

Opportunities rediscovered

Understanding Mergers and
Acquisitions Tax in Asia – 2012



Foreword



A handwritten signature in black ink that reads "Nick Dignan". The signature is fluid and cursive, written over a thin horizontal line.

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During the two years since our last edition of this publication, global market economies continued to fluctuate. While the US is slowly recovering, economic risks have skewed towards Europe. Growth in China is slowing off a high base and the remainder of Asia Pacific continues to perform reasonably strongly.

Despite recent uncertainty and instability of global financial markets, it appears that concerted massive government intervention has assisted in strengthening the world economy. Countries with unsustainable budget deficits continue to focus on closing tax loopholes, increasing tax revenue and reducing spending.

With the focus of global economic activity rapidly shifting East, the prospect for growth in Asia continues to be strong. Many Asian financial markets are continuing their path of deregulation. As M&A transactions provide unique tax planning opportunities, M&A is becoming a more important strategic tool in Asia. However, potential tax risks need to be properly managed.

In recent years, the issue of beneficial ownership and the 'legitimate' ability to claim tax treