

1.3 Withholding Tax

A FE which has no permanent establishment, or place of business, in China but derives profit, interest and other income from sources in China is subject to Withholding Tax (WHT) at the rate of 20% on such income with a possibility of exemption or reduction. The Withholding Tax rate is reduced to 10% by the Detailed Regulations for the Implementation of China's new CIT Law.

1.4 Turnover taxes

Value Added Tax (VAT): is a sales tax where up to 17% is added to the sales price charged for goods (except for certain categories of sales which are exempt from or outside the scope of VAT or charge at lower VAT rate).

Business Tax (BT): generally, BT of 5% is imposed on any transfer of immovable assets (e.g. land and real estate) and intangible assets (e.g. trademarks, patents and copyrights). In addition, a FE that received interest income from China is also subject to BT at the rate of 5%.

Consumption Tax (CT): is imposed on 14 categories of goods, including cigarettes, alcoholic beverages and certain luxury items.

1.5 Stamp Tax

Stamp Tax (ST) is payable by both the purchaser and seller at rates ranging from 0.03% to 0.05% on the value of equity or assets transferred.

1.6 Other relevant taxes

Land Appreciation Tax is imposed on the seller upon the transfer of land use rights and buildings and is assessed at progressive rates from 30% to 60% of the appreciated amount of the land use right and building.

Deed Tax is payable by a purchaser at rates ranging from 3% to 5% on the purchase price of land use right or building.

2. Acquisitions

According to the Provisions on Acquisition of Domestic Enterprises by Foreign Investors (Order No. 10) effective from 8th September 2006 issued by the Ministry of Commerce (MOC), State-owned Assets Supervision and Administration Commission of the State Council (SASAC), the State Administration of Taxation (SAT), the State Administration of Industry and Commerce (SAIC), China Securities Regulatory Commission (CSRC) and the State Administration of Foreign Exchange (SAFE), foreign investors are now allowed to acquire PRC companies in one of the following ways:

- an acquisition of the equity or share holdings of a non-FIE by a foreign investor. This acquisition subsequently converts the target entity into a FIE (hereinafter referred to as a stock deal);
- an acquisition of the assets of a non-FIE by an existing FIE or by a foreign investor through the formation of a new FIE (hereinafter referred to as an asset deal).

Special rules and regulations apply if foreign investors acquire stock in listed Chinese companies (see section 2.2.1).

2.1 The preference of purchasers: stock vs asset deal

The adoption of an asset or a stock deal for an acquisition in China largely depends on the regulatory situations, as well as the commercial and tax objectives of the investors. For example, in some cases, an asset deal may be the only option for acquiring businesses from Chinese domestic enterprises.

Order No. 10 is the first PRC regulation legally endorsing and setting out the regulatory framework for a cross-border share swap as a form of payment for foreign investors to acquire shares of domestic enterprises. Domestic enterprises must engage a M&A advisor to perform a due diligence review on the foreign investor. The M&A advisor, which should be a reputable agency registered in China, has to issue a report to set out its professional opinion on the financial status of the foreign investor.

2.2 Stock deal

According to Order No. 10, under a stock acquisition, the target company remains as a going concern subject to its originally approved operating period. The acquirer also inherits the business risk and hidden or contingent liabilities, if any, of the target company. Accordingly, this risk should be addressed by performing a due diligence on the target, through adjusting the purchase price and / or obtaining a contractual warranty from the target company's shareholders, where commercially viable.

Under a stock deal, there is no change in the legal existence or disruption to the attributes of the acquired PRC company. Thus, the target company may not re-value its asset basis for Chinese tax purposes.

The transfer of a stock interest in a Chinese entity is subject to Stamp Tax on the transfer price. Stamp Tax is payable by both the buyer and the seller. Any acquisition expense incurred by the buyer may not be allocated to the target company and therefore, such expense generally incurred by the offshore buyer may not be claimed as a tax deduction in China.

Generally, tax losses of the target company arising prior to the acquisition may continue to be carried forward after the stock acquisition for any period remaining within the five-year limit (see section 6.2 for details).

2.2.1 Acquisition of stock in listed Chinese companies

The stock of domestic Chinese companies may be listed on one of China's two stock exchanges located in Shanghai and Shenzhen. Two classes of shares are tradable on these stock exchanges:

- Class A shares that are restricted to domestic traders and qualified institutional foreign investors (QFII); and
- Class B shares that are restricted to foreign investors and individual Chinese investors.

There are also two classes of shares that are not tradable. These two classes are:

- state-owned shares that are owned directly by the State; and
- legal person shares that are owned by another company or institution with a legal person status.

The legal person shares may be owned indirectly by the State if the shareholders of the legal person shares are state-owned enterprises (SOEs). These non-tradable shares jointly account for 60% or more of the total issued shares of a listed company.

- Acquisition of tradable stock

  Foreign investors have long been allowed to acquire Class B shares in the Chinese market. However, Class A shares, which had previously been reserved for domestic investors, became available to foreign investors at the end of 2002 under the QFII rules jointly issued by the China Securities Regulatory Commission (CSRC) and the People's Bank of China.

  The term "QFII" refers to foreign funds management companies, insurance companies, securities companies and other asset management institutions approved by the CSRC to invest in the PRC securities market within the limitations set by the SAFE.

  A QFII is able to invest in Class A shares, government bonds, convertible bonds and corporate bonds listed on China's securities exchanges. However, for an investment in Class A shares, each QFII is allowed to hold less than 10% of particular listed company's total issued shares. All QFIIs together are allowed to hold in total no more than 20% of a particular listed company's total issued shares. Also a QFII's domestic investment activities should comply with the requirements set out in the Guidance for Foreign Investment in Various Industries. Therefore, the QFII rules offer only limited possibilities for merger and acquisition activities in China.

- Acquisition of non-tradable stock

  Before 2003, non-tradable shares of listed Chinese companies may be transferred between the State and Chinese legal persons but are not able to be acquired by foreign buyers. On 1 November 2002, the CSRC, the Ministry of Finance and the State Economic and Trade Commission jointly issued the Notice on Relevant Issues Concerning the Transfer to Foreign Investors of Listed Company State-Owned Shares and Legal Person Shares (the State-Owned Share Notice). This State-Owned Share Notice, effective from 1 January 2003, addresses the direct sale of both State-Owned and legal person shares to foreign investors.

  According to the State-Owned Share Notice, in principle, non-tradable shares may be sold by public bid. In the case of crucial items (which have not been defined), the sale must be submitted to the State Council (the highest governmental administrative authority of China) for approval. In addition, a share transfer to a foreign investor is subject to the Foreign Investment Guideline prohibitions and limitations on foreign investment in specified economic sectors.

  As a result of the proposed share acquisition, the foreign-owned interest exceeds the limitations set out in the Foreign Investment Guideline, the transaction may not be approved.

  Furthermore, a listed Chinese company that transfers its shares to a foreign investor, even if the amount of shares transferred resulted in the foreign investor having control over the company, the said company will not qualify as a FIE and thus it may not enjoy the various preferential tax treatments granted to FIEs.

On 4 September 2005, the CSRC issued the Measures for the Administration of Share Capital Segregation Reform of Listed Companies which stipulated that any sale of non-tradable shares would require approval by at least two-thirds of all voting shareholders. It also emphasised the need to compensate the holders of tradable shares for any significant falls, if any, in value of the shares as a result of the sale transaction.

There are still a number of ambiguities as to how the State-Owned Share Notice will be implemented. Therefore, foreign investments under this rule will have to be negotiated not only with the Chinese target company but also with several Chinese government authorities.

2.3 Asset deal

In general, an asset acquisition involves the formation of a new company for the purpose of acquiring the assets, liabilities and business of a target company. However, it should be noted that the formation of a new company requires certain approvals.

An asset deal is typically used in order to leave behind some of the inherent risks associated with the target company. An asset acquisition helps to restrict the risks to the specific assets, liabilities and businesses being acquired. Thus, the acquirer generally does not assume any contingent or hidden liabilities of the target company. However, in certain specific situations, an asset deal is not immune from the inherent risks related to the assets acquired. For example, if there is any default on the target company's part of import duty and VAT on the assets acquired, PRC Customs may pursue the assets, notwithstanding that they have been sold. The seller is required to pay PRC taxes in respect of the transfer of the following assets:

Nature of assets acquired	Relevant tax
Land and buildings	LAT at various rates from 30% to 60% business tax 5%
Intangibles	Business tax 5%
Inventory	VAT 17% (general VAT payer) / 3% (small-scale VAT payer)
Inventory — category of goods subject to CT	CT at various rates
Equipment	VAT 17% / 2% (Please refer to section 7.2 for more details)
Transfer contracts	ST at 0.03% on contracted value on transfer of inventory, and 0.05% on other assets

Generally, the seller and buyer may only retain and carry forward their respective tax losses and may not transfer the tax losses to the other party through the transfer of their assets and business operations to the other party.

2.4 Transaction costs for purchasers

2.4.1 Turnover taxes

- Stock purchase

  In general, stock transfers are not subject to VAT or BT.

- Asset purchase

  From purchaser's perspective, if the purchaser is subject to VAT and is obliged to charge VAT on its sales (output VAT), the purchaser may recover VAT paid by it on purchases (input VAT) of inventory and production-related equipment from the seller. A purchase of inventory and production-related equipment on which VAT has been charged by the seller is regarded as input VAT for the buyer. Therefore, VAT charged by the seller may be recovered by the buyer.

  Note that in some situations, depending on certain VAT related characteristics of the purchaser, the input VAT may not always be recoverable in full. Hence, to the extent to which the VAT paid may not be recovered, such non-recoverable VAT would be a real cost to the purchaser.

  For certain types of inventory, the CT paid for the purchase of inventory can be offset against the CT liabilities for a manufacturing purchaser if the inventory is used for the production of another product that is also subject to CT. Otherwise the CT paid is a real cost to the purchaser.

2.4.2 Stamp Tax and other relevant taxes

- Stock purchase

  Stamp Tax of 0.05% is payable by both the purchaser and the seller on the consideration or value of the transfer of stock, whichever is higher.

- Asset purchase

  Deed tax of 3% to 5% of the amount or value of the transfer consideration is payable by the purchaser on transactions related to land or real estate properties in the PRC.

  In addition, under an asset deal, the sale of inventory and fixed assets are subject to a Stamp Tax at the rate of 0.03% on the value set out in the relevant sales contracts. Stamp Tax at 0.05% would be applied on the transfer of immovable or intangible assets. Stamp Tax is imposed on both the seller and the buyer.

2.4.3 Concessions relating to M&As

According to the notices issued by the SAT and MOF (Caishui [2008] No. 175 and Guoshuifa [2009] No.89), the following Deed Tax concessions relating to M&As:

- In an equity transfer, Deed Tax will not be payable if there is no transfer of ownership of land and real estate;
- In a merger, two or more enterprises combine to one enterprise with the original shareholders continuing to exist, the merged enterprise taking over the land and real estate from the original parties shall be exempted from Deed Tax; and
- In a spin-off, Deed Tax will not be payable if the shareholders of the spin-off enterprise remain the same as the original shareholders of the enterprise being spun-off.

The above preferential tax policy will be extended from 1 January 2009 to 31 December 2011.

2.4.4 Tax deductibility of transaction costs

The new CIT Law does not provide clear rules on the deductibility of transaction costs. Under the old FEIT law, FIEs were explicitly not allowed to take deductions for expenses related to feasibility studies, interest expense on investment loans, management expenses and other investment-related expenses for FEIT purposes. Nevertheless, if a FIE uses non-cash assets (e.g. tangible and intangible assets) to acquire stock or assets, the difference between the original book value of the non-cash assets and the purchase price of the acquired stock or assets is a taxable profit or deductible loss of the seller in the taxable period of the transaction.

The new CIT law also impose new deduction restrictions on intangible assets, where goodwill arising from the acquisition would not be an amortisable item. This goodwill would only be deductible when the acquired entity is subsequently disposed of or liquidated.

3. Tax treatment following asset, stock acquisition, merger and spin-off

The Detailed Implementation Rules (DIR) to the new CIT law, provides a general rule that where an enterprise undergoes a corporate restructuring, it has to recognise a gain or loss resulting from the transfer of the relevant assets at the time of the restructuring, and the tax basis of the relevant assets shall be revised according to the transaction prices, unless it is otherwise prescribed by the MOF, and SAT. The MOF and SAT finally jointly released the rules for corporate restructuring under the Notice entitled “Several Questions about CIT Treatments for Corporate Restructuring” (Caishui [2009] No. 59) which indicates the basis of taxation following an asset or stock acquisition in “General Restructuring“and “Special Restructuring“ respectively.

3.1 General tax treatments

The general principle is that enterprises undergoing corporate restructuring should recognise the gain or loss from the transfer of the relevant assets and / or equity at fair value when the transaction takes place, and the tax basis of the relevant assets in the hands of the transferee should be revised according to the transaction prices. In summary, the tax consequences to the parties involved in the corporate restructuring are instantly recognised.

3.1.1 Share acquisition and asset acquisition

When an enterprise undergoes a restructuring transaction in the form of a share acquisition or an asset acquisition, the relevant transactions shall be treated in the following ways:

a. The transferor shall recognise the gain or loss for the shares and assets transferred;

b. The tax basis of the shares of assets acquired by the transferee shall be determined according to the fair value;

c. The income tax matters of the target company shall, in principle, remain unchanged.

3.1.2 Mergers

In a merger of enterprises, the parties involved shall treat the transaction as follows:

a. The merged enterprise shall determine the tax basis of the items of assets and liabilities received from the enterprise being merged based on the fair value;

b. The enterprise being merged and its shareholders shall treat the transaction as a liquidation for income tax purpose.

3.1.3 Spin-off

In the spin-off of an enterprise, the parties involved shall treat the transaction as follows:

a. The enterprise being spun-off shall determine the gain or loss of the assets transferred based on their fair value;

b. The spin-off enterprise shall determine the tax basis of the assets received based on their fair value;

c. Where the enterprise being spun-off continues to exist, the consideration received by its shareholders shall be treated as a distribution received from the enterprise being spun-off;

d. Where the enterprise being spun-off no longer exists, the enterprise being spun-off and its shareholders shall treat the transaction as a liquidation for income tax purpose.

3.2 Special tax treatments

However, the Restructuring Rules allow that if prescribed conditions are satisfied, then it is possible for the parties involved in the corporate restructuring to choose a special tax treatment.

3.2.1 Prescribed conditions

The Restructuring Rules allow special tax treatments for corporate restructuring that fulfil all of the five following conditions:

a. The corporate restructuring has to have reasonable commercial reason and the main purpose of the corporate restructuring is not for tax reduction, avoidance or postponement of tax payment;

b. The equity or assets being acquired, merged or spun-off have to reach a certain prescribed ratio to reflect the significance of the corporate restructuring. In an equity acquisition deal, the equity acquired should not be less than 75% of the total equity of the enterprise being acquired; whereas in an asset acquisition deal, the assets acquired should not be less than 75% of the total assets of the enterprise that transfers the assets;

c. No change in the original actual business activities within 12 consecutive months after the restructuring (“compulsory operating period”);

d. The deal consideration should mainly comprise of equity (or shares) and the portion of equity-payment has to exceed 85% of the total consideration. In other words, the non-share equity (commonly known as “Boot” which includes cash, bank deposits, receivables, tradable securities, inventories, fixed assets, other assets and undertaking of liabilities, etc.) cannot exceed 15% of the total consideration; and

e. The original shareholder who received the equity-payment on the corporate restructuring has to commit not to transfer the shares received within 12 months after the corporate restructuring (“compulsory holding period”).

For corporate restructuring that satisfies the conditions above, the parties involved may elect the following special tax treatments with respect to the equity payment:

3.2.2 Share acquisition

In an equity acquisition transaction, the parties involved may elect to adopt the following treatment, provided that the acquiring enterprise acquires not less than 75% of the shares of the acquired enterprise, and the amount of equity payment settled at the time the equity acquisition takes place is not less than 85% of the total consideration for the transaction:

a. The tax basis of the equity of the acquiring enterprise received by the shareholders of the acquired enterprise shall be determined according to the original tax basis of the equity of the acquired enterprise;

b. The tax basis of the equity of the acquired enterprise received by the acquiring enterprise shall be determined according to the original tax basis of the shares of the acquired enterprise;

c. The tax basis of all the original assets and liabilities and other income tax matters of both the acquiring enterprise and the acquired enterprise shall remain unchanged.

3.2.3 Assets acquisition

In an asset acquisition, the parties involved may elect to adopt the following treatment provided that the transferee enterprise acquires not less than 75% of the assets of the transferor enterprise and the amount of the equity payment settled at the time the asset acquisition takes place is not less than 85% of the total consideration for the transaction:

a. The tax basis of the equity of the transferee enterprise received by the transferor enterprise shall be determined according to the original tax basis of the assets transferred;

b. The tax basis of the assets received by the transferee enterprise from the transferor enterprise shall be determined according to the original tax basis of the assets transferred.

3.2.4 Mergers

In a merger, the parties involved may elect to adopt the following treatment, provided the amount of equity payment received by the shareholders at the time the merger takes place is not less than 85% of the total consideration of the transaction; or where the enterprises being merged and the merged enterprise are under common control, and consideration is not needed to be paid:

a. The tax basis of the assets and liabilities received by the merged enterprise from the enterprise being merged shall be determined according to their original tax basis to the enterprises being merged;

b. The merged enterprise shall inherit the relevant pre-merger income tax matters of the enterprises being merged;

c. The limit of the amount of losses of the enterprises being merged that may be utilised by the merged enterprise = Fair value of the net assets of the enterprises being absorbed x the Interest rate of the State bonds with the longest term issued by the State as of the end of the year during which the merger takes place;

d. The tax basis of the equity of the merged enterprise received by the shareholders of the enterprises being merged shall be determined according to the original tax basis of equity of the enterprises being merged.

3.2.5 Spin-off

In a spin-off transaction, the parties involved may elect to adopt the following treatment, provided that the ratio of shareholding in the spin-off enterprises received by all shareholders of the enterprise being spun-off is the same as the original ratio of shareholding in the enterprise being spun-off; the spin-off enterprises and the enterprise being spun-off do not alter the original actual business operation; and the equity payment received by the shareholders of the enterprise being spun-off at the time the spin-off taking place is not less than 85% of the total consideration of the transaction:

a. The tax basis of the assets and liabilities received by the spin-off enterprises from the enterprise being spun-off shall be determined according to their original tax basis to the enterprise being spun-off;

b. The income tax matters related to the spun-off assets of the enterprise being spun-off shall be inherited by the spin-off enterprises;

c. The unexpired loss of the enterprise being spun-off may be pro-rated and shared according to the ratio of the value of spun-off assets to the value of the total assets and continue to be utilised by the spin-off enterprises;

d. The tax basis of the equity of the spin-off enterprises received by the shareholders of the enterprise being spun-off (hereinafter referred to as "new shares") shall be determined according to the original tax basis of the shares of the enterprise being spun-off (hereinafter referred to as "old shares") that have been given up if the old shares have to be partially or entirely given up. If the old shares do not have to be given up, the tax basis of the new shares may be determined according to either of the following two methods: the tax basis of the new shares to be determined as zero; or the tax basis of the old shares to be reduced according to the ratio of the spun-off net assets against the total net assets of the enterprise being spun-off and the amount of reduction to be evenly allocated to the new shares.

Where the parties involved in the restructuring do not have to recognise the gain or loss from the relevant assets transfer corresponding to the equity payment temporarily, the gain or loss arising from the assets transferred corresponding to the non-equity payment shall still be recognised in the transaction period, and the tax basis of the relevant assets shall be adjusted accordingly.

Gain or loss arising from assets transferred corresponding to the non-equity payment = (Fair value of assets being transferred — Tax basis of assets being transferred) x (Non-equity payment / Fair value of assets being transferred).

4. Financing of acquisitions

4.1 Thin capitalisation

According to the prevailing PRC FIE laws and regulations, an FIE should comply with the following minimum registered capital, which is expressed as a percentage of the total investment. This relationship between the total investment and registered capital is often referred to as the debt-to-equity ratio.

Total investment (TI) (USD)	Minimum registered capital
Less than 3 million	70% of TI
Between 3 and 10 million	Higher of 2.1 million or 50% of TI
Between 10 and 30 million	Higher of 5 million or 40% of TI
More than 30 million	Higher of 12 million or 33 1/3% of TI

Moreover, the new CIT law contains a specific "thin capitalisation" rule to disallow interest deductions on borrowings from related companies if the interest-bearing loans of the enterprise exceed certain prescribed "safe-harbour" debt-equity ratios, which have been jointly addressed by the "MOF" and "SAT" of Caishui [2008] No.121.

The salient points of Circular 121 can be summarised as below:

a. There are two prescribed debt / equity ratios-one for enterprises in the financial industry and the other one for non-financial enterprises. The former is set at 5:1, while the latter at 2:1. Where the ratio of debt from related parties to the equity exceeds the certain prescribed debt / equity ratio in a year, the interest expense pertaining to the debt from related parties shall not be deductible in that year (and no carry-forward to future years), except in situations where the criteria set out in Point (b) below is met. The prescribed ratio for enterprises in the financial industry is higher than that for non-financial enterprises as financial arrangements in finance industry have their particular features;

b. The excessive interest expense may still be deductible if an enterprise can provide documentation to support that the inter-company financing arrangements comply with the arm's length principle; or if the effective tax rate of the borrowing enterprise is not higher than that of the domestic lending enterprise;

c. If an enterprise carries on both financial business and non-financial business, it has to segregate the related party interest expenses between the two businesses on a reasonable basis; otherwise, it has to follow the prescribed debt / equity ratio for non-finance industry, i.e., the 2:1 ratio, in calculating its deduction threshold for related party interest expense;

d. The lending enterprise shall be subject to CIT on the full amount of interest income (including the non-deductible portion of the borrowing enterprise) in accordance with the relevant tax regulations.

4.2 Deductibility of interest

4.2.1 Stock deal

Under the new CIT law, an interest expense incurred in respect of a loan used to acquire an investment or stock shall be capitalised and is not deductible for tax purposes.

4.2.2 Asset deal

As indicated in section 2.3, an asset deal generally involves the formation of a new company to acquire the relevant assets. In respect of a new company, interest incurred to acquire the relevant assets prior to the company commencing business should be capitalised and depreciated over the useful life of the assets for CIT purposes. Generally, once the relevant assets are put into use, any subsequent interest incurred is deductible.

5. Other structuring and post-deal issues

5.1 Repatriation of profits

Any after-tax profit remitted by a FIE to its foreign investors is subject to PRC withholding tax at 20% but with a possibility of exemption or reduction. The detailed implementation rule confirms that the withholding tax rate is reduced to 10%.

However, before an FIE may distribute dividends to its foreign investor, the FIE must meet the following conditions:

- the registered capital has been duly paid up in accordance with the provisions of its articles of association;
- the company makes profits (i.e. profits after covering the accumulated tax losses from prior years, if any);
- the company has paid PRC CIT, unless in a tax exemption period; and
- the statutory after-tax reserve funds (see below) have been provided for.

According to the PRC Equity Joint Venture Law, a foreign equity joint venture company is required to contribute its after-tax profit to statutory reserve funds before any after-tax profit may be distributed to its shareholders as a dividend. Components of the statutory reserve funds include the general reserve fund (GRF), staff benefit and welfare fund (SBWF) and enterprise development fund (EDF). The contribution rate to the SBWF, GRF and EDF is at the discretion of the board.

A wholly foreign-owned enterprise (WFOE) is only required to provide GRF and SBWF, and not EDF. However, the WFOE must contribute at least 10% of its after-tax profits to the GRF until the cumulative amount represents 50% of the registered capital.

In addition, a FIE is allowed to repatriate its after-tax profits as dividend payments in foreign currency upon the presentation of the following documents / certificates:

- the Board of Directors' resolution on distribution of profits;
- audit report issued by a Chinese CPA certifying the amount of distributable profits; and
- relevant tax payment certificates.

Generally, profit remitted as a dividend payment does not require the approval of SAFE, but may be made by the remitters through their basic foreign exchange accounts in a bank. The remittance amount may also be purchased from designated foreign exchange banks or swap centres by presenting the above documents and certificates.

5.2 Losses carried forward

Under the circular Caishui [2009] No.59, there are new restrictions for losses carried forward in M&A transactions:

- In the case of a merger not qualifying for special tax treatment, the unutilised tax losses of the enterprise(s) being merged will lapse and will not be available for use by the merged enterprise. Where special tax treatment is available to the qualified merger, the tax losses can be carried over to the merged enterprise. In order to deter the abusive use of tax losses by acquiring and merging a "loss-rich" company by a profitable company, a "ring-fencing rule" is included in the Restructuring Rules to limit the utilisation of losses on merger. Under the current "ring-fencing rule", the amount of tax losses of the enterprise(s) being merged that can be utilised by the merged enterprise in a given year is restricted by the following formula:

Fair value of the net assets of the enterprise being merged	×	Interest rate of the longest term treasury bonds issued by the State as at the end of the year of the merger

- In the case of a spin-off not qualifying for special tax treatment, the unutilised tax losses of the enterprise being spun-off have to remain in that enterprise and cannot be carried over to and utilised by the other spin-off enterprises. However, where the special tax treatment is available to the qualified spin-off, the unutilised tax losses of the enterprise being spun-off may be prorated and shared between all the spin-off enterprises according to the ratio of value of spun-off assets to the value of total value and used within the original expiry period.

5.3 Continuation of tax incentives

5.3.1 Phase-in of tax incentives and grandfathering of tax holidays

Per Guofa [2007] No.39, the new CIT regime no longer provides tax incentives based on investment status, location of registration / operation, etc. Instead, tax incentives are granted based on industry (i.e. high-tech) and available to both FIEs and domestic companies. Due to this, tax incentives granted under the old regimes (e.g. foreign investment) are to be passed out unless the company qualifies for tax incentives under the new CIT regime. Beginning 1 January 2008, companies which are currently enjoying an income tax rate of lower than 25% (the new statutory rate) under the old regimes will be raised to 25% gradually over five years as follows:

FEIT regime	CIT regime	Phasing-in of CIT rate
24%	25%	Change will take place on 1 Jan 2008
15%	25%	The rate will gradually increase in the following manner: 2008 18% 2009 20% 2010 22% 2011 24% 2012 25%

The above transition will not apply if the company obtains special status or is in special industry which qualifies for special CIT incentives under the new CIT regime.

Circular 39 also addresses the grandfathering treatment of unutilised tax holidays of the old regimes. For those companies which have already commenced their tax holidays before 2008, they can continue to enjoy the remaining unutilised tax holidays until expiry. For those companies which have not commenced their tax holidays before 2008 due to losses, their tax holidays are deemed to commence in 2008 and can be utilised until expiry.

For sake of clarity, Circular 39 has an appendix showing the types of tax incentives under the old regimes which qualify for the grandfathering treatment.

5.3.2 Tax holidays of merged and spun-off enterprises

Circular Caishui [2009] No.59 also addresses the treatment of the remaining tax incentives of the restructured enterprises in a merger or spin-off.

In an absorption merger, the surviving enterprise can continue to enjoy the unutilised preferential tax treatments brought forward prior to the merger provided that its entity nature and conditions for preferential treatments have not changed. The amount of tax benefits shall be based on the taxable income in the year prior to the merger. It will be zero if the enterprise was incurring losses.

With respect to the unutilised tax preferential treatment available to the enterprises prior to the spin-off, the surviving enterprise may continue enjoying its unutilised tax preferential treatment. However, the amount of tax benefit is limited to the multiple of the taxable income in the year prior to the spin-off and the ratio of assets of the surviving enterprise after the spin-off to the total assets prior to the spin off.

5.4 Group relief

China CIT applies on a separate legal entity basis. Unless otherwise approved tax groupings are not possible for companies in China.

6. Disposals

6.1 The preference of sellers: stock vs assets deal

As explained in section 2.1, the adoption of an asset deal or a stock deal for an acquisition in China largely depends on regulatory issues, as well as the commercial and tax objectives of the investors. In some cases, an asset deal may be the only option for selling the businesses by the seller (especially for SOEs) due to regulatory restrictions.

6.2 Stock disposal

6.2.1 Profit on stock disposal

Gains on the disposal of stock of a Chinese company are regarded as being sourced in China (China-sourced). Therefore, China's tax authorities have the right to tax such gains. When the proceeds are then repatriated to the locality in which the investor is a tax resident, the local tax authorities may impose further taxes on those same amounts. Depending on the income law of such locality, where there is double taxation, relief may be provided by local tax provisions or a double tax treaty (DTT) if that locality has concluded a DTT with China.

The following table provides an overview of the PRC tax treatment for a stock disposal by different types of investors.

Stock investment — tax on disposal gain

Type of the investor	Taxes	Shares in non-listed company	Shares in listed company		
			A-share	B-share	Non-tradable share
QFII	WHT	N/A	Not stipulated in current laws and regulations (may be taxable at 10%)	N/A	N/A
FE (other than QFII)	WHT	10% on net transfer gain	N/A	Not stipulated in current laws and regulations (may be taxable at 10%)	Not stipulated in current laws and regulations (may be taxable at 10%)
Foreign individual	WHT	N/A	N/A	Exempted	N/A
Domestic investor (including FIE)	CIT	25% on net transfer gain	25% on net transfer gain	N/A	25% on net transfer gain
Domestic individual	IIT	20% on net transfer gain	Exempted	Exempted	N/A

According to the PRC CIT law and detailed implementation rules, capital gain subjected to tax is calculated as follows:

Sales proceeds	—	(cost at acquisition + relevant taxes paid at the time of acquisition)

The major change from the old FEIT regime is that retained earnings in the entity being disposed is no longer a deductible item. Therefore, tax planning becomes important when acquiring and disposing investments.

6.2.2 Distribution of profits

Companies

Pursuant to the new CIT law and regulations, any FE which does not have an establishment or place in China but derives profit, interest and other income from sources in China, is subject to WHT generally at the rate of 10% (may be lower than 10% if eligible for tax treaty rate) on such income.

The Circular Guoshuihan [2008] No.897 addresses the WHT treatment on dividends derived from H-shares:

- The Chinese listed companies issuing H-shares have to withhold WHT at the rate of 10% on the distribution of dividends for 2008 and beyond to foreign corporate investors of H-shares; and
- If the foreign corporate investor is eligible for tax treaty rate (usually lower than 10%), it is allowed to apply for a refund on the overpaid WHT upon application and approval by the Chinese tax authorities.

The Circular Guoshuihan [2009] No.47 addressing the WHT treatment on dividends, bonus profits and interest derived by QFIIs from A-shares:

- The Chinese listed companies issuing A-shares have to withhold WHT at the rate of 10% on the payment of dividends (also bonus profits and interest) to QFII for 2008 and beyond;
- If the QFII is eligible for tax treaty rate (usually lower than 10%), it is allowed to apply for a refund on the overpaid WHT upon application and approval by the Chinese tax authorities.

Individuals

Foreign individual investors receive the same treatment as FEs regarding their stock disposals (i.e. exempt from WHT for trading gains derived from B-shares).

6.3 Asset disposal (companies only)

6.3.1 Profit on asset disposal

A valuation for state-owned assets is required for any PRC company involved in an asset transfer, exchange or mortgage procedure. The valuation should be adopted as the pricing basis for the asset disposal (see section 9.2).

Any gain arising from the sale of assets is included as taxable income for the seller and is subject to CIT. There is no PRC tax implications on the transfer of liabilities.

In addition, some of the fixed assets of the seller may have been imported into China free of customs duty and import VAT. For these import duty free assets, the Customs Office imposes a supervision period (generally, a period of five years). In the event that these assets are transferred within the supervision period, the relevant portion of the customs duty and import VAT based on the asset's depreciated value is required to be paid back before these assets can be sold or put to other use.

6.3.2 Distribution of profits

The tax treatment for distribution of profits as asset disposal is the same as share disposal as explained in section 7.2.2.

7. Transaction costs for seller

7.1 Corporate income tax

With respect to CIT, tax basis of transactions for the seller under a general reorganisation and special reorganisation is discussed in section 3.

7.2 Turnover taxes

- Stock disposal

  The disposal of stock is not subject to VAT and BT.

- Asset disposal

  Under the new VAT regime, in general the disposal of assets, other than land, buildings and certain intangibles, is subject to VAT at 17% for general VAT payers and 3% for small-scale VAT payers. However, for used equipment that was acquired by the seller before 1 January 2009 and not subject to VAT input credit at the time of purchase, an effective VAT rate of 2% is applicable on the transfer value.

  There could also be BT of 5% payable on the transfer of land, buildings or intangible assets such as technical know-how, trademarks etc.

7.3 Stamp Tax and other relevant taxes

- Stock disposal

  Stamp Tax is payable by both buyers and sellers on the disposal of shares (refer to section 2.4.2).

- Asset disposal

  Stamp Tax is payable by both buyers and sellers on the disposal of certain assets (refer to section 2.4.2).

  Land Appreciation Tax is imposed on the seller upon the transfer of land use rights and buildings and is assessed at a progressive rate from 30% to 60% of the appreciated amount of the land use right and buildings.

7.4 Concessions relating to M&As

Before the CIT regime, where a foreign corporate investor transferred its equity interest in a FIE to a 100% related enterprise, it was allowed to do so at cost for tax purposes, if the commercial-purpose test could be met under the former STA Notice-Guoshuifa [1997] No.207. The Chinese tax authorities would not challenge the transfer from a transfer pricing perspective; such virtually tax-exemption treatment facilitated the offshore disposal of the underlying Chinese business without any China tax implications. However, from 2008 this is no longer available under the new CIT regime.

Unlike the former tax regime, Special Tax Treatments are available only to the three specific types of cross-border corporate restructuring, unless otherwise specifically approved by MOF and STA. Out of the three specific types, there are only two relevant to foreign investors and FIEs, and they are both related to equity acquisitions only namely:

- Equity acquisition between non tax resident enterprise (“non-TREs”); and
- Equity acquisition between a non-TRE and a TRE.

Special Tax Treatments in the form of tax deferral rather than tax exemption, is available for the transfer of an equity interest in a FIE by a non-TRE (“non-TRE transferor”) to another non-TRE (“non-TRE transferee”). In addition to the prescribed 5 conditions in section 3, additional requirements are imposed on such cross-border equity acquisitions according to the Restructuring Rules, including:

- The non-TRE transferor should have a 100% direct ownership of the non-TRE transferee;
- The transfer should not result in changes in the withholding tax burden on the capital gains arising from the disposal of the TRE in the hands of the non-TRE transferee, as compared to that of the non-TRE transferor; and
- The non-TRE transferor undertakes not to transfer the equity interest of the non-TRE transferee within 4 years subsequent to the transfer of the FIE.

The restructuring rules impose much more restrictive criteria on cross-border equity acquisitions when compared to the usual tax-exemption treatment available under Circular 207.

8. Preparation of target for sale

8.1 Pre-deal planning

A foreign investor should view preliminary targets based on the following aspects before taking the first step to conducting a tax and regulatory due diligence review:

- Regulatory efficacy: Restrictions of the proposed investment under the current PRC laws and regulations;
- Funding options: Capital contribution requirement and financing options for the proposed investment project;
- Investment evaluation: Tax attributes and the possible business scope to be approved for the proposed investment;
- Exit strategy: Options for future disposal of the China investment and the related tax and regulatory considerations.

8.2 State-owned assets valuation

A valuation for the state-owned assets for the entities involved is required in any of the following situations:

- an entity, or a part of an entity, is restructured into a limited liability company or company limited by shares;
- the use of non-cash assets for investment purposes;
- a merger, division or liquidation;
- a change in the equity holding percentage of the original investors (except for listed companies);
- a transfer of all or a part of the ownership or equity of a company (except for listed companies); or
- an asset transfer, exchange or mortgage.

The entities required to obtain a valuation for the state-owned assets should engage specialised valuation agencies with relevant qualifications.

In addition, the entities conducting the transactions that require a valuation should use such valuation as the basis for pricing the transaction. In case the actual price has a difference of more than 10% compared to the valuation result, the entities should provide a written explanation for the price difference to the in-charge financial authorities (or the group company and other relevant authorities).

8.3 Anti-trust review

Investors are required to report an acquisition of shares or assets in certain circumstances. If an acquisition either

- involves strategic important industries;
- has or may have impact on state economic safety; or
- causes a transfer of actual controlling rights of a domestic enterprise which owns well-known trademarks or Chinese traditional brand names, the transaction must be reported to the authorities.

The authorities could deem the transaction invalid either if the relevant parties fail to report the transaction or they consider the transaction places a material impact on state's economic safety.

9. Listing / initial public offering (IPO)

The tax status of a company being listed and its subsidiaries is generally unaffected by listing / IPO.

9.1 Issue of new stock by listed company

The issue of new stock by the listed company results in a capital increase and therefore triggers stamp tax at the rate of 0.05% of the increased capital.

9.2 Disposal of stock by existing shareholders

If the listing / IPO involves the disposal of stock by existing shareholders, the tax position for those shareholders is as outlined in section 7.2.

Hong Kong

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1. Introduction

1.1 General comments on M&A in Hong Kong

A transfer of ownership can take the form of a share or asset transfer. Their different tax implications will be discussed later in this chapter. As Hong Kong company law does not include the concept of "merger", a business combination is generally implemented by way of the transfer of a business from one company to another, or by transferring the business of both companies to a third one.

The relevant taxes to be considered in the context of a M&A transaction are detailed below.

1.2 Corporate tax

General tax regime

Hong Kong imposes profits tax on a person carrying on a trade or business in respect of their assessable profit derived in Hong Kong. Capital gains and income not sourced in Hong Kong are not subject to profits tax. The rules apply equally to Hong Kong incorporated entities (generally limited liability companies) and foreign entities carrying on business in Hong Kong through a branch.

The principal forms in which a business may be conducted in Hong Kong are as follows:

- company incorporated in Hong Kong;
  - private
  - public (normally listed on the Stock Exchange of Hong Kong)
- branch of a foreign company;
- representative or liaison office of a foreign company;
- partnership; and
- unincorporated joint venture.

Private Hong Kong companies and branches of foreign companies are the business entities most commonly used by foreign investors, since limited liability is usually desirable. From a Hong Kong profits tax perspective, the choice between the two is neutral. Some investors may prefer to use a branch of a foreign company for the following reasons:

- it is not required to prepare audited accounts in Hong Kong;
- there is no Hong Kong stamp duty on the transfer of shares in a foreign country, unless the shares constitute Hong Kong stock (see section 1.5 below); and
- there may be a home country tax advantage for some foreign investors.

Tax rates

Starting from the year of assessment 2008/09, the profits tax rate for incorporated businesses is currently 16.5% while that for unincorporated businesses is 15%.

Taxation of dividends

Dividends whether received from a company in Hong Kong or from overseas are not subject to profits tax in Hong Kong.

1.3 Withholding tax

Withholding tax is only charged in respect of royalties or similar payments to a non-resident. The rate of withholding tax is either 4.95% or 16.5%. The higher rate applies where the payer and the payee are related and the intellectual property in question was previously owned by a person in Hong Kong. This rate of withholding tax may be reduced if the recipient of the royalty is entitled to the benefits of one of the 5 comprehensive double tax agreements to which Hong Kong is a party.

Except for the above, Hong Kong does not impose withholding tax on other payments such as dividends and interest.

1.4 GST / VAT

There are no GST / VAT or turnover taxes in Hong Kong.

1.5 Stamp duty

Stamp duty at progressive rates of up to 4.25% applies on conveyances of immovable property and is payable by each party to the contract equally (subject to any commercial negotiation). The rate for the transfer of Hong Kong stock, being shares the transfer of which is required to be registered in Hong Kong, is 0.2%. This is payable by the seller and purchaser equally (i.e. 0.1% each). The level of duty is computed by reference to the higher of consideration or the market value of the assets transferred.

There is an exemption from stamp duty (provided certain conditions are fulfilled), for a conveyance of an interest in immovable property or a transfer of Hong Kong stock, between companies with at least a 90% common shareholding. This exemption must be obtained by application to the Stamp Office supported by relevant documentary evidence.

The term “Hong Kong stock” generally means those shares or stock, the registry of which is maintained in Hong Kong.

1.6 Other relevant taxes

Property tax applies to the net assessable value of real property located in Hong Kong. However, if companies are subject to profits tax on income received from the property, property tax will not be applied.

Capital duty of 0.1% applies to increases in authorised share capital (capped at HK$30,000 per increase) of a company. In addition, should any shares be issued at a premium (i.e. an amount in excess of the par value), capital duty at the same rate will be applied to the premium.

2. Acquisition

2.1 The preference of purchasers: stock vs asset deal

From a tax perspective, a purchaser of a Hong Kong business may prefer an asset deal as this will allow for the re-setting of the tax base of depreciable assets as well as ensuring deductibility of interest on acquisition debt. However, there may be circumstances in which a stock deal results in lower tax transaction costs.

Tax considerations for each option are set out below.

2.2 Stock acquisition

A purchaser generally has a variety of considerations to bear in mind, apart from the basic commercial and financial implications of the chosen method of acquisition. Factors that may offset the usual concerns over the unknown liabilities, which may be locked in a company, include:

- losses that would be preferable to be preserved and utilised in the target company;
- real estate in the target company, which would result in a significantly higher stamp duty cost if an asset purchase takes place;
- potentially higher tax base for depreciable assets; and
- simplified transaction formalities (e.g. contracts previously entered into by the target company may remain undisturbed).

Tax losses carried forward

Tax losses may generally be carried forward indefinitely to offset against a company's future taxable profits. However there is a provision in the tax legislation that may restrict the carry forward of tax losses in the target company if the sole or dominant purpose of the change in shareholding of the company is to use up those losses. This provision is unlikely to be invoked for a commercially driven company acquisition / restructuring.

Unutilised tax depreciation carried forward

For Hong Kong profits tax purposes, tax depreciation in any one year must be calculated and will form part of the deductions from taxable profits taken into account in arriving at the taxable profit (or loss) for the year.

Tax incentives

There are no specific tax incentives that would be impacted by a change in ownership of the stock in the target company.

2.3 Asset acquisition

Subject to the fulfilment of certain statutory requirements, an asset acquisition generally enables the purchaser to avoid exposure to the risk of any historic tax liabilities that may not specifically be recoverable through the sale and purchase agreement. Liabilities associated with a company whose business is being sold remain the responsibility of the company and do not become the responsibility of the purchaser unless the parties contract to transfer specified liabilities to the purchaser.

An asset transaction may also allow the purchaser to step up the costs of the underlying business assets for tax depreciation purposes, although no tax deduction is available for goodwill.

- Tax losses carried forward

  Tax losses in the target company may not be transferred to the purchaser in an asset deal. However, the availability of tax losses may allow the seller and the purchaser to allocate a higher value more appropriate to the market value of items such as inventories and depreciable assets.

- Unutilised tax depreciation carried forward

  As indicated above, there is no concept of unutilised tax depreciation in Hong Kong.

- Incentives

  There are no specific tax incentives.

- Others

  One issue that purchasers should be aware of is that if the target company has claimed an exemption from stamp duty within two years, such duty will become payable on the target company ceasing to be a member of its former (90% or more) associated group as a result of change in share capital of the target company in the beneficial ownership of the associated group.

2.4 Transaction costs

2.4.1 GST / VAT

There is currently no GST / VAT or turnover taxes in Hong Kong.

2.4.2 Stamp duty

- Stock purchase

  The rate for the transfer of Hong Kong stock, being shares the transfer of which is required to be registered in Hong Kong, is 0.2% which is payable by the vendor and purchaser in equal proportions (i.e. 0.1% each).

  Exemption from stamp duty may apply for a conveyance of an interest in immovable property or a transfer of Hong Kong stock between companies with at least a 90% common shareholding if certain conditions are satisfied.

- Asset purchase

  Stamp duty at progressive rates of up to 4.25% applies on conveyances of immovable property, payable by each party equally (subject to any commercial negotiation).

  As above stamp duty is chargeable on the transfer of Hong Kong stock, the details of which are set out in section 1.5.

2.4.3 Concessions relating to M&As

Hong Kong has no specific concessions relating to M&A transactions.

2.4.4 Tax deductibility of transaction costs

In general, a business expense will be treated as being deductible in so far as it is incurred in the production of Hong Kong assessable profits. Whether or not certain transaction costs are deductible will therefore depend on a number of factors, including:

- whether the purchaser or seller is carrying on business in Hong Kong and derives income sourced in Hong Kong (note: dividends are generally not subject to profits tax in Hong Kong and expenses incurred in generating such dividend income are not tax deductible). Thus, costs incurred in connection with a share acquisition are normally not deductible;
- whether the purchaser or seller incurs the expenditure in producing such Hong Kong assessable profits; and
- whether the expenditure is capital or revenue in nature (capital expenditure is generally not tax deductible).

In general terms, the position can be summarised as follows:

- Finance costs

  Interest is only deductible in Hong Kong if it is incurred for the purposes of producing assessable profits and meets one of a number of specified conditions. Thus, interest paid on debt incurred for the purposes of acquiring shares (from which non-assessable dividends will be derived) is not tax deductible, whereas interest on debt incurred under an asset deal should prima facie be tax deductible (although see comments regarding restriction of interest deduction at section 4.2.2).

  Share dealers, venture capital and private equity funds which carry on business in Hong Kong should, however, be treated differently. They will normally be subject to profits tax on Hong Kong sourced profits from a share deal. However, they should be allowed a tax deduction for interest on debt used for acquiring such shares. Share dealers, venture capital and private equity funds which do not carry on business in Hong Kong would not be subject to tax on profits from the disposal of shares, and accordingly are not be able to obtain a tax deduction for any associated interest costs.

- Due diligence and other deal costs

  For share dealers, venture capital and private equity funds that carry on business in Hong Kong and derive Hong Kong assessable profits from "trading" of their investments, the due diligence and other deal costs should prima facie be deductible.

  On the other hand, if the due diligence and other deal costs are incurred in relation to the acquisition of a capital asset held for investment purposes, no deduction will be available.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

In a share acquisition, there will generally not be a change of tax basis for either the purchaser or the target company. However, as mentioned above, there are provisions in the legislation that may restrict the carry forward of unutilised tax losses in the target company if the sole or dominant purpose of the transfer is to utilise such losses.

As there is no tax consolidation or group relief regime in Hong Kong, profits and losses arising in different companies of the same group are dealt with separately and have to be carefully managed so as to minimise profits tax on a group basis.

3.2 Asset acquisition

In an asset acquisition, the purchaser is eligible to claim initial allowances (tax depreciation) in respect of qualifying capital expenditure incurred on the acquisition of plant and machinery items (at 60% of the acquisition cost). Annual allowances (at 10%, 20% or 30% depending on the nature of the asset) are also available each year on a reducing balance basis.

An initial allowance of 20% is available on qualifying capital expenditure incurred by the purchaser on the acquisition of a new industrial building or structure. Annual industrial building allowances and annual commercial building allowances are also available each year at 1/25th (i.e. 4%) of the qualifying capital expenditure. For the acquisition of a second-hand industrial building or structure and other commercial buildings or structures, the purchaser is only eligible to claim annual allowances on the original historic qualifying cost of the construction of the building (rather than the amount actually paid for it). The amount of annual allowances is subject to the age of the building.

Goodwill is not eligible for tax depreciation or deduction. A tax deduction is generally available to the purchaser on the acquisition of patent rights or technical know-how, notwithstanding that the expenditure incurred is of a capital nature. However, a deduction is not allowed where the transfer is made between associated parties.

In a transfer of a trade or business where the seller ceases to carry on the trade or business, the purchaser will normally receive tax basis on the inventory equal to the value of consideration (irrespective whether or not the parties are related) if the purchaser carries on the business of the seller. As a result the purchaser can claim a Hong Kong tax deduction for the cost of the inventory.

Typically, trade debtors are acquired at net book value. Where the amount subsequently received is equal to the net book value, no taxable profit or loss arises. If one of the debts proves irrecoverable (whether in full or in part), a tax deduction is not allowed to the purchaser for the debt which is not recovered.

4. Financing of acquisitions

4.1 Thin capitalisation

There are no formal debt-equity restrictions in Hong Kong. However, there are stringent conditions for the deductibility of interest, which may effectively restrict the use or method of overseas debt finance.

There are no regulatory consents that are required to approve the raising of finance, unless the debt in question is publicly marketable on the Hong Kong Stock Exchange.

4.2 Deductibility of interest

4.2.1 Stock acquisition

Interest on borrowings used to acquire shares is not deductible. This is because dividends received from a company are not chargeable to profits tax.

4.2.2 Asset acquisition

In the case of an asset acquisition, a Hong Kong profits tax deduction may be obtained for financing costs, provided certain conditions are met. In principle, interest on finance obtained from a Hong Kong or overseas financial institution is deductible, but interest on finance from a non-financial institution is generally only deductible if the interest is subject to Hong Kong profits tax in the hands of the recipient (unlikely in the case of interest payments to an overseas company). There are stringent anti-avoidance provisions that operate to deny a deduction for interest under "back-to-back" (or similar) arrangements with financial institutions. There are further conditions that permit a deduction in certain circumstances for interest paid on loans to solely finance the acquisition of inventory and fixed assets, and on debentures and marketable instruments.

Due to the interest deduction restrictions on intra-group financing for asset acquisitions, complex structures have been developed which may achieve the effect of an interest deduction for offshore finance, although at the increasing risk of being challenged by the tax authorities.

5. Merger

Hong Kong company law does not include the concept of a "merger". However, a merger may be achieved by a transfer of trade and assets, either from one company to another company, or by transferring the trade and assets of both companies to a third company. See section 4.2.2 on asset acquisitions.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

Repatriation of profits via dividends is tax-free as Hong Kong does not assess dividends to profits tax and there is no withholding tax on dividends.

6.2 Losses carried forward and unutilised tax depreciation carried forward

Losses may be carried forward and utilised in future years. Losses may not be carried backward and offset against assessable income from prior years. Note that losses incurred by a partnership are treated differently.

6.3 Tax incentives

Hong Kong has no tax incentive regimes for M&A transactions.

6.4 Group relief

Hong Kong does not have group relief for members of the same group. This means that losses may not be transferred to other group members for utilisation.

7. Disposal

For the Hong Kong and foreign-based investor alike, investments in Hong Kong (either in a target company or new company to which the target company's assets have been transferred) are often structured through a holding company in a tax haven or low tax jurisdiction, such as the British Virgin Islands. In the absence of withholding taxes or tax on capital gains, this involves no additional Hong Kong tax cost, and may provide flexibility for stamp duty planning. Some investors also believe that such a structure mitigates political risk.

Profits derived from the sale of a long-term investment, such as the interest in an associated company or a subsidiary company, should not be taxable in Hong Kong.

A seller will be concerned to ensure that no Hong Kong or overseas tax arises in respect of the disposal, other than tax that can be sheltered using existing tax losses. In suitable situations, pre-sale restructure should be considered.

A buyer will be mainly concerned with structuring the investment (and minimising Hong Kong and overseas taxes on exit), financing the investment, and the different transaction costs of the alternative routes. Careful planning from the outset should assist in maximising the buyer's rate of return on the acquisition.

7.1 Preference of sellers: stock vs asset deal

Subject to the clawback of any tax depreciation allowances previously claimed and the impact of stamp duty, a Hong Kong seller of a Hong Kong company will often be neutral over whether to sell the company's shares or assets, as gains on both shares and capital assets should generally not be taxable, while the distribution of retained profits after an asset sale is similarly non-taxable. However, the following issues should also be considered:

- the issue of what constitutes a capital asset has been the subject of many court decisions in Hong Kong. Thus, it is prudent to ascertain the true nature of such asset before deciding on the type of deal; and
- a non-Hong Kong seller will also have foreign tax considerations to take into account. Many investments into Hong Kong are made through holding companies based in low tax jurisdictions, in which case a share disposal may be preferred if the capital gains derived from the disposal of the holding company may be treated more advantageously under the tax legislation of the ultimate owner's home tax jurisdiction.

7.2 Stock sale

7.2.1 Profit on sale of stock

Profit on the sale of stock is normally treated as a capital gain which is not taxable. Unless as indicated in section 7.1, the business of the seller is one of trading in stock, in which case the profits should be regarded as trading profits.

7.2.2 Distribution of profits

Profits may be distributed tax-free as there is no withholding tax on dividends.

7.3 Asset sale

One issue that a seller should be aware of in an asset deal is the apportionment of consideration, particularly in relation to assets qualifying for tax depreciation. For such assets, where the consideration received exceeds the tax written down value, a taxable "balancing charge" (limited to allowances previously claimed) will arise to the seller. Conversely, where the tax written down value exceeds the consideration, a deductible balancing allowance will arise to the seller. Therefore, the seller will generally seek to minimise the allocation of consideration to those assets which have been depreciated over a shorter period for tax purposes than for accounting purposes, thereby minimising the amount of clawback of any taxable balancing charge. Where the seller has tax losses, the reverse may apply, especially since the purchaser will in turn inherit the higher tax bases for future depreciation purposes.

The following points may also be noted in relation to asset valuations:

- real estate should be transferred at market value, otherwise the value for stamp duty purposes may be challenged;
- the tax authorities have the power to deem the transfer of assets between connected persons for tax purposes at market value;
- subject to consideration of general anti-avoidance rules, inventory may be assigned at any chosen value (irrespective of whether the parties are connected persons or not), provided the transfer results from a cessation of business and the purchaser can claim a Hong Kong tax deduction for the inventory cost. Otherwise, market value should apply; and
- an asset purchase that involves a substantial payment for goodwill, which as previously noted is not tax deductible, may dilute future accounting earnings (subject to compliance with applicable GAAP).

7.3.1 Profit on sale of assets

As mentioned previously, whether the profit on the sale of assets will be assessable will be determined by whether the asset is of a capital or revenue nature. Where it is the former and there is merely a realisation of an investment, then the profits should not be taxable.

7.3.2 Distribution of profits

Profits can be distributed tax-free as there is no withholding tax on dividends.

8. Transaction costs for seller

8.1 GST / VAT

There are no GST / VAT or turnover taxes in Hong Kong.

8.2 Stamp duty

Please refer to section 2.4.2 which sets out the stamp duty applicable on the transfer of Hong Kong stock and immovable property in Hong Kong.

8.3 Concessions relating to M&As

There are no concessions relating to M&As.

8.4 Tax deductibility of transaction costs

Please refer to section 2.4.4.

9. Preparation of target for sale

9.1 Stock sale

In relation to a stock sale, there are no specific actions that a vendor should take. As the purchaser is likely to undertake due diligence, the vendor may wish to review the tax compliance status of the company to ensure that there are no "surprises" uncovered by the purchaser during due diligence that may adversely impact the sale price.

9.2 Asset sale

Provisions against (and write-offs of) trade debts are tax deductible only by the company which recorded the corresponding sale. The company to which trade debtors are transferred cannot obtain a tax deduction for a subsequent provision or write-off. Thus, bad debts should be fully provided for by the transferor company before the transfer is made.

A tax deduction claim for a provision against (or write-off of) debts immediately prior to the transfer may be challenged by the tax authorities on the basis that the charge merely represents a (non-deductible) capital loss arising from the revaluation of an asset in contemplation of the business disposal. A company which regularly and fully provides for bad debt risks, irrespective of a potential business disposal, may be able to rebut this argument.

10. De-mergers

Hong Kong has no specific regime for de-merging a business to shareholders.

11. Listing / initial public offering (IPO)

The sale of the stock of a Hong Kong company (or foreign company) to the public is subject to the same tax considerations as a private sale. Potential vendors should carry out proper tax due diligence to ensure that the offering memorandum or other public documents comply with Hong Kong Securities and Futures Exchange rules and Companies Ordinance and fairly represents the tax liabilities or potential tax exposures in the target company.

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1. Introduction

1.1 General information on M&A in India

The Economic Survey 2008-09 released by the Ministry of Finance, Government of India notes that despite the global financial crises, India has still registered a growth rate of 6.7%. The economy continues to face wide ranging challenges — from improving its social and physical infrastructure to enhancing productivity in agriculture and industry and addressing environmental concerns. At the same time, the Indian economy has shock absorbers that will facilitate early revival of growth.

India has taken the next step towards structural changes in direct taxes by releasing a draft of the proposed new Direct Tax Code (DTC) for public debate. The proposed DTC will replace the existing Income-Tax law upon enactment. The principal aim of the DTC is to moderate tax rates, remove exemptions and simplify tax laws in line with international tax principles. Debate and discussions are expected on the DTC between now and the winter session of Parliament when the Government intends to introduce a Bill in the Parliament. The new Code is proposed to come into force on 1 April 2011.

The Government of India is planning to implement a dual Goods and Service Tax (GST) model during financial year 2010-11. Such implementation will be one of the major reforms in indirect taxation wherein the taxes such as Excise duty, Service tax, Value Added Tax (VAT), Central State Tax (CST) and other local taxes such as Entry Tax are subsumed under GST.

A limited liability partnership (LLP) is a new form of business entity created by enactment of the Limited Liability Partnership Act, 2008. A LLP is a body corporate formed and incorporated under the LLP Act. It is a legal entity, separate from its partners, with perpetual succession. Any change in the partners of the LLP shall not affect the existence, rights or liabilities of the LLP. Under the LLP Act a LLP enjoys the beneficial features of incorporated bodies without having the disadvantages of normal partnerships. A LLP is easy and inexpensive to incorporate.

1.2 Direct taxes

1.2.1 Introduction

In India, the tax year is the fiscal year, i.e. from 1 April to 31 March. Income tax is an annual tax on income. Income of the previous year is chargeable in the following assessment year at the rates applicable to that assessment year. This rule is however subject to some exceptions.

The amount of income tax payable is calculated by charging income tax on the taxable income called ‘total income’ at prescribed rates and applicable surcharge. Income tax and surcharge are further increased by 3% (i.e. 2% education cess and 1% secondary and higher secondary education cess).

Surcharge is payable at 10% (2.5% for non Indian companies) for companies with income over INR 10 million.

Taxable income is computed after adding certain disallowances, such as book loss on sale of assets and miscellaneous expenditure written off, and reducing certain allowances / benefits from book profits.

Provisions of computation of taxable income are governed by the Income-tax Act, 1961 (IT Act). However, tax rates are fixed by the Annual Finance Act and not by the IT Act.

All income accruing or arising in India is taxable in India. A resident of India is liable for tax on their worldwide income subject to double tax relief provided under either the domestic law or a relevant double taxation avoidance agreement. A non-resident Indian (NRI) is only subject to India tax on income sourced or received in India.

1.2.2 Individual tax — residents / not ordinary residents and non residents

Maximum effective rate of tax is 30.9% (30% plus cess of 3%). Surcharge of 10% is abolished for individuals and firms by the Finance (No. 2) Act, 2009.

1.2.3 Firms and LLP tax

Maximum marginal tax rates for firms is reduced from 33.99% to 30.90% on account of removal of surcharge. As per the amendment in the Finance (No. 2) Act, 2009, a firm includes a LLP. Thus, all provisions applicable to a firm apply to an LLP as well. Accordingly a LLP will be taxed at the entity level and income of partners of LLP is exempt from tax.

1.2.4 Corporate tax

The corporate income tax rates for a domestic company and a foreign company are as follows:

Company	Where taxable income exceeds INR 10 Million	Other cases
Domestic company	33.99% (30% plus surcharge of 10% plus education cess of 3%)	30.9% (30% plus education cess of 3%)
Foreign company	42.23% (40% plus surcharge of 2.5% and education cess of 3%)	41.2% (40% plus education cess of 3%)

1.2.5 Minimum alternate tax

With the object of bringing zero tax companies under the tax net, Minimum Alternate Tax (MAT) of 15% (plus the applicable surcharge and education cess) of book profits is levied on companies whose tax payable under normal income tax provisions is less than 15% of book profits. MAT is not applicable to developers of special economic zones and units therein.

The effective MAT rate is as follows:

Company	Where taxable income exceeds INR 10 Million	Other cases
Domestic company	16.995%	15.45%
Foreign company	15.836%	15.45%

A credit of tax paid under MAT provisions by a company with effect from financial year 2005-06 is allowed against the tax liability which arises in the subsequent 7 years (Finance (No. 2) Act, 2009) under the normal provisions of the IT Act.

MAT is payable on the following income, otherwise exempt under the IT Act:

- Long-term capital gains from the sale of listed equities through the stock exchange or units of equity oriented mutual funds;
- Income of undertakings set up in special trade zones and Software Technology Park (STP) units claiming exemption under Section 10A of the IT Act;
- Income of export-oriented undertakings claiming exemption under Section 10B.

1.2.6 Dividends

Dividend income is exempt. However, a Dividend Distribution Tax (DDT) is levied on companies declaring dividends. The effective DDT rate is 16.995% (15% plus 10% surcharge and education cess of 3%). An exemption from DDT is granted for profits of Special Economic Zone (SEZ) developers.

Any dividend received by a domestic company (C1) during any financial year from its subsidiary (C2) is allowed to be deducted from the dividend to be declared / distributed / paid by C1 for the purpose of the computation of DDT, provided that the dividend received by C1 had been subjected to DDT by C2. Further, it is provided that C1 should not be a ‘subsidiary’ of any other company.

1.2.7 Capital gains

Any gain on the sale of assets is subject to tax at rates depending on the duration of ownership. The rates are as follows:

Particulars	Resident	Non-residents
(a) Short term capital assets other than (b) below (Note 1)	Normal corporate / individual tax rates	Normal corporate / individual tax rates
(b) Short term capital assets which are listed shares and units of equity oriented funds which have been charged to Securities Transaction Tax (STT)	15%	15%
(c) Long term capital assets which are listed shares in a company or units of an equity oriented fund, which have been charged to STT	Exempt	Exempt
(d) Other long term capital assets	20% (10% without indexation*)	20% (10%**)

A surcharge and education cess, as applicable, is also levied

* *Applicable only for listed shares sold off-market*

** *Various judicial precedents indicate that even non-residents are entitled to a beneficial tax rate of 10% in respect of the sale of listed securities or units or zero coupon bonds not charged to STT*

Note: A Short-term capital asset is one which is held for not more than 36 months (12 months in the case of shares, listed securities, units of mutual funds and zero coupon bonds).

Indexation of the cost of acquisition and improvement of a long-term capital asset of any nature (other than debentures) is available to residents. However, the benefit of indexation is available to non-residents only on long-term capital assets other than shares / debentures in an Indian company acquired in foreign currency.

1.2.8 Fringe Benefit Tax

Fringe Benefit Tax (FBT) has been abolished by the Finance (No. 2) Act of 2009. As a consequence, the fringe benefits shall be taxed in the hands of employees.

1.2.9 Banking Cash Transaction Tax

Banking Cash Transaction Tax (BCTT) has been abolished by the Finance Act 2008 with effect from 1 April 2009.

1.2.10 Wealth tax

Wealth tax is charged in respect of the net wealth as at 31 March every year (referred to as the 'valuation date'). Wealth tax is charged both to individuals and companies at the rate of 1% of the amount by which the 'net wealth' exceeds INR 3 million (Finance (No. 2) Act, 2009). The term 'net wealth' broadly represents excess of prescribed assets less debts. Prescribed assets include a guest house or residential house, motor cars, jewellery-bullion-utensils of gold and silver, etc., yachts, boats, aircraft, urban land and cash. A debt is an obligation to pay a certain sum of money incurred in relation to those assets, which are included in the 'net wealth'.

1.2.11 Tax losses

Business losses (other than unabsorbed depreciation) are allowed to be carried forward for set off against future business income for a period of eight years. Unabsorbed depreciation is allowed to be carried forward without any time limit and can be set off against any income (other than salary income).

The change in ownership of a 'widely held' company through a share acquisition does not affect the carry forward and setoff of unabsorbed business losses within the permitted period. However, a change in ownership of a closely held company beyond 49% results in the lapse of unabsorbed business losses.

The above restriction is not applicable where the acquired company is a subsidiary of a foreign company and at least 51% of the shareholders of the parent foreign company continue as shareholders of the amalgamated or resulting foreign company under a scheme of amalgamation or de-merger.

In case of restructuring by way of amalgamation or de-merger, subject to fulfilment of specified conditions, the accumulated business loss and unabsorbed depreciation of the amalgamating company or the accumulated business loss and unabsorbed depreciation of the de-merged company directly relatable to the undertaking being transferred, as the case may be, is deemed to the business loss or depreciation of the amalgamated company or the resulting company, as the case may be.

1.2.12 Securities Transaction Tax

STT is payable on purchase or sale of equity shares, derivatives and units of an equity-oriented fund on a recognised stock exchange, as well as on the sale of units of an equity-oriented fund or a mutual fund. STT is imposed on the value of taxable securities transactions.

Transaction	Payable by	Rate
Delivery based transactions Purchase / sale of an equity share in a company or unit of an equity oriented fund	Payable both by the purchaser and seller on the transaction value	0.125%
Non-delivery based transactions in equities or units of an equity oriented fund	Seller	0.025%
Sale of an option in securities	Seller	0.017%
Sale of an option in securities, where the option is exercised	Purchaser	0.125%
Sale of futures in securities	Seller	0.017%
Sale of units of an equity oriented fund to the mutual fund	Seller	0.25%

The transaction value is determined as follows:

Option in securities — option premium
Option in securities where option is exercised — settlement price
Futures — traded price
Other securities — purchase / sale price

STT is collected by the recognised stock exchange and paid to the Government.

1.2.13 Commodities Transaction Tax

Commodities Transaction Tax (CTT) was abolished by the Finance (No. 2) Act of 2009.

1.2.14 Thin capitalisation

India does not have formal thin capitalisation rules for tax purposes. However, it does have provisions to disallow an interest deduction which relates to exempt income.

1.2.15 Tax consolidation

A tax consolidation regime allows wholly-owned groups of companies, together with eligible trusts and partnerships, to consolidate for income tax purposes. As there is no tax consolidation or group relief in India, profits and losses arising in different companies of the same group are dealt with separately and cannot be consolidated so as to minimise profits tax on a group basis.

1.2.16 Controlled foreign company

India does not have specific controlled foreign company legislation; thus there is no difference in the treatment of subsidiaries in low-tax or high-tax jurisdictions.

1.2.17 Direct Tax Code

The Direct Tax Code (DTC) has shifted the basis of taxability to financial year and is likely to come into effect from financial year 2011 — 2012.

Tax rates

- Tax rates for individuals are proposed to be revised to a maximum of 30%
- Partnership firms including LLPs will be taxed at a maximum marginal rate of 30%, with the partner's share not taxable in their hands
- Tax rate for companies (both domestic and foreign) is proposed to be reduced to 25%
- Domestic companies will continue to be liable to DDT at 15%
- Profits of Indian branches of foreign companies is additionally subject to branch profits tax at 15%

Minimum alternate tax

- The base for computing MAT is proposed to be shifted from 'book profits' to 'gross assets'
- The rate of MAT is proposed to be 2% on all companies (except for banking companies for which it is proposed to be 0.25%)
- MAT will be a final tax and will not be available as a tax credit in subsequent years

Capital gains

- All capital gains are taxable at normal rates of tax, removing the benefit of lower tax for long term capital gains
- Gains on the transfer of business capital assets as well as slump sale are taxable as business income
- With the proposed abolition of STT, exemption / lower tax for capital gains tax on the sale of shares on the stock exchange is withdrawn
- Fair market value substitution date is shifted to 1 April 2000

Wealth tax

- Wealth tax is proposed to be only on individuals, Hindu undivided family and private discretionary trusts
- No wealth tax is applicable to companies

Carry forward of losses

- Loss of a specified business / special source are allowable only against subsequent years' profits of the same business / source
- Capital losses cannot be set off against any other income
- Losses can be carried forward indefinitely
- Losses of unlisted public companies are not to lapse even on change in shareholding of 49% or more

International tax

- General Anti Avoidance Rules (GAAR) are proposed to be introduced in order to discourage tax avoidance
- GAAR empowers the Commissioner of Income-tax (CIT) to declare an arrangement voidable if it has been entered into with the objective of obtaining a tax benefit and lacks commercial substance
- GAAR overrides applicable Double Taxation Avoidance Agreements (DTAAs)
- The arrangements covered by GAAR include round trip financing, lifting of the corporate veil, etc.
- Provisions of treaty or the DTC whichever is later in time shall prevail

Transfer pricing

- The Code seeks to bring about certain far reaching changes within the Indian transfer pricing regime such as, retention of safe harbour provisions, introduction of advance pricing agreement and thin capitalisation measures

Amalgamation

- Amalgamation to include amalgamation of unincorporated bodies with companies
- Amalgamation is restricted to mergers between residents only
- Conditions of owning an industrial undertaking for allowing the carry forward of losses of the transferor company are removed
- In addition to business losses and unabsorbed depreciation, capital losses are allowed to be carried forward

De-merger

- The Code considers de-merger between residents only
- Requirement of business continuity for a period of five years is introduced
- The successor needs to hold at least 3/4ths of the book value of fixed assets acquired for a period of five years

Slump sale

- Entire sales consideration will be liable to tax under the head business income
- The acquirer of a business may not be able to claim enhanced tax base for the assets acquired on the basis of consideration paid

Other provisions

- Indirect transfer of capital assets situated in India would also be construed as income “deemed to accrue” in India
- Company to be treated as resident of India if place of control and management situated wholly or partially in India at any time during the year.

1.3 Indirect taxes

1.3.1 Value Added Tax

State level sales tax was replaced by Value Added Tax (VAT) with effect from 1 April 2005 in the majority of Indian states.

- Under the VAT regime, the VAT paid on goods purchased from within the State is eligible for a VAT credit. The input VAT credit can be utilised against the VAT / Central Sales Tax (CST) payable on the sale of goods. A cascading effect of taxes is thus avoided and only the value addition is taxed.
- CST has been reduced from 4% to 2%. However, CST continues to co-exist with the State VAT. Inter-state procurement, on which central sales tax is charged by the originating State is ineligible for an input tax credit. Further, inter-state branch / consignment transfers are exempt from CST provided that a declaration in a specific form is submitted and the transfers are also not eligible for an input tax credit. However, certain states allow an input tax credit in excess of 4% on inter-state stock transfers.
- There is no VAT on imports into India. Exports are zero rated. This means that while output exports will not be chargeable to VAT, inputs purchased and used in the manufacture of export goods are refunded.
- Turnover thresholds have been prescribed so as to keep out small traders from the ambit of VAT. A turnover tax may be levied on such small traders in lieu of the VAT.
- VAT registered dealers need to issue serially numbered invoices with prescribed particulars.
- The periodicity of filing of VAT returns is as per State VAT acts.
- A comprehensive self assessment of VAT has been introduced.
- Turnover taxes, surcharges, additional surcharges and the special additional tax have been abolished.

The Finance Minister has reaffirmed the commitment of the Central Government in accelerating the introduction of the Goods and Services Tax (GST) during the financial year 2010-11 and has commended the work done by the Empowered Committee of State Finance Ministers in preparing the design of the dual GST. GST is a comprehensive Value Added Tax on the supply of goods and services. First discussion paper on GST was made public in the month of November 2009 providing broad contours of proposed GST. The dual GST will comprise the Central GST and the State GST that the centre and state will each legislate, levy and administer the Central GST and the State GST respectively. The implementation of GST is a welcome move which will simplify the current indirect tax regime in India and will help to mitigate, if not eliminate the issue of double taxation on various transactions encompassing both the supply of goods and the provision of services.

1.3.2 Stamp duty

Stamp duty is levied at various rates on documents such as bills of exchange, promissory notes, insurance policies, contracts affecting the transfer of shares, debentures, and conveyances for the transfer of immovable and movable property.

Stamp duty is not imposed on the transfer of shares held in the dematerialised mode. However, transfer of shares held in physical form attracts stamp duty generally at 0.25% of market value. Stamp duty is levied on the transfer of immovable property at rates varying from state to state.

Generally, stamp duty is levied by respective states as per the Indian Stamp Act, 1889, whereby each state has modified the Schedule to that Act. Certain states also have their own standalone stamp laws.

1.4 Entity options in India

A foreign company looking at setting up operations in India has the following options for formulating its entry strategy:

1.4.1 Entry strategy 1: operating as an Indian company

Option 1 Wholly owned subsidiary	A foreign company can set up a wholly owned subsidiary company in India for carrying out its activities. Such subsidiary is treated as an Indian resident and an Indian company for all Indian regulations (incl. Income Tax Act, Foreign Exchange Management Act (FEMA) and Companies Act), despite being 100% foreign owned. At least two members for a private limited company and seven members for a public limited company are mandatory.
Option 2 Joint venture with an Indian partner, preferably with majority equity participation	Though a wholly owned subsidiary has been the most preferred, foreign companies have also been formed in India by forging strategic alliances with Indian partners. The trend in this respect is to choose a partner who is in the same field / area of activity and has sufficient experience and expertise in the relevant line of business.

1.4.2 Entry strategy 2: operating as a foreign company

Option 1 Liaison office	Setting up a liaison or representative office is common practice for foreign companies seeking to enter the Indian market. The role of such offices is limited to collecting information about the possible market and providing information about the company and its products to prospective Indian customers. Such offices act as 'listening and transmission posts' and provide a two-way information flow between the foreign company and the Indian customers. A liaison office is not allowed to undertake any business activity other than liaison activities in India and cannot, therefore, earn any income in India, in terms of the approval granted by the Reserve Bank of India (RBI).
Option 2 Project office	Foreign companies planning to execute specific projects in India can set up temporary project / site offices in India for this purpose. RBI has granted general permission to a foreign entity for setting up a project office in India, subject to fulfilment of certain conditions. The foreign entity only has to furnish a report to the jurisdictional regional office of RBI giving the particulars of the project / contract.
Option 3 Branch office	Foreign companies engaged in manufacturing and trading activities abroad can set up branch offices in India for the following purposes, with the prior approval of the RBI: • Export / import of goods • Rendering professional or consultancy services • Carrying out research work in which the parent company is engaged • Promoting technical or financial collaborations between Indian companies and the parent or overseas group company • Representing the parent company in India and acting as its buying / selling agent in India • Rendering services in information technology and development of software in India • Rendering technical support to the products supplied by parent / group companies • Foreign airline / shipping company In general, manufacturing activity cannot be undertaken through a branch office. However, foreign companies can establish branch office / unit for manufacturing in a SEZ subject to fulfillment of certain conditions.

1.5 Foreign ownership restrictions

1.5.1 Foreign direct investment

During the first half of 2009, India received an estimated USD 13.1 billion in Foreign Direct Investment (FDI) inflows, which is a 40% decrease as compared to the same period in 2008. The amount of FDI inflows from April 2009 to June 2009 was USD 7 billion.

The advantage of India as an investment destination rest on strong fundamentals which include a large and growing market; world-class scientific, technical and managerial manpower; cost effective and highly skilled labour; abundant natural resources; a large English speaking population; and an independent judiciary. This is now recognised by a number of global investors who have either already established a base in India or are in the process of doing so. Ongoing initiatives such as further simplification of rules and regulations improvement of infrastructure are expected to provide the necessary impetus to increase FDI inflows in future.

Under the current FDI framework, foreign investment is permitted from all categories of investors and in all sectors except —

- Citizens / entities of Pakistan and Bangladesh
- Certain sectors, namely:
  - Atomic energy
  - Lottery business / gambling & betting
  - Agriculture (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture / acquaculture and cultivation of vegetables and mushrooms under controlled conditions and services related to agriculture and allied sectors)
  - Plantations (excluding tea plantation)
  - Retail trading (other than single brand retail)
  - Chit fund businesses
  - Nidhi companies, trading in transferable development rights
  - Activities / sector not opened to private sector investment
  - Real estate business (excluding construction development projects — including housing, commercial premises, reports, educational institutions, recreational facilities, city and regional level infrastructure and townships)

For other sectors, there are two approval routes for foreign investment in India:

- Automatic route under delegated powers exercised by the Reserve Bank of India (RBI)
- Approval by the Government through the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance

These are discussed in brief below.

1.5.2 Automatic route

FDI is permitted under the automatic route (i.e. without requiring prior approval) for all items / activities except the following:

Where the foreign entity has an existing venture / tie-up in India in the same field ('same field' means the same 1987 National Industrial Classification code) as at 12 January 2005, with the exception of the following cases, which do not require prior FIPB approval:

- investment by a venture capital fund registered with the Securities and Exchange Board of India (SEBI)
- existing joint venture has less than 3% investment by either party
- existing joint venture is defunct or sick

Proposals falling outside notified sectoral policy / caps or sectors in which FDI is not permitted.

1.5.3 FIPB route

In all other cases of foreign investment, where the project does not qualify for automatic approval, as above, prior approval is required from the FIPB.

The decision of the FIPB is normally conveyed within 30 days of submitting the application. The proposal for foreign investment is decided on a case-by-case basis depending upon the merits of the case and in accordance with the prescribed sectoral policy.

Generally, preference is given to projects relating to high priority industries, the infrastructure sector, export potential, large-scale employment opportunities, linkages with the agro sector, social relevance, projects involving infusion of capital or induction of technology.

1.5.4 Downstream investment

Downstream investments by foreign owned Indian holding companies are treated the same as FDI guidelines. Prior approval of the FIPB is required to act as a holding company.

Domestic funds cannot be leveraged by the foreign owned Indian holding company for downstream investments.

1.5.5 Investment by way of acquisition of shares

Acquisitions may be made from an existing Indian company which is either a privately held company or a company in which the public are interested (i.e., a company listed on a stock exchange), provided a resolution to this effect has been passed by the board of directors of the Indian company.

Acquisition of shares of a public listed company are subject to the guidelines of the Securities Exchange Board of India (SEBI). SEBI's takeover regulations require that any person acquiring 15% or more of the voting capital in a public listed company must make a public offer to acquire a minimum 20% stake from the public.

Foreign investors looking at acquiring equity in an existing Indian company through stock acquisitions can do so without obtaining approvals except in the financial services sector, provided:

- Such investments do not trigger the takeover provisions under the SEBI's Substantial Acquisition of Shares and Takeover Regulations 1997; and
- The non-resident shareholding complies with sectoral limits under FDI Policy after the transfer.

Press Note 3 (2009) prescribes prior approval from FIPB for the transfer of ownership or control from a resident to a non resident (directly or through an Indian company owned or controlled by non residents) in sectors and activities which either have a FDI cap or require prior FIPB approval.

As per RBI valuation norms, the acquisition price should not be lower than the:

- Prevailing market price, in case of listed companies; and
- Fair Market Value as per Controller of Capital Issues (CCI) valuation guidelines, in the case of unlisted companies.

1.5.6 Investment by Foreign Institutional Investors

A registered Foreign Institutional Investor (FII) / SEBI approved sub-account of FII may, through SEBI, apply to RBI for permission to purchase the shares and convertible debentures of an Indian company under the Portfolio Investment Scheme.

FIIs are permitted by the RBI to purchase shares / convertible debentures of an Indian company through registered brokers on recognised stock exchanges in India. They are also permitted to purchase shares / convertible debentures of an Indian company through private placement / arrangement.

The total holding by each FII / SEBI approved sub-account of FII cannot exceed 10% of the total paid-up equity capital or 10% of the paid-up value of each series of convertible debentures issued by an Indian company. Further, the total holdings of all FIIs / sub-accounts of FIIs put together cannot exceed 24% of paid-up equity capital or paid-up value of each series of convertible debentures. This limit of 24% may be increased to the specified sectoral cap / statutory ceiling, as applicable, by the Indian company concerned by passing a Board of Directors resolution followed by sanction of the shareholders through a special resolution to that effect.

It is permissible for an Indian company to issue equity shares against lump-sum fee and royalty in convertible foreign currency already due for payment / repayment, subject to meeting all applicable tax liabilities and procedures.

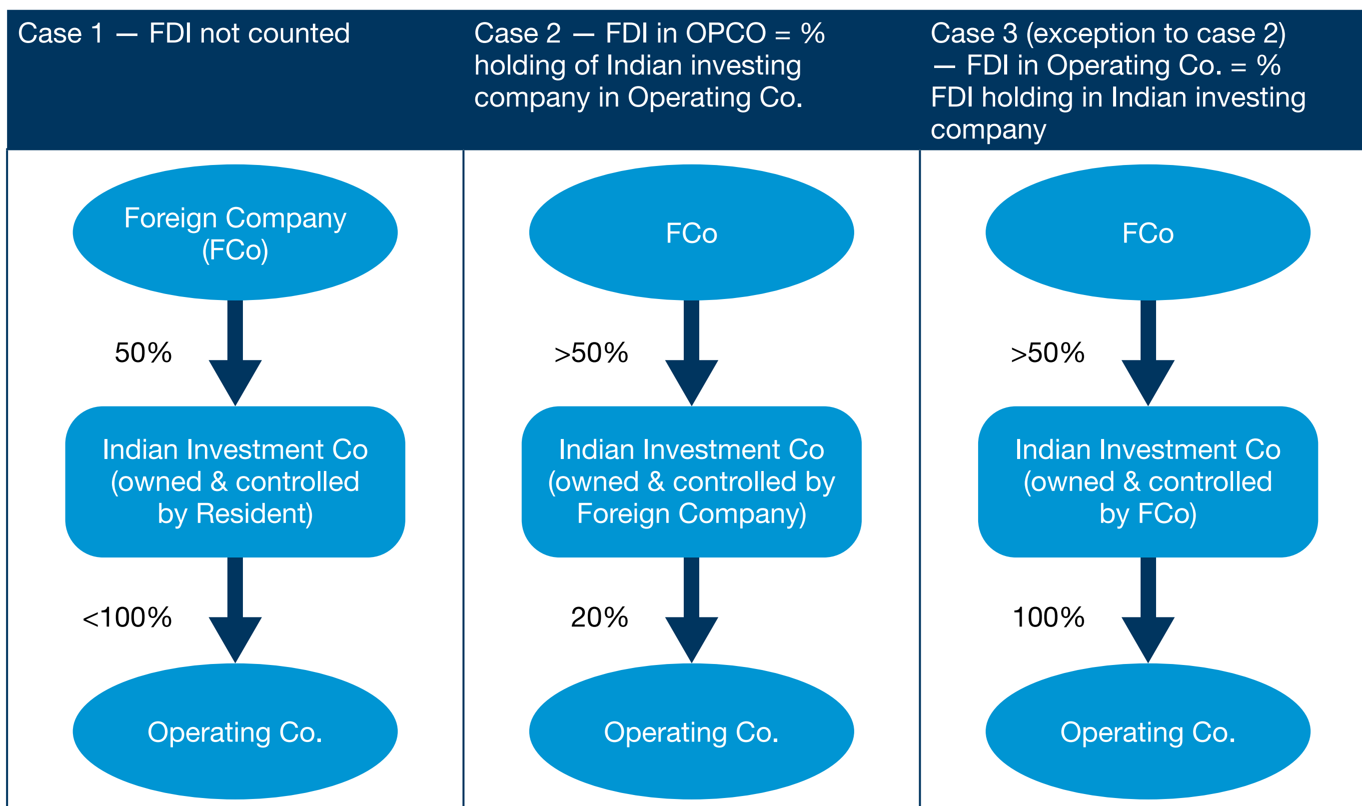
1.5.7 Inbound investment

In an attempt to make FDI norms consistent and transparent, the Department of Industrial Policy and Promotion through Press Notes 2, 3 and 4 of 2009, issued guidelines for the computation of foreign holdings in Indian companies, linking approvals to the concept of control for the first time.

Press Note 2 prescribes the methodology for computing the total foreign investment where:

- All investment directly by a non-resident entity into the Indian operating company will be counted towards foreign investment;
- Indirect foreign investment include all types of foreign investment in the Indian investing company, namely FDI, non-resident Indians (NRIs) and portfolio investment by FII / NRIs, American Depository Receipts / Global Depository Receipts, Foreign Currency Convertible Bonds, Convertible Preference Shares / Convertible Debentures and Foreign Venture Capital Investors. However, NRI investments made on non-repatriation basis will not be counted as FDI for this purpose;

- Calculation of indirect foreign investment in Indian operating companies is illustrated in the following charts:



- For the purposes of the computation, an Indian investing company is deemed to be:
  - owned by a resident, if the resident beneficially owns more than 50% of the equity interest in the Indian investing company, either directly or through Indian companies.
  - controlled by a resident if such resident (either directly or through Indian companies owned and controlled by residents) have the power to appoint the majority of Directors.
- Methodology for computation of foreign investment does not apply to sectors which are governed specifically by a separate statute such as insurance sector;
- The guiding principle of Press Note 4 is that downstream investments by companies 'owned or controlled' by non resident entities are required to follow the same norms as direct investment. While prior approval from FIPB is required for FDI in pure investing companies (irrespective of the amount of FDI), FDI in operating cum investing companies will only need to adhere to sectoral FDI norms.

2. Structuring a share deal

2.1 Seller's perspective

2.1.1 Profit on sale of shares

Gains derived from the transfer of shares in Indian companies are subject to tax in India at the rates prescribed previously as capital gains (see section 1.2.7).

For the purpose of computing the capital gains tax liability of a non resident, the cost of acquisition, expenses incurred in connection with the transfer and consideration receivable for the transfer are required to be converted in the foreign currency utilised for the purchase of such capital asset and the resultant capital gain reconverted into INR.

However, no capital gains tax is imposed on the transfer of shares in Indian companies by one foreign company to another in a scheme of amalgamation or de-merger, if at least 25% of the shareholders of the amalgamating company (at least 75% of the shareholders in de-merged company) continue to remain as the shareholders of the amalgamated company (resulting company in case of de-merger) and the transfer is exempt from capital gains tax in the country where the amalgamating company / de-merged foreign company is incorporated.

2.1.2 Distribution of profits

Distribution of profits will depend on the form of the business entity of the target company. In a corporate entity, Indian Company Law regulations require a maximum retention up to 10% of the profits prior to distribution of dividends except in the case of liquidation. Under the existing laws, the company distributing dividend of the balance of the profits after the retention of the amount required under the Indian Company Law regulations has to pay dividend distribution tax at an effective rate of 16.995%.

The balance may be distributed to the shareholders by way of a dividend without any withholding tax because dividends under the existing laws are not taxed in the hands of the shareholders.

2.2 Buyer's perspective

2.2.1 Acquisition structure

In a share deal, the cost of the assets may not be revalued. Further, in the case of the acquisition of a listed company, the acquirer has to comply with the Takeover Code regulations which, inter alia, make it mandatory for the acquirer to make an open offer to the public shareholders of the acquired company to purchase their holding, if the buyer proposes to acquire 15% or more in the target company.

Acquisition through an overseas intermediate company (with substance) located in Mauritius or Singapore can be considered because of preferential tax treatment with regard to capital gains tax under the respective treaties at the time of exit.

This remains the most preferred method of acquisition and it is also cost effective as compared to an asset deal because of stamp duty implications.

2.2.2 Funding costs

Under the existing tax regime, it is preferable to treat financing costs incurred in acquiring shares as a part of the cost of acquisition, because such costs are not tax deductible against the dividend income which is exempt from tax in the hands of the shareholders.

2.2.3 Acquisition expenses

The acquisition expenses directly related to a share purchase are allowed to be added to the cost of the shares and are eligible for a tax deduction in determining capital gains on sale.

2.2.4 Debt / equity requirements

There are no prescribed debt-equity ratios, which are generally driven by commercial considerations.

2.2.5 Preservation of tax losses

The benefit of tax concessions, incentives and carry forward of prior years' tax losses is not lost in a share deal involving the acquisition of a company, except in the case of a company in which the public is not substantially interested to the extent indicated under section 1.2.11.

2.2.6 Repatriation of profits

Repatriation of profits in a share deal can only be made by paying a dividend. The tax implications, both for the company distributing the dividend and the shareholders, have been dealt with under sections 1.2.6 and 2.1.2.

Stock dividends (on equity shares) in the form of bonus shares are not taxable in the hands of the recipient. However, the entire consideration received on any subsequent sale of such shares is subject to capital gains as the cost of acquisition of such shares is considered to be nil.

3. Structuring an asset deal

3.1 Seller's perspective

3.1.1 Profit on sale of assets

In the case of depreciable assets, the income tax written down value of the block of assets (ITWDV) is reduced by the consideration received from the sale and consequently depreciation at the rate applicable to the block of assets is allowed on the reduced ITWDV. If the consideration receivable for the transfer of the assets exceeds the ITWDV, the excess is considered to be a short-term capital gain and subjected to tax at the corporate tax rate applicable to the entity. In the case of non-depreciable assets, the short-term capital gain is taxed at the corporate tax rate applicable to the entity whereas the long-term capital gains computed (after allowing indexation benefits and substitution of the cost price as at 1 April 1981 if purchased prior to that date) attracts capital gains tax at 20% plus applicable surcharge and cess.

In the case of self-generated intangible assets, the cost of acquisition is generally taken as nil.

For the purpose of computing the capital gains tax liability, the valuation adopted by the registration authorities for the levy of stamp duty in connection with the transfer of immovable property should be adopted if it is more than the consideration receivable for the transfer of the immovable property.

Non-compete fees payable to the seller for not starting / competing in the business which they have transferred, is deemed to be business income and charged at the full rate of 33.99%.

The seller is liable to VAT / sales tax on movable property at appropriate rates depending on whether it is an inter-state or intra-state sale.

'Slump sale' refers to the transfer where an undertaking is transferred at a lump-sum consideration without values being assigned to the individual assets and liabilities in such sales. Any consideration in excess over the 'net worth' arising from the slump sale is chargeable to long-term capital gain tax where the undertaking is held for more than three years, otherwise it is treated as a short-term capital gain.

The term 'net worth' is the excess of book assets (for depreciable assets, ITWDV is used) over the value of liabilities of the undertaking transferred. The net worth computation requires authentication by a chartered accountant.

3.1.2 Distribution of profits

Distribution of profits will depend on the form of the business entity of the target company. In a corporate structure, it can be distributed by way of dividends. The tax implications for both the company distributing the dividend and the shareholders are dealt with under sections 1.2.6 and 2.1.2.

3.2 Buyer's perspective

3.2.1 Acquisition structure

In an asset deal, the acquirer may opt to buy the assets of the company for a slump price and, based on a valuation report, allocate the purchase price properly to the respective assets to ensure the maximum benefit on account of depreciation and amortisation allowed under the tax laws.

It should be kept in mind that the buyer is liable for stamp duty on the transfer of immovable property at a rate which varies from state to state.

The purchase of assets of an Indian company by a foreign company requires the permission of the regulatory authorities unless the purchase is routed through an Indian subsidiary of the foreign company.

3.2.2 Funding costs

If the assets are acquired through an existing Indian subsidiary engaged in business, the interest on loan taken for the acquisition of the assets is considered as a tax-deductible expenditure to the Indian company.

3.2.3 Acquisition expenses

The acquisition expenses directly related to the purchase of the assets will be added to the cost of the assets and be eligible for depreciation allowance in the case of depreciable assets. For non-depreciable assets, such costs are eligible for a tax deduction when the assets are sold.

3.2.4 Cost base step up

In an asset deal, the acquirer may choose to buy the assets of the company for a slump price and based on a valuation report allocate the purchase price to the respective assets to ensure maximum benefit on account of depreciation allowance and amortisation allowed under the tax laws.

This may be resisted by the seller due to adverse current income tax implications.

3.2.5 Treatment of goodwill

Goodwill arising from an asset deal cannot be amortised by the buyer to claim tax benefits. However, the benefit of the cost of acquisition is available on subsequent disposal. Currently, the cost of intangible assets (such as know-how, patents, copyrights, trademarks, franchises or any other business / commercial rights of a similar nature) can be depreciated at the prescribed rates. Consideration should therefore be given to identify and allocating proper values to intangible assets.

3.2.6 Other matters

An asset deal normally attracts stamp duty (potentially significant) at rates varying from state to state on the transfer of immovable property which the acquirer has to bear.

There are various legal precedents which suggest that no VAT is applicable on a slump sale of an undertaking.

4. Concessions relating to M&As

Any transfer, unless specifically exempted, attracts capital gains tax. However, subject to conditions, specified reorganisation schemes, such as amalgamations or de-mergers are exempted from the levy of such tax.

4.1 Amalgamations

Specified conditions in the case of an amalgamation of one or more companies into one includes all assets and liabilities of the amalgamating companies becoming assets / liabilities of the amalgamated company and the shareholders holding 75% of the share value in the amalgamating companies becoming shareholders of the amalgamated company.

4.2 De-mergers

A 'de-merger' refers to the transfer, according to a scheme of arrangement under the Indian Companies Act, by a de-merged company of one or more of its undertakings to any resulting company in such a manner that all the assets and liabilities being transferred by the de-merged company become the property of the resulting company and appear in the books of the de-merged company and the resulting company issues, in consideration of the de-merger, its shares to the shareholders of the de-merged company on a proportionate basis.

Moreover, the shareholders holding at least 75% in value of the shares in the de-merged company become shareholders of the resulting company and the transfer of the undertaking is on a going concern basis.

4.3 Amortisation of the amalgamation / de-merger expenses

In computing taxable income, the reorganisation expenses on account of amalgamation / de-merger is amortised at 20% per annum over a five year period.

4.4 Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance

4.4.1 Amalgamation

Subject to certain conditions, the accumulated tax loss / unabsorbed depreciation of an amalgamating company engaged in an industrial undertaking / ship / hotel / banking / operation of an aircraft business (restricted to public sector company) shall be considered deemed tax loss / depreciation of the amalgamated company provided:

- the amalgamating company that has brought forward tax losses / depreciation has been engaged in that business for at least three years and has continuously held (as on the date of the amalgamation) at least 75% of the book value of fixed assets for two years prior to the date of amalgamation; and
- the amalgamated company holds at least 75% of the book value of fixed assets of the amalgamating company as well as continuing with the business for five years, besides adhering to certain other prescribed conditions.

For this purpose, 'industrial undertaking' means any undertaking which is engaged in:

- the manufacture or processing of goods; or
- the manufacture of computer software; or
- the business of generation or distribution of electricity or any other form of power; or
- the business of providing telecommunications services, whether basic or cellular, including radio paging, domestic satellite services, network of trunking, broadband networks and internet services; or
- mining; or
- the construction of ships, aircrafts or rail systems.

4.4.2 De-merger

In the case of a de-merger, the accumulated losses and unabsorbed depreciation directly relatable to the undertaking being transferred is allowed to be carried forward and set off in the hands of the resulting company. If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, it shall be apportioned between the de-merged company and the resulting company in the same ratio in which the value of the assets have been transferred. In the case of a de-merger, there are no restrictions of the type of 'industrial undertaking' to be transferred.

5. Exit route

The exit route, through a share deal, is the transfer of the shares of the Indian company. The tax implications are detailed in section 2.1.1. As mentioned there, in the case, that shares are held by an entity in Mauritius or Singapore, there is a possibility of availing the capital gains exemption, provided that the conditions stipulated in the respective treaties / circulars of the tax authorities, etc. are complied with. Buy-back of shares, where the funds are drawn from the company, or court approved capital reduction, are also popular routes to provide partial or full exits.

The transfer of shares of an offshore holding company can also be considered, however there is a potential risk of the entire sale consideration being held as taxable in India on account of the controversy triggered by the tax authorities in Vodafone's case, where the indirect transfer of a controlling interest in an Indian company by one non-resident to another non-resident through an overseas transaction was attempted to be brought to tax in India.

The exit route, in the case of an asset deal, is the transfer of the assets. The tax implications are detailed under section 3.1.1.

6. Ending remarks: preparation for a deal

The considerations of the buyer and seller will depend on the facts of each case. The buyer should weigh the possibility of increasing the asset base through an asset acquisition against high stamp duty, loss of unabsorbed losses and depreciation, and recapture of past capital allowances. The buyer should ensure that the acquisition is structured in a manner which will result in improving shareholder value and optimising return on investments. At the same time, the seller will have to consider the structure from current and future tax perspectives.

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1. General information on M&A in Indonesia

With a population of over 220 million people and significant natural resources, Indonesia represents both a significant market and potential supplier to the world economy. The Indonesian Government officially welcomes both domestic and foreign private investment. Over the past several years, the Government has progressively sought to liberalise the local rules governing foreign investment.

Indonesia is in the midst of a serious effort to promote foreign investment, capital accumulation and the export of goods other than oil and gas to expedite economic development and to become internationally competitive. A broad range of deregulatory measures has been implemented, and additional measures can be expected to further enhance the investment climate.

Indonesia's economy has shown resilience in weathering the global financial crisis with the economy growing 4.1% in the first half of 2009, aided by robust domestic consumption.

The Indonesian Rupiah, one of the best performing currencies in the region, appreciated 9% against the US Dollar during the first half of 2009. The Central Bank has cut the benchmark interest rate, currently at 6.75%, by 275 basis points since December 2008 in response to weaker inflation. The lower rate is aimed at boosting credit expansion and supporting recovery in the domestic market.

The positive economic climate and the increase in transaction activity on the Indonesian stock market were underpinned by peaceful political conditions throughout the recent presidential election in which the incumbent President Yudhoyono secured his second term in office.

During the first half of 2009, there were 143 deals announced with a total estimated value of US$3.2 billion compared to 169 deals announced with a total value of US$4.1 billion in the second half of 2008, a decline in deal value of around 20%.

Key deals completed in the first half of 2009 include:

- Acquisition of an 88.89% stake in PT Bank Ekonomi Raharja Tbk by HSBC Asia Pacific Holdings (UK) Ltd.
- Acquisition of an 85.13% stake in PT Bentoel Internasional Investama Tbk., a national cigarette company, by British American Tobacco PLC (BAT).
- Acquisition of PT Darma Henwa (a mining contractor), PT Fajar Bumi Sakti and PT Pendopo Energi Batubara (both coal mining companies) by PT Bumi Resources Tbk.

2. Indonesian tax system

2.1 Tax reforms

The Indonesian Parliament approved amendments to the Income Tax Law in 2008 and has recently passed amendments to the Value Added Tax Law (the VAT Law). The new VAT Law has became effective from 1 April 2010.

The passing of the new VAT Law concludes the 2008 / 2009 tax reforms. However, various regulations implementing the amended laws will still need to be issued by the Government. Developments in implementing these regulations should be monitored closely by business players as well as potential new investors in Indonesia.

2.2 Corporate tax

Indonesian companies are subject to tax on their worldwide income. A non-resident of Indonesia is, however, only subject to Indonesian tax on their Indonesia sourced income.

The corporate tax rates are as follows:

Year	Tax rate
2009	28%
2010 onwards	25%

Certain business sectors (e.g. drilling and shipping) are to use the deemed net taxable profit basis in calculating their corporate income tax while others (e.g. construction services) are subject to a final income tax on revenue which represents the only income tax due on the revenue concerned.

Companies listed on the Indonesia Stock Exchange that meet certain criteria are entitled to an income tax rate reduction of 5%, i.e. to 23% in 2009 and 20% from 2010.

2.3 Withholding tax

The Indonesian tax system relies heavily on a withholding tax mechanism for tax collection purposes.

Certain payments made by a resident taxpayer or the Indonesian permanent establishment (PE) of a foreign company to another corporate or individual resident taxpayer or another Indonesian PE are subject to withholding tax at the following rates:

Nature of payment	Withholding tax rate[1]
Dividends	0% / 10%[2] / 15%
Interest	15%
Royalties	15%
Prizes / awards	15%
Rental fees	2%[3] / 10%[4]
Fees for services	2%

[1] Of the gross amount payable
[2] Payment to individual tax resident
[3] Assets other than land / buildings
[4] Land / buildings (final tax)

Such withholding tax typically constitutes prepaid tax for the income recipients which may be credited against the corporate income tax ultimately payable at year end. Exceptions are withholding tax on bank interest and bond interest, the income tax withheld from which constitutes final income tax.

Certain payments made by a resident taxpayer or the Indonesian PE of a foreign company to a non-resident which does not have an Indonesian PE are subject to withholding tax at the following rates:

Description	Non treaty rate[1]	Treaty rate[1]
Dividends	20%	10% to 20%
Interest	20%	0% to 15%
Royalties	20%	0% to 15%
Branch-profit tax	20%	10% to 20%
Insurance / Reinsurance premiums	1 / 2 / 10%	—
Fees for services	20%	—[2]

[1] Of the gross amount payable
[2] Exceptions are fees for technical, management, and consulting services payable to residents of Switzerland, Germany, Luxembourg and Pakistan which are subject to withholding tax at 5%, 7.5%, 10% and 15% respectively

At present, Indonesia has signed tax treaties with more than 50 countries.

2.4 Taxation of dividends

Dividends received by an Indonesian corporation from other Indonesian corporations are assessable at the normal income tax rate. However, such dividends will not be subject to tax if all the following conditions are met:

- the dividends are paid out of retained earnings; and
- the recipient corporation holds at least 25% of the paid-in capital in the dividend-paying corporation.

For the taxation of dividends payable to non-resident parties, please refer to section 2.3. Dividends are non-deductible to a payer for corporate income tax purposes.

2.5 Tax losses

Losses may be carried forward for a maximum of five years. However, for a limited category of businesses in certain regions, the period may be extended up to ten years. Losses are not permitted to be carried backwards. Indonesia does not have continuity of ownership or continuity of business tests that operate to restrict tax loss utilisation. In general, one company's tax losses may not be transferred to another company.

2.6 Other taxes

2.6.1 Value Added Tax

Value Added Tax (VAT) is imposed on importers, providers of most goods and services, and users of intangible goods and services originating from outside Indonesia or within Indonesia. The rate of VAT is currently 10%. VAT on the export of goods from Indonesia is zero-rated. From 1 April 2010, the export of services from Indonesia will also be zero-rated.

2.6.2 Luxury Sales Tax

Luxury Sales Tax is imposed once only, upon the delivery or sale of specified luxury goods by a manufacturer or upon importation. The rates of tax range from 10% to 200% depending on the type of goods.

2.6.3 Stamp duty

Only nominal stamp duty is payable, at either IDR6,000 (US$0.60) or IDR3,000 (US$0.30) on certain documents, such as letters of agreement, proxy letters, statement letters and notarial deeds.

2.6.4 Land and Buildings Tax

Land and Buildings Tax is payable annually on land and buildings and permanent structures. The effective rate is generally not more than 0.3% per annum of the value of the property.

2.6.5 Income tax on land and building transfers

The sellers of land and buildings are required to pay income tax of 5% which is computed on the transfer value or the value forming the basis of the land and buildings tax, whichever is higher.

The tax payable represents a final income tax, thus it cannot be treated as prepayment of corporate tax liability.

2.6.6 Duty on the acquisition of land and building rights

Acquisition of land and building rights is subject to 5% duty, which should be paid by the purchaser. The duty payable may not be claimed as credit and therefore represents an additional cost of such an acquisition. The duty payable on the acquisition of title to land and buildings is extended to acquisitions made via inheritance or as part of a business merger, consolidation or expansion. The contractual date of a business merger, consolidation or expansion is considered to be the due date for the payment of such duty.

2.7 Tax issues relating to mergers

The transfer of assets in a business merger, consolidation or expansion must be accounted for at market value. However, the transfer of assets at book value may be allowed for certain qualifying mergers, consolidations or expansions. This will result in no gain or loss on the transfer. To benefit from this concession, certain criteria such as the "business purpose test" must be met and a specific approval must be obtained from the Directorate General of Tax.

The business purpose test for mergers includes the following:

- The surviving entity is the entity that has no losses or the smallest losses (losses means fiscal or commercial losses);
- The purpose of the merger is to create strong business synergy and capital structure, instead of tax avoidance;
- The business of the liquidating and surviving entities is to be carried on by the surviving entity for the next five years;
- Assets received by the surviving entity will not be transferred for at least two years from the effective date of the merger.

The transfer of assets in a merger will attract 10% VAT. However, from 1 April 2010, if the merging companies are VAT entrepreneurs (i.e. taxpayers subject to VAT), the transfer of VATable goods between merging companies will be VAT exempt.

Merging companies can apply for a 50% reduction for duty on the acquisition of land and building rights.

2.8 Thin capitalisation regime

There is no thin capitalisation regime in Indonesia. However, interest payable to related parties not determined on an arm's length basis may result in the tax authority denying a portion of the interest expense as a deduction.

The Ministry of Finance is currently drafting a thin capitalisation regime to limit interest costs. The regulation is expected to be issued soon.

3. Business forms

3.1 Common forms of business entity

The following are the common forms of business enterprises in Indonesia:

- Corporation

  A corporation is the most common form of business enterprise in Indonesia. As an investment vehicle, a corporation is regulated by the 2007 Limited Liability Company (PT Company) Law. Being a legal entity distinct from its shareholders, a PT Company is taxed as a separate entity.

  Where foreign investor(s) hold shares in a PT Company, such a company is referred to as a foreign investment company (PMA). Otherwise, it is a domestic investment company.

- Partnership

  Partnerships are normally used by professionals, such as accountants and lawyers, as a vehicle to conduct their business. A partnership is taxed in respect of its income as a single entity while partnership profit distribution to partners is not taxable in the hands of the partners (and not tax deductible to the partnership). Please note that a partnership is not available to foreign residents.

- Joint operation

  As an unincorporated cooperation between two or more legal entities, this vehicle is commonly used in the telecommunications business and for running public works or governmental foreign aid-funded projects. As far as income tax is concerned, a joint operation is a flow-through entity. However, wherever applicable, it is a taxable entity for VAT.

- Branch

  Foreign corporations are allowed to register branches in Indonesia only in exceptional circumstances. It is, however, the most common vehicle for foreign investors engaged in the oil and gas drilling sector, the construction sector, and the oil and gas sector by virtue of production sharing contracts.

  Except for joint operations, all the entities above are subject to corporate income tax in respect of their income.

3.2 Foreign ownership restrictions

A foreign investor may acquire shares in an existing PMA or convert a locally-owned company to a PMA. The acquisition of such a company is permitted as long as the proposed business activities of the company are open for foreign investment.

There are various restrictions on foreign investment which are dependent on the type and nature of activity undertaken. Four broad categories of business restrictions exist:

- Business closed to all investors including local investors, for example, harmful chemical production;
- Business open only to domestic investors, for example, natural forest concessions and radio / television broadcasting services;
- Business where a foreign investor may be a joint venture party, for example shipping, electricity production, transmission and distribution;
- Business open to all investors but subject to certain restrictions, for example, aquaculture and wood pulp industries.

The types of activities listed in each of the above categories are extensive. These are contained in what is referred to as the negative list of investment. Foreign investors should therefore enquire as to the foreign investment rules governing the appropriate sectors of their investments before embarking on any merger or acquisition deal in Indonesia.

A foreign investor may own 100% of the shares in an Indonesian company where there is no foreign ownership restriction in such a company's business, for example distribution, wholesale, business and management consulting. However, such companies must be owned by two or more shareholders. Although there is no specific indication of the required percentage (except for certain specific business sectors), a transfer of at least a nominal proportion of equity (divestment) by the foreign investor to an Indonesian party or parties is required within 15 years (note that this requirement is currently a grey area).

4. Structuring a share deal

4.1 Seller's perspective

4.1.1 Profit on sale of shares

There are a number of considerations surrounding a share (or stock) acquisition by an offshore entity. The sale of shares in an unlisted Indonesian company by a non-resident attracts withholding tax of 5% of the gross proceeds due to the vendor. However, the vendor may be protected from this tax under a tax treaty. It should be noted that where the seller is a resident of Australia or Singapore, Indonesia's tax treaties with Australia and Singapore do not provide for such an exemption.

It should also be noted that under new anti-avoidance rules, the sale of shares in a company resident in a tax haven which holds shares in an Indonesian company (directly or indirectly) can effectively be deemed as a sale of Indonesian shares with a corresponding tax liability arising.

Any capital gain on the sale of unlisted shares by resident corporations is treated as ordinary income and subject to corporate tax at normal corporate tax rates.

The transfer of shares listed on an Indonesian stock exchange are subject to final tax of 0.1% of gross proceeds (0.6% for founder shares).

The sale of shares is likely to be the preferred approach for the seller, as this tax liability is an one-off income tax on the profit on disposal. In many cases, offshore elements are introduced into share transactions so as to further limit the Indonesian tax on disposal. Note however that Indonesia recently introduced an anti-avoidance rule on this type of transaction which has had the result that the sale of an offshore company resident in a tax haven country may be treated as the sale of an Indonesian company and subject to 5% final income tax if the offshore company being sold directly / indirectly has a subsidiary or PE in Indonesia.

4.1.2 Stamp duty

Only nominal stamp duty is payable on the issue of shares — IDR6,000 per document.

4.2 Buyer's perspective

4.2.1 Acquisition structure

Most share acquisitions are structured as direct investments from outside Indonesia. The acquirer generally seeks to hold Indonesia Target Companies through a company located in a country which has entered into a double tax treaty agreement with Indonesia so as to minimise dividend withholding tax and / or capital gains tax. The choice of a suitable jurisdiction will depend on the acquirer's own tax considerations and the extent of its operations in the preferred holding jurisdictions.

Note that the Directorate General of Tax is now focusing on beneficial owner issues on passive income such as dividends, and has issued regulations implying that special purpose vehicles, conduit companies and pass-through companies located in tax treaty countries cannot enjoy the tax treaty benefit. The regulations require an Indonesian Tax Office Certificate of Domicile form to be completed by the foreign income recipient and endorsed (stamped) by the Competent Authority of the foreign country. The regulations also require the foreign taxpayer to fulfil certain anti-tax treaty abuse criteria. These criteria are potentially difficult to meet and must be considered in the investment structure.

4.2.2 Financing costs

Interest paid on borrowing to finance a share acquisition must satisfy the normal tests for deductibility. Where a local corporate taxpayer uses borrowing to finance a share acquisition, interest would not generally be deductible because any dividends received would not be taxable (refer to section 2.4 above).

Interest on borrowing used to finance equity investment or to participate in rights issues is deductible by way of capitalisation to the share investment, i.e. increase of the cost base.

4.2.3 Equity structure

The minimum authorised capital requirement is IDR50 million and the minimum paid-up capital is 25% of the authorised capital. The minimum allowable foreign investment may be determined by the investors on the basis of the type and scale of the business. It may comprise both debt and equity.

4.2.4 Preservation of tax losses, tax depreciation and tax incentives

A change in ownership of the shares of a company does not alter the depreciation allowances claimed by the company or its carry-forward tax losses. There is no facility for stepping up or increasing the assets value to reflect the purchase price. The acquisition of shares in a tax loss company in theory provides flexibility in loss utilisation because of the lack of provisions on continuity of ownership or business.

4.2.5 Unpaid taxes of the acquired company

Unpaid taxes or unrecorded liabilities of the company being acquired remain with the company. It is generally recommended to obtain warranties and indemnities from the seller to meet unknown and undisclosed tax and other liabilities.

5. Structuring an asset deal

5.1 Seller's perspective

5.1.1 Profit on sale of assets and goodwill

Capital gains derived by a company on the transfer of goodwill and assets are taxed as ordinary income and (after utilising any carry-forward tax losses) are subject to income tax at the corporate rate of 28% (25% from 2010). The transfer of land and / or buildings will attract final income tax of 5% of the proceeds, hence no more corporate tax on capital gains or losses is to be accounted for in the transferor's annual income returns.

5.1.2 VAT

The transfer of assets is subject to 10% VAT. Specific concessions may be available, for example, where the transferor company is a company not required to be registered for VAT purposes.

5.1.3 Stamp duty

Only nominal stamp duty is payable on the asset transfer agreement.

5.2 Buyer's perspective

5.2.1 Selection of acquisition vehicle

An asset acquisition or transfer is subject to the approval of various government departments including the Investment Coordinating Board (BKPM). The acquisition of assets may be effected either by an existing subsidiary company or through a newly established Indonesian entity.

Generally, an asset acquisition is preferred in Indonesia because of the difficulties in determining the undisclosed liabilities (such as tax) of the target. For fiscal years up to 2007, the Indonesian Tax Office can initiate a tax audit and issue tax assessments within ten years of the end of the relevant tax year but no later than 2013. For fiscal years 2008 onward, the time limit has been shortened to five years.

The legal uncertainties in trying to enforce warranties and indemnities against vendors generally mean that asset acquisitions are preferred. However, as noted in section 4.1.1 above, sellers usually prefer stock / share deals for various reasons, which means there are a limited number of asset deals in Indonesia.

5.2.2 Unpaid taxes of the transferor company

Unpaid taxes or unrecorded liabilities remain with the seller.

5.2.3 Financing costs

The buyer in an asset acquisition is entitled to deductions for interest expenses on loans used to acquire such assets, provided the assets are used in generating income and the transaction is effected at arm's length. Interest paid to non-residents will be subject to 20% withholding tax (which may be reduced by a tax treaty).

5.2.4 Cost base step-up

In an acquisition of assets, the assets should be recorded at transfer value for tax purposes. An asset appraisal may be required for a related party transaction to determine the market value at the time of acquisition.

Purchased goodwill and the cost of intangible property may be amortised under Indonesian accounting principles using the declining-balance method or the straight-line method. The method adopted must be applied consistently. The amortisation will generally be deductible for tax purposes.

Assets other than buildings are divided into four classes. Depreciation is calculated on an asset-by-asset basis. Buildings are divided into two classes: permanent (useful life of 20 years) and non-permanent (useful life of 10 years). The current rates of depreciation are as follows:

Asset category	Declining-balance (%)	Straight-line (%)
Class I	50	25
Class II	25	12.5
Class III	12.5	6.25
Class IV	10	5
Permanent building	—	5
Non-permanent building	—	10

Costs incurred to extend certain rights over land (such as rights to build, rights to commercial use, and rights to use), may be amortised over the useful life of the rights. Land acquisition costs are not amortisable.

5.2.5 VAT

VAT paid by the buyer should be available as input VAT, which may be recovered against output VAT, or by claiming a refund (provided that the buyer is a VAT enterprise). A request for a refund will automatically trigger a tax audit. Special concessions may be available, for example, where the transferor company is a company not required to be registered for VAT purposes.

5.2.6 Duty on the acquisition of land and building rights

On acquiring land and / or buildings, the purchaser must pay 5% transfer duty which is computed on the transfer value or the value forming the basis of the land and building tax, whichever is higher. The duty paid is considered as a cost of the acquiring company, that is, it is not creditable against corporate income tax.

5.2.7 Withholding tax

No Indonesian withholding tax should apply to the transfer of assets.

6. Exit route

The sale of shares in an Indonesian company can provide a tax-free exit mechanism for foreign investors provided the seller is resident in a treaty country and the capital gains article in the treaty gives protection from the 5% withholding tax discussed previously. Other profit extraction techniques such as interest, technical service fees and dividends may be used to provide an exit route for Indonesian profits but care must be taken to limit withholding taxes and ensure that Indonesia's transfer pricing rules and the beneficial owner test are not infringed.

7. Final remarks: preparation for a deal

Indonesia represents significant opportunities for foreign investors. However, while the country warmly welcomes foreign investment, doing business in Indonesia often poses a unique set of challenges. Careful planning is recommended from the earliest stage of considering a merger or acquisition in Indonesia. Legal, tax, government, regulatory and human resources teams will need to work together to ensure that unnecessary hurdles are not overlooked at the outset.

Japan

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1. General introduction

1.1 General comments on M&A in Japan

This chapter details the main issues relevant to purchasers and sellers of the transfer of ownership in a Japanese company or business.

Non-tax considerations normally play a major role in determining the form taken by Japanese M&A transactions (e.g. regulatory or licensing issues, employment laws, etc.). Some of these considerations are noted where appropriate in this chapter.

1.2 Corporate tax

1.2.1 General tax regime

Japanese corporate income tax generally consists of a national tax, prefectural and inhabitants taxes, and an enterprise tax. The corporate tax rates are as follows:

Corporations with paid-in capital of over JPY100 million	30%
Corporations with paid-in capital of JPY100 million or less:	
• first JPY8 million of taxable income	18%
• over JPY8 million of taxable income	30%

The inhabitants' tax is a local tax consisting of prefectural and municipal taxes. It is levied on a corporation in each prefecture in which the corporation has an office to carry on its activities and is computed as a percentage of the corporation tax. The allocation to each local jurisdiction is based on the number of employees or months during which the corporation has it offices. In addition, each local Government levies a per capita tax on each corporation that has an office or business place in its jurisdiction. This equalisation tax varies depending on the amount of paid-in capital, plus capital surplus, and the number of employees.

Enterprise tax is a prefectural tax levied on a corporation in each prefecture in which the corporation has offices to carry on its activities. For a corporation with paid-in capital of JPY100 million or less, the enterprise tax liability will be calculated by multiplying the taxable income that is allocated to each prefecture by the appropriate tax rate. The allocation is generally made on the basis of the number of employees. The rates vary depending on the amount of the corporation's taxable income. For a corporation with paid-in capital exceeding JPY100 million, the enterprise tax liability will be the sum of three different factors (i.e. an income-based factor, a capital factor and a value-added factor), each with its own tax rate and calculation rules.

The effective tax rate (including local enterprise and inhabitants' tax) is generally around 42% for businesses with income exceeding JPY8 million. Enterprise tax is deductible in computing the taxable income. However, the effective corporate tax rate may differ depending on the amount of corporate taxable income and the way the enterprise tax is calculated.

1.2.2 Tax losses

Tax losses may be carried forward in Japan for seven years for losses incurred in fiscal years beginning on or after 1 April 2001. Currently, the tax loss carry back provision is suspended but is only applied under the limited situation where a corporation whose paid in capital is JPY100 million or less. The tax loss carry back is applied to the previous one year upon application by the taxpayer.

A majority change in the ownership of shares in a company followed by the occurrence of a specified trigger event within a certain period of time may give rise to the expiration or limitation of the use of tax losses or latent tax losses in Japan. "Latent" tax losses (e.g. the difference between the Japanese tax book value of assets and their actual market value) are generally not realised until a taxable event (e.g. a sale of the assets or a transfer of assets pursuant to a merger).

1.2.3 Taxation of dividends

Dividends, net of attributable financing costs, which are received by a Japanese company (Parent KK) from another Japanese company (Sub KK), may be excluded from the taxable income of Parent KK provided that Parent KK owns 25% or more of Sub KK for a continuous period of six months or more ending on the date on which the dividend is declared. If Parent KK owns less than 25% of Sub KK for a continuous period of six months or more ending on the date on which the dividend is declared, only 50% of the dividends from Sub KK, net of attributable financing costs, may be excluded from the taxable income of Parent KK. There are also special rules relating to minority shareholding and investment trusts and certain types of interest that may be excluded from the above definition of financing costs that should be considered. Under the tax reform proposal for FY2010, for dividends paid within a 100% group, the allocation of financing costs will no longer be required.

However, exclusion from taxable income is not permitted for dividends on shares that were acquired within one month prior to the year-end of the company paying the dividends concerned and sold within two months after the same year-end.

Under the 2009 tax reform, 95% of a dividend received by a Japanese company from a foreign company in which it has held at least 25% of the outstanding shares or voting shares for a continuous period of six months or more ending on the date on which the dividend is declared can be excluded from the Japanese company's taxable income. The 25% threshold is limited to direct shareholdings i.e. individual shareholdings of less than 25% do not qualify for the exemption even if the aggregate shareholding held within a wholly-owned group is 25% or more.

If the foreign company is a resident in a country with which Japan has concluded a tax treaty for the avoidance of double taxation, and such treaty provides for the allowance of an indirect foreign tax credit for taxes paid by the foreign company on the profits out of which the dividend is paid, where the company holds a certain percentage of the foreign company's outstanding or voting shares e.g. 10% shareholdings under the Japan-Australia Tax Treaty, that percentage will apply for the purpose of determining the availability of the above exemption.

1.3 Withholding taxes

Japanese-sourced dividends, interest, royalties, service fees, and rent received by a foreign corporation are generally subject to withholding tax at the rate of 20% under Japanese domestic law. Service fees that are not sourced in Japan and remittances of branch profits are not subject to withholding tax.

Japan has a comprehensive network of double tax agreements, which operate to reduce withholding tax and exempt business profits derived by a company resident in a treaty country that does not have a permanent establishment in Japan.

Where a non-resident entity conducts its operations in Japan through a permanent establishment (e.g. a branch), the above-mentioned Japan-sourced income would be subject to tax under the same procedure as that applicable to a resident entity.

Under the Japan-U.S. Tax Treaty (Treaty), all royalties paid by residents of one contracting State to residents of the other may be paid without being subject to withholding tax at source. The Treaty also eliminates withholding tax at source on dividends where the shareholder owns more than 50% of the dividend-paying company. The withholding tax rate on dividends is reduced to 5% where the beneficial ownership is between 10% and 50% and the rate is reduced to 10% where the beneficial ownership is less than 10%. However, complex rules and detailed tests in order to substantiate treaty entitlements have been included in the Treaty. These tests, in the form of a comprehensive limitation of benefits test, anti-conduit rules for certain income, and the legal concept of beneficial ownership, must be fully complied with by taxpayers when submitting their treaty relief forms. Other recent treaties that Japan has entered into contain similar tests.

The payment of a royalty and interest to foreign related parties will be subject to the Japanese transfer pricing regulations (and thin capitalisation rules for interest).

1.4 Consumption tax (GST / VAT)

Japanese consumption tax (currently 5%) applies to goods sold and services rendered in Japan (excluding shares or securities but including goodwill). Export and certain services provided to non-residents are zero-rated. Such tax may be recoverable by the payers depending on their consumption tax recovery position. Typically it would not be recoverable for an individual. It may only be partially recoverable for a company in the financial sector and fully recoverable for manufacturing or other service companies.

1.5 Stamp tax

Stamp tax ranging from JPY200 to JPY600,000 is payable on documents which require formal stamping to have legal effect. This includes agreements for the sale of certain assets. Stamp tax is generally payable by the purchaser, unless otherwise stated in the agreement.

1.6 Other relevant taxes

Where compulsory registration of real property applies, there is an imposition of registration and license tax. This also applies on the registration of a company or branch. The rate varies depending on the type of property.

2. Acquisition

2.1 The preference of purchasers: stock vs asset deal

In many situations, the purchaser and seller could have conflicting interests regarding whether to structure the transaction as a sale of shares or assets.

For purposes of corporate taxation, there is no distinction between the taxation of capital gains on the sale of shares or assets. However, in some cases, purchasers may want to purchase only selected assets or businesses to avoid issues such as acquiring contingent or unrecorded liabilities, or incurring a substantial amount of time and expense in completing a due diligence if shares are acquired. The purchase of a business may also enable the purchaser to report and deduct goodwill.

Further, a purchaser may prefer to acquire assets, for example, where the target does not have attractive tax attributes, such as tax operating loss carryovers or there is an intention to integrate those assets into its existing business.

2.2 Stock acquisition

Generally, an acquisition of a Japanese company is achieved through a direct acquisition by a foreign investor of the shares in the Japanese company. Where a purchaser intends to exit in subsequent years, it may wish to use an appropriate holding company in the U.S., Netherlands, Switzerland or Germany as the Japanese tax treaties with these countries provide exemptions from Japanese tax on gains from the sale of shares in a Japanese corporation, assuming that the company satisfies the eligibility requirements under the particular treaty.

An acquisition of the target's shares will permit the survival of any Japanese corporate tax attributes of the target, including tax net operating loss carry forwards, depending on the particular facts. However, where a premium is paid to acquire shares, the goodwill arising from the purchase of shares is not amortisable to the purchaser for Japanese tax purposes.

The target's tax basis in its assets remains unchanged in connection with a share purchase, as there is no change in the tax attributes of the target. Further, there would not necessarily be any costs from the transfer of employees, which tend to be normal features of asset purchases. On the other hand, subsequent decisions made by the purchaser regarding personnel issues may be constrained by the target's existing work rules, severance and retirement plans.

Currently, Japanese accounting principles do not require extensive financial statement disclosures and permit, in certain situations, the recording of assets and liabilities off balance sheet in the financial statements of non-consolidated subsidiaries.

2.3 Asset acquisition

If a purchaser does not have a presence in Japan, it could form a domestic corporation (e.g. a KK) that would purchase the assets and take over the business operations of the target company.

Any accumulated tax net operating losses of the target will remain with the target under an asset acquisition.

An asset acquisition will generally allow the purchaser to avoid exposure to contingent or unrecorded liabilities. These liabilities will remain with the seller unless they are contractually assumed by the purchaser under the sale and purchase agreement.

However, asset acquisitions are more likely to encounter regulatory difficulties. Many industry sectors are subject to one or more forms of regulation or licensing. Obtaining consent to transfer licenses (or perhaps more accurately, obtaining a new license) can be a long process.

Employment law can also be a key issue, as the transfer of employees in an asset (or business) transfer requires each transferring employee's individual consent.

From a tax perspective, an asset purchase at above historic tax basis will allow a step-up of its tax basis. Goodwill, in particular, may generally be amortised on a straight-line basis over a five-year period. A valuation to support any goodwill paid should be considered to avoid any issues being raised at a later tax audit.

One point of detail to note in the case of an asset acquisition relates to provisions for retirement benefits, Japanese companies often operate unfunded pension arrangements, where provisions are simply set up on the companies' own balance sheets. These provisions are generally non-tax deductible, until actually paid. In the event of a business disposal by means of an asset sale, the purchaser may be paid by the seller to take over these pension liabilities. This amount would be taxable income to the purchaser in the period in which it is received unless certain conditions are satisfied. Thus, the failure to plan in advance may result in an unexpected "up-front" tax liability to a purchaser.

2.4 Transaction costs to purchasers

2.4.1 Consumption tax (GST / VAT)

- Stock deal

Consumption tax does not apply to the sale of stock.

- Asset deal

Consumption tax is imposed on the transfer of assets, including goodwill. Consumption tax is neither imposed on the transfer of monetary assets, such as cash or receivables, nor land. Consumption tax that is paid by the purchaser may be recovered, depending on the purchaser's consumption tax position.

2.4.2 Stamp tax

- Stock deal

No stamp tax is payable on an agreement for the sale of stock.

- Asset deal

Stamp tax is payable on documents which require formal stamping to have legal effect. This includes agreements for the sale of real property, intangible assets, or businesses, agreements for corporate reorganisations, and stock certificates. Stamp tax is generally payable by the purchaser, unless otherwise stated in the agreement.

2.4.3 Registration and license tax

- Stock deal

Registration and license duties are not applicable to stock acquisitions.

- Asset deal

Registration and license duties are imposed on the registration of real property or intangible assets, a company's commercial registration, as well as other transactions. For example, where title to real estate is transferred and the new owner is registered, tax may be imposed on the value of the real estate that is transferred.

A registration and license tax will also be imposed when new share capital is issued (e.g. when an acquisition company is incorporated and funded in order to complete an asset acquisition). The current tax rate is 0.7% of the amount of capital that is allocated to the paid-in capital account (or 0.15% in the case of capital increase in the course of a merger to the extent of the former share capital of the disappearing company).

2.4.4 Assets transfer tax (real property acquisition tax)

The acquisition of real property (e.g. land, buildings and factories) is generally subject to a real property acquisition tax at the rate of approximately 3% of the assessed value. The tax rate that will apply depends on the type of asset and the date of acquisition.

2.4.5 Concessions relating to M&A

No consumption tax is imposed in the case of a merger or a spin-off. In the case of a contribution in-kind, consumption tax is imposed. It is, however, calculated based on the value of shares issued in exchange for the transferred assets and liabilities (i.e. upon the net value of the assets and liabilities. See section 5 for more detailed information regarding M&A.)

The consent of each employee who will be transferred to the transferor is required in the case of a business transfer, although this is not required in the case of a spin-off and merger.

2.4.6 Tax deductibility of transaction costs

- Stock deal

Acquisition costs incurred by a Japanese company with respect to the acquisition of shares in another Japanese company are not deductible. Such costs may be capitalised and deductible for tax purposes when the shares are sold.

- Asset deal

For asset acquisitions, the cost of the acquisition (including professional fees, taxes, and charges) should, to the extent identifiable, be added to the cost of the relevant assets that are acquired. The tax treatment of these costs should then correspond with the tax treatment of the underlying assets (i.e. depreciable, amortisable or tax deductible when the assets are finally sold).

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

The purchase price generally constitutes the purchaser's tax basis in the purchased stock. The tax basis in the underlying assets does not change. Therefore, a stock acquisition would not allow the purchaser to maximise the tax benefits which are generally available in an asset deal.

3.2 Asset acquisition

The purchaser's basis in the target's assets, for Japanese tax purposes, will determine the amount of allowable depreciation and the cost of goods sold that may be deducted for purposes of determining the purchaser's taxable income after the acquisition. The purchaser will take a fair market value basis in the assets acquired and will be required to allocate the purchase price among the assets acquired for purposes of calculating future depreciation deductions to be reported.

If the target's fair market value exceeds its net book value, an asset acquisition allows the purchaser to record goodwill and obtain tax deductions for amortisation of such goodwill.

4. Financing of acquisitions

4.1 Thin capitalisation

The Japanese thin capitalisation rules provide for a 3 to 1 debt: equity ratio and apply to all companies having interest-bearing debt due to foreign related parties. The portion of interest expense that exceeds this ratio is permanently disallowed as a deduction. This excess interest may still be subject to withholding tax.

The rules state that interest expense will be permanently disallowed to the extent that the average balance of interest-bearing indebtedness to a foreign-controlling shareholder (who owns at least a 50% direct or indirect ownership interest) exceeds three times the net equity of the foreign-controlling shareholder in the debtor company. However, if the total interest-bearing debt of the debtor company is less than three times its net assets, then the thin rules do not apply.

Net assets will not be less than the capital account for Japanese tax purposes (i.e. paid-in capital and capital surplus). Therefore, if there is a deficit in retained earnings, then the capital account is deemed to be the net assets of the company.

Third-party loans guaranteed by a related foreign party will be subjected to the thin capitalisation rules and the guarantee fee may also be permanently disallowed as a deduction.

The thin capitalisation rules provide a comparable company ratio exception, which is determined based on standards similar to those that should be used under a transfer-pricing context. Under this exception, it is permissible to use a ratio that is higher than 3:1, if such ratio is also used by a specific Japanese company of similar size conducting similar business activities. It should be noted, however, that the tax authorities take a very strict position on the comparability exception.

4.2 Deductibility of interest

4.2.1 Stock acquisition

Interest incurred by a Japanese company on funds used to acquire shares in another Japanese corporation is not tax deductible in the year that the company receives a dividend from a Japanese corporation since the dividend from a Japanese subsidiary to a Japanese shareholder is generally tax-free. This rule may change as a result of the proposed tax reform for FY2010.

4.2.2 Asset acquisition

The debt to equity ratio of the Japanese company could be structured so that it is within the scope of the conditions stated under the thin capitalisation rules (see section 4.1) to maximize the interest deduction.

Since the Japanese national and local tax rates are relatively high, the use of debt financing could reduce the Japanese company's overall tax liability.

5. Reorganisations

5.1 Overview of corporate reorganisation rules

Under the corporate reorganisation rules, assets and liabilities may be transferred at their tax basis such that no taxable gain or loss would be recognised, provided that certain conditions are met. As a result, the capital gain or loss that would be realised on the transfer will be deferred.

Currently, if cash or assets (other than shares) are paid to the transferor, the merged company or shareholders of the transferor / merged company as consideration, the assets must be transferred at their fair market value (i.e. the transaction will be a taxable reorganisation).

The corporate reorganisation rules apply to the following types of corporate reorganizations:

- Qualified corporate spin-offs and split-ups;
- Qualified investment (contribution) in-kind;
- Qualified post-establishment transfers;
- Qualified mergers; and
- Qualified share for share exchange.

As of the date of this publication, the tax reform proposal for FY2010 includes the introduction of a group taxation system that would, in general, allow for the transfer of assets between a 100% group on a no gain, no loss basis.

5.1.1 100% ownership in subsidiary

A transfer of a business unit to a new or existing wholly-owned subsidiary in return solely for shares / stock in the subsidiary or the parent company (refer to section 5.1.4 for additional information relating to the types of consideration that can be used) may be accomplished on a tax-free basis. No other tests need to be satisfied.

5.1.2 More than 50% ownership in transferee corporation

Tax-free transfers of a business unit to a less than 100% owned subsidiary may be accomplished if the transferor owns more than 50%, directly or indirectly, in the transferee corporation and the following conditions are satisfied:

- Only shares in the subsidiary or the parent company are issued (refer to section 5.3 for additional information relating to the types of consideration that can be used);
- Transfer of business unit — it is expected that about 80% or more of the employees in the transferred business unit will continue to be engaged in the transferred business at the transferee corporation;

- Continuing business requirement — the business that is transferred will continue to be operated by the transferee corporation after the transfer;
- The principal part of the business assets and liabilities used in the transferred business unit will be transferred to the transferee corporation; and
- In case of spin-offs and split-ups, more than 50% of the existing ownership is expected to continue after the spin-off or split-up.

5.1.3 Joint business reorganisation (50% or less ownership)

In the case of a reorganisation between two companies that have a group relationship of 50% or less (i.e. a joint business reorganisation), the reorganisation may still be treated as a qualified reorganisation if the following conditions are satisfied:

- The conditions for a tax-free transfer applicable to a more than 50%-owned subsidiary as stated above are satisfied;
- Continuing shareholding requirement (this is not required for a corporation with the number of shareholders exceeding 50) — in general, more than 80% of the former shareholders of the transferor corporation must continue to hold the shares of the transferee corporation;
- Business relevancy requirement — the business transferred by the transferor and one of the businesses of the transferee must be relevant to each other; and
- Comparable business size requirement — either of the following must be satisfied:
  - the ratio of either sales, number of employees, or other appropriate measure, of the transferred business unit and the transferee's relevant business must be no greater than 5:1; or
  - if the above cannot be met, this condition will still be satisfied if at least one of senior management-level persons continue to be the management of the transferee corporation.

5.2 Types of corporate reorganisations

5.2.1 Corporate spin-off

A corporate spin-off within 100% affiliated companies may be accomplished on a tax-free basis if the consideration is solely for stock. Transfers on a corporate spin-off to less than 100% affiliated companies may be made tax-free if the requirements discussed above are met. (See sections 5.1.2 and 5.1.3) In the case of a spin-off, the tax losses will remain with the transferor corporation.

5.2.2 Investment in-kind

An investment in-kind, or contribution to capital, which generally meets the above conditions may be accomplished on a tax-free basis. Under this scenario, an entire business unit need not be transferred, but single assets may be transferred as a contribution to capital on a tax-free basis if it is made to a wholly-owned subsidiary. Transfers to less than 100% affiliated companies may be made tax-free if the transfer is of a business unit, and the requirements discussed above are met. (See sections 5.1.2 and 5.1.3.)

5.2.3 Post-establishment transfer

Under a post-establishment transfer, the transferor corporation first incorporates a new corporation (transferee corporation) via a cash contribution and the transferee corporation then uses the cash to purchase the transferred assets. This transaction may be accomplished tax-free if the following conditions are satisfied:

- the transferor company held all of the outstanding shares of the transferee company throughout the period up to and including the asset transfer;
- the transferor company expects to continue to hold all of the outstanding shares of the transferee company;
- the assignment of assets was planned at the time of the establishment of the subsidiary, and the assets were actually transferred within six months from the establishment of the subsidiary; and
- the amount of cash paid to the transferor company is approximately the same as the amount contributed by the transferor company to the transferee company.

5.2.4 Merger

In general, a tax-free merger may be accomplished if the above-mentioned conditions are satisfied. All assets and liabilities of the merged company are transferred to the surviving company at the tax basis (tax book value). Thus, no taxable gain or loss will be incurred with respect to the merger. There will be no deemed dividend payment with respect to the liquidation of the merged company. Note that a cancellation loss on the merged corporation shares held by a merging corporation at the time of the merger will not be tax deductible.

Thus, the merger will be tax-free if:

- The merger of 100% affiliated group companies is solely for stock;
- The merger of more than 50%, but less than 100% affiliated companies, meets the conditions similar to those in section 5.1.2; or
- The merger of less than 50% affiliated companies meets the conditions similar to those in section 5.1.3.

In a tax-free merger, the tax losses of the merged company will be carried over to the surviving company if certain conditions are satisfied. In general, tax net operating losses that arose while both companies were owned by the same interests (group years), may be carried forward in a tax-free merger. There are limits placed on tax net operating losses carried over from pre-group years as well as limits on built-in losses. The limitations on the use and carry over of tax losses apply equally to both the merged company and the surviving company.

Triangle merger where shares of the parent corporation are exchanged by a Japanese acquiring corporation solely for the shares of a Japanese target corporation will be treated as tax qualified only if (i) the parent directly owns, and will continue to own, 100% of the shares of the Japanese acquiring corporation prior to, and after, the reorganisation and (ii) any one of the other requirements for a tax qualified reorganisation are met (e.g. refer to sections 5.1.1 through 5.1.3).

5.2.5 Share-for-share exchanges

Under a share-for-share exchange (Kabushiki Kokan), the issued and outstanding shares that are held by shareholders of a company that will become a 100%-owned subsidiary (Company B) will be transferred to a company that will become the 100% parent company of Company B (Company A). Company A will issue new shares to Company B's shareholders in exchange for the shares in Company B.

Under a share-for-share transfer (Kabushiki Iten), shares of a company that will become a 100%-owned subsidiary (Company B) which are held by Company B's shareholders will be transferred to another newly established company (Company A). Company A will issue new shares to Company B's shareholders so that Company A will become the 100% parent company of Company B.

The share-for-share exchange will be treated as a tax qualified transaction if:

- the share-for-share exchange of 100% affiliated group companies is solely for stock;
- the share-for-share exchange of more than 50%, but less than 100% affiliated companies, meets the conditions similar to section 5.1.2 , i.e., at least 80% of the employees in Company B will continue to be engaged in the business at Company B and Company B's primary business will continue to be operated by Company B after the share transfer; or
- the share-for-share exchange of less than 50% affiliated companies meets the conditions similar to section 5.1.3.

If the share-for-share exchange is not treated as a tax qualified transaction, certain assets of Company B must be marked to market and any revaluation gains and loses are included in the taxable income computation of Company B.

Recognition of the capital gain that would be realized by the shareholders of Company B on the transfer of Company B's shares pursuant to a share-for-share exchange for tax purposes is deferred provided that the shareholders only receive shares of Company A. It does not matter if the share-for-share exchange is qualified or not under the above conditions on this aspect.

5.3 New corporation law

A new Corporation Law (Law) was passed by the Japanese Diet on 29 June 2005 and promulgated by the government on 26 July 2005. The purpose for the Law was to modernise the overall corporate legislation in response to the changing societal and economic circumstances. The Law is designed to stimulate the formation of new companies and allow more flexible corporate management.

In the area of corporate M&A, the Law provides greater flexibility in reorganising companies as well as the implementation of counter measures against hostile takeover attempts. For example, the Law relaxes the rules relating to the type of consideration that may be used for merger transactions as well as cross-border M&A transactions so that in-kind dividends of shares may be used to reorganise a company. In addition, cash as well as shares of the parent company (foreign or domestic) of the Japanese acquiring company may be used as consideration to be paid to shareholders of the non-surviving company in a reorganisation (i.e. a so called triangular merger is possible).

The Law also allows for simple corporate mergers that do not need shareholders' approval. For example, under a simplified reorganisation (e.g. merger and spin-off), a surviving company of a merger is not required to obtain approval from its shareholders under certain circumstances.

In addition, the Law allows for a short form reorganisation in which a Japanese controlling corporation which owns 90% or more of the voting rights of a controlled corporation may complete a reorganisation (including merger) without approval of a shareholders' meeting by a controlled corporation.

Further, it allows for a reorganisation (i.e. merger, spin-off and share exchange), even if it may result in a capital deficit to the surviving company or transferor company. Such capital deficit may be recognised from a merger where the acquired entity has a capital deficit or the consideration to be paid for the merger is greater than the net assets of the acquired entity.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

The payment of royalty and interest will be subject to the Japanese transfer pricing regulations (and thin capitalisation rules for interest). See sections 1.2.3 and 1.3 for a discussion of the withholding tax implications relating to the payment of dividends, royalties, and interest paid to Japanese shareholders and foreign shareholders.

6.2 Losses carried forward and unutilised tax depreciation carried forward

Please refer to sections 1.2.2, 2.2 and 2.3.

6.3 Tax incentives

Tax incentives enjoyed by a target are generally preserved through a stock deal. Where the target enjoys any tax incentives, these would generally be lost when the business is transferred through an asset deal.

6.4 Group relief

Japanese tax law allows for the filing of consolidated tax returns by a Japanese company and its 100% owned Japanese subsidiaries. Adoption of the consolidated tax system is optional but it has to be continuously applied once elected, and all of the 100% subsidiaries are subject to consolidation without exception.

Parent companies should file tax returns and pay taxes on the consolidated corporate income. The system applies only to the national corporation tax. The local inhabitants taxes and local enterprise tax will continue to be imposed on each member company.

The parent company and its subsidiaries will be jointly and severally liable for tax liability. Tax allocation will be made according (and limited) to each company's taxable income or tax liability. The parent company will pay the tax on behalf of the entire group and later seek tax reimbursement from its subsidiaries, or record it as a credit on its books until receipt of payment from the subsidiaries.

The recognition of profits or losses from intra-group transactions will be deferred until the assets are transferred to a party outside the consolidated group when the consolidated group dissolves, or when a member company withdraws. However, this rule will not apply to transfers of inventory (i.e. no deferral of profits or losses is allowed).

With very limited exceptions, the only tax losses incurred pre-consolidation which may be utilised against consolidated profits are those of the parent company of the consolidated group. Under the proposed tax reform for FY2010, tax losses of subsidiaries can be carried forward into the group but may only be offset against taxable income of those subsidiaries.

Upon joining a consolidated tax group, subsidiary companies will generally be required to separately recognise gains / losses and pay tax on the built-in gains. This rule will not apply to the parent company or to subsidiaries that have been associated with the parent for a certain period. This rule will also not apply to companies joining the group under a tax-qualified share-for-share exchange.

As noted under section 5.1, the tax reform proposal for FY2010 includes the introduction of a group taxation system that will be applicable to 100% group companies that do not file a consolidated tax return.

7. Disposal

7.1 Preference of sellers: stock vs asset deal

A seller of a profitable business is more likely to be interested in selling shares since this may mitigate the consequences of possible double taxation on gains at both the corporate and shareholder levels.

However, where the seller has operating loss carry forwards which are available to shelter gains on appreciated assets, a seller may be willing to dispose of its assets.

There is no distinction under Japanese corporate tax law between capital gains and ordinary income. In most cases, the tax and accounting basis in the assets should be the same since there is a close degree of book and tax conformity.

7.2 Stock sale

7.2.1 Profit on sale of stock

Gains realised by a Japanese seller company from the sale of stock are included as income to the seller and taxed at the normal tax rates.

Under Japanese domestic tax law, a disposal of shares by a non-resident will be subject to Japanese law if the non-resident seller owns 25% or more of the shares in a Japanese company in the year of sale or prior two years and sells 5% or more of the shares during the taxable year.

Gains derived by a foreign seller on the disposition of shares of a Japanese company may not be subject to Japanese tax, if the seller is a resident of a country with which Japan has a treaty and the treaty exempts profit from the sale of shares in a Japanese company from Japanese tax.

Capital gains derived by an individual seller from the sale of stock are taxed separately from other income.

In principle, net capital gains are subject to a flat 15% national tax and an additional (non-deductible) local tax of 5%, for a total of 20%.

However, for the period from 1 January 2003 to 31 December 2011 (a further extension is under discussion), an individual shareholder is subject to tax at the reduced rate of 10% (7% national tax and 3% local tax) for transfers of listed shares under certain circumstances.

7.2.2 Distribution of profits

Capital gains may be distributed as dividends to the shareholders without any restrictions. See sections 1.2.3 and 1.3 for a discussion of the withholding tax implications relating to the payment of dividends to Japanese shareholders and foreign shareholders. Please see also section 6.1 on the repatriation of profits.

7.3 Asset sale

7.3.1 Profit on sale of assets

A business may be transferred from one entity in Japan to another by way of a sale of the assets and liabilities of the business (business transfer) at fair market value for Japanese tax purposes. The seller will record profit or loss for Japanese tax purposes based on the difference between the proceeds received for the transfer and the book value of the business that is transferred.

The difference between the transfer price and the fair market value of the assets and liabilities in the Business Transfer will generally be treated as goodwill for Japanese tax purposes. A payment received by the seller for goodwill will be included in its taxable profit, but any carried forward tax net operating losses of the seller may be used to offset against such taxable profit.

In the absence of real estate or marketable securities or goodwill, it may be possible to structure the Business Transfer so that most of the business assets are transferred at net book value without the recognition of a taxable gain.

In the case of asset disposals by non-resident companies, both national and local corporate income taxes will arise if the asset is held through a Japanese permanent establishment. If the assets are not held through a Japanese permanent establishment, taxation will be limited to national corporate income tax on profits from the disposal of Japanese shares or Japanese real estate. Some, though not all, Japanese double tax treaties exempt capital gains on certain categories of asset.

7.3.2 Distribution of profits

Capital gains may be distributed as dividends to the shareholders without any restrictions. See sections 1.2.3 and 1.3 for a discussion on the withholding tax implications relating to the payment of dividends paid to Japanese shareholders and foreign shareholders. Please see also section 6.1 on repatriation of profits.

8. Transaction costs for sellers

8.1 Consumption tax (GST / VAT)

The seller of assets is required to collect Japanese consumption tax (current rate is 5%) from the purchaser in connection with a sale of assets that are located in Japan. Depending on the seller's consumption tax position, it may be required to remit to the tax authorities the excess of consumption tax collected over consumption tax paid.

8.2 Stamp tax

As stated previously, stamp tax is generally payable by the purchaser, unless otherwise stated in the agreement.

8.3 Concessions relating to M&A

No consumption tax is imposed in the case of a merger or a spin-off. In the case of a contribution in-kind, consumption tax is imposed, however it is calculated based on the value of the shares issued in exchange for the transferred assets and liabilities (i.e. upon the net value of the assets and liabilities). Please see section 5 for more detailed information regarding M&A.

The consent of each employee who will be transferred to the transferor is required in the case of a business transfer, although this is not required in the case of a spin-off and merger.

8.4 Tax deductibility of transaction costs

Transaction costs may generally include legal fees, any costs required to conclude the sale agreement, arrangement fees, etc. Such costs should generally be deductible to the seller.

9. Preparation of target for sale

9.1 Distribution of surplus cash

Dividends paid from a Japanese subsidiary to a Japanese corporate shareholder (a corporation) may be partly or wholly non-taxable, subject to certain conditions. There may be an incentive for a seller to extract the maximum possible value from a subsidiary by way of a dividend prior to its disposal.

The following rules apply to the payment of dividends:

In general, dividends may be paid on an annual basis after approval at the annual general shareholder's meeting. A Japanese company whose business year is one year may stipulate in the Articles of Incorporation that it may distribute an "interim dividend" by resolution of the board of directors, only once per year, and within three months after a fixed date stipulated in the Articles of Incorporation.

Under the new Corporation Law that became effective in May 2006, Japanese companies can pay dividends whenever and as many times during the fiscal year as they want, subject to a shareholders resolution (under the prior Law, only at an annual general shareholders meeting) unless the Articles of Incorporation stipulate that a dividend may be paid by a board member's resolution where the board of directors as well as an independent auditor exists. Interim dividends as described above will remain. However, the Law stipulates that regardless of the size of the capitalisation, companies with net assets of less than JPY3 million may not pay dividends to shareholders even if they have enough retained earnings to do so, in order to protect the interests of creditors.

Please refer also to section 6.1 on repatriation of profits.

9.2 Transfer assets to be retained to another affiliate

For assets that will be retained, the seller may want to transfer (e.g. via spin-off and split-off) the target's assets (that will not be sold to the purchaser) to another Japanese affiliate and then sell the shares in the target to the purchaser. The tax implications of such a transfer will be affected by the proposed introduction of a group taxation system in the FY2010 tax reform proposal. Alternatively, the seller may want to transfer the assets to be sold to another Japanese company and then sell the shares of that Japanese company.

10. De-mergers

A de-merger usually takes place through the sale of assets or a business. The implications of a de-merger should be the same as an asset deal as discussed in sections 2.3 and 7.3.

11. Listing / initial public offering (IPO)

After acquiring a target, a financial buyer generally looks for an exit route either through a sale or an IPO. Since the objectives of a financial buyer are to maximise its return on investment and optimise its exit multiples, any profits derived from the exit route through an asset or stock sale are generally regarded as income subject to tax. To realise profits in a tax efficient manner, an appropriate structure should be put in place to effect the acquisition.

For a non-Japanese resident, there are no special tax laws or regulations applicable to capital gains arising from an IPO in Japan (preferential tax treatment exists for an individual resident investor). Therefore, profits derived from an IPO by a financial buyer may be subject to tax in Japan, as the gains will be regarded as income, unless the shares are held through a company that is resident in a treaty country that exempts such gains.

Korea

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1. Introduction

1.1 General information on M&A in Korea

M&A opportunities in Korea have increased since the Asian Economic Crisis in the late 1990s. Cross-border acquisitions have been increasing in various industries. Sales of distressed companies have represented a large proportion of M&A deals in Korea since the Asian Economic Crisis. In recent years, a growing number of companies are turning their attention to M&A opportunities in order to increase corporate revenues and / or to gain various synergistic benefits. M&A activities among listed companies are also expected to become more common as shareholders become more knowledgeable about the advantages of M&A activities and related tax and legal issues. Although the number of M&A deals in Korea is growing, the Korean government continues to provide tax and other benefits to actively promote M&A activities.

1.2 Common forms of business entity

The following forms of business entity are available in Korea. However, Chusik Hoesa is by far the most common form of business entity, although recently Yuhan Hoesa has been used by some U.S. companies as it may be used to benefit from “check-the-box” rules under the U.S. tax code.

- Chusik Hoesa

Chusik Hoesa (CH) is the only Korean business organisation permitted to publicly issue shares or bonds and therefore is the most common form of business entity used in Korea.

- Yuhan Hoesa

A Yuhan Hoesa (YH) is a closely held corporation which may not have more than 50 shareholders. A YH may not publicly issue debentures. In most other respects, the formation, structure and conduct of a YH is similar to those of a CH.

For U.S. tax planning, one possible advantage of using a YH is that it may be possible to obtain “flow-through” tax treatment in the U.S. At present, a Korean YH is an eligible entity under the U.S. “check-the-box” regulations and as such it may make an election to be treated as a partnership or “disregarded entity” for U.S. tax purposes. By contrast, a Korean CH is on the list of “per-se” corporations under the U.S. “check-the-box” regulations, and thus is not eligible to make such an election.

- Hapmyong Hoesa (Partnership)

A Hapmyong Hoesa is organised by two or more partners who bear unlimited liability for the obligations of the partnership. A Hapmyong Hoesa is subject to corporate income tax.

- Hapja Hoesa (Limited Partnership)

A Hapja Hoesa consists of one or more partners having unlimited liability and one or more partners having limited liability. A Hapja Hoesa is subject to corporate income tax.

1.3 Foreign ownership restrictions

Foreign investors may invest in most industries without any ownership restrictions. However, for a few industries such as newspaper and magazine publishing, telecommunications and cable broadcastings, the Korean government encourages foreign investors to establish a joint venture company with Korean partners rather than a wholly-owned subsidiary by restricting the amount of foreign ownership to a certain designated percentage.

1.4 Corporate tax

A corporation formed under Korean law is subject to Korean tax on its worldwide income.

A Korean corporation is entitled to either a deduction or a tax credit for foreign taxes paid with respect to the foreign-sourced income. A branch of a foreign corporation is subject to tax on its income generated in Korea. The corporate tax rate is 11% (including resident surtax) up to tax base amount of KRW 200 million and 24.2% (including resident surtax) over KRW 200 million for the fiscal year starting in 2010. The rate over KRW 200 million will be further reduced to 22% (including resident surtax) for the fiscal year starting in 2012.

Applicable rates are summarised below:

	Corporation tax	Resident surtax*	Total
W0 — W200 million	10% (10%)	1.0% (1.0%)	11% (11%)
Over W200 million	22% (20%)	2.2% (2.0%)	24.2% (22%)

**Resident surtax is a local tax which is levied at 10% of corporation tax.*

Korea has specific tax provisions dealing with transfer pricing rules, thin capitalisation and tax havens.

1.5 Tax losses carry forward / carry back

In general, from 1 January 2009 tax losses may be carried forward for ten years without having to satisfy any tests. Carry back of tax losses is generally not allowed except for one year carry back of losses which is available to small and medium size companies.

1.6 Tax groupings

A consolidated tax return system was introduced from the fiscal year starting on or after 1 January 2010, which allows taxpayers to elect the current separate tax return filing system or the proposed new system.

Book-to-tax adjustments shall first be made for each entity in the consolidated group and additional tax adjustments on consolidated group are also made to calculate the consolidated tax base. Additional tax adjustments are triggered by the consolidation to reflect the eliminated profits or losses from intercompany transactions, recalculation of the tax limit on donations and entertainment expenses, etc.

Consolidated NOL carry-over, non-taxable income and income deductions will be subtracted to calculate the consolidated tax base. In this context, NOL of an entity in the consolidation group, which were incurred prior to the consolidation election, can be utilized only against taxable income from the concerned entity. When a corporation becomes a wholly-owned subsidiary of a parent subject to tax consolidation, losses from such subsidiary shall be deductible only from its taxable income over the next five years following the acquisition.

Calculation of consolidated tax liability: The amount of tax shall be computed by applying the corporate income tax rates to the consolidated tax base. Tax exemptions or reductions shall be computed by each respective consolidated entity to be summed up before being subtracted from the consolidated income tax liability.

1.7 Partnership taxation

Entities including Hapmyong Hoesa, Hapja Hoesa, and certain Yuhan Hoesa engaged in rendering personal services can elect to be treated as a partnership as long as certain conditions are satisfied. While a partnership is not subject to corporate income tax (i.e. flow-through entity), each partner generally must account for his / her share of the partnership's taxable income in computing his / her income tax.

1.8 Tax incentives for foreign investment

Foreign invested corporations may be entitled to tax incentives if they are involved in attracting advanced technologies or industry supporting services, as defined under the Special Tax Treatment Control Law, are located in a designated Foreign Investment Zone, or the investment is of one that is designated by the Presidential Decree as being essential to attract foreign investment. The incentives may include an exemption from and / or reduction in income tax, acquisition tax, registration tax, property tax and aggregate land tax, customs duties, special excise tax and VAT on capital goods imported and withholding tax exemption on the payment of dividends and royalties to a foreign supplier of technology.

2. Acquisitions: buyer's perspective

2.1 Stock or assets acquisition

An acquisition may be achieved through an asset or stock acquisition.

Buyers often prefer an asset deal to a stock deal, primarily to minimise business, legal and financial risks of acquiring a company with cross-guarantees, uncollectible receivables, contingent liabilities and other unknown exposures. Furthermore, when assets are acquired rather than shares, the buyer may be able to step up the basis of the assets to fair market value and amortise goodwill resulting from the transaction over a period of five to twenty years.

2.1.1 Stock acquisition

Acquisition of shares in a target company may be achieved in the following forms:

- Purchase of existing shares from existing shareholders by foreign investors

  A foreign investor may purchase shares in a target company from existing shareholders. The consideration for the shares is paid to the existing shareholder who would be subject to capital gains tax in Korea on the gains. If the share ownership of the foreign investor is equal to or exceeds 51%, the foreign investor is subject to acquisition tax as explained below.

  A foreign investor is not eligible for tax incentives under a share acquisition where existing shares are acquired.

- Purchase of new shares of the target company by foreign investors

  A foreign investor may increase their share ownership in the target company through the purchase of newly issued shares of the target company. Acquisition tax may also apply in this case. This type of foreign investment may be eligible for tax incentives applicable to foreign investment.

- Purchase of shares in a target company through a holding company

  A foreign investor may set up a holding company in Korea to purchase existing shares or new shares in a target company.

  However, the investment by a holding company in a target company will not be treated as a foreign investment. As such, the target company may not be eligible for tax incentives available to foreign investors.

2.1.2 Asset acquisition

An asset acquisition may take the form of a "business transfer" which means "a comprehensive transfer of all the rights and obligations of a transferor related to the business" as defined under the Presidential Decree of the Basic National Tax Law. Where a transferee acquires only a portion of the target business' assets or liabilities, it is usually called an "asset transfer" which is not considered "a comprehensive business transfer". However, in many cases it may be difficult to clearly differentiate between an "asset transfer" and a "business transfer".

2.2 Taxation

2.2.1 Stock acquisition

- Deemed acquisition tax

  When a purchaser acquires a 51% or greater interest, together with related parties, in a target Company, the purchaser is deemed to have acquired the target's assets and is subject to acquisition tax as described above. Through careful planning the relevant tax may be minimised.

- Withholding tax

  A foreign acquirer's dividend income paid by a target company is subject to withholding tax at 22% (including surtax), or at a treaty reduced rate, if applicable.

- Secondary tax liability

  An acquirer is liable for a secondary tax liability of a target company as a majority shareholder (i.e. a holder of 50% or more of the target's outstanding shares) for any taxes in arrears (to the extent such tax liability is fixed on or after the acquirer becomes the majority shareholder) as well as relevant penalties, interest, collection expenses, and any remaining tax liabilities after appropriation of the target's property to pay such taxes. A secondary tax liability on a majority shareholder is born to the extent of his or her share ownership ratio.

- Government reporting requirements

  An acquisition of target company's shares qualifies as a foreign direct investment (FDI) subject to reporting requirements under the Foreign Investment Promotion Act (FIPA).

2.2.2 Asset acquisition

- Acquisition tax

  Acquisition tax ranging from 2.2% to 11% (including surtax) on the acquisition price of assets such as real estate, vehicles, certain construction equipment, aircrafts, vessels, mining rights, golf memberships, health club memberships, etc. is generally imposed at the time of acquisition.

- Registration tax

  Registration tax ranging from 1.2% to 7.2% (including surtax) on the value of assets such as real estate, vehicles, certain construction equipment and aircrafts is imposed at the time of registration of a change in ownership.

- Capital registration tax

  If the acquirer uses a new company as an acquisition vehicle, the acquirer is required to pay a registration tax of 0.48% (or 1.44%, where the surviving company is located in a prescribed metropolitan area, the registration tax rate would be levied at three times the regular rate) of the nominal value of paid-in-capital upon establishment or incorporation of the new company.

- Exemption or reduction of registration tax or acquisition tax

  Certain local governments may grant exemptions or reductions of registration tax and acquisition tax arising in the course of a comprehensive business transfer. If a transferee of a business is exempt from registration and acquisition taxes in accordance with the concerned local government's ordinance, only the Special Tax for Rural Development is required to be paid at the rate of 20% of the amount of the exempt registration and acquisition taxes.

- Secondary liability for taxes in arrears

  An acquirer of a complete business (comprehensive business transfer) bears a secondary tax liability for national taxes, penalty taxes, interest on deferred payments and expenses for collection of such taxes as well as local taxes, in arrears, but only to the extent of the liability of the transferor of the business at the date of the business transfer and limited to the value of assets transferred. Therefore, the potential purchaser of a comprehensive business should confirm with the relevant tax authorities whether the transferor has any tax liabilities in arrears before proceeding with the business purchase.

  In the event that a transferee acquires only a portion of the target business assets or liabilities (asset transfer), then the transferee may not be subject to secondary tax liability.

- Preservation of tax losses and tax incentives

  Tax losses and tax rate incentives of a target company are not allowed to be transferred to the acquiring company.

2.2.3 Tax treatment of transaction costs

Due diligence and legal fees, if any, incurred by a foreign buyer before the incorporation of a Korean entity are not allowed as a deduction, as such expenses are not relevant to the business of the Korean entity but are related to the acquisition of a new business by the foreign buyer.

3. Impact on basis

3.1 Stock acquisition

The acquisition price of stock forms the cash base of the acquirer's stock in a target company, and there is no election available to step up the tax basis of the underlying assets.

3.2 Asset acquisition

If a comprehensive business is purchased at fair market value, the acquisition cost of the target businesses' assets may be stepped up (or down, as the case may be) to fair market value. If the transferee pays consideration in excess of the fair market value of the net target business assets acquired, the excess will be regarded as goodwill. For tax purposes, goodwill may be amortised in accordance with the accounting amortisation which is over five years or longer (but not longer than 20 years) using the straight-line method.

4. Tax issues in connection with financing of acquisitions

4.1 Debt

Specific tax issues relating to the overall level of borrowings and interest charged on debt are as follows.

4.1.1 Withholding tax

Interest payments to foreign lenders are subject to withholding tax at 22% (including surtax). This rate may be reduced to a lower rate by a double tax treaty with a country of which the foreign lender is a resident and the treaty provides for such a reduction. However, interest payments to foreign lenders may be exempt under local rules from withholding tax if certain conditions are met.

4.1.2 Deductibility of interest / thin capitalisation

Interest incurred in relation to a trade or business is generally deductible.

A Korean subsidiary, or a Korean branch of a foreign corporation, is subject to thin capitalisation rules (the "thin-cap rule"). Under the thin-cap rule, if loans from overseas controlling shareholders (OCS) or loans guaranteed by OCSs exceed three times the equity held by OCSs (six times in the case of financial institutions), the interest on the excess amount of the loans is not deductible. For purposes of the thin-cap rules, an OCS may be defined as any of the following:

- a foreign shareholder owning directly or indirectly 50% or more of the Korean company's shares;
- any foreign company in which the parent company (foreign shareholder of a Korean company, as defined above) owns directly or indirectly 50% or more of the shares; or
- any related / unrelated foreign shareholder company which has a common interest with the Korean company through capital investment, business trade, or financing and one party has substantial control or influence over the other through one of the methods prescribed in the tax law.

4.1.3 Key non-tax issues

A loan with maturity of five or more years made by a foreign parent to a Korean subsidiary qualifies as foreign direct-investment subject to reporting requirements under FIPA.

4.2 Equity

Capital registration tax is imposed at a rate ranging from 0.48% to 1.44% (including surtax) on the amount of paid-in capital on the acquisition of new stock.

Dividends paid on stock are not tax deductible to the company paying the dividends.

Dividend income received by a Korean company constitutes taxable income of the company. However, a qualified holding company under the Fair Trade Act (FTA) is allowed a deduction equivalent to 80% to 100% of the dividend received.

A company which is not a qualified holding company under the FTA is allowed a deduction equivalent to 30% to 100% of the dividends received if certain conditions are met.

Where a company has extended loans to its subsidiaries, a dividend received deduction is reduced as the outstanding borrowing amount and interest costs of the parent company is increased.

Dividend income paid by a Korean company to a non-resident is subject to withholding tax.

5. Disposals: seller's perspective

5.1 Stock disposal

5.1.1 Capital gains tax

A domestic corporate shareholder, including a taxable permanent establishment or branch of a foreign entity, will generally be subjected to 24.2% (22% for fiscal year starting in 2012) corporate income tax on gains derived from the sale of shares in a Korean entity. The capital gain is generally calculated as the difference between the acquisition cost of the shares and the sales proceeds received in the exchange. Securities transaction tax paid is deducted from the sales proceeds of the shares for the purpose of calculating the capital gain.

Under Korea tax law, non-resident shareholders' capital gains on the sale of shares in a Korean company are generally subject to income tax (by way of withholding) at the lesser of 11% of the gross proceeds received or 22% of the net capital gain.

However, gains derived from the sale of shares in a Korean company are not subject to Korean tax if a foreign transferor meets the following conditions:

- the foreign transferor does not have a permanent establishment (PE) in Korea;
- the shares transferred are publicly listed; and
- the foreign transferor did not own 25% or more of the shares of the publicly listed entity during the last five years.

In addition, the above tax rates may be reduced or eliminated in accordance with the provisions of an applicable double tax treaty.

5.1.2 Securities transaction tax

Security transaction tax of up to 0.5% may apply (based on the fair market value of the unlisted shares transferred). This tax shall generally be paid by the seller and applies even where the transfer is a share exchange between foreign companies. To the extent the fair market value of the shares is not readily ascertainable, the value may be assessed in accordance with the Individual Income Tax Law.

5.2 Asset disposal

5.2.1 Corporate income tax on capital gains

Corporate income tax will generally apply to any taxable gains realised by the seller in a business transfer. The applicable tax rate will be the regular corporate income tax rate. It should be noted that there exists a risk of double taxation because a dividend distributed to shareholders may also be subject to Korean taxation.

5.2.2 Value Added Tax

Generally, the seller in a “comprehensive business transfer” is not required to charge the 10% Value Added Tax (VAT) for the assets transferred to the buyer, because a “comprehensive business transfer” is generally not regarded as a supply of goods for VAT purposes.

However, in the event that a buyer acquires only a portion of the target business’ assets or liabilities, the transfer may be subjected to VAT.

5.2.3 Corporate income tax on liquidation income

If, after a business transfer, the transferor company is liquidated, the liquidating company may be subject to corporate income tax on the “liquidating income”.

5.2.4 Income tax on shareholders’ unrealised gains as deemed dividends

When a corporation is liquidated and the remaining assets are distributed to shareholders, to the extent the proceeds received by a shareholder exceed the acquisition price for its shares, the shareholder is deemed to have received the excess as a dividend.

Korean corporate shareholders must include such deemed dividends when calculating their taxable income.

Foreign corporate shareholders are subject to Korean withholding tax on deemed dividends (assuming the dividend is not connected with a PE of the foreign shareholder in Korea). The rate of withholding tax on such dividends under Korean domestic law is 22% (including surtax). However, the tax rate may be reduced under an applicable double tax treaty between Korea and the resident jurisdiction of the foreign shareholder.

6. Mergers

Mergers are legally allowed in Korea, but only between Korean domestic companies. The updated version below is effective from 1 July 2010.

6.1 Tax consequences

Unless carefully planned and executed, a Korean merger may result in a Korean tax liability for the dissolving company, shareholders of the dissolving company, and / or the surviving company as mentioned below.

However, through careful planning and agreement among the shareholders, substantially all of the merger-related taxes may be mitigated or deferred, particularly if the merger is considered a “Qualified” merger, as further outlined below.

A merger meeting the following basic conditions will be considered a "Qualified Merger" for Korean tax purposes:

- both involved companies — surviving and dissolving (merged) companies, have been engaged in business for one year or longer as of the merger date;
- at least 80% of the consideration paid to the shareholders of the merged company consists solely of shares in the surviving company, and the distribution of the shares is in accordance with the Presidential Decree, and the shareholders hold the shares until the end of the fiscal year in which the merger takes place; and
- the surviving company continues to carry out the operations of the transferred business until the end of the fiscal year in which the merger takes place.

Meanwhile, a merger between a parent company and its wholly-owned subsidiary will be considered as a Qualified Merger.

6.1.1 Tax implications for a merged company

Capital gains may result when a merged company is liquidated. Generally, such gain is the amount of the excess of the adjusted net equity of the merged company. Such gain is subject to regular corporate income tax (generally 24.2% and 22% for fiscal year starting in 2012). However, in a "Qualified Merger", tax on such income may be exempt.

6.1.2 Tax implications for shareholders of the merged company

Where the proceeds (surviving company's shares, cash and other consideration) received by the merged company's shareholders exceed the acquisition costs of such shares, the difference will generally be treated as a deemed dividend for Korean tax purposes. Deemed dividend income to a Korean corporate shareholder is included in its taxable income. Generally a deemed dividend to a foreign shareholder is subject to withholding tax at 22%, or a lower treaty rate if applicable.

6.1.3 Tax implications for surviving company

- Registration tax

  In the case of a merger, an exemption from registration tax may be available for registration of certain properties acquired in a merger between companies that have been in existence for at least one year.

- Acquisition tax

  Assets acquired in a merger should generally be exempt from acquisition tax which ranges from 2.2% to 11%.

- Corporate tax on appraisal gains

  If in the course of a merger, the surviving company records assets transferred from a merged company at an appraised value that is in excess of the book value, such appraisal gain would normally be treated as taxable income for the surviving company. One fifth of such gain will be added back to taxable income equally each year for 5 years. However, in a "Qualified Merger", the corporate income tax on gain resulting from the appraisal of assets would be deferred until the surviving company depreciates or disposes of such assets. Nevertheless, it should be noted that if within three years of the merger (this period can be shorted in accordance with the Presidential Decree) the surviving company discontinues the business of the merged company or the shareholders of the merged company dispose the shares, the deferred income will be added back to taxable income within 5 years of the merger.

- Others
  - Unfair mergers

    If the stock exchange ratio between related companies is manipulated in such way that one of the shareholders obtains a disproportionate economic advantage, the transferor of the benefit (Donor) is subjected to the "Denial of Unfair Transactions" and the benefiting party (Beneficiary) is subject to "Tax on Deemed Income from Unfair Transaction".
  - Succession of tax attributes

    Certain tax attributes of the dissolving company can be transferred to the surviving company.
  - Succession of net operating loss

    If certain conditions under tax laws are met, the tax losses of the dissolving company can be transferred to the surviving company.

7. De-mergers

De-merger structures may involve various tax implications and must be carefully designed to minimize potentially negative tax consequences. For example, Korean tax rules permit various tax benefits in split-offs (and spin-offs) that satisfy certain requirements (qualified split-off requirements). The updated version below is effective from 1 July 2010. The qualified split-off / spin-off requirements are as follows:

- the divided company must be a domestic company which has been in business for at least five years prior to the split-off registration date;
- 100% of the consideration received by the divided company's shareholders must be in shares of the new split-off company, and must be distributed in proportion to the shareholders' ownership ratio;
- the split-off company must be a business unit which is capable of carrying on its business wholly on its own, and the assets and liabilities of the divided business unit(s) must be comprehensively transferred to the split-off company.

7.1 Type of de-mergers

- Split-off (Injuk-boonhal)

  A split-off is defined as the separation of a company's business division to a new entity as subsidiary of the company's parent or shareholders.

- Spin-off (Muljuk-boonhal)

  A spin-off is defined as the separation of a company's business division to a new entity as subsidiary of the company.

7.2 Split-off

7.2.1 Acquirer

- Deemed dividend income

  This tax normally applies to shareholders of a split off company which receives compensation of a split-off.

7.2.2 A new split-off company

- Tax on appraisal gains

  Appraisal gains from a split-off (i.e. appraisal value of assets transferred less their book value) may be recognised according to the 5-year deferral rule in a similar manner as a merger. However, if the requirements for a qualified split-off are met, tax on such gains would be deferred. Nevertheless, it should be noted that if within three years of the split-off (this period can be shorted in accordance with the Presidential Decree) the new company discontinues its split-off business or the shareholders of the new company dispose the shares, the deferred income will be added back to taxable income within 5 years of the split-off.

- Transfer of tax attributes

  All tax attributes can be transferred to the new company, provided that it satisfies requirements for a qualified split-off and the assets are transferred at book value of the parent company.

- Acquisition / registration tax

  In general, 2.2% acquisition tax and 2.4% registration tax would be payable by a new split-off company (in the case of Seoul Metropolitan area, triple rate may apply). However, if the requirements for a qualified split-off are met, these taxes may be exempt.

7.2.3 Target (from which a new company is split off)

- Capital gains tax

  Capital gains (i.e. consideration received by target less amount of capital reduction at target) are recognised upon split-off. However, if the requirements for a qualified split-off are met, tax on such gains may be exempt.

7.3 Spin-off: tax and other considerations

7.3.1 A new spun-off company

- Acquisition / registration tax

  In general, 2.2% acquisition tax and 2.4% registration tax would be payable by a new spun-off company (in the case of Seoul Metropolitan area, triple rate may apply). However, if the requirements for a qualified spin-off are met, these taxes may be exempt.

- Transfer of tax attributes

  Certain tax attributes could be transferred to the new company.

7.3.2 Target (from which a new company is spun off)

- Gains from the transfer of asset

  In the case of a spin-off, if the consideration for the transferred asset and liabilities to the new company exceeds the book value of the parent company, such gains would normally be treated as taxable income for the parent company. However, if the requirements for a qualified split-off are met, these taxes may be deferred.

  It should be noted that there exists a risk of potential double taxation because capital gains from an asset transfer upon spin-off are taxed at the target's level and dividends later distributed to the target's shareholder are also be taxed at the shareholder's level.

8. Other pertinent issues

8.1 Exit route

Before entering a deal to acquire an investment in Korea, a foreign buyer would need to consider its investment strategies and if applicable, the exit strategies. As indicated, an asset deal will result in a host of tax issues to the seller whereas a share deal may be structured more tax effectively.

Therefore, by selecting an appropriate buying entity for a Korean target, a foreign investor may exit Korea with a relatively reduced tax cost.

Malaysia

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1. Introduction

1.1 General comments on M&A in Malaysia

This chapter details the main issues that are relevant to both buyers and sellers on the transfer of business or shares in a Malaysian company.

In Malaysia, there is no statutory concept of “merger” and the mode of a merger typically involves an acquisition of shares or business assets (and liabilities) of another company. When structuring M&A transactions in addition to commercial considerations, income tax (including impact on tax incentives) and stamp duty implications should be considered. Non-tax considerations, such as exchange control and foreign equity participation requirements may also impact the transactions.

1.2 Corporate tax

Malaysia operates a unitary tax system on a territorial basis. Tax residents of Malaysia, whether corporate or individuals, are taxed on income accruing in or derived from Malaysia or received in Malaysia from outside Malaysia. However, resident companies (except for those carrying on banking, insurance, sea or air transport operations) and resident individuals are exempted from income tax on foreign-sourced income remitted to Malaysia. Non-residents are only taxed on income accruing in or derived from Malaysia.

The corporate tax rate for resident and non-resident corporations (including branches of foreign corporations) has been reduced to 25% from year of assessment (YA) 2009 onwards. However, companies resident in Malaysia with paid-up capital not exceeding RM2.5 million are subject to income tax at the concessionary rate of 20% on chargeable income up to RM500,000. The remaining chargeable income will be taxed at the prevailing corporate tax rate. With effect from YA 2009, a company which controls or is being controlled directly or indirectly by another company which has a paid-up ordinary share capital of more than RM2.5 million will not be eligible for the concessionary tax rate.

The basis of income assessment is on a current year basis. Malaysia is on a self-assessment system of taxation with effect from the year 2001.

There is no capital gains tax regime in Malaysia. However, there is real property gains tax (RPGT), which is a variation of capital gains tax imposed on gains arising from the disposal of real properties (i.e land and buildings) and shares in real property companies. With effect from 1 January 2010, where the disposal of real properties (i.e. land and buildings) and shares in real property companies are made within 5 years from the date of acquisition of the properties / shares, RPGT will be imposed at a fixed rate of 5% on the gains. Disposals made after the period of 5 years will be exempted from RPGT.

- Taxation of dividends

Malaysia has an imputation system of taxing dividends. The ability of a company to pay dividends to a shareholder depends on the availability of tax franking credits (see Section 108 credit) and its distributable reserves. If the company does not have sufficient franking credits (which is the amount of income tax paid by the company less the amount already used to frank payments of dividends), any dividend paid would be subject to tax at the current rate of 25%. Such tax paid is not creditable against any future tax liability of the company.

Malaysia has however, introduced the single-tier tax system with effect from 1 January 2008 to replace the above imputation system. Companies which do not have credit balances in their Section 108 account as at 31 December 2007 will pay dividends under the single-tier tax system.

Companies which have unutilised Section 108 tax credit balances as at 31 December 2007 are given a 6-year transitional period (from 1 January 2008 to 31 December 2013) to utilise the Section 108 credits for payment of franked dividends. These companies will pay dividends under the single-tier tax system once their Section 108 account is depleted or latest by 31 December 2013 even though they have not yet fully utilised their Section 108 tax credit balances.

Under the imputation system, Malaysian-sourced dividends received by shareholders are deemed to have suffered tax at source at the corporate tax rate (currently 25%) by the paying company. If there are expenses incurred in deriving such dividends, these expenses are tax deductible and may result in the shareholders receiving a tax refund upon filing a tax return.

With the introduction of the single-tier tax system, dividends payable to shareholders under the single-tier tax system are exempt from Malaysian income tax in the hands of shareholders.

Exempt income, generated from offshore income or tax incentives (such as pioneer income) may be distributed to the shareholders without having to satisfy the above-mentioned franking requirement. Notwithstanding the introduction of the single-tier tax system, exempt dividends will continue to be paid out as exempt dividends. Such dividends, paid out of tax-exempt profits, are not subject to tax in the hands of the shareholders.

There is no withholding tax on dividends paid by Malaysian companies.

1.3 Withholding tax

The Malaysian income tax legislation provides for withholding tax to be deducted at source on certain payments made to non-residents. The withholding tax rates are as follows:

	Non-treaty rate%	Treaty rate%
Interest	0 — 15	0 — 15
Royalties	10	0 — 10
Management / technical fees*	10	0 — 10
Rental of moveable properties	10	0 — 10
Other gains or profits#	10	—

* Effective from 21 September 2002, payments to non-residents in respect of management / technical services rendered outside Malaysia will not be subject to withholding tax.

Effective 1 January 2009, the scope of withholding tax on non-residents has been expanded to include income from gains or profits not included under gains from a business, dividends, interests, rents or royalties. The types of income under this category include commissions, guarantee fees, introducer's fees, etc. which do not represent business gains of the non-residents.

Malaysia has a comprehensive network of double tax treaties which may reduce the withholding tax rates on the above payments made to a resident of a treaty country.

Malaysia also imposes withholding tax on payments made to non-resident contractors in respect of services rendered in Malaysia at the following rates:

- 10% of contract payment on account of tax which is, or may be, payable by the non-resident contractor; and
- 3% of contract payment on account of tax which is, or may be, payable by employees of the non-resident contractor.

It is generally the view of the Malaysian tax authorities that reimbursement or disbursement of out-of-pocket expenses to non-residents in respect of services rendered by the non-residents in Malaysia, or the rental of moveable properties from non-residents, will be considered as part of the contract value and should be subject to withholding tax.

1.4 Goods and Services Tax / Value Added Tax

Currently, Malaysia does not have a Value Added Tax (VAT) system. However, the Government has proposed to implement a consumption tax system based on the value-added model to be known as Goods and Services Tax (GST). GST is proposed to replace the existing consumption taxes i.e. sales tax and service tax. The implementation date for the GST has yet to be announced.

Based on the discussion paper issued by the Government, it is proposed that the transfer of a going concern is disregarded for GST / VAT purposes on the basis that it is neither a supply of goods nor services.

Currently, the following indirect taxes may be imposed on goods and services, as the case may be:

- import duties at specific rates, ad valorem rates (up to 60%) or composite rates, on dutiable goods imported into Malaysia;
- sales tax at specific rates or ad valorem rates (5% and 10%) on taxable goods that are manufactured in, or imported into, Malaysia;
- excise duties at specific rates, ad valorem rates (up to 105%) or composite rates, on goods subject to excise duty that are manufactured in, or imported into, Malaysia; and
- service tax at 5% on taxable services provided by taxable persons, which are prescribed by way of regulations.

1.5 Stamp duty

Malaysia imposes stamp duty on chargeable instruments executed in certain transactions. In a stock deal, Malaysian stamp duty is payable at the rate of 0.3% on the consideration paid or market value of the shares (whichever is higher). In an asset deal, stamp duty ranging from 1% to 3% is payable on the market value of the dutiable properties transferred under the instrument. Stamp duty is payable by the buyer.

Specific exemptions from stamp duty are available provided stipulated conditions are met (see section 2.4.3).

1.6 Capital gains tax

There is no capital gains tax regime in Malaysia.

Real property gains tax (RPGT) is a variation of capital gains tax. Under the RPGT Act 1976, RPGT is charged on gains arising from the disposal of real property situated in Malaysia or shares in a real property company (RPC). Depending on the period of ownership, these gains will be subject to RPGT at rates ranging from 30% to 5%. A RPC is a controlled company, the major assets of which consist substantially of real property or RPC shares.

With effect from 1 January 2010, where the disposal of real properties (i.e. land and buildings) and shares in real property companies are made within 5 years from the date of acquisitions of the properties / shares, RPGT will be imposed at a fixed rate of 5% on the gains. Disposals made after the period of 5 years will be exempted from RPGT.

Specific exemptions from RPGT are available, provided stipulated conditions are met (see section 7.3.1). Approval for exemption must be secured prior to the disposal.

2. Acquisitions

2.1 The preference of purchasers: stock vs assets deal

The benefits and drawbacks of either a stock or asset acquisition depends on various factors, including the tax attributes of the target company, the acquiring company, business fit of the target company with the buyer, and most importantly, the commercial considerations. Potential buyers can also improve shareholder values and returns on investment through tax efficient structuring and planning.

In a stock acquisition, the buyer may be exposed to liabilities and exposures in the target company. As such, the buyer would need to carry out a due diligence exercise on the target company's business in a stock acquisition compared to an asset acquisition.

2.2 Stock acquisition

The main advantage of a stock acquisition is that the tax attributes such as unabsorbed tax losses, tax incentives or dividend franking credits (where the credits are still available for dividend franking until 31 December 2013) remain with the target company.

- Preservation of tax losses and unutilised tax depreciation carried forward

  Generally, companies are allowed to carry forward their accumulated tax losses and unutilised tax depreciation to be set off against their future business income. Such tax treatment is accorded for an unlimited period of time. With effect from the YA 2006, accumulated tax losses and unutilised tax depreciation of a target company which is dormant shall be disregarded in the event there is a change of more than 50% of the shareholding in the target company.

- Continuity of tax incentives

  Where the target company is entitled to any tax incentives or exemptions, the conditions attached to the incentives or exemptions should be examined to ensure that a change in ownership will not affect the target's entitlement to such incentives or exemptions.

- Others

  As highlighted previously, the buyer may be exposed to liabilities in the target company in a stock acquisition. Hence, a thorough due diligence exercise on the target company's business in a stock acquisition will need to be conducted. This step will help identify the potential tax costs and, where appropriate, explore means of minimising the impact or applying for exemption. The due diligence could also contribute towards managing potential risks in the future.

2.3 Asset acquisition

In an asset acquisition, any tax attributes such as unabsorbed tax losses, tax incentives and dividend franking credits (available for dividend franking until 31 December 2013) remain with the target company and may not be transferred to the buyer.

- Preservation of tax losses and unutilised tax depreciation carried forward

  Generally, unabsorbed tax losses and unutilised tax depreciation of a target company may not be transferred to the acquiring company in an asset acquisition.

- Continuity of tax incentives

  Under an asset deal, any tax incentives or exemption currently enjoyed by the target company will unlikely be transferred to the acquiring company. Generally, the buyer will have to submit a new application for tax incentives or exemptions upon acquiring the business, if it is eligible.

- Others

  In an asset acquisition, the buyer has the choice of determining the assets / liabilities to be acquired. However, the buyer should still carry out a limited due diligence exercise on the assets to be acquired.

2.4 Transaction cost

2.4.1 GST / VAT

As mentioned in section 1.4, based on the discussion paper issued by the Government, it is proposed that the transfer of a going concern be disregarded for GST / VAT purposes on the basis that it is neither a supply of goods nor services.

2.4.2 Stamp duty

In a stock deal, Malaysian stamp duty is payable by the buyer at the rate of 0.3% on the consideration paid or market value of the shares (whichever is higher). For an asset deal, stamp duty ranging from 1% to 3% is payable by the buyer on the market value of the dutiable properties transferred under the instrument. With effect from 1 January 2008, private valuation reports on properties instead of valuation from the Government can be accepted provided that a bank guarantee payable to the Stamp Collector for the additional duty is furnished.

Specific stamp duty exemption is available provided stipulated conditions are met (see section 2.4.3).

2.4.3 Concessions relating to M&As

The Malaysian Income Tax Act and Stamp Act provide some concessions when a company is being reorganised.

- For income tax purposes, sale of tax depreciable assets between related parties may be effected at the tax written down value of the assets. This means that the seller will not have any taxable balancing charge or deductible balancing allowance arising from the sale. The buyer will also be deemed to have acquired the assets at its tax written down value. The transfer value of the fixed assets will be disregarded and the buyer would be entitled to claim annual allowances based on the original acquisition cost of the fixed assets but restricted to the tax written down values of the assets acquired. No initial allowance may be claimed on these fixed assets.

  Additionally, the costs incurred in acquiring a foreign company will also be allowed a tax deduction over a period of five years provided stipulated conditions are met. For instance, the acquisition is for the purpose of acquiring high technology for production within the country or for acquiring new export markets for local products; the acquirer must be a company incorporated in Malaysia with at least 60% Malaysian equity ownership and is involved in manufacturing or trading / marketing activities and the acquired entity must be a foreign company with 100% foreign equity ownership that is located abroad and involved in manufacturing or trading / marketing activities.
- In respect of corporate restructuring or amalgamations, relief from stamp duty is available under the following circumstances:
  - if the acquisition of shares or assets is in connection with a scheme of amalgamation or reconstruction and the consideration comprises substantially of shares in the transferee company; or
  - if the shares or assets are transferred between associated companies (i.e. there must be 90% direct or indirect relationship between the transferee and the transferor).

In addition to the above, to further encourage public listed companies to expand and compete globally, stamp duty exemptions would be given on an approved scheme of merger and acquisition undertaken by companies listed on Bursa Malaysia. The M&A must be approved by the Securities Commission up to 31 December 2010 and executed not later than 31 December 2011.

2.4.4 Tax deductibility of transaction costs

Generally, transaction costs incurred during M&A exercises are not tax deductible to the buyer. However to the extent to which the expenses are incurred in relation to the purchase of trading stock, such expenses should be deductible.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

For agreements dated on or after 1 January 2006, Financial Reporting Standard ("FRS") 3 requires that for acquisitions that result in a parent-subsidiary relationship, all identifiable assets, liabilities, contingent liabilities and intangible assets are to be valued at fair values. The difference between the cost of the acquisition and the fair values of these assets and liabilities is the goodwill on acquisition.

For tax purposes, the change in the accounting standard does not affect the tax treatment under a stock acquisition. As there is no capital gains tax regime in Malaysia, there is no requirement to ascertain the acquisition price of the shares.

3.2 Asset acquisition

As in 3.1 above, agreements for the sale of assets dated on or after 1 January 2006 are also required to comply with the rules under FRS 3 where all identifiable assets, liabilities, contingent liabilities and intangible assets are to be valued at fair values.

For tax purposes, tax treatment of the purchase of assets are not necessarily determined by accounting method. The general principles of taxation are still applicable.

In the purchase of assets, the buyer would generally be treated as having acquired the assets at their acquisition price which is the fair values of the assets under FRS 3. The buyer may claim initial and annual allowances on the fair values of plant and machinery. As the assets are valued at fair values, it may be possible to achieve a step up in the cost base of depreciable assets for the buyer. As required under FRS 3, in allocating the purchase price of the assets, an independent professional valuation report is normally obtained to support the reasonable allocation of the purchase price to the various asset categories.

FRS 3 also requires the recognition of contingent liabilities. These do not qualify for deduction as it is not incurred. There is also a requirement to recognise other intangible assets such as brands, customers base, software development, other research and development expenditure, etc. These are generally not tax deductible but some intangibles may qualify for tax deduction under specific tax rules.

The step up in cost base is not relevant where fixed assets are transferred between companies under common control, as the tax provisions would deem the transfer of fixed assets to be at their tax written down values. The transfer value of the fixed assets will be disregarded and the buyer would be entitled to claim annual allowances based on the original acquisition cost of the fixed assets but restricted to the tax written down values of the assets acquired. No initial allowance may be claimed on these fixed assets.

No tax deduction is available for the amortisation of acquisition goodwill to the buyer. Therefore, the purchase price on an asset deal should ideally be allocated as much as possible to inventory, depreciable capital assets, and other items which are entitled to a tax deduction or tax depreciation.

4. Financing of acquisitions

4.1 Thin capitalisation

Thin capitalisation has been introduced under a new Anti-Avoidance Provision relating to transfer pricing. The new section 140 A(4) imposes thin capitalisation rules on financial assistance granted by a person to an associated person who is a resident. Currently, there is no "safe harbour" rules specified in the legislation. The effective date for thin capitalisation has been deferred from the original effective date of 1 January 2009.

4.2 Deductibility of interest

4.2.1 Stock deal

In a stock deal where dividends are paid under the tax imputation system, interest expense incurred on money borrowed to finance the acquisition of shares is tax deductible to the extent of the dividend income received in the same year. This could result in a tax refund to the shareholder company. However, companies which do not have credit balance in their Section 108 account as at 31 December 2007 will pay dividends under the single-tier tax system. In this case, a tax refund would not be available to the shareholder company as the dividends received under the new single-tier tax system are exempt from tax and expenses are not deductible.

For example, assume that a Malaysian company receives a gross dividend of RM100 from its Malaysian subsidiary. In the same year, the Malaysian company incurred an interest expense of RM40 on the investment. Under the tax imputation system, as the interest expense will be tax deductible against the dividend income, there will be a tax refund to the Malaysian company.

Tax system	Tax imputation RM	Single-tier dividend RM
Dividend	100	75
Interest expense (say)	40	
Net taxable dividend income	60	
Tax on net taxable dividend income	15	
Tax paid (imputation system)	(25)	
Tax to be refunded	10	

Under the tax imputation system, it is important to time the payment of interest with the flow of dividends to maximise the interest deduction and therefore maximise the tax refund. It should be noted that excess interest costs are not eligible for offset against other income, nor can they be carried forward to offset against future dividend income.

Under the single-tier dividend system, the dividends receivable are exempt from tax. Hence, no deduction of expenses, including interest is allowable against the dividends.

4.2.2 Asset deal

Interest incurred on funds used to acquire a business under an asset deal should be fully tax deductible. However, once the thin capitalisation rules come into effect, excess interest costs will not be tax deductible. Therefore, the level of debt used to fund the acquisition of a business should be monitored. There are also specific industries in Malaysia which are required to maintain minimum paid-up share capital.

5. Mergers

In Malaysia, there is no statutory concept of a "merger". The mode of merger in Malaysia involves either the acquisition of shares in an existing Malaysian company, or an acquisition of assets (and liabilities) of another entity.

Prior to 30 June 2009, all proposed acquisitions of assets (including a subscription of shares), or any interests, mergers and takeovers of a Malaysian business or company required approval of the Foreign Investment Committee (FIC), which is responsible for the co-ordination and regulations of such matters under the Guideline on the acquisition of interests, mergers and takeovers by local and foreign interests. From 30 June 2009, the Government has liberalised the FIC guidelines. The FIC guidelines covering the acquisition of equity stakes, mergers and takeovers have been repealed and as such, no equity conditions are imposed on such transactions. Notwithstanding this deregulation, the national interest in terms of strategic sectors will continue to be safeguarded through sector regulators. Companies in such sectors will continue to be subject to equity conditions as imposed by their respective sector regulator such as the Energy Commission, National Water Services Commission, Malaysian Communications and Multimedia Commission, certain sectors under the Ministry of Domestic Trade, Cooperative and Consumerism and others.

The FIC guidelines with respect to the acquisition of properties are also rationalised. The FIC approval for property transactions will now only be required where:

- it involves a dilution of Bumiputra or government interests for properties valued at RM20 million and above; and
- indirect acquisition of property by other than Bumiputra through acquisition of shares resulting in a change in control of the company owned by Bumiputra interest and / or government agency, having property more than 50% of its total assets and the said property is valued more than RM20 million.

All other property transactions including those between foreigners and non-Bumiputras, will no longer require FIC approval.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

The common methods to repatriate profits are through the payment of dividends, interest, royalties, technical fees and management fees.

The ability of a company to pay dividends to a shareholder (resident or non-resident) depends on the availability of retained earnings and dividend franking credits under the imputation tax system. With effect from 1 January 2008, companies with insufficient dividend franking credits will pay dividends under the new single-tier dividend system. Under the new single-tier system, the ability of a company to pay dividends to a shareholder (resident or non-resident) would only depend on the availability of retained earnings.

Exempt income (e.g. offshore income or pioneer income of the company) may be distributed to the shareholders without having to satisfy the franking requirement. There is no restriction for exchange control purposes on dividend distributions by Malaysian subsidiary to non-residents.

Payment of interest and royalties to non-residents is subject to withholding tax, at rates which may be reduced under the relevant double tax treaty. As for management and technical fees, if the services are performed wholly outside Malaysia, there is no withholding tax on the payments. Other payments not falling within the definition of business income or the above types of payments are also subject to withholding tax as mentioned in section 1.3 above.

6.2 Losses carried forward and unutilised tax depreciation carried forward

As explained under 2.2 above, a company is generally allowed to carry forward its accumulated tax losses and unutilised tax depreciation to be set off against its future business income. Unutilised tax depreciation may be carried forward indefinitely, but can only be used to set off against future income of the same business source. In other words, these unutilised balances may not be applied against income of a new business source.

A dormant company however, is only allowed to carry forward its accumulated tax losses and unutilised tax depreciation provided there is no change of more than 50% of its shareholding.

Unabsorbed tax losses, unutilised tax depreciation and dividend franking credits (where applicable) may not be transferred to the acquiring company under an asset deal.

6.3 Tax incentives

Under an asset deal, any tax incentive or exemption currently enjoyed by the target company cannot be transferred to the acquiring company. Generally, the buyer will have to submit a new application for tax incentives or exemptions upon acquiring the business, if it is eligible.

For a stock deal, the conditions attached to the incentives should be examined to ensure that a change in ownership will not affect the target company's entitlement to such incentives or exemptions.

An unutilised tax incentive may be carried forward indefinitely but may only be used to set off against future income of the same business source.

6.4 Group relief

Beginning from YA 2006, tax losses of a Malaysian company may be utilised to set off against the aggregate income of another company within the same group provided stipulated conditions are met.

The group relief is limited to 70% (increased from 50% to 70% effective YA 2009) of the current year's unabsorbed losses of the surrendering company. The following conditions need to be satisfied before the losses may be surrendered:

- the claimant and surrendering companies each must have a paid-up capital in respect of ordinary share of more than RM2.5 million;
- both the claimant and the surrendering companies must have the same accounting period;
- the shareholding, whether direct or indirect, of the claimant and surrendering companies in the group must not be less than 70%. In determining the 70% shareholding relationship, shares with fixed dividend rights are ignored;
- the 70% shareholding must be on a continuous basis during the preceding year and the relevant year;
- the claimant company must be able to demonstrate that it is beneficially entitled, directly or indirectly, to at least 70% of the residual profits and assets (in the case of liquidation) of the surrendering company, available for distribution to all equity holders (and vice versa); and
- the companies are not enjoying tax incentives in the year where tax losses are being surrendered or claimed.

Losses resulting from the acquisition of proprietary rights, or a foreign-owned company, should be disregarded for the purpose of group relief.

7. Disposal

7.1 Preference of sellers: stock vs asset deal

In preparing for a deal, the seller should identify the income tax impact on any gains arising from the stock or asset deal. Where possible, the tax costs should be quantified and the potential tax exposure minimised. Positive tax attributes and value of tax shelters (e.g. the availability of carry forward tax losses, unutilised tax depreciation and availability of tax franking credits (which can be utilised until 2013)) could also be factored in and used as a bargaining tool when negotiating with the buyer. As mentioned earlier, if the target company is a dormant company, accumulated tax losses and unutilised tax depreciation of the target company shall be disregarded in the event there is a change of more than 50% of the shareholding in the target company.

Generally, from a seller's perspective, it may be less complicated to sell a target through a stock deal.

7.2 Stock sale

7.2.1 Profit on sale of stock

Unless the seller is in the business of dealing in shares, the profits on the sale of shares should not be subject to income tax as such profits are considered capital in nature. Malaysia does not have a capital gains tax regime.

7.2.2 Distribution of profits

Provided that the seller has sufficient retained earnings, the cash proceeds received from the sale of stock can be distributed as a dividend to the shareholders.

7.3 Asset sale

7.3.1 Profit on sale of assets

With effect from 1 January 2010, where the disposal of real properties (i.e. land and buildings) and shares in real property companies are made within 5 years from the date of acquisition of the properties / shares, RPGT will be imposed at a fixed rate of 5% on the gains. Disposals made after the period of 5 years will be exempted from RPGT.

However, if the company trades in real property or develops real property, the gains on sale of real property would be subject to income tax.

There are however exemptions available under the RPGT Act 1976. The most notable is the exemption in relation to the transfer of real property between companies in the same group. It is possible to apply for exemption from RPGT on the transfer of assets between companies in the same group if the assets are transferred to bring about greater efficiency in business operations.

The exemption also may cover assets:

- transferred between group companies under any scheme of reorganisation, reconstruction or amalgamation; or
- distribution by a liquidator in the case of a liquidation made under any scheme of reorganisation, reconstruction or amalgamation.

Prior approval must be obtained from the Malaysian tax authorities for transactions in the above mentioned categories.

In respect of the sale of trading stock of a company, any gains arising from the sale are subject to income tax as it is considered part of business income. Any gain on the sale of fixed assets is not subject to income tax. For transactions between unrelated parties, a balancing adjustment (balancing charge or allowance) may arise. If the transfer value exceeds the tax written down value of the asset, the difference, known as a balancing charge, is taxable to the company. The balancing charge is restricted to the amount of allowances previously claimed. If the transfer value is less than the tax written down value of the asset, the shortfall, a balancing allowance, is deductible against the adjusted income of the company. If the transaction is between related parties, no balancing adjustment arises on the seller as the assets are deemed to be transferred at their tax written down value.

Currently, there is no indirect tax implications for the disposal of real property (e.g. factory and office premises) and for the sale of machinery / equipment and trading stocks, where import duty and / or sales tax have been paid. In addition, the disposal of shares will not be subject to any indirect taxes in the form of import duty / excise duty / sales tax / service tax.

If the seller has any exemptions from import duty and / or sales tax, including any facility for licensed manufacturers in Malaysia (licensed under the Sales Tax Act), the following indirect tax implications apply:

- the sale of exempt dutiable and / or taxable machinery / equipment (inclusive of spare parts) and raw materials results in import duty and / or sales tax becoming due and payable, unless the buyer is able to obtain exemption of import duty and / or sales tax for the purchase of the said machinery / equipment and raw materials from the relevant authorities; and
- in respect of sales tax-free raw materials, taxable work-in-progress and taxable finished goods manufactured by the seller, who is a licensed manufacturer under the Sales Tax Act, there are provisions in the Sales Tax Act to allow the buyer to purchase these items free of sales tax subject to certain conditions being met. However, the buyer has to be a licensed manufacturer as well. Otherwise sales tax would be due and payable upon sale by the seller.

7.3.2 Distribution of profits

As mentioned under the section on stock sale, the gain arising from the disposal of assets may be distributed as dividend to the shareholders provided there is sufficient retained earnings in the company.

8. Transaction costs for seller

8.1 GST / VAT

As mentioned in section 1.4, based on the discussion paper issued by the Government, it is proposed that the transfer of a going concern be disregarded for GST / VAT purposes on the basis that it is neither a supply of goods nor services.

8.2 Stamp duty

Stamp duty is borne by the buyer for any transfer of shares or real property.

8.3 Concessions relating to M&As

The Malaysian Income Tax Act provides some concessions when a company is being reorganised.

- For income tax purposes, sale of tax depreciable assets between related parties can be effected at the tax written down value of the assets. This means that the seller will not have a balancing charge or balancing allowance arising from the sale.
- In addition to the above, to further encourage public listed companies to expand and compete globally, stamp duty exemptions are given on an approved scheme of merger and acquisition undertaken by companies listed on Bursa Malaysia. The M&A must be approved by the Securities Commission up to 31 December 2010 and executed not later than 31 December 2011.

8.4 Tax deductibility of transaction costs

Generally, transaction costs incurred on M&A exercises are not tax deductible to the seller. However, to the extent to which the costs are incurred in relation to the sale of trading stock, such costs shall be tax deductible.

9. Preparation of target for sale

In preparing for a deal, it is appropriate for the seller to identify the income tax impacts on any gains arising from the share or asset deal. Where possible, the tax costs should be quantified and the potential tax exposure minimised. Positive tax attributes and value of tax shelters (e.g. the availability of carry forward tax losses, unutilised tax depreciation and availability of tax franking credits (available to be utilised until 2013)) could also be factored in and used as a bargaining tool when negotiating with the buyer. As mentioned earlier, if the target company is a dormant company, accumulated tax losses and unutilised tax depreciation of the target company shall be disregarded in the event there is a change of more than 50% of the shareholding in the target company.

- Intra-group transfer of assets being retained

  In preparing for a sale of assets, it is important to do an identification of the assets to be transferred, identification of costs and net book values of the assets to be transferred and to engage an independent professional appraiser to value the assets.

- Pre-sale dividend

  A company may decide to pay a dividend to its shareholders prior to a sale of the shares in the company The ability of a company to pay dividends depends on the availability of retained earnings. There is no adverse tax implication arising from a distribution of pre-sale dividends.

10. De-mergers

There is no statutory concept of a “de-merger” in Malaysia. The mode of de-merger in Malaysia typically involves either a disposal of shares / assets to another party or a distribution in specie of the shares / assets to the shareholders either via a dividend distribution or a capital reduction exercise (which requires Court approval).

The taxation treatment of a disposal is as stated above under section 7.

From 1 January 2008 onwards, where the de-merger is by way of a dividend in specie, the dividend paid is considered as single-tier dividend, as mentioned in section 1.2 above. This dividend is exempt in the hands of the shareholders.

Where the de-merger is affected through a return of capital via a capital reduction exercise, the shareholders would generally not be taxed on the capital distribution (unless the shareholders are treated as share dealers).

11. Listing / initial public offering (IPO)

Where an IPO is concerned, there should be no tax implications if the shares have been held as long-term investments.

New Zealand

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1. Introduction

1.1 General information on M&A in New Zealand

The New Zealand tax base is reasonably broad and includes, in addition to income tax, a flat rate consumption tax (goods and services tax) and a comprehensive international tax regime. New Zealand does not have a comprehensive capital gains tax but certain capital gains are taxed under different regimes.

A foreign investor tax credit regime allows a resident company's profits to be distributed to foreign investors without the economic cost of non resident withholding tax in certain circumstances.

Recent and current reforms include:

- significant changes to the rules governing the taxation of income from offshore equity investments (including the partial removal of the current 'grey list' concessions under the foreign investment fund regime);
- the introduction of an active income / Australian exemption for income derived through controlled foreign companies and removal of current 'grey list' concessions;
- introduction of rules which exempt foreign dividends received by a New Zealand company;
- expansion of the current thin capitalisation rules;
- removal of the general availability of the foreign investor tax credit; and
- introduction of limited partnership rules.

Company and tax law allow companies to amalgamate. Amalgamation can be used as an alternative to a share purchase or as part of a post acquisition restructuring.

Companies are also able to migrate both into New Zealand and out of New Zealand.

New Zealand's tax legislation allows companies to carry forward (but not to carry back) losses subject to shareholder continuity requirements. Losses may be offset amongst commonly owned group companies.

Companies in a 100% group may elect to enter into a tax consolidated group, which enables the group to be treated as a single entity for income tax purposes.

New Zealand has a general anti-avoidance provision which allows the Commissioner of Inland Revenue to strike down arrangements that have a purpose or effect (not being incidental) of tax avoidance. Any structuring transaction aimed at achieving tax efficiency should be reviewed in light of this provision.

1.2 Corporate tax

1.2.1 Income tax

Income tax is currently levied at the rate of 30% on a New Zealand resident company's world-wide income. For the 2007-2008 and earlier income years the corporate tax rate was 33%. Non-resident companies are taxed at the same rate as New Zealand resident companies on their New Zealand sourced income. There are no state or local income taxes.

Whilst New Zealand does not currently have a comprehensive capital gains tax regime, capital gains on certain transactions are deemed to be income subject to income tax. For example, profits from the sale of real and personal property purchased with the purpose of resale or in specified other circumstances are subject to income tax.

1.2.2 Dividends

The income tax payable by a shareholder on a dividend depends on the number of imputation credits which are attached to the dividend. Imputation credits are generated through the payment of income tax by the company and may be carried forward by companies from year to year provided 66% continuity of shareholding is maintained.

Provided sufficient imputation credits are attached to a dividend, that dividend may be paid to both resident and non resident shareholders, effectively without the economic or cash cost of further withholding tax being imposed. Under the foreign investor tax credit regime the withholding tax in certain instances may be funded effectively by payment of a supplementary dividend. Subject to certain restrictions the paying company may claim a tax credit for the cost of the supplementary dividends.

New Legislation (awaiting royal assent) has been recently introduced to remove the general availability of the foreign investor tax credit and to replace it with a zero rate of withholding tax on fully imputed dividends paid to non-portfolio shareholders.

1.2.3 Withholding tax

Interest, dividends and royalties paid to non residents are subject to New Zealand withholding tax. The rate of withholding tax varies depending on whether or not New Zealand has entered into a double tax agreement with the recipient entity's country of residence. New Zealand currently has double tax agreements in force with 35 countries.

Generally the rates are:

	Non-treaty country	Treaty country
Interest	15%	10—15%
Royalties	15%	10—15%
Dividends	15—30%	15%

The Government has indicated it will review the withholding tax rates as part of its double tax agreement re-negotiation process. Currently New Zealand has signed new Double Tax Agreements (awaiting legal ratification) with Australia, the United States and Singapore, which include lower rates on dividends (as low as 0% in some cases) and royalties (5% in most cases). As part of the negotiation process with other treaty partners, New Zealand may need to revisit the withholding tax rates in place with relevant treaty countries.

Although withholding tax is levied on dividends, as noted above, effectively the withholding tax may be funded at no additional cash cost to the company if sufficient imputation credits are attached.

The rate of withholding tax imposed on interest is a minimum tax in the case of non-treaty and certain treaty countries. In these circumstances, the recipient is required to register with the New Zealand Inland Revenue and file annual returns. The rate of withholding tax can also be reduced to nil if interest is paid to a non-associated party and the security is registered with Inland Revenue. In such circumstances, a 2% 'approved issuer' levy on the gross interest amount is paid. The levy is deductible to the payer. Recently enacted legislation introduces new associated persons rules, which are significantly broader in application and will need considering when determining the application of the approved issuer levy regime.

There is no specific withholding tax on service or management fees. However, the definition of 'royalty' is very wide and can include what might be regarded as service fees in some other jurisdictions. In addition, New Zealand has a strict transfer pricing regime to ensure service charges imposed are at arm's length.

1.3 Goods and Services Tax

Goods and Services Tax (GST) is a transaction based tax and is levied on the supply of goods and services in New Zealand and on goods imported into New Zealand (in addition to any Customs duty). GST is levied at the rate of 12.5%, although some supplies are taxed at zero percent (principally exported goods, certain 'exported' services and the transfer of a business as a 'going-concern') and other supplies, including the supply of financial services (other than those which are zero-rated), are exempt from GST. In certain circumstances, taxpayers may elect into the GST 'business to business' (B2B) regime, which allows the supply of certain financial services to be zero-rated, so that the supplier can obtain input tax deductions.

A ‘reverse charge’ mechanism requires the self-assessment of GST on the value of services imported by some registered persons. If certain thresholds and criteria are satisfied the recipient of the services must account for GST output tax as if they were the supplier of the inbound services. The reverse charge applies to those imported services that would have been subject to GST if they had been provided in New Zealand.

1.4 Stamp duty and Gift duty

Stamp duty has been abolished in respect of instruments executed after 20 May 1999. There is no capital duty on the issue of shares.

Gift duty is levied progressively on most transactions where the consideration provided is less than market value.

1.5 Common forms of business entity

The most common form of business entity used in New Zealand is the limited liability company. A company can be incorporated with relative ease with the New Zealand Companies Office, which offers an on-line incorporation service.

Another popular investment vehicle is the branch, which, unlike the company, is not a separate legal entity. If operated by a non-resident, the branch is treated as a non-resident company for New Zealand tax purposes enabling profits to be repatriated free of withholding tax. The other benefit of a branch structure is the potential to utilise branch losses to offset foreign income. Like the company, a branch must file an income tax return in respect of its New Zealand sourced income. When ascertaining the taxable income of the branch, head office costs can be allocated.

The branch and the legal company must both file annual audited financial statements with the New Zealand Companies Office. A non-resident company which operates in New Zealand via a branch must also file its own financial statements with the Companies Office.

Other investment vehicles include partnerships, trusts and unincorporated joint ventures. Partnerships and unincorporated joint ventures are not treated as separate entities for assessment purposes and tax is assessed on the participants’ share of income.

Legislation introduced in April 2008 allows taxpayers to use a limited partnership vehicle. Limited partnerships will have separate legal status but flow through tax treatment for income and expenditure in the same way as ordinary partnerships. Registration of limited partnerships is generally straight-forward and partners are not necessarily required to contribute capital to the limited partnership.

1.6 Foreign ownership restrictions

Irrespective of which structure is utilised, a non-resident may need to obtain consent from the Overseas Investment Office to acquire or establish (or acquire a 25% or more ownership or control interest in):

- Business or non-land assets worth more than NZ$100 million; or
- 'Sensitive land'; or
- Fishing quotas or entitlements.

2. Acquisitions

2.1 The preference of purchasers: stock vs assets deal

In most cases, New Zealand vendors prefer to sell stock (shares) in the target company rather than the company's assets, due to the absence of a comprehensive capital gains tax regime. Purchasers on the other hand generally prefer to buy assets rather than shares, as asset deals ensure that the tax history (and risk) remains with the vendor and often allow cost base uplifts.

As a general rule asset transfers must be made at market value for tax purposes. With limited exceptions New Zealand's Income Tax Act does not prescribe how transferred assets are to be valued, simply that they are deemed to be disposed of for a consideration equal to market value.

Specific anti-avoidance provisions address share dealing transactions and cost allocations. The share dealing provisions are designed to counter dividend stripping and loss utilisation arrangements, while the cost allocation provisions give the Commissioner of Inland Revenue the power to determine the cost of some assets transferred on sale.

With a share sale it is usual for the purchaser to seek substantial warranties and a comprehensive indemnity from the vendor to limit the purchaser's potential liabilities.

2.2 Stock acquisition

2.2.1 Tax losses

Losses may be carried forward by companies and branches provided there is 49% continuity of ownership from the time the losses are incurred to the time the losses are utilised. There is limited scope to refresh losses before a shareholding change occurs. Losses may not be carried back.

Losses incurred by companies may be used to offset income of other companies in the same group where a 66% commonality of shareholding ownership test is satisfied.

Where a target has a significant amount of tax losses and has appreciating assets, the buyer may consider an asset deal with cost base step up.

2.2.2 Imputation credits and other memorandum accounts

Imputation credits and other memorandum account credits require an at least a 66% continuity of ownership test to be satisfied from the time the credits arise to the time they are utilised. Where continuity is breached any brought forward credits are forfeited.

Where a target company has significant imputation credits, a pre-sale dividend or taxable bonus issue should be considered.

Legislation enacted recently introduces new rules which exempt certain foreign dividends (not including deductible foreign equities or fixed rate foreign equities) and repeals the conduit tax relief regime. As a result, it is expected that certain memorandum accounts including dividend withholding payment and branch equivalent tax accounts regime may no longer be necessary and are likely to be repealed by future tax legislation. However, the credits generated by the application of the respective regimes are expected to be retained for a period of time and then either cancelled or converted to imputation credits.

2.2.3 Tax incentives and concessions

Legislation enacted in 2004 provides an exemption from income tax for gains derived by certain non-residents from the sale of 'shares' in New Zealand unlisted companies that do not have certain prohibited activities as their main activity. The concessions are known as the venture capital tax related reforms.

The legislation targets foreign investors who are materially affected by the imposition of New Zealand tax as they cannot claim or make use of credits for any tax they pay in New Zealand in their own jurisdiction. The rules apply to foreign investors who are resident in all of the countries with which New Zealand has a double tax agreement (except Switzerland) and who invest into New Zealand venture capital opportunities.

2.2.4 R&D credits

New Zealand's research and development (R&D) tax credit regime has been repealed. At present there are no specific tax concessions for R&D businesses in New Zealand, with the exception of deductibility for certain R&D expenditure.

2.3 Asset acquisition

An asset sale must be conducted at arm's length terms or risk being deemed to have been made at market value. However, when the vendor and the purchaser are unrelated the Commissioner of Inland Revenue generally accepts the prices agreed between the parties.

It is prudent to ensure that the values for different assets or categories of asset agreed between the vendor and the purchaser are specified in the sale and purchase agreement.

2.3.1 Depreciation

All depreciation recovered is taxable in the year of sale. Generally proceeds in excess of the original cost of an asset give rise to a non-taxable capital gain.

For an asset deal, generally the purchaser wishes to attribute as much of the purchase price as possible to depreciable assets. A third party purchaser should be able to 'step up' the value of depreciable assets to maximise depreciation claims but it would be advisable for the 'step up' to be supported by a valuation and for the vendor and purchaser to have agreed the purchase price apportionment.

2.3.2 Goodwill

In most cases the vendor would attribute as much of the sale price as possible to goodwill. Generally the disposal of goodwill is not subject to income tax. If the vendor is a company, capital gains can be distributed free of income tax on liquidation (and then generally only to resident shareholders).

The purchaser is not entitled to a tax deduction for goodwill. However, the initial cost of specific types of intangible property, which have a fixed legal life, such as patents, rights to use a copyright or trademarks, may be depreciable.

2.4 Transaction costs

2.4.1 GST

The transfer of shares can be an exempt supply for GST purposes and therefore, generally, there may not be any GST recovery on transactions costs for the transfer of shares. If shares are sold to an offshore acquirer the sale may be zero rated (rather than exempt) and the seller could be entitled to a GST recovery on associated costs.

The sale of assets is not subject to GST provided the assets are sold as part of a going concern and certain criteria are satisfied. If GST is payable on an asset transaction, the parties may agree to enter into a GST offset arrangement, which effectively avoids the need for any cash to be outlaid. Written approval from the IRD is required for a GST offset arrangement.

2.4.2 Stamp duty and Gift duty

No stamp duty is payable on the transfer of real and personal property (including shares) in New Zealand and there is no capital duty on the issue of shares.

Gift duty is levied progressively, at marginal rates from 0% to 25%, on most transactions that involve consideration being provided at less than market value (although unlikely where parties are dealing at arm's length).

2.4.3 Concessions relating to mergers and acquisitions

The Income Tax Act contains some concessions which apply to qualifying amalgamations and tax consolidated groups. Refer to section 5 below.

2.4.4 Tax deductibility of transaction costs

In general, acquisition expenses are accorded the same tax treatment as the assets purchased. For a stock acquisition, therefore, the costs are a non-deductible capital item. However, in certain circumstances, transaction costs incurred directly for the purposes of obtaining funding for the transaction may be deductible. By comparison, an asset acquisition allows for such expenses to be allocated to the assets purchased. To the extent that those assets are depreciable a tax deduction should be available over time for the acquisition costs.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

Under a stock deal, assets maintain the values they had prior to the acquisition and no step up of the cost basis of the assets is possible.

Most new depreciable assets acquired in New Zealand are eligible for a 20% ‘economic loading’ on the applicable depreciation rate. If the loading was applied to the assets prior to the acquisition of the company’s shares by the purchaser the loading continues to apply to those assets after the acquisition i.e. the purchaser retains the benefit of the depreciation loading.

3.2 Asset acquisition

Under an asset deal the purchaser may be able to step up the cost base of the assets acquired for tax purposes from the cost base used by the vendor. To the extent the purchase price for depreciable assets exceeds the vendor’s cost base, then the third party purchaser should be entitled to increased depreciation claims. However, as the assets acquired by the purchaser are not new assets, the 20% depreciation rate loading does not apply to the assets post acquisition.

4. Financing of acquisitions

4.1 Thin capitalisation

New Zealand resident companies and other entities controlled by non-residents (by a 50% or greater ownership interest or by any other means) are subject to the thin capitalisation rules. Under the rules, a deduction for interest is denied to the extent the taxpayer's total interest bearing debt / total asset ratio exceeds:

- 75% of the New Zealand group debt percentage; and
- 110% of the worldwide group debt percentage.

All interest bearing debt is included in the calculation, not only debt with associated parties.

Legislation enacted recently will extend the thin capitalisation rules to New Zealand entities with income interests in controlled foreign companies to prevent the New Zealand entities excessively debt funding controlled foreign companies that derive exempt active income. Where thin capitalisation rules have not applied previously, certain de minimis exemptions may apply. Generally, the definitions of assets and liabilities for thin capitalisation purposes have also been amended by the aforementioned legislation.

4.2 Deductibility of interest

Generally, acquisitions are financed with a mixture of debt and equity.

Most companies are allowed a deduction for interest without the need for a nexus to income. Interest is also deductible where funds are borrowed to acquire shares in a subsidiary. As a result, the use of holding companies in New Zealand is common.

Notwithstanding the thin capitalisation rules, costs incurred in the course of raising finance are normally deductible.

Debt instruments are generally subject to the financial arrangement rules, which require income and expenditure arising from the financial arrangement to be spread over the life of the arrangement on a prescribed basis, generally irrespective of when the payments under the instrument are made.

Certain debt instruments with a very specific set of characteristics are treated as equity for taxation purposes. Such instruments include certain debentures that have been issued in substitution for equity and debentures under which the amount paid is linked to the profit or dividends of the company.

Legislation enacted recently to introduce 'stapled debt securities' rules, which aim to recharacterise debt instruments which are 'stapled' to equity instruments, as equity for taxation purposes. As a consequence, all 'interest' paid on that instrument is treated as dividends and therefore non-deductible.

4.3 IFRS and taxation of financial arrangements

As a result of the adoption of International Financial Reporting Standards, recent tax changes have been made to the rules governing the taxation of financial arrangements, including the introduction of a default method which requires taxpayers to follow the financial reporting method for tax treatment of income and expenditure arising from the financial arrangement.

5. Merger

New Zealand has a set of tax and company law rules which allow companies to amalgamate with each other. When two or more companies amalgamate, effective from the date of amalgamation, the company nominated by shareholders succeeds to all rights and obligations of the other amalgamating company or companies. The other companies are struck off the company register.

Wholly owned groups of companies may be amalgamated using a simple ‘short form’ procedure. Groups of companies not wholly owned must amalgamate under a more complicated ‘long form’ procedure. For tax purposes the company succeeding on amalgamation takes over the tax obligations of all the amalgamating companies. In the case of a ‘qualifying amalgamation’, the general rule is that there is no transfer of assets or liabilities for tax purposes, as these are assumed to have been held throughout by the same party, consequently limiting exposure to tax.

As an alternative to amalgamation, companies in a 100% group may elect to form a tax consolidated group which enables the group to be treated as one company for tax purposes. The main advantages of tax consolidation are that transfers of assets between consolidated group members are ignored for tax purposes (with no immediate tax consequences) and compliance requirements are simplified. Care is needed on the exit from a tax consolidated group to ensure previous tax concessions are not unwound. Members of a tax consolidated group are jointly and severally liable for the tax liabilities of group members.

6. Other structuring and post deal issues

6.1 Repatriation of profits

Profits may be repatriated in a number of ways, most commonly by the payment of dividends, repayment of debt, royalties, service fees or interest. Each method of repatriation needs to be considered in light of withholding taxes and / or the transfer pricing rules.

As capital gains are not taxable in New Zealand it is more common for non-residents wishing to exit investments to sell shares rather than assets. However, irrespective of whether an investor sells assets or shares, an objective is to minimise withholding tax on repatriation of any surplus cash. This can be achieved in three ways:

(i) Payment of a fully imputed dividend utilising the foreign investor tax credit regime. If shares are being sold, the payment of a dividend before sale enables imputation credits to be used before they are forfeited. NB: The regime is likely to be replaced with a zero per cent withholding tax for non-portfolio shareholders with probable effect from February 2010.

(ii) Capital reduction. New Zealand's company law legislation allows a company to repurchase its own shares if it is permitted to do so under its constitution. Subject to certain "bright line tests" and anti-avoidance rules, a share repurchase is not treated as a dividend to the extent of the company's available subscribed capital.

(iii) Migration of the company. New Zealand's company law legislation allows a company to be removed from New Zealand's register and placed on an overseas register. For New Zealand tax purposes, a migrating company will be treated as if it has been liquidated (i.e. a notional realisation of its assets occurs) and a distribution paid to its shareholders. The resulting deemed distribution will be free of withholding tax only to the extent of available imputation credits and the company's available subscribed capital. A company's ability to migrate depends on whether the foreign jurisdiction's corporate law provides for migration.

The repayment of debt from an overseas associate is not subject to withholding tax and is therefore a simple method of repatriating cash.

6.2 New legislation and further reforms

As briefly outlined, there are a number of legislative changes to the taxation of offshore investments, which may have an impact on the New Zealand entity. Accordingly, these changes should be considered when repatriating profits from New Zealand. In addition, the new stapled debt securities and associated persons rules will need consideration when determining the acquisition structure.

7. Disposal — the preference of sellers: stock vs asset deal

7.1 Stock deal

There are generally no tax consequences for the vendor on a sale of shares provided the shares are held by the vendor as capital assets. Although a share sale is beneficial for the vendor, it is usual for the purchaser to seek substantial warranties / indemnities from the vendor to limit potential tax liabilities.

Generally with an asset sale the vendor will aim to attribute values that are as high as possible to items such as goodwill or other capital assets, as any gain on disposal of such assets is generally non-taxable.

7.1.1 Distribution of profits

If the vendor is a New Zealand company, the distribution of sale proceeds to non-resident shareholders as a dividend (and, in certain instances, on liquidation) attracts withholding tax unless imputation credits are attached. The sale itself generally will not generate imputation credits as the gain is usually a non-taxable capital gain.

Other methods of distribution, which allow shareholders to receive sale proceeds tax free if certain requirements are met, are often possible (refer to comments at 6.1).

7.2 Asset sale — profit on sale of assets

As noted above, most vendors prefer to attribute as much of the sale proceeds as possible to goodwill as the disposal of goodwill is not generally subject to income tax.

On sale depreciation previously claimed on the asset being sold is reversed and, therefore, subject to tax if the sale proceeds exceed the asset's tax depreciated value. Proceeds in excess of original cost generally give rise to a non taxable capital gain.

If the vendor is a company, proceeds from disposal of goodwill can be distributed tax free only on liquidation of the company (and then only to resident shareholders).

8. Transaction costs for seller

8.1 GST

As noted in section 2, the sale of shares is exempt from GST. If assets are sold as part of the sale of a going concern the transaction may be zero rated for GST purposes subject to satisfying certain criteria.

8.2 Stamp duty

No stamp duty is payable on the sale of either shares or assets.

8.3 M&A concessions

See comments above in respect of amalgamation.

8.4 Tax deductibility of transaction costs

If a vendor has held the shares being sold as a capital asset, the transaction costs associated with selling those shares are generally not tax deductible. Transaction costs incurred on the disposal of assets used in the income producing process should generally be tax deductible.

9. Preparation of target for sale

9.1 Transfer of assets to be retained to another group company

Generally transfers of assets between group companies must be made at market value. This rule does not apply to transfers of assets between members of a tax consolidated group. If the vendor wishes to retain certain depreciable assets without any adverse tax consequences, it could transfer the assets to another company within the same tax consolidated group, prior to sale. If one of the companies in the consolidated group is sold it will cease to be a member of the consolidated group. Provided the company leaving the consolidated group no longer holds assets that have been transferred to it from another consolidated group member, the sale should have no income tax consequences. General anti-avoidance provisions will need to be considered.

9.2 Declaration of dividend prior to sale

Given that a company forfeits any brought forward tax losses and imputation credits on a breach of the relevant shareholder continuity tests, the losses and imputation credits should be utilised to the extent possible prior to any share sale. One way of utilising imputation credits is to declare a pre-sale dividend or taxable bonus issue (where there are insufficient profits). A pre-sale dividend could be appropriate where the company has surplus cash or assets which can be distributed to shareholders and the company is able to impute the dividend fully.

10. De-mergers

New Zealand's income tax legislation contains no specific provisions relating to de-mergers or spin-offs. A de-merger is normally achieved by the sale of assets. However, under the tax consolidation regime reorganisations may be achieved by transferring assets between member companies with tax consequences deferred for tax purposes until an 'exit' event occurs. An exit event occurs generally only when a company leaves the consolidated group and then only to the extent that it holds assets transferred to it whilst a member of the group.

11. Listing / initial public offering (IPO)

For companies that are contemplating undertaking an IPO or otherwise listing on a stock exchange, there are a variety of New Zealand tax issues that need to be considered. Usually careful consideration of whether tax losses or imputation credits will be forfeited due to the shareholder changes will be needed. Certain tracing concessions for the shareholder ownership continuity tests could apply. To the extent there is reorganisation or transfers of assets etc in preparation for IPO / listing the New Zealand tax issues discussed above will need to be considered.

12. Preparation for a deal

The New Zealand tax and investment environment provides opportunities for structuring investments and tax efficient exit strategies. Careful planning is required to ensure that pitfalls are avoided.

Philippines

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1. Introduction

1.1 General comments on M&A in the Philippines

Mergers and acquisitions activity in the Philippines has picked-up despite last year's global recession. Major acquisitions involved independent Power Producer companies that have existing Build-Operate-Transfer agreements with the government, call centers, insurance and telecommunication companies.

The Philippines Government promotes the principles of transparency and free enterprise, and believes that economic development is best led by the private sector. Inbound foreign investment is actively encouraged and generous incentives are available for investment activities that will facilitate the country's development or export capacity. These incentives are granted to:

- Board of Investment registered enterprises;
- Philippine Economic Zone Authority registered enterprises;
- Subic Bay and Clark Freeport registered enterprises;
- regional headquarters; and
- regional operating headquarters.

Entities carrying on approved activities may take advantage of reduced / preferential tax rates or full exemption from income tax and certain taxes for a specified period (generally between four to eight years depending on the nature of tax incentives).

The most common form of business entity in the Philippines is locally incorporated companies or branches of overseas companies. Other forms of business such as partnerships (generally for professionals) and joint ventures are also available.

Investment laws permit 100% foreign ownership in an enterprise in the Philippines, unless the enterprise will be undertaking activities listed in the Foreign Investment Negative Lists (FINL). For example, a maximum of 40% foreign equity is allowed for ownership of private land and the operation of public utilities.

1.2 Corporate tax

The Philippines imposes income tax on income derived in the Philippines and in the case of domestic corporations on income derived from within and outside the Philippines.

The current corporate income tax rate which took effect on 1 January 2009 is 30%.

A minimum corporate income tax rate (MCIT) of 2% of the gross income is imposed, if it is higher than the normal corporate income tax. MCIT is imposed on domestic and resident foreign corporations from the fourth taxable year following the year in which such corporations were registered with the Bureau of Internal Revenue. MCIT is computed on an annual basis. However, beginning from the quarter ended September 2007, the computation and payment of MCIT shall also apply at the time of filing the quarterly corporate income tax return.

Further, in computing the corporate tax, effective 6 July 2008, companies are given the choice whether to claim itemised deductions or the Optional Standard Deduction (OSD). The OSD is equivalent to an amount not exceeding forty percent (40%) of the company's gross income. For this purpose "Gross Income" means the gross sales less sales returns, discounts and allowances and cost of goods sold.

Dividends received by a resident corporation from a domestic corporation are not subject to tax. Dividends received by a domestic corporation from a non-resident corporation are subject to corporate tax, however the tax paid in the foreign country may be used as tax credit or as an expense subject to certain limitations.

1.3 Withholding tax

1.3.1 On payments to non-residents

Dividends, interest, leases, royalties and other technology transfer related services, management and other service fees paid by a resident of the Philippines to non-residents may be subject to withholding tax. The rates are as follows:

	Non-treaty rate (%)	Treaty rate (%)
Interest	20	10 — 15
Dividends	15 — 30	10 — 25
Royalties (technology transfer related services)	25 — 30	10 — 25
Leases	4.5 — 7.5	10 — 25 (royalties)
Services and management fees	30	Exempt if no PE

The Philippines has a comprehensive network of double tax agreements which operate to reduce withholding tax and exempt business profits derived by a company resident in a treaty country which does not have a permanent establishment (PE) in the Philippines.

1.3.2 Branch profits tax

Any profit remitted by a branch to its overseas head office is generally subject to 15% branch profit remittance tax unless reduced by a tax treaty. However, profits from activities registered with the Philippine Economic Zone Authority are not subject to branch profit remittance tax.

1.3.3 On payments to domestic companies

- Interest payments

  Interest payments made by a domestic company to another domestic company are generally not subject to withholding tax. However, if the payor belongs to the top twenty thousand private corporations, the interest payments are subject to 2% expanded withholding tax (EWT).

  Moreover, interest payments on borrowings obtained from an expanded foreign currency deposit system of a domestic bank or offshore banking unit are subject to 10% final withholding tax.

  Interest paid on funds sourced from the public is subject to final withholding tax of 20%. Income derived by domestic corporations and individuals from a depository bank under an expanded foreign currency deposit system is subject to 7.5% final tax.

- Royalties

  Payments for royalties and services involving technology transfer by a resident to a domestic company are subject to 20% final withholding tax.

- Other payments

  Certain domestic payments are subject to EWT which is creditable against income tax due by a recipient of the relevant income. Following are some of the payments, which are subject to EWT and the applicable EWT rates:

	Applicable EWT rates
Professional and talent fees for services paid to domestic corporations and resident individuals, including fees paid to medical practitioners	15% if the gross income for the current year exceeds P720,000 and 10%, if otherwise
Income payments to partners of general professional partnerships	15% if the income payment to the partner for the current year exceeds P720,000 and 10%, if otherwise
Rent for the use of real and personal property	5%
Payments to customs, insurance, stock, real estate, immigration and commercial brokers and agents of professional entertainers	10%
Payments to certain contractors	2%
Certain payments by credit card companies to a business entity	1% based on one-half of the gross amounts paid

1.4 Value Added Tax

Generally, 12% or 0% Value Added Tax (VAT) is imposed on the sale of goods and services. The 0% VAT applies only to specific transactions.

Further, payments to non-residents for services rendered in the Philippines is subject to 12% withholding VAT. In this event, the local payer, as the withholding agent, is required to remit VAT to the Government by filing a separate return on behalf of the non-resident payee. The duly validated VAT return, however, shall be used to support the input VAT claims of the local payer.

1.5 Stamp duty

The Philippines imposes stamp duty on certain transactions evidenced by documents including:

- issuance and transfer / sale of shares, at the rates of 0.5% and 0.375% respectively based on the par value of the shares;
- loan agreement / debt instruments, at the rate of 0.5% based on the issue price of the debt instrument, provided that if the term is less than one year, the tax shall be of proportional amount in accordance with the ratio of its term in days to 365 days;
- transfer of real estate, at the rate of 1.5% based on the selling price or the market value, whichever is higher.

1.6 Other relevant taxes

1.6.1 Fringe Benefit Tax

Fringe Benefit Tax (FBT), at the rate of 32%, is imposed on the grossed-up monetary value of fringe benefits furnished or granted to the employee (except for rank and file employees) unless the fringe benefit is required by the nature of the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer. The value of fringe benefits granted is divided by 68% to arrive at the grossed-up amount.

The term “fringe benefit” is defined to mean any goods, services or other benefits furnished or granted in cash or in kind by any employer to an individual who is a non-rank and file employee.

1.6.2 Local Business Tax

Local Business Tax (LBT), at the rate not exceeding 2%, imposed on the gross sales / receipts of the preceding calendar year is payable to the local Government units where its principal and / or branch office(s) is / are located. However, LBT is not imposed on an enterprise which has been granted certain tax incentives provided certain conditions are met.

1.6.3 Real Property tTax

Real Property Tax (RPT), at the rate not exceeding 1% in the case of a province and not exceeding 2% in the case of a city or municipality within the Metropolitan Area, respectively, is imposed on the assessed value of the real properties and fixed machineries and equipment of a domestic company. An additional 1% of the assessed value of the real property may be collected, in addition to the basic RPT, for the Special Education Fund. RPT is not imposed on an enterprise which has been granted certain tax incentives provided certain conditions are met.

1.6.4 Transfer tax

Transfer tax of 0.5% is imposed on the selling price or the fair market value, whichever is higher, of the real property transferred.

1.6.5 Capital gains tax

Generally, gains from the sale of shares of stock (not traded on the stock exchange) are subject to capital gains tax of 10% (5% for the first P100,000) unless exempted under a tax treaty. The sale of shares listed and traded through the local stock exchange are also subject to Stock Transaction Tax (STT) of 0.5% based on the gross selling price, which is payable by the seller or transferor.

Generally, gains on the sale of real and personal property are subject to the normal income tax if the real property is used in trade or business. However, gains on sale of real properties which are treated as capital assets are subject to 6% final tax based on the gross selling price or fair market value, whichever is higher.

1.6.6 Percentage tax / gross receipts tax

Percentage tax ranging from 3% to 30% is imposed on the sales or receipts of certain corporations engaged in activities or industries which are not subject to the VAT. Among such activities are banking, insurance, common carriers or transportation contractor, overseas dispatch, amusement, etc.

1.6.7 Excise tax

Excise tax is imposed on certain goods or articles manufactured or produced in the Philippines for domestic sale or consumption, or for any other disposition, and to certain imported items. For imports, the excise tax is in addition to any applicable customs duties and VAT.

The Philippines has both specific excise tax (i.e. excise tax based on weight or volume capacity) and ad valorem excise tax (i.e. excise tax based on selling price or specified value of an article). Among the articles covered by excise tax are alcohol products, tobacco products, petroleum products, mineral products, jewelry, perfumes, automobiles and cinematographic films.

2. Acquisition

2.1 Stock vs asset deal

The Philippines has no restrictions on acquisitions, mergers or consolidations, unless they will result in unfair competition, or restrain trade to artificially prevent free competition in the market, or violate the foreign ownership limitation under as provided under the Constitution or the Foreign Investment Negative List.

Accordingly, general principles of taxation would apply while structuring a deal and choosing between an acquisition of assets or stock.

Whether a deal is structured as a stock deal or asset deal should largely depend on commercial considerations.

2.2 Stock acquisition

In a stock deal (for shares not traded on the stock exchange), the gain is subject to the lower capital gains tax of 10% as compared with the 30% (effective 1 January 2009) corporate income tax, payable by the seller. Sale of shares listed in the stock exchange is subject to 0.5% STT. Exemption under the relevant tax treaty may be availed of. Note, however, that there are tax treaties where exemption from STT is not covered.

Documentary stamp tax of 0.375% applies on the par value of the shares sold. The parties may agree on who will pay the DST. In practice, the buyer usually pays the DST.

2.2.1 Tax loss carried forward

Net operating losses may be carried forward by a company for a period of three consecutive years immediately following the year of such loss. However, net operating loss carry over (NOLCO) shall not be allowed if there has been a substantial change (i.e. more than 25%) in the ownership of the company.

Under the implementing regulations, it was clarified that the phrase “change in ownership” pertains to a merger, consolidation, or any form of business combination with another person only and not a direct transfer of shares. Hence, the transfer of shares from a company’s current stockholders to the buyer / investor through a straight sale of shares will not constitute a “change in ownership” for net operating loss carry-forward purposes. As a result, the tax losses can still be carried forward post acquisition. This means that in a stock deal, the NOLCO of the target company as well as its other tax assets are retained.

2.2.2 Unutilised tax depreciation carried forward

Unutilised tax depreciation is preserved under a stock acquisition.

2.2.3 Incentives

In a stock deal, the tax incentives granted to a target company are retained. Generally, approval is secured from the relevant government body on the transfer of ownership of the target company.

2.3 Asset acquisition

An asset deal allows a purchaser to select the desirable assets to be acquired and to transfer assets between one or various entities (including offshore entities) so as to optimise future intra-group payments. It often allows the buyer to step up the cost basis of acquired assets for tax purposes. This enables tax deductions to be maximised through depreciation or amortisation and / or additional interest costs if the acquisition is funded by debt.

However, in transferring the business, care should be taken to ensure that the income tax (on the gain), value added tax and local business tax (based on gross selling price), documentary stamp tax and transfer tax (particularly with respect to the transfer of property) are minimised.

Moreover, the sale / transfer of real property is subject to 0.5% transfer tax based on the selling price or the fair market value, whichever is higher.

Further, the sale of assets may be covered by the Bulk Sales Law (BSL). The primary objective of BSL is to compel the seller to execute and deliver a verified list of his creditors to their buyer, and notice of intended sale to be sent in advance to creditors. Non-compliance with the requirements under the law would not only render certain transactions void, but would also subject the violators to criminal liabilities. The sworn statement of the listing of creditors must be registered with the Department of Trade and Industry.

2.4 Transaction costs

2.4.1 VAT

- Stock deal sale of shares is not subject to VAT.

- Asset deal

  The sale of assets is subject to 12% VAT, which may be passed on to the buyer, and a maximum of 3% local business tax based on the gross selling price.

2.4.2 Stamp duty

In the case of an asset sale, documentary stamp tax applies only on sale / transfer of real property. Stamp duty is 1.5% based on the selling price or the fair market value, of the real property, whichever is higher.

2.4.3 Concessions relating to M&As

For income tax purposes, no gain or loss shall be recognised if such gain or loss occurs in connection with a plan of merger or consolidation, such as:

- a corporation (which is a party to a merger or consolidation) exchanges property solely for stock in a corporation (which is a party to the merger or consolidation);
- a shareholder exchanges stock in a corporation (which is a party to the merger or consolidation) solely for the stock of another corporation (which is also a party to the merger or consolidation); or
- a security holder of a corporation (which is a party to the merger or consolidation) exchanges his securities in such corporation, solely for stock or securities in another corporation (which is also a party to the merger or consolidation).

Likewise, the transfer of property (assets or shares) may be done through a tax-free exchange. To qualify for a tax-free exchange, the property must be exchanged for shares of the transferee entity and as a result of such an exchange, the transferor would gain control of the transferee entity. However, a ruling from the Philippine tax authorities is required to confirm the tax-exempt status of the transaction.

In addition, transfers of property (which qualify for a tax-free exchange and merger) are not subject to VAT, except for real property held for sale or lease, and documentary stamp tax.

2.4.4 Tax deductibility of transaction costs

- Stock deal

  Under a stock deal acquisition costs such as professional fees and taxes passed on to the buyer, relating to the acquisition are not deductible for income tax purposes. Costs however may be capitalised or form part of the costs of the investment and allowed as deduction when calculating any capital gains tax which is applicable in the case of a subsequent disposal of the shares.

- Asset deal

  In the case of an asset deal transactions costs may be attributed to various assets form part of the cost of the relevant assets and may be depreciated or amortised based on the tax treatment of the assets.

  Professional costs which cannot be allocated to specific assets are expensed and may be claimed as a tax deduction.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

A stock deal will not allow the buyer to step up the basis of the assets owned by the target company. Thus, it would not allow the buyer to maximise tax benefits which are generally available in an asset deal.

3.2 Asset acquisition

An asset deal often allows the buyer to step up the cost basis of acquired assets for tax purposes. This would enable the buyer to maximise tax benefits through allocating (if possible) higher costs to inventories, depreciable assets and intellectual properties.

In addition, no tax deduction is available for the amortisation of goodwill. Therefore, the purchase price on an asset deal should (if appropriate) be allocated as much as possible to inventory, depreciable capital assets, and other items (such as intellectual property) that will generate a tax deduction.

4. Financing of acquisitions

4.1 Thin capitalisation

There are no thin capitalisation rules in the Philippines.

The decision to set a debt to equity ratio is generally governed by commercial considerations or by other Government agencies (i.e. the Board of Investments in order for the Board to monitor if the company meets the requirements for the incentives granted). However, where a company is set up to take advantage of a tax concession or requires a special license from the Government (e.g. banking and insurance), the regulatory body may require certain ratios to be complied with.

4.2 Deductibility of interest

4.2.1 Stock acquisition

Interest expense incurred in respect of borrowings used to acquire shares may not be tax deductible.

4.2.2 Asset acquisition

Interest incurred on funds used to acquire a business under an asset deal is tax deductible.

5. Merger

As mentioned earlier, there are no restrictions on mergers or consolidations in the Philippines unless these will result in unfair competition, or will restrain trade to artificially prevent free competition in the market, or will violate the foreign ownership limitation as provided under the Constitution or the Foreign Investment Negative List.

However, mergers involving two corporations must be approved by a majority vote of the board of directors or trustees, by the stockholders owning or representing at least two-thirds of the outstanding capital of the constituent corporations, and by the Securities and Exchange Commission. Those involving specialised industries commonly also require approval from the appropriate government agency.

In a merger, the assets (including the tax assets) and liabilities of the absorbed companies are assumed by the surviving company. However, the absorbed company's net operating losses which have been transferred through a merger, may only be used by the surviving entity if as a result of the merger the shareholders of the absorbed companies gain control of at least 75% or more in nominal (par or stated) value of the outstanding issued shares or paid-up capital of the surviving company.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

Distribution of profits / dividends by a domestic corporation to a resident or domestic corporation shall not be subject to tax. Distributions by a domestic corporation to non-resident foreign corporations are generally subject to 30% (effective 1 January 2009) income / withholding tax. However, the tax rate may be reduced to 15% if the country where the recipient is domiciled allows a credit against the tax payable by the recipient in respect of taxes deemed to have been paid in the Philippines or if such country does not impose any tax on dividends.

Moreover, the foreign company investor may be entitled to the preferential tax treaty rate (if any).

6.2 Losses carried forward

Net operating losses may be carried forward for a period of three consecutive years immediately following the year of incurrence of such losses.

6.3 Tax incentives

Where the target company enjoys tax incentives, these would generally be lost when the business is transferred through an asset deal. However, it may be possible to obtain approval from the authority granting the incentive to ensure the continued applicability of the incentive to the transferred business.

Tax concessions enjoyed by a target company are generally preserved through a stock deal. However, prior approval from the respective Government body is required.

6.4 Group relief

The Philippines has no group relief system. Related companies are taxed separately.

7. Disposal

7.1 Stock vs asset deal

From a seller's view point, it is less complicated to sell a target company through a stock deal.

7.2 Stock sale

7.2.1 Profit on sale of stock

Generally, gains on the sale of shares (not traded in the stock exchange) are subject to capital gains tax of 10% (5% for the first P100,000). Likewise, the sale of shares traded in the stock exchange are subject to stock transaction tax of 0.5% based on the selling price. However, the sale may be exempted from capital gains tax and stock transaction tax under a relevant tax treaty.

The Philippines taxes gains derived from any subsequent disposal of an investment in the Philippines. However, this may be minimised depending on the residence of the holding company of the Philippines' target. For residents of countries such as the Netherlands and Singapore, any gains derived from the sale of the shares of the Philippines target should not be subject to tax in the Philippines. However, in respect of gains derived by the Singapore investors, the exemption would apply provided that the target's major assets do not consist of immovable property.

When acquiring a target company in the Philippines, the residence of the holding company should be considered. Setting up of a holding company in the Philippines may no longer be tax efficient due to the imposition of the 10% improperly accumulated earnings tax on unreasonable retained profits. Retention due to reasonable business needs must be proven to avoid this tax.

7.2.2 Distribution of profits

Dividends may only be declared out of the company's unrestricted retained earnings. Equity in net earnings in subsidiaries may not be declared as dividends unless received as dividends.

7.3 Asset sale

7.3.1 Profit on sale of assets

Any gains / profits on the sale of inventories or tax depreciable assets is subject to income tax in the hands of the seller. The gain is the difference between the selling price and the costs of the assets.

Likewise, any price received for goodwill is taxable in the hands of the seller. However, the buyer may claim a deduction only if the same forms part of depreciable assets, amortisable intangibles or inventories.

A corporate seller may be willing to enter into an asset deal if it has tax losses to off set against any gains from the sale of assets.

7.3.2 Distribution of profits

Dividends may only be declared out of the company's unrestricted retained earnings. Equity in net earnings in subsidiaries may not be declared as dividends unless received as dividends.

In the case of a liquidation (after all the assets are sold) corporate debts and liabilities should be settled before any distribution among stockholders is made. Debts secured by liens are entitled to some preferences. This preference is also applied to claims which are given priority by statute. Stockholders are entitled to participate in the assets, after the payment of the creditors, in proportion to the number of shares held by each, unless the articles of incorporation regulate the distribution of corporate stock among stockholders.

8. Transaction costs for seller

8.1 VAT

As stated previously VAT of 12% which is applicable on the sale of assets / business may be passed on to the buyer, while the sale of shares is not subject to VAT.

8.2 Stamp duty

The sale / transfer of shares is subject to documentary stamp tax of 0.375% based on the par value of the shares. The tax can be paid by either of the parties.

The sale / transfer of assets / business may also be subject to documentary stamp tax if it involves real property.

8.3 Concessions relating to M&As

No gain or loss shall be recognised if such gain or loss occurs in connection with a plan of merger or consolidation.

In addition, the transfers of property, which qualify for a tax-free exchange and merger are not subject to VAT and documentary stamp tax.

8.4 Tax deductibility of transaction costs

Transaction costs involving the sale of assets are deductible from gross income of the seller for income tax purposes. While transaction costs involving the sale of shares does not form part of the cost of the shares for purposes of computing the gain subject to capital gains tax.

9. Preparation of target for sale

The target's management may conduct a tax due diligence review for purposes of determining deal issues which may have an impact on the success and the pricing of the deal. Management may decide on appropriate actions in respect of the issues identified during such review. In a stock deal any outstanding tax liability and potential tax exposures remain with the target company.

10. De-mergers

Business spin-off is the most common de-merger activity in the Philippines. It usually occurs when a company with several business lines decides to sell one or more of its business segments, or split its business operations by creating a new company to undertake one or more of its business lines.

In either way, the tax effects of this procedure are similar to that of an asset sale or a tax-free exchange as discussed previously.

11. Listing / initial public offering (IPO)

Another exit route for investors may be through a listing / initial public offering (IPO). The acquisition vehicle / acquired company may be listed on the Philippines Stock Exchange (PSE) provided certain requirements are complied with.

Generally the sale of shares through an IPO is taxed at the rates specified below based on the gross selling price or gross value of the shares sold in accordance with the proportion of shares sold to total outstanding shares of stock after the listing in the local stock exchange:

Up to twenty-five percent (25%)	4%
Over twenty-five percent (25%) but not over thirty-three and one third percent (33 1/3%)	2%
Over thirty-three and one third percent (33 1/3%)	1%

The sale of shares of stock listed and traded through the PSE shall be subject to tax at the rate of 0.5 % of the gross selling price.

The sale may be exempt from the stock transaction tax (STT) under the relevant tax treaty. Note, however there are tax treaties where exemption from STT is not covered.

Under existing rules the availability of tax treaty protection needs to be preceded by an application for tax treaty relief with the Philippines tax authorities not later than 15 days from the transaction date.

Singapore

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1. Introduction

1.1 General information on M&A in Singapore

This chapter provides an overview of the main issues that are relevant to both purchasers and vendors on a transfer of ownership of a Singapore business.

A transfer of ownership of a Singapore business can take the form of a disposal of stock or assets. While there are significant differences in the tax implications of an asset or stock sale, where operational, commercial and financial objectives are to be met it may be possible to reorganise the business such that the tax benefits are optimised.

Some of the key considerations to take into account in a reorganisation exercise are set out below.

1.2 Corporate tax

Singapore adopts a territorial system of taxation where income tax is imposed on income accrued in or derived from Singapore or received in Singapore from outside Singapore. Income is received in Singapore from outside Singapore when it is remitted to, transmitted or brought into Singapore, applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore, or applied to purchase any movable property which is brought into Singapore.

The following income is however exempt from tax, subject to conditions:

- Partial or full exemption of taxable profits – of the first S$300,000 of taxable profits of a company, S$152,500 is exempt from tax. This is arrived at by exempting 75% of the first S$10,000 and 50% of the next S$290,000. The amount exempted is increased to S$200,000 in the first 3 years of operation for new start-up companies.

  The first S$100,000 of a start-up company's taxable profits are fully exempt during this period, while one-half of the next S$200,000 profits is exempt from tax.

- Singapore dividends – Singapore dividends are exempt from tax.
- Foreign-sourced income received in Singapore on or after 1 January 2003 by Singapore tax resident companies – certain types of foreign-sourced income may qualify for exemption when remitted into Singapore. They are:
  - dividend income;
  - trade or business profits of a foreign branch; or
  - service fee income derived from a business, trade or profession carried on through a fixed place of operation in a foreign jurisdiction.

In order to qualify for foreign-sourced income exemption:

- in the year in which the income is received in Singapore, the headline tax rate in the foreign jurisdiction from which the income is received must be at least 15%. The headline tax rate refers to the highest corporate tax rate of the foreign jurisdiction, but can be lower than this rate where the specified income is taxed under special tax legislation which is independent of the main body of income tax legislation in that country; and
- the income must have suffered some tax in the foreign jurisdiction from which the income is received. For dividends, the tax paid or payable by the dividend-paying company can be included but not beyond this tier. This requires some form of tracing and the Singapore tax authorities have suggested tracing methods which companies can adopt to prove that the dividends are subjected to some taxes in the dividend-paying country. These methods are however non-prescriptive. Companies are free to adopt other methods but they must be applied consistently.

Where any of the above conditions are not met, companies can still apply to the Singapore tax authorities to have the income exempt from tax when they meet certain qualifying criteria or investment structures prescribed by the authorities.

To help businesses obtain financing from their overseas investments and operations during the current economic downturn, the Singapore Government temporarily liberalised the scope of the foreign-sourced income exemption scheme for one year from 22 January 2009. Under these temporary liberalisation measures, companies will be exempt from income tax on the remittance of all foreign-sourced income earned or accrued outside Singapore prior to 22 January 2009, if they remit it to Singapore before 21 January 2010.

- Income qualifying for tax incentives – companies may be granted tax incentives where they are carrying out qualifying activities and the qualifying conditions set out for the relevant incentives are met. More details of available tax incentives are provided in section 12.

In addition to the above exemption or incentive schemes, Singapore does not tax capital gains. However, gains derived in the ordinary course of business or from a transaction entered into with the intention of realising a profit are considered revenue gains subject to tax. The relevant facts and circumstances of each case must be considered in order to determine this issue.

Once the taxable profits (net of tax deductible expenses and allowances) of a company are computed, a tax rate of 17% applies to the taxable profits for income year 2009 onwards.

1.3 Withholding tax

Generally, the following payments which are made to non-resident person are subject to withholding tax at the rates set out below:

Royalties	10%
Interest and payments in connection with loan or indebtedness	15%
Rent or payment for use of movable property	15%
Management fees and technical assistance fees	17%
Professional service fees	15%[1]

Dividend payments made to non-resident shareholders are not subject to withholding tax.

Singapore has a comprehensive network of tax treaties which operate to reduce or exempt tax on income derived by a company resident in a treaty country. Hence, the above rates may be reduced to a lower rate under the relevant treaties. As the Singapore tax legislation does not have specific anti-treaty shopping provisions, and where an arrangement (with commercial substance) takes advantage of a tax treaty, the reduced rate provided under that treaty would generally apply.

In addition, payments may fall outside the ambit of the withholding tax system in certain circumstances. In the case of technical services for example, fees relating to services which are performed entirely outside Singapore are not subject to tax as long as the transactions are conducted on an arm's length basis. This treatment is extended to management service fee payments[2] made on or after 29 December 2009 (i.e. when the legislative provisions giving legal effect to the exclusion of such services were gazetted).

Prior to that date, only management fees paid for services rendered outside Singapore that are recharged at cost are excluded, unless they are protected under a treaty.

Furthermore, interest and royalty payments may be exempt from tax under tax incentive schemes or tax concessions granted to the payer.

Where a non-resident entity conducts operations in Singapore through a branch, it is possible to obtain a waiver from withholding tax where the branch is subjected to tax under the Singapore tax filing system. In order to obtain the waiver, the branch must meet certain conditions which include being part of a substantial overseas group, having carried on business in Singapore for at least 2 years, having a good record of tax compliance and providing a letter of undertaking from the head office that it would make good the tax unpaid by the branch on the income, if any.

[1] The payee may opt to be taxed at 20% on net income.

[2] Refers to the earlier of:
(a) the contractual due date or the date of invoice in the absence of a contractual date; or
(b) when the fees are credited to the account of a non-resident person; or
(c) the actual date of payment of the fees.

Where a non-resident conducts operations in Singapore through a partnership, including a Limited Liability Partnership (LLP) or a Limited Partnership (LP), a waiver from withholding tax may be available where the partnership is subjected to tax under the Singapore tax filing system. The waiver is automatically granted where the partnership has at least one tax resident partner. In a case where they do not have a resident partner, a letter of undertaking from the partnership's head office, confirming that it will bear all outstanding tax should there be a default of tax payment by the non-resident partners, must be submitted to the Singapore tax authorities.

1.4 Goods and Services Tax

Goods and Services Tax (GST) is charged at 7% on supplies of goods and services made in Singapore by a GST registered person. There are few exemptions, the main ones being financial services, life insurance, the sale or rental of residential property, the sale or leasing of containers and container services, and sale of shares. In these cases, no GST is charged on the supply and no GST can be recovered on the costs relating to the making of that supply. GST can therefore create significant cash flow issues for both the purchaser and vendor if the transactions or arrangements are not carefully considered.

1.5 Stamp duty

Stamp duty is levied only on written documents relating to stocks, shares and immovable property. The rates vary according to the nature of the document and the values referred to in the document. Generally, the applicable rates for the following transactions are:

Transfer of shares:	0.2% of the higher of the purchase price or net asset value.
Transfer of immovable property:	Ad valorem rates of up to 3% of the higher of the purchase price or market value.
Mortgage of immovable property:	0.4% of the amount of facilities granted on a mortgage of immovable property or stocks and shares, but up to a maximum of S$500.
Lease of immovable property:	Depending on the lease term, rates range from 0.4% to 1.6%, of the higher of the contractual rent or market rent.

Exemptions may be available upon the reconstruction or amalgamation of companies, or the transfer of assets between associated companies, subject to conditions.

As the tax is levied on documents, stamp duty is payable even though the transaction may be subsequently aborted.

2. Acquisitions

2.1 Preference of purchasers: stock vs asset deal

Other than a proposed new tax framework for corporate amalgamations (more details at section 2.4.3), Singapore does not have specific legislation dealing with the tax treatment of acquisitions. Accordingly, general principles of taxation will apply. Whether the purchaser chooses to acquire shares or the business assets may largely depend on commercial considerations. However, the tax consequences are different.

2.2 Stock acquisition

Generally, it is less expensive for a purchaser to acquire a business by acquiring the shares of the company owning it where real estate is concerned. The applicable stamp duty rate for a transfer of shares is 0.2%, whereas the rates for a transfer of real property under an asset deal is as high as 3%.

Unabsorbed tax losses / capital allowances

In an asset deal, unabsorbed tax losses and capital allowances will be lost with the transfer of the business of the target company.

In a stock deal, the same tax treatment will apply, where due to the share acquisition, changes in the shareholder's shareholdings exceeds 50%.

Where changes in the shareholdings exceed the 50% threshold, the target company can seek a waiver from the authorities such that the losses and allowances survive. This is usually granted where the company can prove to the satisfaction of the authorities that the change was due to genuine commercial reasons, and is not tax driven. The waiver is granted on a case by case basis and once obtained; the unabsorbed tax losses brought forward may be set off against the target's future income but subject to the same business test.

See section 6.2 for more details of the utilisation of unabsorbed tax losses and capital allowances, and section 6.4 for group relief transfer rules.

Continuity of tax incentives / concessions

Where the target company enjoys tax incentives / concessions, the purchaser will have to acquire the stock in the company if it wishes to preserve the tax incentives / concessions and seek prior approval from the relevant Government body. See section 6.3 for further details.

2.3 Asset acquisition

An asset deal allows a purchaser to select the desirable assets to be acquired and to transfer assets between one or various entities (including offshore entities) so as to optimise future intra-group payments.

Where a vendor insists on a stock deal, but there are operational, commercial and financial objectives to support a restructuring by the purchaser after the stock acquisition, it may be possible to obtain a step-up on the tax cost base of certain assets and to justify the deductibility of interest costs.

2.4 Transaction costs

2.4.1 GST

GST is collected by a GST-registered person (i.e. vendor) and is payable by the end user (i.e. purchaser). However, supplies of goods or services, such as the transfer of shares, are exempt from GST. A transfer of a business which satisfies certain conditions can be excluded from GST.

2.4.2 Stamp duty

As noted in section 1.5, Singapore imposes stamp duty on documents relating to the transfer of shares and real estate.

2.4.3 Concessions relating to Mergers and Acquisitions

The Income Tax Act, GST Act and Stamp Duty Act provide some concessions when a company is being reorganised:

(a) For income tax purposes, where tax depreciable assets are sold to a related party, the transferor and transferee may elect to transfer these assets at tax written down value, without giving rise to a claw-back of tax depreciation previously allowed. Parties are related where the purchaser controls the vendor or vice versa or where they belong to the same group of companies. A consequence of the election is that the purchaser can only claim tax depreciation on the tax written down value of the relevant asset;

(b) For GST purposes, a transfer of a business as a going concern will not be regarded as a taxable supply and will therefore not be subject to GST. In order for a transfer of a business to qualify as a transfer of a business as a going concern, certain strict tests must be fulfilled. For example, the assets must be used by the transferee to carry on the same kind of business as that of the transferor. Where only part of a business is transferred, that part must be capable of separate operation in order for the transfer to meet the going concern requirement; and

(c) Corporate reconstructions and amalgamations may be exempt from stamp duty (on the transfer of shares or real estate as stamp duty is not applicable on the transfer of other assets) if certain conditions are met.

New tax framework for corporate amalgamation

A new tax framework for corporate amalgamations was proposed in the 2009 Budget and took effect from 22 January 2009. The new tax framework aligns the tax consequences with the effect given under statutory amalgamations carried out in accordance with the Singapore Companies Act. This is where two or more companies (amalgamating companies) merge into a single entity (amalgamated company) without seeking court approval and all assets and liabilities are transferred to the amalgamated company – or in the case of a merger which is approved under section 14A of the Banking Act. See section 5 for more details of such mergers and acquisitions.

Under the previous tax treatment, statutory amalgamations were simply treated as transfers of business assets and liabilities. No tax deductions for expenditure or losses, tax credits, exempt dividend account balances and all other items arising from the activities of the amalgamating companies will be available to the amalgamated company.

Broadly, the new framework treats the amalgamated company as having stepped into the shoes of the amalgamating companies and as continuing with those businesses. Hence, the tax treatment for assets, liabilities and tax items transferred by the amalgamating companies will continue in the amalgamated company.

While the tax treatment of items such as bad debt provisions, trading stocks, industrial buildings, capital allowances, and writing down allowances for intellectual property can continue in the amalgamated company (subject to conditions), the new framework adopts a different tax treatment for interest expenses and borrowing costs. Such expenses must meet the general deduction rule to qualify for tax deduction in the amalgamated company. A direct nexus between the money borrowed and the income earned must exist for the interest to be allowed. Hence, in a stock deal, where a loan is taken to purchase shares in one of the amalgamating companies which ceases to exist upon amalgamation, interest or borrowing costs arising from that loan will not be deductible for the amalgamated company.

Also, in addition to the carry forward rules in section 6.2, additional tests were introduced for the utilisation of unabsorbed losses, capital allowances and donations. This is that the amalgamating company which is transferring the unabsorbed losses, capital allowances and donations must not be dormant at the time of amalgamation. In addition, the amount transferred can only be set off against income of the same trade or business as that which gave rise to the losses or allowances.

Stamp duty relief and GST exclusion for qualifying amalgamations may be available under the new framework, subject to conditions. As for the transfer of tax incentives, approval must be obtained from the relevant authorities (for incentives that require specific approvals) prior to amalgamation before they can be transferred to the amalgamated company.

The new tax framework is elective. The amalgamated company must make an election in writing or by completing and submitting a prescribed form to the IRAS. The election must be made within 90 days from the date of amalgamation. However, amalgamations that took place prior to 20 January 2010 (i.e. the date of issue of the IRAS guidelines for the new framework) will have until 20 April 2010 to submit their applications.

Subject to the approval of the Minister for Finance, the new framework may be extended to other court-directed or approved amalgamations under the Companies Act or any other amalgamations that have a similar effect to that of a statutory amalgamation.

2.4.4 Tax deductibility of transaction costs

Acquisition expenses are generally not tax deductible for the purchaser in Singapore as they will be treated as capital in nature. However, expenses which may be attributed to the purchase of revenue items such as inventory should be allowable if they can be suitably apportioned to these items. Thus, if possible, it is preferable to book the expenses in a country where a tax deduction may be available.

Proposed new M&A allowance and stamp duty remission

Currently, dividends received by a Singapore acquisition company (the “buyer”) from another Singapore company (the “target”) are not taxable. Where the buyer borrows to buy the target, the interest costs are attributable to the exempt dividend income and therefore have no tax benefits.

In the new tax framework for corporate amalgamation, under which the tax features of the amalgamating companies could be transferred to the amalgamated (surviving) entity. However, borrowing and transaction costs incurred to finance the acquisition of a company which was then amalgamated remains non-deductible, even though the outcome would be that the buyer had acquired the income producing business assets of the target.

As at the date of this publication, the Singapore Government has taken a step forward along this trail in its 2010 Budget. A new M&A tax allowance and stamp duty remission will be introduced for qualifying M&A deals, to encourage companies to grow through M&A. To an extent, these measures help alleviate the continuing restrictions for interest costs outlined above, however they do not remove them. The details of the new allowances are as follows:

- An M&A allowance will be granted to qualifying M&A executed between 1 April 2010 and 31 March 2015.
- The allowance is 5 percent of the value of the acquisition, subject to a cap of S$5 million granted for all qualifying deals executed in a year of assessment. The allowance will be written down equally over five years, and is deductible against the buyer’s taxable income. At a 17 percent rate of corporate tax, this effectively gives a buyer up to S$850,000 of tax benefits, or S$170,000 a year.
- Stamp duty on the transfer of unlisted shares for qualifying M&A deals executed between 1 April 2010 and 31 March 2015 will also be waived. This remission is capped at S$200,000 of stamp duty per year.

The Singapore tax authorities will release details by June 2010.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

A stock deal does not allow the purchaser to step-up the tax cost base of assets owned by a target company. Thus, it would not allow the purchaser to maximise tax benefits which are generally available in an asset deal. In addition, there are limitations on the deductibility of financing costs associated with a stock deal (refer to section 4.2.1 below in relation to the deductibility of interest).

3.2 Asset acquisition

An asset deal often allows the purchaser to step-up the cost base of acquired assets for tax purposes. This would enable the purchaser to maximise tax benefits through allocating, if possible, higher costs to inventory, depreciable assets and intellectual property (IP). However, the effect may be equal and opposite for the vendor.

Generally, the cost of plant and equipment can be depreciated on a straight-line basis over a period of three years. The cost of automated or similar equipment may be fully depreciated in the first year. For plant and machinery acquired in accounting periods ending in 2009 and 2010, companies may elect to accelerate the straight-line basis of depreciation to two years with 75% of the depreciation claimed in the first year and the balance in the second year.

A Singapore company which purchases certain types of IP is entitled to claim a deduction on a straight-line basis over a period of five years (which may be reduced to two years for approved IP for media digital entertainment content) for capital expenditure incurred in acquiring it. The types of IP covered are patents, copyrights, trademarks, registered designs, geographical indications, layout designs of integrated circuits, trade secrets and information that has commercial value. Legal and economic ownership of the IP must be acquired. The IP must be used in the acquirer's trade or business. Third party valuations are required where the capital expenditure incurred in acquiring the IP is S$2 million or more (for unrelated party transactions) or S$0.5 million or more (for related party transactions). However, with effect from 16 December 2008, acquirers of the IP may be denied a deduction where the seller of the IP is a related party and the seller has previously claimed deductions for the creation of the IP.

No tax deduction is available for the cost of goodwill or any impairment in its value. Therefore, the overall purchase price in an asset deal should, from the purchaser's perspective, be allocated to inventory, depreciable assets and other items that qualify for tax deductions.

4. Financing of acquisitions

4.1 Thin capitalisation

There are no thin capitalisation rules in Singapore. The decision to set a debt to equity ratio is generally governed by commercial considerations. However, where a company is set up to take advantage of a tax concession or requires a special (e.g. banking, insurance, telecommunications) licence from the Government, the regulatory body may require certain ratios to be complied with.

4.2 Deductibility of interest

4.2.1 Stock deal

If a Singapore company is used to acquire a target company, interest expenses incurred on funds used to finance the acquisition are only deductible against the dividend received from the target company. As dividends received from Singapore companies are generally exempt, deductibility will generally be problematic.

4.2.2 Asset deal

Interest incurred on funds used to acquire a business under an asset deal may be tax deductible. Since Singapore does not have formal debt to equity ratio requirements for tax purposes, it is possible to be flexible with the amount of debt used to acquire a business. However, Singapore does have a standard set of transfer pricing rules which has to be observed and a new section (effective from 29 December 2009) which deals with non-arm's length transactions was inserted to the Income Tax Act.

Where, however, the business acquired consists of assets which may not produce regular returns, interest would not be tax deductible if no income is derived from those assets in a particular year. Thus, in an asset deal, it may be preferable for non-income producing assets to be acquired by separate entities and the debt / equity financing mix of each particular entity structured appropriately to maximise interest deductibility.

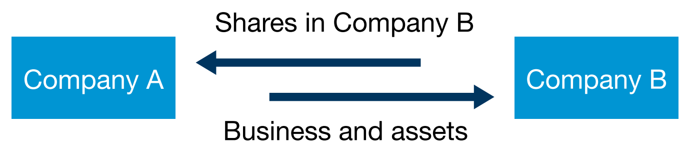
5. Mergers and acquisitions

In the Singapore context, the following options are available:

a. Transfer of trade and assets from one company to another company

Example 1

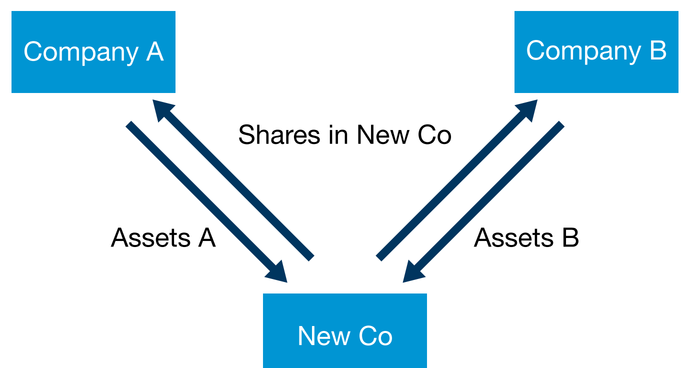
Under this example, the business and assets of the Company A are transferred to Company B in consideration for shares in Company B being issued to Company A.



Example 2

Under this example, shares in New Co are issued to Company A and Company B in proportion to the respective value of the assets transferred.

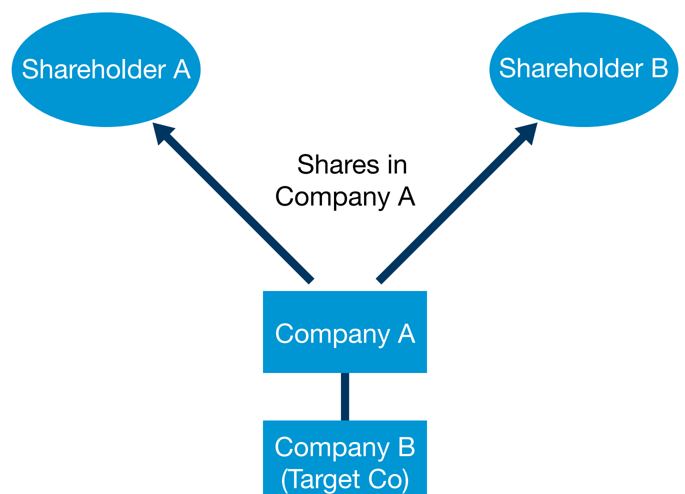
The tax implications would generally be the same as in the case of an asset deal.



b. Share swap

Example 3

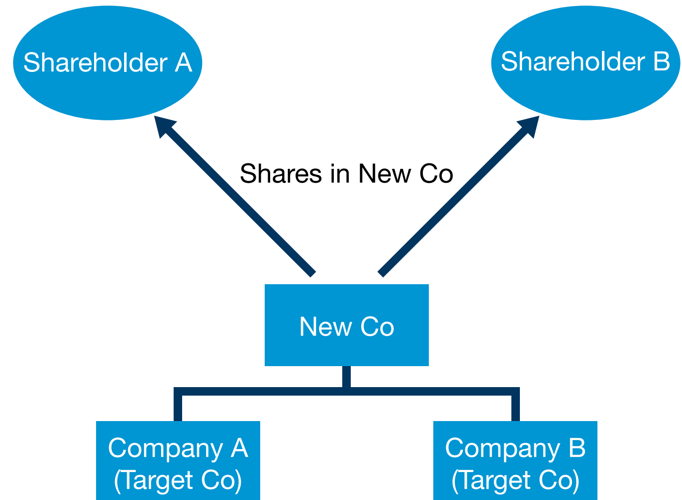
Under this example, shares in Company B are transferred to Company A, which will issue new shares to the existing shareholders of Company B.



Example 4

Under this example, shares in New Co are issued to shareholders of Company A and Company B in proportion to the respective value of the shares transferred.

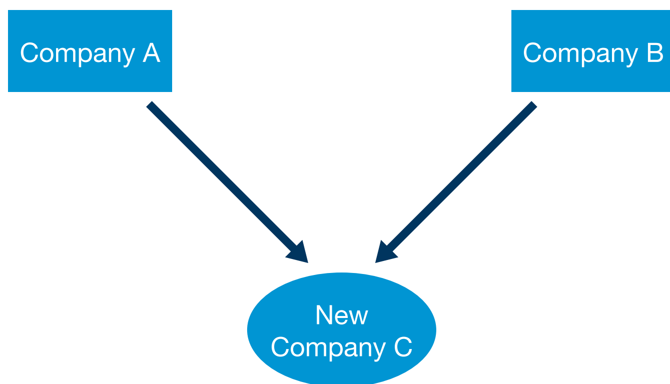
The tax implications would generally be the same as in the case of a stock deal.



c. Statutory amalgamation – where companies (i.e. amalgamating companies) merge into one single company (i.e. amalgamated company) without seeking court approval and all assets and liabilities of the amalgamating companies are assumed by the amalgamated company.

Example 5

Amalgamating companies cease to exist after the merger.

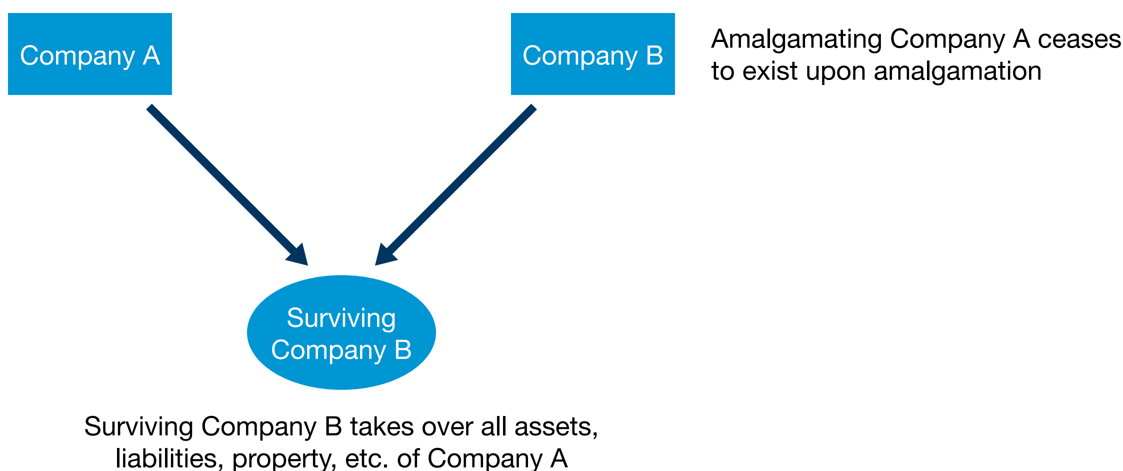


Amalgamating companies A & B cease to exist upon amalgamation

A new Company C takes over all assets, liabilities, property, etc. of both amalgamating companies

Example 6

Only one of the amalgamating companies ceases to exist.



A new tax framework where the amalgamated company will be treated as having stepped into the shoes of the amalgamating companies and continuing with those businesses and the tax consequences of a continuing business continues to apply to the amalgamated company. See section 2.4.3 for more details of the proposed tax framework.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

6.1.1 Dividend payments

Singapore does not impose any restrictions on the repatriation of profits. In addition, generally dividends are exempt from tax in the hands of the shareholders.

6.1.2 Deemed dividend payments

Companies that repurchase their shares (which may be subject to legal restrictions) are considered to have paid a dividend out of distributable profits in respect of the amount paid in excess of the contributed capital (i.e. share capital and share premium, excluding any profits capitalised through bonus issues). Similarly, payments under share capital reductions or redemptions of redeemable preference shares in excess of the original capital contribution are treated as a dividend distribution. It is important to note however that under certain circumstances, the income may not be treated as dividend income in the hands of the shareholders. The issue of whether the amount received is of a capital or revenue nature in the shareholder's hands must be considered in these cases.

6.1.3 Other payments

There are various alternatives whereby the profits of the target company may be repatriated to the home country by means other than dividends. These include the payment of royalties, interest, technical or management fees. Payment of such amounts may be subject to withholding taxes and where a relevant treaty applies, the tax rate will be reduced accordingly. See section 1.3 for more details.

6.2 Unabsorbed tax losses and capital allowances

Unabsorbed tax losses from operating a trade may be carried forward indefinitely and applied against income in future years. A company may utilise its tax loss as long as its shareholders on the last day of the year in which the loss was incurred are substantially the same as the shareholders on the first day of the year of assessment in which the loss is to be utilised. The shareholders are considered to be substantially the same if 50% or more of the shareholders at the two points in time are the same.

Unabsorbed capital allowances may also be carried forward indefinitely if the company carries on the same business, and the shareholders on the last day of the year of assessment in which the allowances arose are substantially the same as the shareholders on the first day of the year of assessment in which the unabsorbed allowances would be utilised.

A waiver from complying with the above ownership requirements may be obtained from the Singapore tax authorities where the substantial change in shareholding is not for the purpose of obtaining a tax benefit. Unabsorbed tax losses and capital allowances, which would otherwise be forfeited, may then be utilised but only against income from the same business in respect of which they were incurred or allowed.

With effect from 1 January 2006, companies are also allowed a one-year carry-back of their current year unutilised trade losses and capital allowances. An aggregate of S$100,000 of current year unutilised trade losses and capital allowances can be carried back, subject to the same shareholding test as required in the carry forward of these loss items. For accounting periods ending in 2008 and 2009 however, the maximum number of years a loss can be carried back is increased to three and the amount of losses and capital allowances claimable is increased to S$200,000.

6.3 Continuity of tax incentives

Tax incentives will generally be lost when a business is transferred under an asset deal. However, it may be possible to obtain approval from the authority granting the incentive to ensure is continued applicability to the transferred business.

Tax incentives enjoyed by a target company are generally preserved under a stock deal, unless prior approval is required as a condition of the initial granting of those incentives to the target.

6.4 Group relief

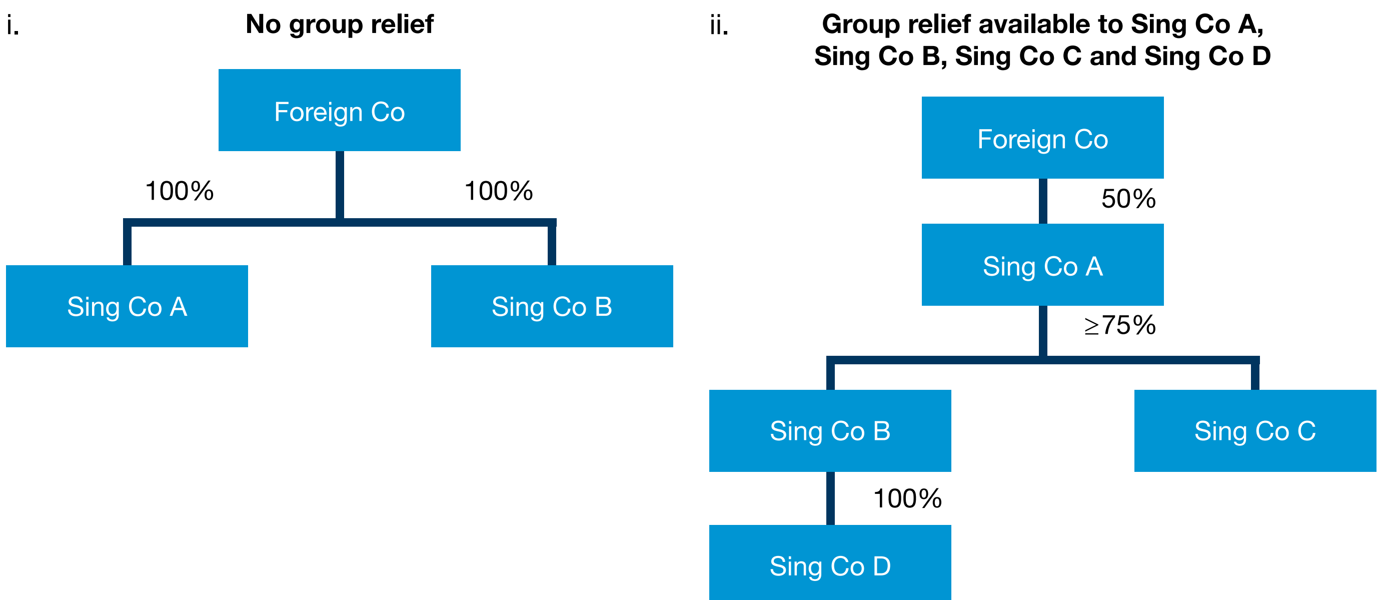
Under the group relief system, current year unabsorbed tax losses and capital allowances of a company may be set off against the assessable income of another company belonging to the same group. Two Singapore incorporated companies are regarded as members of the same group if:

- at least 75% of the ordinary share capital of one company is beneficially held, directly or indirectly, by the other; or
- at least 75% of the ordinary share capital in each of the two companies is beneficially held, directly or indirectly, by a third Singapore company.

In determining whether the minimum 75% shareholding threshold is achieved, equity interests held through foreign companies and shares with fixed dividend rights are ignored. Additionally, the shareholder company must be beneficially entitled, directly or indirectly, to at least 75% of residual profits and assets (in the case of liquidation) available for distribution to all equity holders in the relevant company.

To be eligible for group relief, the companies in question must have a common year end and the shareholding requirement must be fulfilled for a continuous period that ends on the last day of the common accounting period. If the above continuous period ends on the last day of the accounting period, but does not actually cover the entire accounting year, then only the loss items attributable to that continuous period may be transferred.

Group relief may be illustrated as follows:



7. Disposals

7.1 Preference of vendor: stock vs asset deal

From a vendor's view point, it is generally less complicated to sell a business through a stock deal.

7.2 Stock disposal

7.2.1 Profit on sale of shares

Generally, unless the vendor is a share dealer or venture capitalist, the profits derived from the sale of shares should not be subject to tax as such profits should be of a capital nature. As a result, from the vendor's perspective, it is generally preferable to sell shares. Where a vendor is a private equity investor, it is generally accepted that the acquisition would be for a short-term gain and thus the profit derived from the disposal of shares may be of an income nature. In this regard, it may be beneficial, in anticipation of a future exit, to acquire the Singapore target through a company set up offshore such that the gain is outside the scope of Singapore tax, or treaty protected, as appropriate.

7.2.2 Distribution of profits

All profits (including capital gains which have not been subject to tax) may be distributed as tax-free dividends by a Singapore resident company.

7.3 Asset disposal

7.3.1 Profits on sale of assets

In an asset deal, any consideration received for the sale of goodwill (including self-generated IP which has been used in the business) should not be subject to tax in the hands of the vendor. However, any profits on the sale of inventory or tax depreciable assets (i.e. to the extent of the tax depreciation recouped) should be subject to tax. Under certain circumstances, the inventory may be treated as trading stock for the purposes of section 32 of the Income Tax Act and transferred at cost in a restructuring exercise. Hence, the vendor can manage his tax costs on the disposal of the inventory.

As discussed in section 2.4.3, the assessable balancing charge may be avoided in a transfer of assets between related parties. An election must however be made where the vendor intends to retain certain assets in another group company.

A corporate vendor may be prepared to enter into an asset deal if it has unabsorbed tax losses or capital allowances, or if the sale price of the inventory and tax depreciable assets is not substantially higher than their tax value.

In allocating the overall sale price to specific assets sold, unless trading stock or transfer of assets between related party rules (as mentioned above) apply, the value allocated to inventory and tax depreciable assets should be on an arm's length basis, otherwise the allocation may be challenged by the tax authorities.

7.3.2 Distribution of profits

All profits (including capital gains which have not been subject to tax) may be distributed as tax-free dividends by a Singapore resident company.

8. Transaction costs

8.1 GST

The GST rate is 7%. GST is collected by a GST-registered service provider (i.e. vendor) and is payable by the end user (i.e. purchaser). However, certain goods or services, such as transfers of shares are exempt from GST. A transfer of a business which satisfies certain conditions is also excluded.

8.2 Stamp duty

As indicated in section 2.4.2, stamp duty is generally payable by the purchaser unless otherwise stated in a contract.

8.3 Concessions relating to M&As

As stated in section 2.4.3 above, the Income Tax Act, GST Act and Stamp Duty Act provide concessions when a company is being reorganised.

8.4 Tax deductibility of transaction costs

Transaction costs are generally not tax deductible to the vendor in Singapore, except for any expenses which may be attributed to the sale of inventory.

9. Preparation of target company for sale

9.1 Transfer of certain assets to another group company

As discussed in section 2.4.3, it is possible to elect for the transfer of assets between related parties to occur at tax written down value, so that the transferor is not subject to an assessable balancing charge. This election may be useful in the context of a stock deal where the vendor wants to transfer certain assets which are to be retained by another group company.

9.2 Declaration of dividend prior to sale

One means of extracting surplus cash in a company that is identified for sale is through dividends. This also has the effect of reducing the value should any disposal gain be taxable.

10. De-mergers

There are no specific provisions in relation to de-mergers. A de-merger usually takes place through the sale of assets or business. It is important to note that any unabsorbed tax losses or capital allowances may not be transferable. The implications of a de-merger would generally be the same as for an asset deal.

11. Trade sale or listing / initial public offering (IPO)

After acquiring a target, a financial purchaser generally looks for an exit route either through a trade sale or a public listing. Since the objectives of a financial purchaser are to maximise its return on investment and optimise its exit multiples, any profit derived from the exit route through an asset or share sale are generally regarded as income subject to tax. To realise profits in a tax efficient manner, an appropriate structure should be put in place to effect the acquisition.

12. Tax incentives

As mentioned earlier, there are a number of tax incentives granted for doing business in Singapore. These include the following:

- regional headquarters / international headquarters awards;
- pioneer incentive;
- investment allowance;
- development and expansion incentive;
- overseas enterprise incentive;
- enterprise investment incentive;
- financial sector incentive scheme;
- finance and treasury centre;
- approved fund managers;
- approved international shipping enterprise;
- global trader programme; and
- approved venture company.

Entities carrying on approved activities may take advantage of a concessionary tax rate ranging from 0% to 15% for a specified period (generally between 5 to 15 years) on specified income, depending on the particular tax incentive and the outcome of negotiations with the relevant Government agency.

A detailed list of a the all the tax incentives, with details of the key criteria and benefits, is available at http://www.pwc.com/extweb/pwcpublications.nsf/DocID/4610e4db559ef813852569a6001fc64c/$file/tff2007.pdf.

Sri Lanka

Country M&A team

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1. Introduction

1.1 General information on M&A in Sri Lanka

A transfer of ownership of a Sri Lanka business entity can take the form of a disposal of its stock or of its assets. The tax implications arising from a disposal of stock significantly differ from those arising from a disposal of assets.

The Government of Sri Lanka encourages foreign investment, subject to some restrictions, the details of which are given in Appendix A.

Many fiscal incentives are accorded to industrial and other business activities promoted by the Sri Lankian Government. A detailed list of such incentives is provided in Appendix B.

1.2 Corporate income tax

Tax residents of Sri Lanka are taxed on their worldwide income. Non-residents are taxed only on their profits and income arising in, or derived from, Sri Lanka, which are defined to include all profits and income derived from services rendered in Sri Lanka, or from property in Sri Lanka, or from business transacted in Sri Lanka, whether directly or through an agent.

A resident company, for purposes of income tax, is one which has its registered or principal office in Sri Lanka or whose business is managed or controlled from Sri Lanka.

The current standard rate of income tax for a company is 35%, effective from the Year of Assessment 2006 / 2007. Lower rates of 10%, 15% or 20% apply to some specific activities.

The corporate income tax rates for the years of assessment 2008 / 2009 and 2009 / 2010 are as follows —

On profits and income	2008 / 2009 (%)	2009 / 2010 (%)
Companies engaged in non-traditional exports, promotion of tourism, construction work and for overseas management activities paid for in foreign currency	15	15
Companies with taxable income not exceeding Rs. 5 million (Other than a unit trust mutual fund or a venture capital company, or a holding company, a subsidiary of a group of company)	15	15
Specialised Housing Banks	20	20
Existing venture capital companies or new venture capital companies not qualified for tax exemption	20	20
Unit Trusts and Mutual Funds	10	10
Companies offering professional services in Sri Lanka to persons outside Sri Lanka for payment in foreign currency remitted through a bank	15	0
Shipping Agents approved by Director of Merchant Shipping in respect of profits attributable to trans-shipment fees received in foreign currency	15	15
All other companies: Quoted Public for the first 5 years of assessment from the year of assessment which it becomes a quoted company.	33 1/3	33 1/3
Others	35	35

Social responsibility levy is payable at —

- 1.5% for the Years of Assessment 2008 / 2009 and 2009 / 2010 of the amount of income tax, dividend tax and remittance tax payable.

1.3 Taxation of dividends

Dividends are generally subject to withholding tax of 10% of the gross dividend, unless otherwise distributed out of tax exempt profits by a company, which has entered into an agreement with Board of Investment of Sri Lanka (BOI) under Section 17 of the BOI Law No 4 of 1978, prior to 6 November 2002 or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the BOI under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

The tax withheld is required to be paid to the Sri Lanka tax authorities within 30 days of distribution of the dividends.

Non-resident companies are required to pay remittance tax at 10% of the remittance of profits abroad.

Corporate shareholders are not required to include dividends in their assessable income if such dividends are paid by a resident company, which has deducted tax from the said dividends, or the dividends are paid out of dividends received from another resident company. The 10% dividend tax paid will be the final tax applicable on any dividends distributed. Dividends received from abroad through a bank by a resident shareholder are exempt from income tax.

1.4 Withholding tax

Dividends, interest, rent, royalties and service fees paid by a person or partnership to another person or partnership are subject to withholding tax. The rates are as follows:

	Paid to resident person	Paid to non-resident person
Dividends	10%	10%
Interest	10%	20%*
Royalty / annuity>50,000 pm or 500,000 pa	10%	20%*
Service or management fees	5%	5%
Non-residential rents	10%	20%
Lottery prizes > Rs 500,000	10%	10%

**Lower rate of 10% applies with respect to countries with which Sri Lanka has entered into double taxation treaties.*

Withholding tax paid may be set off against the income tax payable by the recipient concerned, provided such income is included in their taxable income.

1.5 Value Added Tax

Value Added Tax (VAT) is chargeable at the time of supply on the value of goods imported by any person and on the value of the local supply of goods or services made by a registered person at the following rates.

Category	Rate	Items	Input tax allowability
Zero rated	0%	Applies to export of goods, services connected with international transportation of goods and passengers, and with any movable or immovable property outside Sri Lanka, any services provided to a person outside Sri Lanka to be consumed outside Sri Lanka, for which payment is received in full in foreign currency through a bank in Sri Lanka.	Full, other than on goods and services chargeable to output VAT at 20%, on which input VAT credit is restricted to 12%
Standard rate	12%	Items not included under zero rate and luxury rate, and other than exempt and excluded supplies	12%
Luxury rate	20%	Applies to goods deemed on luxury goods — any kind of liquor, air conditioners, refrigerators, washing machines, dish washing machines, television sets, television antennas, cameras, motor vehicles (other than three wheelers, passenger transport buses, motor cycles, bicycles) services provided by hotels, restaurants for wedding receptions and other similar receptions and supply of financial services.	12%

1.6 Stamp duty

Stamp duty was re-imposed under the Stamp Duty (Special Provisions) Act, No. 12 of 2006, effective from 04 April 2006.

Stamp duty is chargeable on every specified instrument:

- Executed, drawn or presented in Sri Lanka; or
- Executed outside Sri Lanka being an instrument which relates to property in Sri Lanka at the time of such instrument presented in Sri Lanka at rates prescribed in the Gazette.

1.7 Economic Service Charge

Economic Service Charge (ESC) is levied quarterly, effective from 1 April 2006, on every person or partnership in respect of the liable turnover of every trade, business profession or vocation carried on by such person or partnership, provided the liable turnover is not less than Rs 7.5 million in the relevant quarter. The maximum ESC chargeable is Rs 30 million for a quarter.

ESC rates

ESC rates applicable for any quarter commencing on or after 1 April 2007 are as follows:

On such part of the liable turnover —	Rates %
1 As consists of the turnover from any trade or business of a distributor	0.05
2 As consists of the turnover of —	
(a) Export of apparels or the supply of locally manufactured textiles to apparel exporters for use in the manufacture of apparels for export by such exporter	0.1
(b) Any BOI approved trading house engaged in the business of the export of apparels	0.1
(c) The relevant turnover from any entrepot trade conducted by any consignor or consignee in respect of the export of any goods	0.1
3 As consists of the turnover from —	
(a) Any trade, business, profession or vocation:	0.25
(i) The profits of which are exempt from income tax	
(ii) Of any enterprise which has entered into an agreement with the BOI and which enjoys income tax exemption on its profits	
(b) Any trade or business which deals in wholesale or retail (other than as a distributor or dealer in motor vehicles or liquor)	0.25
(c) Primary conversion of any tea, rubber or coconut plantation including desiccated coconut, coconut oil, coconut fibre, copra and sheet rubber (other than any conversion which produces any alcoholic beverage)	0.25
(d) Export of any article or goods	0.25
4 As consists of the turnover from —	
(a) Any trade or business which deals in wholesale or retail (other than as a distributor) of motor vehicles or liquor not manufactured by the dealer	0.5
(b) Any trade, business, profession or vocation of any venture capital company, unit trust or mutual fund	0.5
(c) Any trade, business, profession or vocation of which the taxable income does not exceed Rs 5 million	0.5
(d) Any trade, business, profession or vocation	
(i) The profits of which are chargeable at lower rates specified in the 5th schedule to the Inland Revenue Act other than item 28 of that schedule	0.5
(ii) Of any enterprise which has entered into an agreement with BOI and whose profits are chargeable at the rates equal to the rates specified in the 5th schedule to the Inland Revenue Act	0.5

5 As consists of the turnover from —	
(a) Any trade or business of carrying on any lottery or betting or gaming activity	1.0
(b) Any trade, business, profession or vocation the profits of which are chargeable at any rate other than a rate specified in the 5th schedule to the Inland Revenue Act	1.0
(c) Any business of freight forwarder in relation to turnover reduced by the sum payable on account of the carriage as per Gazette No 1502 / 10 of 20/06/2007	1.0
(d) Any trade or business of export of cut and polished diamonds from raw diamonds imported in relation to the turnover on the excess of the FOB value of such exports over the CIF value of such raw diamonds	1.0
(e) Any trade or business of export of garments manufactured from materials imported on NFE basis in relation to the turnover on the excess of the FOB value of such exports over the CIF value of such materials	1.0
(f) Any trade or business of primary dealer in relation to the turnover on the excess of proceeds of sale of securities held by such primary dealer over the aggregate of	1.0
(i) sum invested in that quarter in the purchase of securities and	
(ii) the interest paid or the discount allowed by such primary any repurchase transaction entered into in that quarter.	

ESC may be set off against the total income tax payable for the relevant year; any balance may be set off against the total income tax payable for the next four succeeding years. No part of the ESC is refundable.

1.8 Share Transaction Levy

Share Transaction Levy at the rate of 0.2% is imposed on the buyer as well as the seller on the turnover on listed share transactions.

1.9 Stamp duty on unlisted shares

Stamp Duty of Rs.5 for each Rs.1000 or part thereof on the market value of unlisted shares is payable at the time of the transfer of such shares. Stamp duty is payable by the buyer of the shares.

1.10 Other taxes

Excise duties and Special Excise Levies are charged on tobacco, cigarettes, liquor, motor vehicles and selected petroleum products.

2. Acquisitions

2.1 The preference of purchasers: stock vs assets deal

Sri Lanka does not have specific legislation dealing with the tax treatment of acquisitions. Accordingly, general principles of taxation would apply when structuring a deal and choosing between an acquisition of assets or of stock.

Whether a deal should be structured as a stock deal or asset deal may largely depend on commercial considerations.

2.2 Stock acquisition

Generally, it is less expensive for a purchaser to acquire the business under a stock deal, as currently no stamp duty is payable on a transfer of listed stock. However, 0.2% share transaction levy is payable by the seller and the buyer on the turnover of such stocks.

2.2.1 Preservation of tax losses

Where a target company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business via a stock deal, as there are no provisions for the transfer of losses from one entity to another. The tax statute provides that, where there has been a change in the ownership of a company resulting in more than 33 1/3% of the issued capital of that company being held directly or through nominees who did not hold such share capital in the tax year in which the loss was incurred, the carry forward losses may only be set off against the profits derived from the same business.

The amount of loss incurred by a company in any year of assessment in any trade, business, profession or vocation, including any brought forward loss, may be set off only up to 35% of the total statutory income excluding any income that does not form part of the assessable income.

However, any loss incurred on or after 1 April 2007 from the business of life insurance could be set off against the profits from the business of life insurance included in the total statutory income. Similarly, from 1 April 2008 any loss incurred in any business of finance leasing can be set off only against any profits from leasing business included in the statutory income.

2.2.2 Continuity of tax incentives

Where the target company enjoys any tax incentives, the business has to be acquired via a stock deal to ensure the continued applicability of the incentives.

2.3 Asset acquisition

An asset deal allows a purchaser to select the desirable assets to be acquired and to transfer assets between one or more entities (including offshore entities) so as to mitigate the future inter-group tax payments.

2.4 Transaction costs

2.4.1 Value Added Tax

- Stock deal

The transfer of shares is exempt from VAT.

- Asset deal

A transfer of a continuing business which satisfies certain conditions is also exempt from VAT. The transfer of assets is however, liable to VAT at the standard rate of 12% or luxury rate of 20% depending on the type of the assets. If the asset is used in the business, the input VAT suffered could be claimed, provided the asset is purchased from a VAT registered person, subject to the 12% restriction where output VAT had been paid at 20%.

2.4.2 Stamp duty on immovable property

Stamp duty is payable to Provincial Councils on the transfer of immovable property. Stamp duty is payable by the purchaser at 3% on the first Rs 100,000 of the consideration and 4% on the balance consideration (or market value in the absence of a consideration) in excess of Rs 100,000.

2.4.3 Share transaction levy

A levy at the rate of 0.2% is imposed on both the buyer and seller on the turnover on listed share transactions.

2.4.4 Tax deductibility of transaction costs

The share transaction levy is not tax deductible to the buyer in computing profits and income for income tax purposes. Similarly, the stamp duty, if levied, would also not be deductible for income tax purposes as it relates to a capital transaction.

Any input VAT not claimable can be capitalised and added to the purchase price of the relevant assets acquired.

3. Financing of acquisitions

3.1 Thin capitalisation

Effective from 1 April 2006, any interest payment made between members of a group of companies is restricted in computing profits and income for income tax purposes in the debt-equity ratio of 3:1 in the case of manufacturing companies and 4:1 in the case of other companies.

3.2 Deductibility of interest

3.2.1 Stock deal

Prospective buyers can utilise domestic loans to fund an acquisition. There are, however, restrictions placed on Sri Lankan companies raising debts from overseas markets.

Interest on loans and overdrafts is deductible only if such loans and overdraft are used in any trade, business, profession or vocation. Interest on any loan taken to purchase stocks is not deductible for tax purposes unless buying and selling of stock is the business of the company.

3.2.2 Asset deal

Interest incurred on loans used to acquire assets under an asset deal is tax deductible, provided such assets are used in the production of income.

4. Mergers

There are no specific provisions relating to mergers. Specifically, the transfer of carry forward losses and of unabsorbed capital allowances may not be made from the merging entities to the merged entity. Thus, where a company has substantial tax losses or unutilised capital allowances, the profit making company should, subject to commercial considerations, be merged into the loss making company.

5. Other structuring and post deal issues

5.1 Repatriation of profits

Sri Lanka does not impose any restrictions on the repatriation of profits, other than on any capital profit. Dividends distributed out of prior year profits need specific exchange control approval for remittance abroad.

5.2 Losses carry forward and unabsorbed capital allowance

Operating losses may be carried forward indefinitely and applied against income in future years. However, the amount of losses that may be set off is restricted to 35% of the total statutory income, excluding any income that does not form part of the assessable income. Any loss incurred from the business of life insurance can be set off only against the profits from the business of life insurance included in the total statutory income, and any loss incurred in any business of finance leasing could be set off only against the profits from such leasing business included in the total statutory income.

5.3 Continuity of tax incentives

Where the target company enjoys any tax incentives the business has to be acquired via a stock deal to ensure the continued applicability of the incentives.

5.4 Group relief

No such group relief system is available in Sri Lanka.

6. Disposals

6.1 The preference of seller: stock vs assets deal

From a seller's viewpoint, it is less complicated to sell a target company through a stock deal.

Generally, when the investor wants to exit, they may sell their investment through a stock or asset deal. Where a non-resident investor is selling stock in a Sri Lankian company, the investor will not be exposed to a liability to income tax on any gains arising from sale of unlisted stocks.

However, listed stocks would attract a share transaction levy of 0.2% on the sale / purchase price from both the buyer and the seller; and unlisted stocks would attract the stamp duty of 0.5% on the market value of such stocks.

Listing the stock of the target company will also avoid exposure to stamp duty, if any, on subsequent transfers of stock.

If the exit is via a sale of assets, the seller will be liable to income tax on the profit on sale. From a tax efficiency perspective, a stock deal is the preferred route.

6.2 Stock disposal

6.2.1 Profit on sale of stock

Gain from sale of listed and unlisted stocks is not liable to income tax.

6.2.2 Distribution of profits

Dividends are generally subject to withholding tax of 10% of the gross dividend unless otherwise distributed out of tax exempt profits by a company which has entered into an agreement with the BOI of Sri Lanka under Section 17 of the BOI Law No 4 of 1978 prior to 6 November 2002 or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the BOI under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

Corporate shareholders are not required to include dividends in their assessable income if the dividends are paid by a resident company which has deducted tax from the dividends or the dividends are paid out of dividends received from another resident company. 10% dividend tax paid will be a final tax applicable to any dividends distributed.

Avenues by which profits of the target company could be repatriated to home country (other than by way of dividends), include such payments as interest, royalties, technical and management fees. However, the tax authorities may disallow payments in excess of what is considered reasonable and commercially justifiable.

6.3 Asset disposal

6.3.1 Profit on sale of assets

In an asset deal, any price received for goodwill (including self generated intellectual property which has been used in the business) should not be subject to tax in the hands of the seller. However, any profits on the sale of inventories or tax depreciable assets (i.e., to the extent of the tax depreciation recouped) should be subjected to tax in the hands of the seller.

A corporate seller should be prepared to enter into an asset deal if it has tax losses or un-utilised tax depreciation, or if the sale price of the inventories and tax depreciable assets are not substantially higher than their book value.

In allocating the price for the assets sold, the value allocated to inventories and tax depreciable assets should be on an arm’s length basis, otherwise it may be challenged by the tax authorities.

6.3.2 Distribution of profits

Dividends are generally subject to withholding tax of 10% of the gross dividend unless otherwise distributed out of tax exempt profits by a company which has entered into an agreement with the BOI of Sri Lanka under Section 17 of the BOI Law No 4 of 1978 prior to 6 November 2002, or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the BOI under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

Corporate shareholders are not required to include dividends in their assessable income if the dividends are paid by a resident company which has deducted tax from the dividends or the dividends are paid out of dividends received from another resident company. 10% dividend tax paid will be a final tax applicable to any dividends distributed.

Avenues by which profits of the target company could be repatriated to the home country, (other than by way of dividends), include: interest, royalties, technical and management fees. However, the tax authorities may disallow payments in excess of what is considered reasonable and commercially justifiable.

7. Transaction costs for sellers

7.1 Profits on sale of assets

An asset deal could involve the disposal of assets on which depreciation for tax purposes has been deducted and the disposal of assets on which tax depreciation has not been deducted.

The gain representing the excess of the sale proceeds over the tax depreciated value on the sale of assets is taxed at normal rates as part of business profits.

The profit from the disposal of assets (tangible and intangible) on which tax depreciation has not been deducted is not subject to tax.

The assets should be transferred at their open market value. In certain circumstances in respect of depreciable assets, the tax authorities may accept a valuation based on the net book value.

7.2 Value Added Tax

The sale of assets will be subject to VAT at 12% (20% if falling into the category of luxury goods). The seller has to charge and account for VAT to the tax authorities. However, if the buyer is VAT registered, the buyer is entitled to claim a credit in respect of the VAT paid, subject to the 12% restriction where output VAT has been paid at 20%. There is also a general restriction where the total allowable input tax can be claimed only up to 85% of the output tax with provision for the balance to be carried forward.

7.3 Stamp duty

Stamp duty, if imposed, would generally be payable by the purchaser unless otherwise stated in a contract.

7.4 Concessions relating to mergers and acquisitions

No tax concessions are available with respect to mergers and acquisitions.

7.5 Tax deductibility of transaction costs

Transaction costs are generally not tax deductible to the seller in Sri Lanka except any expenses which may be attributed to the sale of inventories.

8. Preparation of a target company for sale

8.1 Declaration of dividend prior to the sale

One of the means of extracting surplus cash in a company that is identified for sale is through the payment of dividends. Where the company identified for sale has revenue reserves that could be distributed, dividends should be declared to the maximum extent provided the payment of dividends does not adversely affect the sale price.

9. De-mergers

There are no specific provisions in relation to de-mergers. A de-merger usually takes place through the sale of assets or a business. It is important to note that any brought forward losses, unabsorbed capital allowances may not be transferred. The implications for a de-merger would be the same as an asset deal as discussed in section 2 — Asset acquisition.

10. Listing / initial public offering (IPO)

Generally, when an investor wants to exit, they may sell their investment through a stock or asset deal. Where a non-resident investor is selling stock in a Sri Lankian company, the investor will not be exposed to liability to income tax on any gains arising from such sale.

However, listed stock would attract a share transaction levy of 0.2% on the sale / purchase price or from the buyer and the seller each; and unlisted stocks would attract the stamp duty of 0.5% for the market value of such stocks.

Listing shares of the target company will also avoid exposure to stamp duty, if any, on subsequent transfers of shares.

If the exit is via a sale of assets, the seller will be liable to income tax on the profit on sale. From a tax efficiency perspective, a share deal is the preferred route.

Avenues by which profits of the target company could be repatriated to the home country (other than by way of dividends), include: interest, royalties, technical and management fees. However, the tax authorities may not allow payments in excess of what is considered reasonable and commercially justifiable.

Appendix A

1. Common forms of business entity

Business may be conducted in Sri Lanka in any of the following forms:

- Company incorporated in Sri Lanka
  - Private
  - Public
  - Quoted
- Branch office of an overseas
- Partnership
- Sole proprietorship
- Offshore company

Private limited liability companies and branches of foreign companies are most commonly used by foreign investors. Certain tax concessions are available to foreign investors, depending on the amount of investment and type of business activity carried out in Sri Lanka.

2. Foreign ownership restrictions

Since the opening of Sri Lanka economy in 1977, Sri Lanka has adopted a policy of encouraging foreign investment. Except for investment in certain business activities (see below), foreign investors are permitted to set up wholly owned subsidiaries in Sri Lanka.

The following businesses are restricted to citizens of Sri Lanka:

- Money lending
- Pawn broking
- Retail trade with a capital of less than one million US dollars
- Coastal fishing
- Providing personal services other than for the export and tourism sectors

3. Areas subject to automatic or conditional approval

Foreign investments in the areas listed below will be approved, limited to 40% of equity. Foreign ownership in excess of 40% will be approved on a case by case basis by the BOI.

- Production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions
- Growing and primary processing of tea, rubber, coconut, cocoa, rice, sugar and spices
- Mining and primary processing of non-renewable natural resources
- Timber based industries using local timber
- Fishing (deep-sea fishing)
- Mass communications
- Education
- Freight forwarding
- Travel agencies
- Shipping agencies

4. Regulated areas

Foreign investments in the areas listed below will be approved by the respective government agency or BOI (up to the percentage of foreign equity specified by BOI). The BOI assists potential investors by referring applications to the appropriate agency and approval is usually straightforward:

- Air transportation
- Coastal shipping
- Industrial undertaking in the Second Schedule of the Industrial Promotion Act No. 46 of 1990, namely:
  - any industry manufacturing arms, ammunitions, explosives, military vehicles and equipment aircraft and other military hardware, any industry manufacturing poisons, narcotics, alcohols, dangerous drugs and toxin, hazardous or carcinogenic materials, any industry producing currency, coins or security documents.
- Large scale mechanised mining of gems
- Lotteries

Appendix B

Tax incentives

1. Introduction

Sri Lanka offers private investors fiscal incentives designed to stimulate investment, in the expectation that more investment in the Sri Lanka economy would produce enhanced employment opportunities, yielding higher income for Sri Lankans. Tax holidays, tax-rate concessions and customs duty waivers have been the major instruments granted under the incentive system.

Fiscal incentives are offered by the investment authority; the BOI of Sri Lanka; and also under the tax statute. Pursuant to rationalisation of the incentive structures, the fiscal incentives now offered by the BOI follow substantially similar incentives offered under the tax statute. Discussed below are the current fiscal incentives offered under the tax statute, and under the BOI.

2. Agricultural and industrial projects

2.1 Qualifying activities

Tax incentives are granted in respect of the profits of:

(i) An undertaking carried on by a company incorporated on or after 1 April 2002 with a minimum investment of Rs 10 million, for:

- Agriculture (i.e cultivation of land with plants of any description and rearing of fish)
- Agro processing (i.e processing of any agricultural product or fishing product other than processing of black tea in bulk)
- Industrial and machine tool manufacturing
- Information technology and allied services
- Electronics
- Export of non-traditional products which means export of any goods (other than export of black tea in bulk, crepe rubber, sheet rubber, scrap rubber, latex, fresh coconuts) including deemed export of goods (i.e manufacture of non traditional products and supplied to an exporter), where not less than 80% of the total turnover of such undertaking for any year of assessment is from the export or deemed export of such non-traditional goods.
- Animal husbandry including poultry farms, veterinary and artificial insemination services and other support services.
- Deep sea fishing
- Manufacture of machinery

(ii) An undertaking carried on by a company on or after 1 April 2002 but before 1 April 2004 with an investment in excess of Rs 250 million.

(iii) Any designated project carried on by a company incorporated before 1 April 2002 and which undertaking commenced operations on or after 1 April 2004, with a minimum investment of Rs 50 million.

The designated projects are as follows:

- Manufacture of ceramics, glassware or other mineral based products
- Manufacture of rubber based products
- Any project in light or heavy engineering industries
- Any project engaged in the provision of refrigerated transport services or cold room storage services
- Export production village company
- Management of any offshore company or maintaining a back office in relation to any activity in a foreign country

(Note: The minimum investment is not required in respect of an Export Production Village Company.)

(iv) Any pioneering project carried on by a company on or after 1 April 2004 with an investment in excess of Rs 250 million.

2.2 Incentives offered are as follows:

Period		Tax rate
Where the tax exemption period commences prior to 1 April 2008		
1 — 5th year*		0%
Where the tax exemption period commences after 31 March 2008		
1 — 3rd year		0%
After the end of the tax exemption period for every year of assessment commencing on or after 1 April 2008		
Immediately succeeding	1st year	5%
	2nd year	10%
	3rd year	15%
Thereafter		Normal rates

Where the investment exceeds Rs 1 billion in any pioneering undertaking, the concessions offered for any year of assessment commencing on or after 1 April 2008 will be as follows:

Amount of minimum investment Rs (million)	Tax exemption period (Years)
1,000 to 2,499	8*
2,500 and above	10*

After the end of the tax exemption period		Tax rate %
Immediately succeeding	1st year	5%
	2nd year	10%
	3rd year	15%
Thereafter		Normal rates

** The tax exemption period will be granted from the tax year in which the undertaking commences to make profits but not later than two years from the commencement of commercial operations*

3. Infrastructure projects — large scale

3.1 Qualifying activities

Tax incentives will be granted to any company on its profits and income from an undertaking carried on by it on or after April 1, 2002 for

- Development of any airport, sea-port, highway or railway
- Development of any industrial park
- Development of any warehouse or store
- Provision of any sanitation facility or solid waste management system
- Power generation, transmission or distribution
- Development of water services
- Urban housing or town centre development

3.2 Qualifying investment criteria and incentives offered are as follows:

Amount of minimum investment (Rupees million)	Tax exemption period* (Years)
1,000	6
2,500	8
5,000	10
7,500	12

** The tax exemption period is in the same manner as for agricultural and industrial projects. This exemption is restricted to the profits and income of any undertaking commencing prior to 1 April 2009.*

After the expiry of the tax exemption period for any year of assessment commencing on or after 1 April 2008

Period		Tax rate %
Immediately succeeding	1st year	5%
	2nd year	10%
	3rd year	15%
Thereafter		Normal rates

4. Infrastructure projects — small scale

4.1 Qualifying activities

Tax incentives will be granted to any company on its profits and income from an undertaking carried on by it on or after April 1, 2002 and which is engaged in infrastructure development for:

- Generation of power
- Tourism
- Recreation
- Warehousing and cold storage
- Garbage collection and disposal
- Construction of houses
- Construction of hospitals
- Re-development of housing schemes

4.2 Qualifying investment criteria

Investment of not less than 10 million rupees but not exceeding 50 million rupees which investment should be made within one year of commencement of the undertaking.

4.3 Incentives offered are as follows:

Period		Tax rate
Where the tax exemption period commences prior to 1 April 2008		
1st — 5th year*		0%
Where the tax exemption period commences after 31 March 2008		
1st — 3rd year		0%
After the end of the tax exemption period for every year of assessment commencing on or after 1 April 2008		
Immediately succeeding	1st year	5%
	2nd year	10%
	3rd year	15%
Thereafter		Normal rates

** The tax exemption period is in the same manner as for agricultural and industrial projects*

5. Research and development

5.1 Qualifying activity

Tax incentives will be granted to any company which commences a new undertaking which is engaged in research and development.

“Research and development” is defined to mean any systematic or intensive study carried out in the field of science and technology with the object of using results thereof for the production or improvement of materials, devices, products, produce or process (other than quality control of products or routine testing materials, devices, products or produce, research in social sciences or humanities, routine data collection, efficiency surveys or management studies and market research or sales promotion).

5.2 Qualifying investment criteria

Minimum investment of 2 million rupees should be made within one year from the commencement of the new undertaking.

5.3 Incentives offered

Period		Tax rate
Where the tax exemption period commences prior to 1 April 2008		
1st — 5th year*		0%
Where the tax exemption period commences after 31 March 2008		
1st — 3rd year		0%
After the end of the tax exemption period for every year of assessment commencing on or after 1 April 2008		
Immediately succeeding	1st year	5%
	2nd year	10%
	3rd year	15%
Thereafter		Normal rates

** The tax exemption period is in the same manner as for agricultural and industrial projects. The exemption is limited to the income earned from the research and development activities only.*

6. New individual undertakings in less developed areas

6.1 Tax incentives are granted in respect of the profits of a new undertaking:

- Carried on by a company
- Located in any area outside the administrative districts of Colombo and Gampaha
- In which the sum invested is not less than Rs. 30 million before 01 April 2009
  - In any plant, machinery, furniture, building or land used in such undertaking where such undertaking is an agricultural undertaking; or
  - In any plant machinery, furniture or building used in such undertaking, where such undertaking is an undertaking other than an agricultural undertaking.
- Not formed by the splitting up or reconstruction or acquisition of any undertaking which was previously in existence
- In which the number of employees employed at any time prior to 01 April 2009 and thereafter throughout that year of assessment is not less than:

(i) 50, where such undertaking is an undertaking for the provision of information technology enabling services or printing on paper or the manufacturing of any packing materials; or

(ii) 200, where such undertaking is an undertaking other than an undertaking referred to in paragraph (i).

6.2 Qualifying investment criteria and incentives offered are as follows:

Amount of investment	Tax exemption period	
	Any administrative district part of the boundary of which overlaps with part of the boundary of the administrative district of Colombo or of Gampaha	Any administrative district part of the boundary of which does not overlap with part of the boundary of the administrative district of Colombo or of Gampaha
More than Rs 30 million but not more than Rs 50 million	5	7
More than Rs 50 million but not more than Rs 50 million	6	8
More than Rs 100 million	8	10

The tax exemption period is from the year of assessment in which the undertaking commences to make profits, but not later than 3 years from the year of assessment in which such undertaking commences commercial operation.

6.3 Rate of income tax for period after the expiry of the tax exemption period

Period	Tax rate
First post exemption year	5%
Second post exemption year	10%
Third post exemption year	15%

7. New or upgraded cinemas

7.1 Qualifying activity

Tax incentives are granted in respect of profits and income from the exhibition on or after 1 April 2007 of any cinematographic film in any new cinema or any upgraded cinema.

7.2 Incentives offered are as follows:

Qualifying activity	Tax exemption period
New cinema	10 Years
Upgraded cinema	7 Years

The tax exemption period is granted from the commencement of the year of assessment in which the exhibition of cinematographic films in such new cinema or upgraded cinema as the case may be commenced.

In the post-tax exemption period, concessionary tax rates are offered as follows:

1st year after the end of the tax exemption period, being any year of assessment commencing on or after 1 April 2008	5%
2nd post exemption year	10%
3rd post exemption period	15%
Thereafter	Normal rates

7.3 Setting up a new cinema or upgraded cinema

"New cinema" means in which the exhibition of cinematographic films commences on or after 1 April 2007 and which is certified by the National Film Corporation of Sri Lanka as being equipped with digital technology and Digital Theatre Systems and Dolby Sound Systems.

"Upgraded cinema", means a cinemas in which the exhibition of cinematographic films had commenced prior to 1 April 2007 and which was not equipped with digital technology and Digital Theatre Systems and Dolby Sound Systems prior to 1 April 2007 and which is certified by the National Film Corporation of Sri Lanka, as being equipped on or after 1 April 2007 with digital technology and Digital Theatre Systems and Dolby Sound Systems.

8. New undertakings located in any lagging region

8.1 Tax incentives are granted in respect of the profits and income of a new undertaking:

- Other than an undertaking engaged in the sale of any article not produced or manufactured by such undertaking
- Which is located in any lagging region ("lagging region" means any divisional secretaries division other than such division in the Western Province)
- Which commences commercial operations on or after 1 April 2008
- In which the sum invested in the acquisition of capital assets (other than land) after 07 November 2007 but before 31 March 2010 is not less than Rs 30 million

8.2 Incentives offered are as follows:

Period	Tax rate
1st — 5th Year	0%
6th Year	5%
7th Year	10%
8th Year	15%
Thereafter	Normal rates

The tax exemption period (5 years) commences from the year of assessment in which such undertaking commences to make profits from transactions entered into in that year of assessment or from the commencement of the year of assessment immediately succeeding the year of assessment in which the undertaking completes 2 years from the date on which the undertaking commences to carry on commercial operations whichever occurs earlier.

9. Undertakings in Eastern Province

9.1 Tax incentives are granted in respect of profits and income of any new undertaking set up in the Eastern Province of Sri Lanka.

Qualifying criteria

- Located in Eastern Province;
- Investment (other than in land) of not less than Rs 30 million made prior to 1 April 2010;
- Not formed by the splitting up, reconstruction or acquisition of an undertaking which existed prior to November 2007; and
- Commence commercial operations on or after 7 November 2007.

9.2 Incentives offered are as follows:

Period	Tax rate
1st — 5th Year	0%
6th Year	5%
7th Year	10%
8th Year	15%
Thereafter	Normal rates

Exemption will commence from:

- Year of assessment in which the new undertaking commences to make profits; or
- Year of assessment in which the undertaking commences its third year of commercial operations.

Whichever occurs earlier.

10. Agricultural undertakings

Agricultural undertakings, carried on by any individual, partnership or company, qualify for tax exemption on their profits and income.

10.1 Period of tax exemption

A period of 5 years from the commencement of the year of assessment commencing on 1 April 2006 and ending on 31 March 2011.

10.2 Incentives offered

The profits and income from the cultivation of land and the sale of the produce there from are exempt for 5 years commencing on 1 April 2006.

Where the undertaking is also engaged in any process of production or manufacture of the produce from the cultivation of land, such produce should be deemed to have been sold for production or manufacture at the prevailing open market price and the profits and income should be computed, based on such deemed sales.

11. Dividend exemption

The dividends paid by companies carrying on the aforesaid projects and activities out of their exempt profits during the period of tax exemption or one year thereafter will be exempt from income tax in the hands of the shareholders. Such exemption will not apply to any dividend paid on or after 1 April 2004 by any company which qualified for tax exemption on or after 6 November 2002.

12. Other tax concessions under the tax statute

Profits attributable to the export of non-traditional goods by an undertaking are entitled to pay income tax at a maximum rate of 15%.

(Non-traditional goods are defined to include goods other than black tea not in packet or package form and each packet or package weighing not more than one kilogram crepe rubber, sheet rubber, scrap rubber, latex fresh coconuts.)

Profits attributable to the performance by an undertaking of any of the following services for payment in foreign currency are made liable to income tax at a maximum rate of 15%.

- Ship repair
- Ship breaking
- Repair and refurbishment of marine cargo containers
- Provision of computer software, computer programmes, computer systems or recording computing data
- Such other services as may be specified by the Minister of Finance by notice published in the Gazette

Profits attributable to the production or manufacture and supply to any specified undertaking, of non-traditional goods (for export by that undertaking of such goods or for the production or manufacture of any commodity for export by such undertaking) will be liable to income tax subject to a ceiling of 15% of such profits, provided the undertaking is chargeable at the concessionary rate of 15% and there is documentary evidence to satisfy the Inland Revenue Department that the exports relating to such supplies were made.

Profits by any resident company or partnership in Sri Lanka attributable to services rendered outside Sri Lanka in carrying out a construction project, in the course of carrying out a trade, profession, vocation are exempt from income tax, where the respective profits are earned in foreign currency and are remitted to Sri Lanka.

Corporate profits from agriculture, fisheries, livestock, tourism and specified construction undertakings are taxed at 15%.

Profits and income earned in foreign currency by any resident company, any resident individual or any partnership in Sri Lanka from any services rendered in or outside Sri Lanka to any person or partnership outside Sri Lanka in the course of any profession or vocation as is specified by the Commissioner General by notice published in the gazette are exempt from income tax where the respective profits are earned in foreign currency and are remitted to Sri Lanka, through a bank.

13. Other tax incentives — under BOI regime

There are a few tax exemptions and incentives, which are offered only under the BOI regime.

13.1 Export trading houses

Qualifying activity

- Export of the entirety of the locally procured manufactured products or re-export of the entirety of imported products
- Location of warehouse within an export processing zone (EPZ) which is continuously supervised by Sri Lanka Customs

Qualifying criteria and incentives offered as follows:

Export value	Incentives
US$ 5 mn to 10 mn	10% tax rate for 5 years and 15% tax rate thereafter
US$ 10 to 25 mn	5% tax rate for 5 years and 15% tax rate thereafter
Over US$ 25 mn	Tax holiday for 5 years and 15% tax rate thereafter

(No minimum investment required)

13.2 Export oriented services

Qualifying activity

- Provision of services to persons outside Sri Lanka for which payment should be made in foreign currency

Qualifying investment criteria

- Minimum investment of US$ 150,000

Incentives offered are as follows:

Period	Tax rate
1st — 5th year	0%
6th — 7th year	10%
8th year onwards	15%

13.3 Regional operating headquarters

- Qualifying activity

  Provision to offshore companies of two or more of the following services: administration, business and co-ordination, sourcing of raw materials and components, R&D services, technical support services, financial and treasury management, marketing or sales promotion.

- Qualifying criteria
  - Receipt of not less than 70% of its turnover from offshore companies
  - Minimum investment of US dollars 250,000

Incentives offered are as follows:

Period	Tax rate
1st — 3rd year	0%
4th — 5th year	10%
6th year onwards	20%

13.4 Information technology (IT) and / or IT enabled services

- Qualifying activity

  IT enabled services include call centers or contact centers, transcription (data entry), data centers, hosting centers, e-governance related projects and any other related activity determined by the BOI with the concurrence of the Minister in charge.

Incentives offered are as follows:

Employment no. of persons	Tax exemption period (years)
Up to 250	5
251 — 400	6
401 — 600	7
601 — 800	8
801 — 1000	10
1001 & above	12

After the end of the tax holiday:

	Tax rate
1st 2 years	10%
Thereafter	
If export oriented	15%
If not export oriented	20%

Existing BOI companies will also qualify for the above tax concessions provided they increase employment as indicated in the above table.

13.5 Training institutes

Incentives offered

The incentives increase depending on the institutes setting up expansion units outside Colombo and Gampaha districts and undertaking training of more students as given below:

No. of students to be trained per annum	No. of units outside Colombo and Gampaha Districts	Tax exemption period (years)
250	—	3
500	1	4
750	2	5
1000	3	6
1250	4	7
1500	5	8
1750	6	9
2000	7	10

After the end of the tax holiday:

	Tax rate
1st 2 years	10%
Thereafter	20%

13.6 BPO industry

- Provision of Business Process Outsourcing (BPO) services to persons outside Sri Lanka for which payment should be made not less than 70% (of total receipts) in foreign currency.

Qualifying criteria

- Minimum investment of US$ 150,000
- Provision of employment to Sri Lankans

Incentives offered vary with the number of persons provided employment

Employment no. of persons	Tax exemption period (years)
Up to — 100	3
101 — 250	5
251 — 500	6
501 — 1000	8
1001 — 1500	10
1501 — 2000 & above	12

After the expiry of the tax exemption period:

	Tax rate
1st 2 years	10%
Thereafter	20%

Existing BOI companies will also qualify for the above concessions provided they increase employment as given above.

13.7 Establishment of industrial estates

Qualifying activity

- Develop and manage industrial estates or special economic zones

Qualifying investment criteria and incentives offered:

Amount of minimum investment (US dollars)	Tax exemption period (years)
500,000	3
1,000,000	5
5,000,000	6
10,000,000	7
15,000,000	8
20,000,000	9
25,000,000	10
50,000,000	12
75,000,000	15

After the expiry of the tax exemption period, 15% tax rate will apply.

13.8 Other BOI incentives

Other incentives offered by the BOI are for the following:

- Any special project approved by the Cabinet Sub-committee on Investment Facilitation or the Cabinet of Ministers
- Any industry or any other business activity of advanced technology / pioneering nature as approved by BOI
- Expansion of an existing non-BOI company engaged in hotel industry (3 star and above) as approved by BOI
- Existing company which undertakes modernization, or a new company been set up with HACCP certification or internationally recognised certification for food processing units in the export plantation sector
- Textile / fabric manufacturing, printing, dyeing, washing and finishing (including deemed exports)
- Export trading house for rural sector for procurement of agricultural products, handicraft items, handloom and other locally manufactured products and any other rural products with collection centres set up outside Colombo and Gampaha districts.

Note: The tax exemption period will, in all above mentioned activities, be reckoned from the tax year in which the enterprise commences to make profits but not later than two years from the commencement of commercial operations.

Taiwan

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1. Introduction

1.1 General information on M&A in Taiwan

Since the new Government took office in 2008, it has been aiming to encourage foreign investment and promote the domestic economy by the liberalisation of capital markets and relaxation of cross-strait relations with China. A comprehensive tax reform programme is also underway with the focus on simplifying tax administration and increasing global competitiveness. It is expected that these policy changes will create a friendlier environment for prospective investors and encourage active M&A activity.

Moreover, Taiwan's Tax Reform Committee has proposed to introduce a number of anti-tax avoidance measures. Although the schedule and final conclusion remain unclear, we list out some of the proposed measures that are relevant to M&A activities:

- CFC rules: if a Taiwan company owns more than 50% of a CFC in a jurisdiction with a corporate income tax rate equal or less than 80% of the current Taiwanese corporate income tax rate, income retained at the CFC level will be considered as taxable regardless of whether it is distributed or not.
- Thin capitalisation rule: the debt and equity ratio is expected to be set at 6:1 for the banking industry and at 3:1 in all other cases.
- Anti-treaty shopping rules: tax reduction benefits/exemptions provided under double taxation agreements (DTAs) will only be granted to the actual ultimate beneficiary owner.
- The substance over form rule and other related regulations.

1.2 Corporate tax

The income tax regime in Taiwan is divided into personal consolidated income tax for individuals (individual income tax), and profit-seeking enterprise income tax for business enterprises (business enterprise tax or corporate income tax). The term "business enterprise" refers to an entity that engages in profit-seeking activities, including sole proprietorship, partnership, company, or any other form of organisation that is organised for profit-seeking purposes.

A resident corporate taxpayer is subject to income tax on its worldwide income. For non-resident corporate taxpayers, including those that do not have a permanent establishment (PE) in Taiwan, only Taiwan-sourced income is subject to tax in Taiwan (normally in the form of withholding tax).

Taiwanese corporations and foreign corporations operating in Taiwan through branches are subject to progressive corporate tax rates depending on their level of taxable income before 2010. Beginning in 2010, a single tax rate is adopted and the corporate income tax rate is reduced to 20%. Tables illustrating the corporate tax rates before and after 2010 are shown below:

Before 2010

Taxable income	Tax
Up to NT$50,000	Exempt
NT$50,001 to NT$71,428	50% of taxable income, less NT$25,000
NT$71,429 to NT$100,000	15% of taxable income
NT$100,001 and over	25% of taxable income, less NT$10,000

After 2010

Taxable income	Tax
Up to NT$120,000	Exempt
NT$120,001 to NT$200,000	50% of taxable income, less NT$60,000
NT$200,001 and over	20% of taxable income

The Taiwan Government introduced the Income Basic Tax Act (IBT Act) on 28 December 2005, which took effect on 1 January 2006. Pursuant to the IBT Act, companies (which are residents in Taiwan and foreign companies having a permanent establishment in Taiwan) and resident individuals have to calculate an IBT (also known as AMT (Alternative Minimum Tax)) amount under the relevant formulae and compare such amount with regular income tax payable. If the former is more than the latter, taxpayers have to pay AMT.

Below is a table illustrating the position.

Items	Companies	Individuals
AMT rate	10% to 12%	20%
Tax exemption amount	NT$2 million	NT$6 million
Taxable base	Regular taxable income with adjustments for the following items: **Plus** • tax-exempt capital gain on the sale of domestic marketable securities and futures; • tax-free income provided by the Statute for Upgrading Industries (including tax holiday and Operational Headquarter incentives); • tax-free income provided by other laws (including tax holiday granted for investment in industries at scientific park and participation in construction of communication and public work); • tax-free income provided by the EMAL (carry over of tax holiday); • tax-free income earned by offshore banking unit (OBU); and • other tax-free income announced by the Ministry of Finance (MOF); **Minus** • losses deriving from domestic securities and futures transactions; • losses incurred by OBU; and • other losses announced by the MOF. The deduction of each type of losses is limited to the same type of income and can be carried forward for five years.	Regular taxable income with adjustments for the following items: **Plus** • non-Republic of China-sourced and Macau and Hong Kong-sourced income over NT$1 million; • tax-exempt life or annuity insurance proceeds paid for death over NT$30 million; • tax-exempt capital gain on sale of non-listing and non-OTC shares and private-placement shares, mutual funds, etc; • deducted non-cash contribution; • tax-exempt difference between market price and face value of employee stock bonus; and • other tax-free income or deduction announced by the MOF; **Minus** • loss on sales of shares non-listing and non-OTC shares and private-placement shares, mutual funds, etc; and • other losses announced by the MOF. The deduction of each type of losses is limited to the same type of income and can be carried forward for three years.

- Dividends

  Taiwan adopts an imputation tax system in relation to the taxation of dividend income. The system is designed to reduce the overall tax liabilities of a shareholder in respect of dividends which have effectively suffered corporate tax (at the corporate level) and personal consolidated income tax (at the individual level). Under this system, dividends received from a Taiwan corporation out of profits which have been subject to corporate tax, a resident individual share-holder is entitled to offset the company's underlying corporate tax paid against his/her own personal consolidated income tax payable. As a result, the effective tax rate for a resident individual taxpayer with the highest marginal tax rate may be reduced from 55% to 40% on such dividends.

  Domestic dividends received by a Taiwanese corporate shareholder are exempt from tax in the hands of the shareholder. Any dividends paid by the corporate shareholder to its resident individual shareholders would, in turn, carry the underlying tax credit for corporate tax paid by its subsidiary.

  A 10% profit retention tax may be imposed on any part of the current year's profit (after statutory reserves) that is not distributed as dividends. This rule also applies to FIA subsidiaries (i.e. those companies which were established with the approval of the Foreign Investment Board). This retention tax paid by the company may be used by a resident individual shareholder to offset against the shareholder's tax payable once the company distributes dividends from the corresponding undistributed earnings in subsequent years.

  For non-resident shareholders, the 10% profit retention tax may be credited against dividend withholding tax once the company distributes dividends from the corresponding retained earnings in subsequent years. Effectively, the imputation tax system has little impact on foreign investors.

1.3 Withholding tax

Payments made to foreign recipients (which do not have a PE in Taiwan) will normally be subject to withholding tax at the following rates:

Type of income	Withholding tax rates
Dividends	20%, provided that foreign investment approval is obtained
Interest	20%
Royalties	20% or Nil (for approved royalties)
Service fees/rental	20% or 3.75% (for approved technical services/equipment lease/construction, the preferential rate is reduced to 3% beginning year 2010)
Commission	20%
Other	20% or 2.5% (for approved international transportation services) or 20% (for gain on sale of property)

Withholding tax rates on dividends, interest and royalties may be reduced if a recipient is a tax resident of one of the tax treaty countries and the relevant treaty provides for a reduced rate. As of 25 September 2009, tax treaties with Australia, New Zealand, Indonesia, Singapore, Malaysia, Vietnam, South Africa, Swaziland, Gambia, Macedonia, Netherlands, United Kingdom, Senegal, Sweden, Belgium and Denmark have been signed and effected.

A Taiwan branch of an overseas company may remit after-tax profits to its head office without any further Taiwan tax.

1.4 Business tax

Business taxes are levied on the sale of goods or services in Taiwan and on the importation of goods. Business tax consists of Value Added Tax (VAT) and non-Value Added Tax (Non-VAT). Generally, the former is applicable to general industries whereas the latter is applicable to financial institutions.

Under the VAT system, each seller collects output VAT from the buyer at the time of sale, deducts input VAT paid on purchases from output VAT and remits the balance to the Government. Where input VAT exceeds output VAT, the excess will be refunded or carried forward to be offset against future VAT payable. The current VAT rate is 5%, but the rate is expected to be increased by 1 to 2% in 2013. However, revenues derived from exclusively authorised businesses of the banking, insurance, investment trust, securities, futures, commercial paper, and pawnshop industries are subject to 2% VAT.

1.5 Stamp duty

Stamp duty is imposed on each copy of the following business transaction documents, property titles, permits, and certification executed within the territory of Taiwan.

Stamp duty

Monetary receipt	0.4% of amount received
Service contract	0.1% of consideration
Real property transfer contract	0.1% of value announced by Government
Sales contract for personal movable property	NT$12 per copy

1.6 Other relevant taxes

1.6.1 Securities Transaction Tax

The transfer of stock is subject to Securities Transaction Tax of 0.3% of the gross proceeds. Securities Transaction Tax is also imposed on the transfer of corporate bonds issued by Taiwanese companies, mutual funds issued by Taiwanese security investment trust enterprises, Taiwan depository certificates and other securities at 0.1% of the gross proceeds.

Securities Transaction Tax is imposed on the seller.

1.6.2 Land Value Increment tax

Land Value Increment Tax is levied when the title to land is transferred and is payable by the seller. The tax is levied on the increment in the Government-announced value between the time of purchase and sale. The Government-announced value at the time of purchase is adjusted for Government-announced consumer price index during the ownership period for the purposes of calculating the increment. The tax rate ranges from 20% to 40%. To encourage an owner to hold land for more than 20 years, a tax deduction is granted for land ownership exceeding 20 years. The tax paid may be refunded if another piece of land is acquired within two years to be used as a factory and other stipulated conditions are met.

1.6.3 Deed Tax

Title Deed Tax is levied on the transfer of the title to real estate and payable by the buyer. The transfer of land is not subject to Deed Tax if the seller is subject to Land Value Increment Tax. The tax rate ranges from 2% to 6% of the Government-assessed value.

1.7 Exchange control

Foreign exchange control regulations restrict the outward remittance of funds exceeding a certain amount. A resident individual is allowed to remit outward funds up to US$5 million per annum without obtaining prior approval from the Central Bank of China. However, if any single remittance is in excess of US$1 million, the bank may seek consent from the Central Bank of China before remittance. A resident corporation is allowed to remit outward funds up to US$50 million per annum without obtaining a prior approval from the Central Bank of China.

Overseas investment must be reported to the Investment Commission of the Ministry of Economic Affairs (ICMOEA). Nonetheless, any overseas investment of more than US$50 million requires prior approval from the ICMOEA. Any investment in the People's Republic of China (even if the investment is made through a third country) requires prior approval from the ICMOEA.

2. Acquisition

2.1 The preference of purchasers: stock vs asset deal

The EMAL of Taiwan provides certain tax incentives to qualified asset acquisitions while the general principle of taxation would apply to stock acquisitions and unqualified asset acquisitions.

Nevertheless, whether a deal is structured as a stock deal or asset deal depends on commercial considerations. In terms of tax costs, a stock deal may generally be preferable as it should incur less tax costs than an asset acquisition.

2.2 Stock acquisition

- Tax loss carried forward

  The target company may continue to enjoy unutilised taxes losses carried forward that have been granted before the stock deal.

- Unutilised tax depreciation carried forward

  The target company may continue to depreciate fixed assets at the same tax base after the stock acquisition, i.e. there is no change in the cost base and the method of depreciating the assets.

- Tax incentives

  The target company may continue to enjoy unused tax incentives (i.e. investment tax credit, tax holiday, etc.) after a stock acquisition.

- Others

  In general, since only the shareholder is different after a stock deal, the financial accounting books and the tax basis of the target company are not affected. Also, tax attributes of the target company prior to the stock deal generally remain unaffected after the acquisition.

2.3 Asset acquisition

- Tax losses carried forward

  Tax losses carried forward in the target company may not be transferred to the acquiring company in an asset deal.

  In general, gains arising from the transfer of tangible and intangible assets (except for land and securities) are taxable at the corporate income tax rate of 25% (20% starting from 2010). If the target company has tax losses carried forward, gains may be offset against the tax losses for corporate income tax purposes. The aforementioned gains may be exempt if certain requirements are met pursuant to the EMAL.

- Unutilised tax depreciation carried forward

  An asset deal potentially allows the purchaser to step up the basis of acquired assets for tax purposes. Such step up in value enables the buyer to reduce its future tax liability through a larger amount of depreciation of tangible assets or amortisation of intangibles.

  The differences between the transaction price and the fair market value (or, in some cases, the book value) of the assets transferred shall be recognised as "business right" or "goodwill" of the target company. For corporate income tax purposes, the business right shall be amortised over no less than ten years and the goodwill shall be amortised over no less than five years.

- Tax incentives

  In general, tax incentives (i.e. investment tax credits on qualified machinery and equipment or qualified research and development expenditures, tax holiday, etc.) may not be carried over by the transferee (the acquiring company in an asset deal). Furthermore, the transfer of qualified machinery and equipment, on which the investment tax credits were granted, may lead to a recapture of previously used tax credits if the qualified machinery and equipment are transferred within three years of when the tax credits were obtained.

  Where an asset deal meets all the criteria set out under the EMAL, the unutilised tax holiday and the investment tax credits on the qualified machinery and equipment may be transferred to the acquiring company. However, the amount of tax holiday and investment tax incentives that may be carried over by the acquiring company are limited to the portion of taxable income/tax payable attributed to the target company.

2.4 Transaction cost

2.4.1 VAT

- Stock acquisition

  The transfer of stock falls outside the scope of VAT.

- Asset acquisition

  In an asset deal, the seller is generally required to issue Government Uniform Invoice (GUIs) and charge VAT at the rate of 5% to the buyer for the sale of its operating assets, including inventories, fixed assets and intangibles. The sale of land and marketable securities is exempt from VAT.

  However, VAT is exempted for the transfer of tangible or intangible assets if the asset acquisition is carried out in accordance with the EMAL and the acquiring company issues voting shares accounting for more than 65% of the total consideration to the target company for the asset acquisition.

2.4.2 Stamp duty

- Stock acquisition

  On the disposal of qualified securities (e.g. stock in the Taiwanese company organised as a company limited by shares), Securities Transaction Tax at the rate of 0.3% on gross proceeds received from the disposition applies.

- Asset acquisition

  The acquiring company is required to pay stamp duty on the contract for sale of chattels concluded within Taiwan at NT$12 for each original contract as well as on the contract for transfer of real estate (such as buildings and land) at 0.1% of the Government-announced value. However, stamp duty is exempt for the transfer of contracts, if the asset acquisition is carried out in accordance with the EMAL and the acquiring company issues voting shares accounting for more than 65% of the total consideration to the target company for the asset acquisition.

2.4.3 Deed Tax

- Stock acquisition

  Title Deed Tax is not applicable in respect of a stock deal as there is no transfer of title of real estate.

- Asset acquisition

  The acquiring company should bear the Title Deed Tax levied on the contract for the sale of buildings, at 6% of the Government-assessed value. However, the Deed Tax is exempt for the transfer of titles of real estate, if the asset acquisition is carried out in accordance with the EMAL and the acquiring company issues voting shares accounting for more than 65% of the total consideration paid to the target company for the asset acquisition.

2.4.4 Land Value Increment Tax

- Stock acquisition

  Land Value Increment Tax is not applicable in respect of a stock deal as there is no transfer of land.

- Asset acquisition

  Land Value Increment Tax is levied on the increase in the Government-announced value at applicable progressive tax rates between 20% and 40%. However, Land Value Increment Tax is deferrable for the transfer of land, if the asset acquisition is carried out in accordance with the EMAL and the acquiring company issues voting shares accounting for more than 65% of the total consideration to the target company for the asset acquisition.

2.4.5 Tax deductibility of transaction costs

- Stock acquisition

  Costs (including professional fees, Securities Transaction Tax, etc.) on a stock deal incurred by a foreign investor are not tax deductible for Taiwan tax purposes. In addition, such costs are also not deductible to a Taiwan acquiring company.

- Asset acquisition

  Transaction costs are generally deductible. Some transaction costs incurred on fixed assets are generally part of the cost of the relevant assets acquired. If the assets are eligible for tax depreciation or amortisation, such cost could also be depreciated or amortised. Costs relating to the purchase of land and marketable securities are generally not tax deductible.

  VAT paid by the acquirer, if a VAT entity, may be creditable to the acquirer.

  Professional fees are generally recorded as expenses. If professional fees can be directly attributed to certain real estate, such fees will follow the tax treatment of the relevant asset.

3. Basis of taxation following stock or asset acquisition

3.1 Stock acquisition

A stock deal will not allow the buyer to step up the basis of assets owned by the target company. The asset value would remain unchanged as it was before the stock deal. Thus, it would not allow the buyer to maximise tax benefits that are potentially available on an asset deal.

3.2 Asset acquisition

An asset deal allows the buyer to step up the basis of acquired assets for tax purposes, thus enabling the buyer to reduce its future tax liability through depreciation of the fixed assets or amortisation of the intangibles. Generally, the costs of plant and equipment may be depreciated over their respectively useful life prescribed by the tax authority.

Furthermore, the difference between the consideration price paid and the fair market value (or, in some cases, the book value) of the assets transferred may be recognised as an operating right or goodwill. The minimum amortisation period is ten years for an operating right and five years for goodwill. The EMAL further stipulates that goodwill may be amortised within fifteen years.

4. Financing of acquisitions

4.1 Thin capitalisation

Equity falls into two categories, namely common shares and preferred shares. Currently, there are no thin capitalisation rules in Taiwan. However, Taiwan's Tax Reform Committee has proposed to introduce a thin capitalisation rule, which is anticipated to take effect in the near future. It is expected that the debt to equity ratio be set at 3:1 for general industries and at 6:1 for the banking industry. Any excess interest will not be tax deductible.

Except for certain restricted industries (e.g. financial industry) there is no minimum equity capital requirement for companies limited by shares or limited companies.

4.2 Deductibility of interest

4.2.1 Stock acquisition

Interest incurred by a foreign investor on the purchase of stock in a Taiwan target is not tax deductible against dividend income paid by the target company.

Alternatively, the foreign investor may set up a new company in Taiwan to acquire shares of the target company. In such a case, the new Taiwan company may obtain funds through either local finance vehicles or cross-border inter-company loans to finance the acquisition with an aim to reduce the dividend withholding tax. However, the interest expenses may not be tax deductible by the new Taiwan company at the time of calculating the corporate income tax.

When a foreign loan is obtained, the payment of interest may be subject to interest withholding tax.

4.2.2 Asset acquisition

Interest incurred on funds used to acquire fixed assets generally needs to be capitalised and amortised in accordance with the nature of the assets. Furthermore, since capital gains arising from the sale of land and marketable securities are exempt from income tax, the interest relating to the purchase of the land and marketable securities is not deductible for corporate income tax purposes.

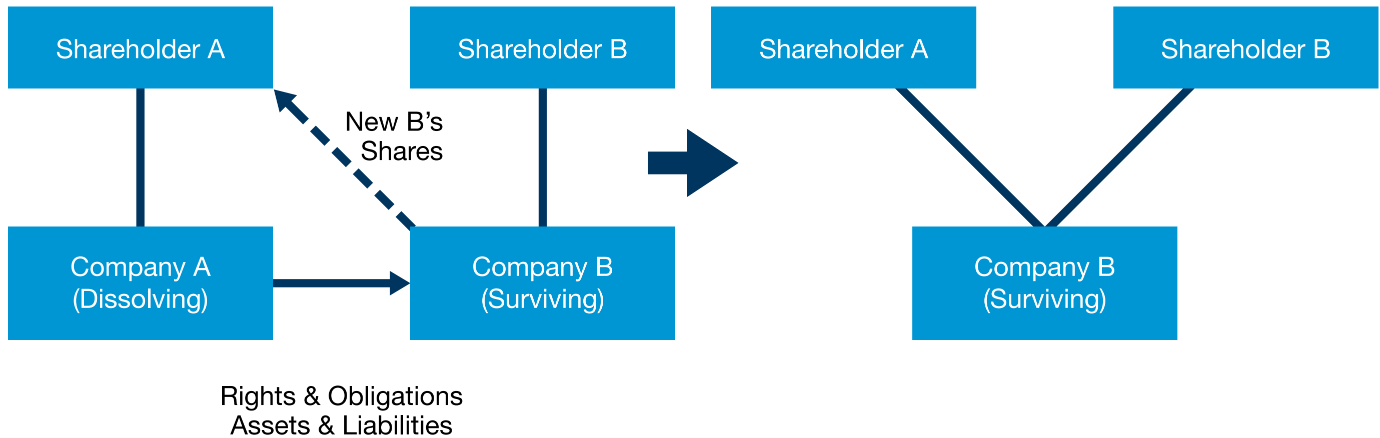
5. Mergers

For most M&A cases to the extent to which the issues are covered in the EMAL, the EMAL prevails over other laws, such as Company Law, Securities Trade Law, Statute for Upgrading Industries, Fair Trade Law, Labour Standard Law, Statute for Foreigner Investment, etc. Any M&A matters not dealt with in the EMAL is governed by these other laws.

The M&A of financial institutions is subject to the FHCL, and the FIML. Any M&A matters not dealt with in these two laws should be governed by the EMAL failing which the other laws would apply.

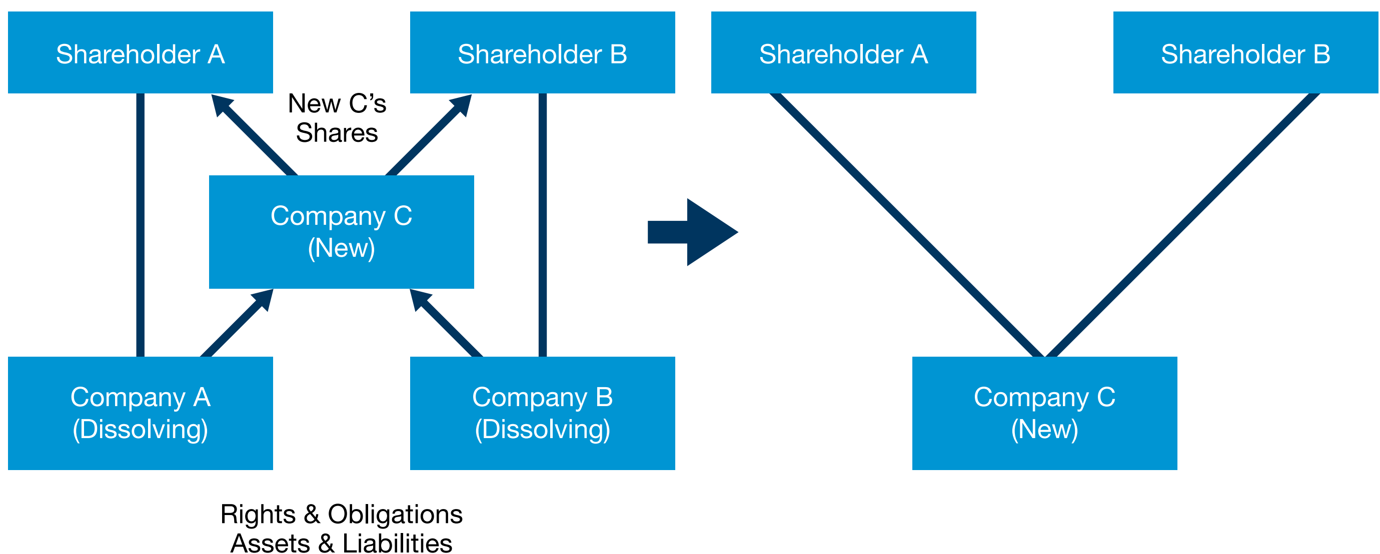
In the Taiwan context a "merger" could take place as follows.

- Merger



Under this example, the business and assets of Company A are transferred to Company B. In return, Company B issues shares to shareholders of Company A in exchange for the business of Company A. Company A is subsequently dissolved.

- Consolidation



Under this example, the business and assets of Company A and B are transferred to newly established Company C. Company C issues shares to shareholders of Companies A and B. Companies A and B are subsequently dissolved.

The EMAL also allows cash, shares in the other company and other property as payment for the consideration.

According to the tax ruling issued in October 2008, for mergers effective on or after 1 January 2009, if the consideration (either in the form of cash or shares) of a merger received by the shareholders of the dissolved company exceed the original paid-up capital, the excess amount is deemed as dividend income of the shareholders of the dissolved company.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

Taiwan does not impose significant restrictions on the repatriation of profit. Company Law requires the company to reserve 10% of the current year's profit as a legal reserve which may not be freely distributed as a dividend. Also, some laws require reservation of a portion of annual profit as a special reserve. Except for the said reserve requirements, FIA companies may remit dividends overseas freely.

Under the imputation tax system, for dividends received from a Taiwan corporation out of profits which have been subject to corporate tax, a resident individual shareholder is entitled to offset the company's actual underlying corporate tax paid against his/her own personal consolidated income tax payable. Such dividends received by a resident corporate shareholder are exempt from tax in the hands of the shareholder.

Dividends paid to non-residents of Taiwan are subject to withholding tax. Dividends paid by a FIA company to a foreign shareholder are taxed at 20%. Withholding tax rates on dividends may be reduced if a recipient is based in one of the tax treaty countries and the relevant treaty provides for a reduction in the dividend withholding tax rate. Taiwan has entered into comprehensive tax treaties with Senegal, United Kingdom, Sweden, Australia, New Zealand, Indonesia, Singapore, Malaysia, Vietnam, South Africa, Swaziland, Gambia, Macedonia, the Netherlands, Belgium and Denmark.

For non-resident shareholders 10% Profit Retention Tax may be credited against dividend withholding tax payable once the company distributes dividends.

There are various avenues whereby the profits of the target company may be repatriated to the home country by means other than dividends. These include the payment of license fees, royalties, interest and management fees. However, the payment of such amounts may be subject to withholding taxes. Generally withholding tax is 20%. Tax treaties may reduce withholding tax payable.

6.2 Losses carried forward

Following the amendment of the Income Tax Act in January of 2009, net operating losses (NOL) may be carried forward for ten years starting from filing the tax return of tax year 2008 onwards if the company's income tax return is certified by a certified public accountant or it has received an approval to use a blue form income tax return and it maintains complete and adequate accounting records.

However EMAL, the superior law governing M&A activities, still stipulates a five-year loss carry forward. Hence after the merger the surviving or newly formed company may deduct from its net income the NOL resulted from each merged entity in the preceding five years. The deductible amount is calculated according to the ratio of shares in the surviving or newly formed company held by shareholders of each merged entity.

6.3 Tax incentives

Remaining tax incentives of the target company may be carried over to the acquiring company. However some requirements must be met:

- Tax holiday
  - the M&A activity is conducted pursuant to the EMAL or the Statute for Upgrading Industries;
  - the acquiring company continues to produce the same products or render the same services as those that produced or rendered by the acquired company before the M&A deal and has been awarded the carry over tax holiday;
  - the carry over tax holiday may only apply to income derived from the corresponding products or the services that have been awarded the carry over tax holiday and that can be independently produced or rendered; and
  - the acquiring company has to meet the same tax holiday requirements as those applicable to the target company.
- Investment tax credit
  - the M&A activity is conducted pursuant to the EMAL or the Statute for Upgrading Industries;
  - the carry over investment tax credit may only apply to income that is attributable to the target company; and
  - the acquiring company has to meet the same tax credit requirements as those applicable to the target company.

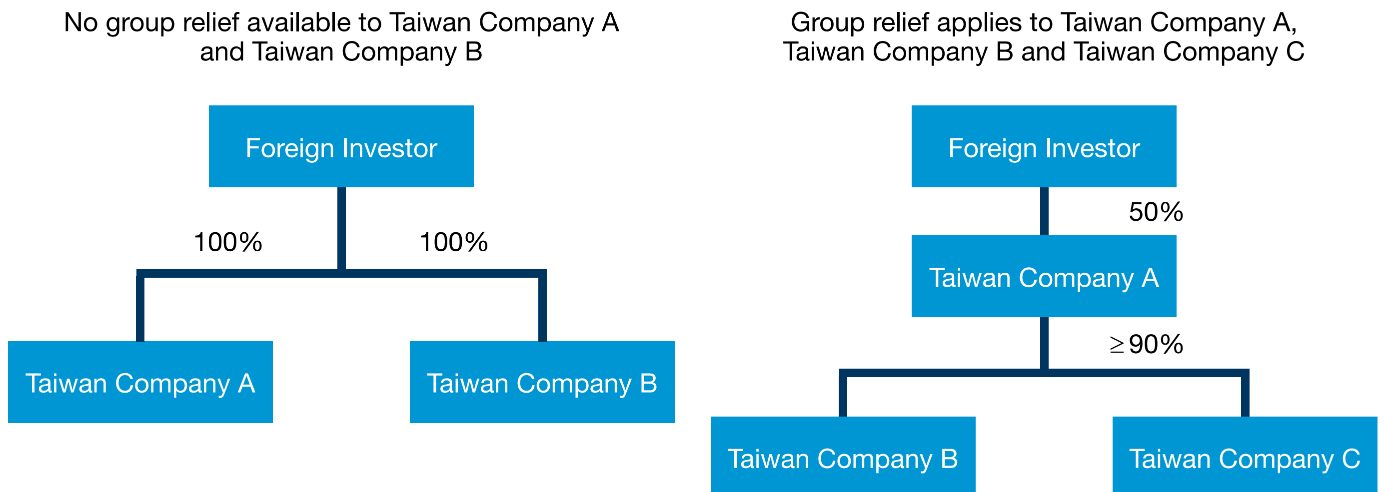
As part of a comprehensive tax reform programme, tax incentives provided by the Statute of Upgrading Industries will be abolished at the end of 2009, except for tax incentives for the R&D tax credit, personnel training tax credit, operational headquarter and logistic center.

6.4 Group relief

After the M&A deal under the EMAL is completed, the acquiring company may choose to file a single consolidated corporate income tax return (including profit retention tax return) with the 90%-or-more-owned target company if the acquiring company continuously holds shares in the target company for 12 months in a taxable year.

The group relief regime applies only to Taiwan companies, it is not applicable to foreign companies.

Group relief may be diagrammatically illustrated as follows:



7. Disposal

7.1 Preference of sellers: stock vs asset deal

The seller generally favours a stock deal for the following reasons:

- stock sale procedures are much simpler;
- gain on the sale of shares of companies limited by shares, are currently exempt from tax unless the seller is taxed on an AMT basis; and
- asset sales may result in corporate income tax on gains from the sale of assets.

7.2 Stock sale

7.2.1 Profit on sale of stock

Gains derived by the seller of a target company's shares are exempt from income tax unless the seller is taxed on an AMT basis. However, an sale is subject to Securities Transaction Tax of 0.3% on the proceeds from the share transfer. Such tax is borne by the seller. The EMAL exempts Securities Transaction Tax arising from a qualified share swap.

Accordingly, for a shareholder of the target company, a stock sale may be the most tax efficient way to exit an investment. In the event that the target company has a considerable amount of undistributed earnings, by selling its shares in the target company at a fair market value (which should include the value of the undistributed earnings), the seller effectively receives all the gain from the disposal tax-free, unless the seller is taxed on an AMT basis.

7.2.2 Distribution of profits

Under the imputation tax system all profits, including capital gains, may be distributed as a dividend that will not be assessable unless such dividends are received by the shareholders who are resident individual shareholders or non-resident shareholders. Dividends distributed to foreign shareholders are subject to withholding tax.

7.3 Asset sale

7.3.1 Profit on sale of assets

Generally capital gains arising from a sale of assets, including intangibles, are taxable at the corporate income tax rate of 25% (20% beginning year 2010). If the seller has NOLs, the NOLs may be used to offset against the capital gain. Capital gains may be exempted from corporate income tax if prescribed requirements are met pursuant to the EMAL. The gain from the sales of land is exempt from corporate income tax, but is subject to Land Value Increment Tax. The gain on the sale of Taiwanese marketable securities is also tax exempt unless the seller is subject to AMT.

7.3.2 Distribution of profits

Refer to section 7.2.2.

8. Transaction costs for seller

8.1 VAT

VAT should be levied on all goods sold and services rendered in Taiwan. The target company is required to issue a Government Uniform Invoice and charge VAT at the rate of 5% to the acquirer for the sale of assets, such as inventories and fixed assets. The 5% VAT paid by the acquirer may be used to offset its output VAT if the acquirer is a Taiwan company. The sale of land and marketable securities is exempt from VAT.

8.2 Stamp duty

Stamp duty is imposed on certain types of business transaction documents, such as property title deed, money receipts and contracting agreements. Those who keep the original aforementioned transaction document bear the tax liabilities.

8.3 Securities Transaction Tax

Securities Transaction Tax is levied on securities transactions at the rate of 0.3% of the gross proceeds from the sale of the stock. The target company should bear the liability of Security Transaction Tax.

8.4 Land Value Increment Tax

The target company should pay the Land Value Increment Tax upon selling land to the acquirer. The tax is levied on the increment in the Government-announced value at progress rates ranging from 20% to 40%.

8.5 Deed Tax

Generally speaking, the acquirer pays Deed Tax on the transfer of building title. The tax rate is generally 6% on the Government-assessed value.

8.6 Income tax

The target company has to pay corporate income tax on gains, if any, from the sale of assets. When the gains are distributed as dividends, the dividends will not be taxable unless they are received by resident individual shareholders or non-resident shareholders. Some investment tax credits granted pursuant to the Statute for Upgrading Industries may be clawed back. However, if the deal complies with EMAL and other laws, the tax may be exempt and the investment tax credits might not have to be clawed back.

8.7 Concessions relating to M&As

The EMAL provides for certain Transaction Tax concessions on mergers, spin-offs and acquisitions (refer to section 12.1). Furthermore, the FIML, the FHCL and the Statue for Upgrading Industries provide similar Transaction Tax incentives on M&A activities if the prescribed requirements are met or prior approval is obtained.

8.8 Tax deductibility of transaction costs

- In general stamp duty is deductible for income tax purposes, unless it is incurred as a result of selling land or domestic marketable securities. Stamp duty paid for the purchase of real estate should be capitalised as part of the cost of the relevant asset.
- Land Value Increment Tax is not deductible for income tax purposes, because it is deemed to be a cost of selling the land and any gain/loss on the sale of land is exempted from income tax.
- Securities Transaction Tax is not deductible for income tax, because the gain on the sale of marketable securities is the exempted from income tax.
- Deed Tax for the purchase of buildings should be included in the purchase cost.

9. Preparation of target for sale

9.1 Declaration of dividend prior to the sale

One method to extract surplus cash in a company that is identified for sale is by paying a dividend. For a foreign investor, withholding tax is levied on a dividend payment. Where the company identified for sale has an imputation credit balance derived from the 10% profit retention tax, the dividend withholding tax liability may be reduced.

9.2 Capital reduction prior to the sale

Another means of extracting original investment cash in a company is by a capital reduction. Return of the principal investment amount will be generally be exempt from tax. However, the company may lose qualification to enjoy some unutilised tax incentives due to the capital reduction.

10. De-merger

There are no specific provisions in relation to de-mergers. A de-merger usually takes place through the sale of assets or a business.

11. Listing / initial public offering (IPO)

The sale of shares is exempted from income tax unless the seller is subject to tax on an AMT basis, the sale of shares will be subject to 0.3% Security Transaction Tax, irrespective of whether the company is a listed or a private company limited by shares.

In 2008, as part of its capital market liberalisation policy, the Taiwan Government amended the stock exchange rules to actively encourage foreign businesses to list in Taiwan. Now, as long as foreign businesses meet the relevant requirements, they can apply to list on the Taiwan Stock Exchange or the over-the-counter GreTai Securities Market. Both IPOs and secondary listings (Taiwan Depositary Receipts) are available for foreign businesses as listing options.

12. Tax incentives

There are a number of tax incentives available under the Enterprise Merger & Acquisition Law and Statue for Upgrading Industries on Taiwan's M&A activities.

12.1 Tax incentives provided by the Enterprise Merger & Acquisition Law

For acquisitions of assets or shares (voting shares delivered account for more than 65% of total considerations of the M&A deal), mergers or divisions pursuant to the EMAL, the following tax incentives may be available:

- deeds, agreements and money receipts created for M&A are exempted from stamp duty;
- transfer of title to acquired immovable property is exempted from Deed Tax;
- Securities Transaction Tax payable is exempted;
- transfer of goods or service is deemed as not falling within the scope of business tax;
- Land Value Increment Tax payable can be postponed until next transfer;
- goodwill is amortised within 15 years;
- expenses incurred from M&A is amortised over 10 years;
- any capital gain on the transfer of the main business and/or assets of a company can be exempted from corporate income tax;
- exchange loss from a company applying its business or assets in subscription or exchange for the shares of another company is amortised over fifteen years;
- group taxation is available; and
- tax incentives of the acquired company are carried over to the acquiring company.

12.2 Income tax incentives granted for doing business in Taiwan

The main income tax incentives granted for doing business in Taiwan are set out below:

- Income tax exemption granted on foreign-sourced income received by Operational Headquarter;
- Income tax exemption granted on domestic sales made by Logistic Distribution Center;
- withholding tax exemption granted for royalties paid to use technological know-how, trademark or patent of a foreign profit-seeking enterprise; and
- investment tax credit granted on expenditure for research and development and personnel training.

Thailand

Country M&A team

Country leader ~ Paul B.A. Stitt

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1. Introduction

1.1 General comments on M&A in Thailand

As with most countries, M&A transactions in Thailand can take the form of a stock acquisition or an asset acquisition. These transactions may give rise to liabilities to a number of taxes in Thailand, including corporate income tax, value added tax, specific business tax and stamp duties. However, exemptions from taxes are available in certain circumstances.

1.2 Corporate tax

1.2.1 General tax regime

A juristic company or partnership incorporated in Thailand is generally subject to corporate income tax at a rate of 30% on its worldwide income. The corporate income tax may be reduced in the following cases:

(a) Regional Operating Headquarters (ROH) established in Thailand

Provided that certain conditions are met, a ROH is subject to corporate income tax at a rate of 10% on certain income streams. An exemption from tax is also granted for dividends received from its domestic and overseas affiliated companies.

(b) Companies listed on the Stock Exchange of Thailand (SET) and the Market for Alternative Investment (MAI) between 6 September 2001 and 31 December 2005

- Companies listed on the SET 25%
- Companies listed on the MAI 20%

The reduced rate applies for 5 accounting periods commencing from the first accounting period which begins on or after the day the company has listed its securities on the SET or the MAI.

(c) Companies which applied for listing between 1 January 2008 and 31 December 2008 and are duly listed within 31 December 2009

- Companies listed on the SET 25%
- Companies listed on the MAI 20%

These rates will apply for 3 accounting periods commencing from the first accounting period which begins on or after the day the company has listed its securities on the SET or the MAI.

(d) Listed companies other than those in items (b) and (c) above

Companies listed on the SET

Net profit	Rate
a. Baht 0 — 300 million	25%
b. Over Baht 300 million	30%

Companies listed on the MAI

Net profit	Rate
a. Baht 0 — 20 million	20%
b. Over Baht 20 million	30%

These rates apply for 3 accounting periods commencing from the accounting period beginning on or after 1 January 2008.

Companies listed on the SET or MAI between 6 September 2001 and 31 December 2005, and whose concession rate as noted under item (b) above has expired, will be able to enjoy the concession rate under item (d) but not beyond the accounting period ending on or after 31 December 2010.

Exemptions / reductions of corporate income taxes may also be granted to enterprises promoted by the Board of Investment.

1.2.2 Taxation of dividends

Dividends derived by a Thai company from another Thai company are exempt from tax if the recipient is either:

- A company listed on the SET; or
- A company that holds at least 25% of the voting shares in the company paying the dividends provided there is no direct or indirect cross shareholding.

If the dividend is not exempt from tax, it may nevertheless qualify for partial exemption, under which only 50% of the dividend is subject to tax. In order to qualify for either full or partial exemption, the recipient must hold the shares for at least 3 months before and after the dividend is paid. Where this holding period is not met, the full amount of the dividend received will be subject to tax.

Exemption from tax is also available for dividends received from companies which have been granted a tax holiday by the Board of Investment, provided the dividend is paid out of tax exempt profits during the period of the tax holiday.

Dividends received by a branch of a foreign company are fully taxable.

1.2.3 Tax losses

Tax losses may generally be carried forward for 5 accounting periods for offset against profits from all sources. This is no provision for loss carry-back. Extended loss carry-forward (effectively up to 13 years) is available under privileges granted by the Board of Investment. Each company's losses are dealt with separately; there is no group relief.

1.3 Withholding tax

A foreign company that does not carry on business in Thailand is subject to final withholding tax on the following categories of income derived from Thailand:

- Dividends
- Brokerage, fees for provision of services
- Royalties
- Interest
- Rent from property
- Capital gains

Withholding tax is imposed at the rate of 15% on the remittance of all of the above types of income or profits, except dividends (which are subject to a withholding tax rate of 10%).

The rate of withholding tax may be reduced under a double taxation agreement as follows:

- Some double taxation agreements may exempt brokerage, service fees and capital gains from Thai tax.
- The rate of withholding tax on interest may be reduced to 10% if paid to a foreign financial institution.
- The rate of withholding tax on copyright royalties may be reduced to 5% under some double taxation agreements.

No double taxation agreement reduces the rate of withholding tax on dividends to below the domestic rate of 10%.

Dividends may be exempt from withholding tax if paid by:

- a ROH to a foreign company or partnership (provided the dividend is paid out of qualifying income); or
- a promoted business during the tax holiday.

1.4 Valued Added Tax (VAT)

Valued Added Tax (VAT) is levied on the import and supply of most goods and services. VAT is levied at a current rate of 7% (from 1 October 2007 to 30 September 2010) on the total price of the goods delivered or services provided or imported.

The supply of certain goods and services, such as immovable property and educational services, is exempt from VAT.

Exports of goods and services are subject to VAT of 0%.

Input VAT on purchase of goods or services related to a VAT registered business may be credited against output VAT. Surplus input VAT may be carried forward against future output VAT liabilities or refunded in cash.

1.5 Stamp duty

Certain types of documents and transactions are subject to stamp duty at various rates. Among the more significant instruments subject to stamp duty are lease contracts for immovable property, share transfers, hire purchase contracts, and contracts for the hire of work, all subject to duty of 0.1% (without limit) and loan documents, subject to duty of 0.05% (subject to a limit of Baht 10,000).

1.6 Specific Business Tax

Specific Business Tax (SBT) is collected on certain types of gross revenue at fixed rates. Among the more significant types of revenue subject to SBT are interest and proceeds on transfers of immovable property, both subject to SBT of 3.3% (including municipal tax). Note however that SBT has been temporarily reduced to 0.1% (0.11% inclusive of the 10% municipality tax) under a Cabinet Resolution issued on 4 March 2008. The rate will apply for a 1 year period from 29 March 2008. An extension for one more year to 28 March 2010 has been granted under Royal Decree 488.

2. Acquisition

2.1 The preference of purchasers: assets vs stock deal

Thailand does not have detailed legislation dealing with the tax treatment of acquisitions. Accordingly, general principles of taxation apply when structuring a deal and choosing between an acquisition of assets or stock. Whether a deal is structured as a stock deal or asset deal may largely depend on commercial considerations.

2.2 Stock acquisition

Most share acquisitions are structured as direct investments from outside Thailand, except where foreign ownership restrictions necessitate the establishment of a holding vehicle in Thailand.

If it is intended that the whole, or part of, the investment in the Thai Target will ultimately be sold, it may be advantageous to hold the investment through a holding company located in a country which has entered into a double tax agreement with Thailand that exempts gains on the subsequent sale of the stock of the Thai Target from Thai tax.

Foreign investors have the opportunity to invest through property or equity funds. Investment through such funds has been used both in order to take advantage of preferential tax treatment granted to such funds and as a mechanism for avoiding foreign ownership restrictions under the Foreign Business Act.

2.3 Asset acquisition

In most asset acquisitions, the purchaser will form a new limited company in Thailand through which the assets would be acquired. Rarely, a foreign investor will directly acquire assets and thereby form a branch in Thailand.

In most circumstances, the capital of a limited company will consist only of ordinary shares. Where foreign ownership restrictions require the participation of local shareholders, such shareholders may hold preference shares carrying diluted rights.

Preference share financing may also be used where the company acquiring the assets would not be able to utilise interest deductions, for example, where it has been granted a corporate income tax holiday under investment promotion privileges. In such circumstances, the preference shares will be used as quasi-debt, with mechanisms being put in place to effectively redeem the preference shares (through a capital reduction) on termination of the tax holiday.

In the case of acquisitions of real property assets, where foreign ownership restrictions apply, foreign investors may acquire ownership of the assets via a property fund.

2.4 Transaction costs

2.4.1 Valued Added Tax

- Stock deal

A transfer of shares is not subject to VAT.

• Asset deal

A sale of movable assets will usually be subject to VAT, based on the value of the assets transferred. However, provided certain conditions are met, exemption from VAT is available for a statutory merger of companies (an amalgamation) and the transfer of a company's entire business.

If a transfer is not otherwise exempt from VAT, then, provided it is VAT registered at the time of the transaction, the purchaser should be entitled to recover (with certain exceptions) VAT paid on the acquisition of the assets. The recovery may be made either by offsetting the VAT paid against a future liability to output VAT, or by claiming a cash refund.

2.4.2 Stamp duty

• Stock deal

A document effecting a transfer of shares in a Thai company is subject to stamp duty, where such documents are executed in Thailand, or executed overseas and subsequently brought into Thailand. Stamp duty is calculated at 0.1% of the greater of the selling price, or the paid-up value, of the shares.

Unless otherwise agreed, stamp duty is payable by the seller of the shares.

• Asset deal

In the case of an asset deal, stamp duty will usually only be payable if it is necessary to execute new documents subject to duty (for example, leases, hire purchase contracts etc).

2.4.3 Specific Business Tax

• Stock deal

A transfer of shares is not subject to SBT.

• Asset deal

Sales of immovable property are generally subject to SBT at 3.3% (however currently reduced to 0.1% under Royal Decree No 472) of the gross income received. Unless otherwise agreed, SBT is payable by the seller.

A sale may be fully exempt from tax if immovable property forms part of an entire business transfer or an amalgamation.

2.4.4 Concessions relating to mergers and acquisitions

Provided that certain conditions are fulfilled, an amalgamation and a transfer of entire business may be exempt from:

- Corporate income tax
- VAT
- Stamp duty
- SBT for the sale of an immovable property

The main conditions for the exemption are:

- There must be an amalgamation (as per the Civil Code) or a transfer of an entire business.
- The merging companies or the transferor and transferee must both be VAT registrants (if VAT exemption is sought).
- In the case of a transfer of business, the transferor company must enter liquidation in the same accounting period as the transfer.

Additionally, exemption from VAT, SBT and stamp duty on income derived from the partial business transfer can be obtained (under Royal Decree 484) provided the partial business transfer is executed between 1 January 2009 and 31 December 2009 in accordance with the criteria, methods and procedures announced by the Director General of the Revenue Department.

The main conditions for the exemption are:

- The transfer must be between affiliates, which are public limited companies or limited companies incorporated under Thai law. The term 'affiliates' means that the transferor company holds more than 50% of total shares of transferee company, or vice versa, and includes cases where the transferor company holds not less than 99% of the shares with voting rights of another company which in turn holds not less than 99% of the shares with voting rights in the transferee company. Note that the shareholding ratio in the transferee company after the transfer of business could be reduced provided that the shareholding with voting rights continues to exceed 50%.
- The status of an affiliated company must continue to exist for a period of at least six months from 31 December 2009.
- The registered and paid-up capital of the transferee must not be less than net value of the assets transferred.
- The transfer must be completed within 31 December 2009.

- If the transferor is a VAT registrant, the transferee must also be a VAT registrant and use the assets transferred in its business that is fully subject to VAT.
- The transferor and transferee must not be debtors of the Revenue Department for outstanding tax as of the transfer date.

2.4.5 Tax deductibility of transaction costs

Acquisition expenses are typically non-deductible, but form part of the capital cost base for calculating profit on future disposals and for calculating depreciation on depreciable assets.

3. Basis of taxation following asset or stock acquisition

3.1 Stock acquisition

The acquisition by a foreign investor of the shares of a domestic company has no tax consequences for the investor but, if the shares are subsequently sold and sale proceeds are paid from or in Thailand, the investor would be liable to tax on any gains realised on the sale. The Target would continue to be liable to corporate income tax on the same basis as before the sale (i.e. there is no step up of the cost base on the assets owned by the Target).

The utilisation of tax losses is not affected by a change in shareholding.

Interest charges incurred by the foreign investor on borrowings for the share acquisition are not deductible against the income of the Target.

3.2 Asset acquisition

Unless the transfer of assets has taken place on a tax-free basis (e.g. through an amalgamation or entire business transfer), the purchaser is entitled to depreciate assets acquired based on the acquisition price. The purchaser may therefore obtain a step-up in the cost basis of the asset. The purchaser will depreciate the asset as if it was acquired new. The fact that the asset has previously been depreciated would not result in a reduction in the minimum depreciation periods to the purchaser.

Maximum tax depreciation rates are imposed by statute. The maximum rates for certain categories of asset are illustrated below.

Asset depreciation rates

Asset category	Maximum depreciation rate (%)
Durable buildings	5
Temporary buildings	100
Cost of acquisition of goodwill, patents, trademarks and other rights:	
• if period of use is not limited	10
• if period of use is limited	100 / Period of use
Other assets	20

If an accounting method whereby depreciation rates vary from year to year during the useful life of an asset is adopted, the company may, in some years, use depreciation rates that are higher than the above prescribed rates provided the number of years of the useful life of the asset for the purpose of depreciation is not less than 100 divided by the above prescribed rate.

- Special depreciation methods for certain assets may be applied as follows:
  - Newly acquired machinery for R&D may be depreciated at a higher rate (i.e. 40%) of cost in the first year and the remaining balance depreciated at the prescribed rate.
  - Newly acquired machinery and equipment may be depreciated at a higher rate (i.e. 40%) of cost in the first year and the remaining balance depreciated at the prescribed rate. This method is valid for machinery and equipment acquired between 29 July 2008 and 31 December 2010.
  - Computer hardware and software may be depreciated within 3 accounting periods.

- Goodwill

Goodwill purchased as a separately identifiable asset may be capitalised for tax purposes and depreciated over a period of not less than 10 years.

No goodwill may be recognized for tax purposes on a tax free amalgamation or an entire business transfer.

- Tax free amalgamation or entire business transfer

In the case of an amalgamation, the new company formed through the amalgamation continues to depreciate assets on the same basis as the original companies. However, any tax losses in the merging companies may not be transferred to the new company formed through the merger.

Under an entire business transfer, the transferee continues to depreciate assets on the same basis as the transferor company. As with a merger, the tax losses in the transferor may not be transferred to the transferee.

4. Financing of acquisitions

4.1 Thin capitalisation

Thai limited companies are permitted to issue only ordinary shares or preference shares. Neither category of share may be issued as redeemable. There are few restrictions on the rights that may be attached to preference shares. For example, preference shares may have diluted voting rights compared with ordinary shares.

Thailand currently has no thin capitalisation rules that restrict the amount of interest that may be deducted for tax purposes. Interest paid by a Thai company will usually be deductible provided the rate of interest is within the limits provided by transfer pricing rules and civil law.

Certain debt / equity ratios may be imposed on companies that are seeking tax concessions under the Investment Promotion Act.

4.2 Deductibility of interest

4.2.1 Stock acquisition

Interest on loans taken out by a Thai company and used to fund investments is deductible from profits, if any, subject to corporate income tax. However, as Thailand has no group relief or consolidated filing, the use of a leveraged Thai acquisition vehicle is not tax effective. In addition, as dividends received by the holding vehicle should be fully exempt from tax, the holding vehicle would have no taxable income against which to offset interest costs.

4.2.2 Asset acquisition

Interest on loans used to acquire assets is generally fully deductible in calculating profits subject to corporate income tax. One exception is where the acquired asset is not immediately brought into use in the business. In such circumstances, interest should be capitalised as part of the cost of acquiring the asset, until such time as the asset is brought into use. The capitalised interest may be depreciated as part of the cost of the asset.

Interest is deductible when it falls due for payment. Where the acquiring company is unable to utilise interest deduction, such as where it benefits from a tax holiday, financing may be provided using discounted notes in order to defer interest deductions. If the debt is appropriately structured the discount on the note would only be deductible upon the redemption of the note. If this takes place after the tax holiday, deduction for interest payments may be deferred until tax relief may be obtained.

5. Merger

Under a statutory merger of companies (an amalgamation), the merging companies are dissolved and a new company is formed. For tax purposes, the merging companies recognise no gain or loss on the transfer of assets. The new company formed through the merger continues to depreciate assets on the same basis as the original companies. However, any tax losses in the merging companies may not be transferred to the new company formed through the merger.

6. Other structuring and post deal issues

6.1 Repatriation of profits

In addition to dividends, profit may be repatriated through the payments of royalties, service fees and interest, but each of these is subject to various limitations in terms of withholding taxes and / or the transfer pricing regime (see Section 1.4 for withholding tax implications relating to these payments).

6.2 Losses carried forward and unutilised tax depreciation carried forward

- Stock deal

A change in ownership of a company does not affect its carry-forward of tax losses.

- Asset deal

Tax losses are not transferable on a sale of assets, even where the sale represents the transfer of an entire business.

6.3 Tax incentives

- Stock deal

A change in ownership through a stock deal will generally not affect the availability of tax incentives, provided there is no breach of any ownership condition imposed by the Board of Investment.

- Asset deal

Tax incentives would generally be lost when the business is transferred through an asset deal. However, they may be transferred at the discretion of the Board of Investment.

6.4 Group relief

There is no form of group relief or consolidated filing in Thailand.

7. Disposal

7.1 Preference of sellers: asset vs stock deal

From a seller's point of view, it would be less complicated to sell a Target through a stock deal.

7.2 Stock sale

7.2.1 Profit on sale of stock

Capital gains derived by a Thai company from the sale of shares are included in income subject to corporate income tax. The gain is calculated as the difference between the sales proceeds and the cost of investment.

Gains derived by a foreign investor on the sale of shares in a Thai company are generally subject to withholding tax of 15% if the gain is paid "in or from" Thailand. If the sale is made between two offshore entities, the gain will not usually be paid "in or form" Thailand, and is not subject to Thai taxation. If the exit route is a sale to a Thai resident, or via the Thai exchange, tax on the gain may be mitigated either by:

- Holding the investment through a company located in a territory having a double tax agreement with Thailand that provides for exemption from Thai tax on gains from the sale of shares; or
- Stepping up the cost base of the shares via an offshore sale before the sale into Thailand so that no gain is generated on the exit sale.

7.2.2 Distribution of profits

If the seller is a Thai company, the distribution of sale proceeds to shareholders as a dividend will attract withholding tax at the rate of 10% unless the shareholder is a company listed on the SET; or a company that holds at least 25% of the voting shares in the dividends paying company (and subject to the other conditions noted in 1.1.2).

7.3 Asset sale

7.3.1 Profit on sale of assets

A company that sells any assets, which may include its entire business, is liable to corporate income tax on any gain derived on the sale. The company may offset its tax losses, if any, against the gain. The gain is calculated as the difference between the proceeds received less the tax book value of the assets.

Various tax exemptions apply to a statutory merger of companies and the transfer of a company's entire business (see section 8 'Transaction costs for seller').

7.3.2 Distribution of profits

Profits including capital gains may be distributed to shareholders as a dividend (see section 7.2.2 'Distribution of profits'). Alternatively, the shareholder may consider liquidating the company, when all or a substantial part of the business is being sold off. Generally, liquidation proceeds in excess of the cost of investment paid to offshore shareholders are subject to a withholding tax of 15%. However, the liquidation proceeds received from an amalgamation or an entire business transfer may be exempt from tax, provided that certain conditions are met.

8. Transaction costs for seller

8.1 Valued Added Tax

See section 2.4 'Transaction costs for purchaser'.

8.2 Stamp duty

See section 2.4 'Transaction costs for purchaser'.

8.3 Specific Business Tax

See section 2.4 'Transaction costs for purchaser'.

8.4 Concessions relating to mergers and acquisitions

Exemption from income tax may be provided for the transfer of assets under an amalgamation and an entire business transfer where the transferor enters into liquidation in the same accounting period as the transfer.

See section 2.4 'Transaction costs for purchaser' for other concessions available for an amalgamation and an entire business transfer.

8.5 Tax deductibility of transaction costs

Transaction costs are generally tax deductible to the seller in Thailand.

9. Preparation of target for sale

In preparing for a deal, it would be expedient for the seller to identify tax costs arising from the stock or asset deal. Tax concessions relating to mergers and acquisitions should be taken into account in order to minimise the tax costs. Positive tax attributes and value of tax shelters, for example, the availability of carry-forward tax losses, could also be factored in and used as a bargaining tool when negotiating with the buyer.

10. De-mergers

There are no specific provisions in relation to de-mergers. A de-merger usually takes place through the sale of assets or business. It is important to note that any brought forward losses may not be transferable. The implications for a de-merger would be the same as an asset deal as discussed in section 2.3 'Asset acquisition' and section 7.3 'Asset sale'.

11. Listing / initial public offering (IPO)

After acquiring a target, a financial buyer generally looks for an exit route either through a sale or an IPO. There are no special tax laws or regulations applicable to capital gains derived by a corporate shareholder and arising from an IPO in Thailand. The implications for profits derived from an IPO would be the same as a stock deal as discussed in section 7.2 'Profit on sale of stock'.

Vietnam

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1. Introduction

1.1 General comments on M&A in Vietnam

In Vietnam, M&A transactions take the form of share or asset acquisitions. Corporate income tax (CIT), Value Added Tax (VAT) and Capital Assignment Profits Tax (CAPT) implications should be considered when structuring an M&A transaction.

The Vietnam tax environment is developing rapidly and new CIT and VAT laws were introduced effective 1 January 2009.

1.2 Corporate tax

1.2.1 General tax regime

Companies incorporated in Vietnam are subject to a standard CIT rate of 25%.

Oil and gas companies and companies which are involved in exploitation of precious minerals are subject to tax at rates ranging from 32% to 50% depending on the specific project.

Preferential rates of 10% and 20% are available where certain criteria are met. The criteria for receiving preferential rates are the scope of activities and location of the investment. Preferential rates are available for a period of 15 years and 10 years respectively, starting from the first year the company has turnover. When the preferential rate expires, the CIT rate generally reverts to the standard rate.

1.2.2 Taxation of dividends

Dividends received by a Vietnamese company from another Vietnamese company are exempted from tax.

1.2.3 Tax losses

Tax losses may be carried forward for a maximum period of five years from the year in which the loss arose. Carry back of losses is not permitted.

Each company's tax losses are dealt with separately; there is no group relief.

1.3 Withholding tax

Foreign companies performing business in Vietnam / having contracts with Vietnamese customers without establishing a legal entity in Vietnam are subject to “Foreign Contractor Withholding Tax” (FCWT), which includes a VAT and a CIT element. Withholding tax also applies to payments of interest, royalties, license fees, and cross border lease charges. Withholding tax applies on the income derived from Vietnam, regardless of where the services are performed, inside or outside Vietnam. From 2009, certain services performed outside Vietnam are exempted from FCWT. Tax rates for some typical business activities are as follows:

	Effective VAT rate	Deemed CIT rate
Royalties	Exempt	10%
Interest	Exempt	10%
General services	5%	5%

There is currently no withholding tax on dividends paid by a Vietnamese company.

1.4 Double tax agreements

The above withholding taxes may be affected by relevant double tax agreements (DTA)s. Vietnam currently has DTAs with numerous other countries.

1.5 Value Added Tax

VAT applies to goods and services used for production, trading and consumption in Vietnam (including goods and services purchased from abroad). In each case the business must charge VAT on the value of goods or services supplied. In addition, VAT applies on the duty paid value of imported goods. The importer must pay VAT at the same time that they pay import duties.

VAT rates are 0%, 5% and 10%. Certain goods and services are VAT exempt.

1.6 Capital Assignment Profits Tax

Gains on transfers of interests (as opposed to shares) in a Vietnamese limited liability company are subject to 25% CAPT. The taxable gain is determined as the excess of the sales proceeds less cost (or the initial value of contributed charter capital for the first transfer) less transfer expenses. The CAPT must be withheld by the purchaser, who must file a CAPT return with the Vietnamese tax authorities.

In the case of a transfer of shares held in a Vietnamese joint stock company by a foreigner, CIT payable is 0.1% of the gross sales proceeds.

DTAs may provide protection from the above taxes.

2. Acquisition alternatives

Acquisitions in Vietnam can be structured as a share or asset deal. In the case of an asset deal, a foreign purchaser would generally have to establish a new subsidiary in Vietnam.

2.1 Share acquisition

Share acquisitions by foreign purchasers are commonly structured as direct investments from offshore. In a share acquisition, tax attributes, such as unutilised losses and tax incentives, would generally remain with the target.

2.2 Asset acquisition

In an asset acquisition, tax losses cannot be transferred to the purchaser. The purchaser would generally be eligible for tax incentives based on its activities and location, but there are anti-avoidance rules to prevent the use of asset transfers to refresh tax incentives.

Tax depreciation can generally be claimed on the purchase price of the assets. However, the tax authorities may in practice challenge the tax depreciation of large goodwill balances.

Vietnam has transfer pricing regulations which require transactions between related parties (which are widely defined) to be effected at market value for tax purposes.

Where assets have been imported duty and VAT free, there may be a duty and VAT claw back upon sale of such assets.

2.3 Transactions costs

2.3.1 Value Added Tax

- Share deal

  A transfer of shares is not subject to VAT.

- Asset deal

  VAT would be payable on the assets transferred and recoverable if the purchaser makes VAT-able supplies.

2.3.2 Registration fees

- Share deal

  No registration fees are imposed on the transfer of shares.

- Asset deal

  In an asset deal, registration fees are only applicable to the transfers of certain assets, as below:

Assets	Registration fee rates
Land and housing	0.5%
Ships and boats	1%
Deep-sea fishing boats	0.5%
Motorcycles	1 — 5%
Automobiles	2 — 15%
Shotguns and sports guns	2%

3. Basis of taxation following share or asset acquisition

3.1 Share deal

The acquisition by a foreign investor of the shares of a domestic company has no tax consequences for the investor but, if the shares are subsequently sold, the investor would be liable to tax on any gains realised on the sale. The target would continue to be liable to CIT on the same basis as before the sale (i.e. there is no step up of the cost base in the assets owned by the Target).

The utilisation of tax losses is not affected by a change in shareholding.

Interest charges incurred by the foreign investor on borrowings for the share acquisition are not deductible against the income of the target.

3.2 Asset deal

Generally, the purchaser is entitled to depreciate assets acquired based on the acquisition price. The purchaser may therefore obtain a step-up in the cost basis of the asset. For brand-new assets, the tax depreciation is based on the useful life of the asset which is based on the regulations. For used assets, the useful life is determined based on the following formula:

$$\text{Useful life of fixed asset} = \frac{\text{Acquisition price}}{\text{Sale price of the brand-new fixed asset of the same or similar type}} \times \text{Useful life of the brand-new fixed asset of the same type based on the regulations}$$

Some examples of useful life for certain categories of assets are illustrated below:

Asset category	Useful life (new asset)
Buildings with a high durability	25 — 50 years
Other buildings	6 — 25 years
Machinery and equipment	5 — 15 years

Accepted tax depreciation methods are straight line method, reducing balance method and depreciation method based on quantity or volume of products (only if certain conditions are fulfilled).

4. Financing of acquisitions

4.1 Thin capitalisation

Vietnam currently has no thin capitalisation rules. The debt / equity ratio is specified in the business registration certificate, specifying the charter and loan capital.

4.2 Deductibility of interest

Interest on loans granted by lenders other than credit institutions and economic organizations is deductible for CIT purposes provided that the interest rate does not exceed 1.5 times the rate of State Bank of Vietnam. Interest on loans corresponding to the portion of charter capital not yet contributed is not tax deductible.

5. Merger

Under Vietnamese regulations, one or more companies of the same type can be merged into another company by way of transfer of all assets, rights, obligations and interests to the merged company and, at the same time, termination of the existence of the merging companies.

For tax purposes, if the assets are not revalued upon merger, the merging companies recognise no gain or loss on the transfer of assets.

6. Other structuring and post deal issues

6.1 Repatriation of profits

In addition to dividends, profits may potentially be extracted through the payment of royalties, service fees and interest, but each of these is subject to various limitations in terms of withholding taxes and / or transfer pricing rules.

6.2 Losses carried forward and unutilised tax depreciation carried forward

- Share deal

  A change in ownership of a company does not affect its carry-forward of tax losses.

- Asset deal

  Tax losses are not transferable on a sale of assets, even where the sale represents the transfer of an entire business.

6.3 Tax incentives

- Share deal

  A change in ownership through a share deal will generally not affect the availability of tax incentives.

- Asset deal

  Tax incentives would generally be lost when the business is transferred through an asset deal.

6.4 Group relief

There is no form of group relief or consolidated filing in Vietnam.

7. Disposal

7.1 Share sale

Capital gains derived by a Vietnamese company from the sale of interest in a Vietnamese limited liability company or sale of shares in a Vietnamese joint stock company are included in income and subject to 25% CIT. The taxable gain is determined as the excess of the sales proceeds less cost (or the initial value of contributed charter capital for the first transfer) less transfer expenses.

Gains derived by a foreign investor on the sale of interest in a Vietnamese Limited Liability Company are also subject to 25% CIT. The taxable gain is determined as the excess of the sales proceeds less cost (or the initial value of contributed charter capital for the first transfer) less transfer expenses. The CAPT must be withheld by the purchaser, which must file a CAPT return with the Vietnamese tax authorities.

Upon the sale of shares in a Vietnamese joint stock company, CIT payable is 0.1% of the gross sales proceeds.

DTAs may provide protection from the above taxes. Use of dual tier holding structures may also provide a method to mitigating CAPT costs.

7.2 Asset sale

A company that sells any assets, which may include its entire business, is liable to CIT on any gain derived on the sale. The company may offset its tax losses, if any, against the gain. The gain is calculated as the difference between the proceeds received less the tax book value of the assets.

8. Transaction cost for seller

8.1 VAT

See section 2.3.1.

8.2 Registration fees

See section 2.3.2.

9. Preparation of target for sale

One of the means of extracting surplus cash in a company that is identified for sale is through dividends. Dividends are not subject to withholding tax and dividends received by a Vietnamese company are CIT exempt. This also has the effect of reducing the value should any gain on sale be taxable.

10. De-mergers

There are no specific provisions in relation to de-mergers. A de-merger usually takes place through the sale of assets or business. It is important to note that any brought forward losses may not be transferable. The implications for a de-merger would be the same as an asset deal.

11. Listing / initial public offering (IPO)

After acquiring a target, a financial buyer generally looks for an exit route either through a sale or an IPO. There are no special tax laws or regulations applicable to capital gains derived by a corporate shareholder and arising from an IPO in Vietnam. The implications for profits derived from an IPO would be the same as a share deal as discussed in section 7.1.

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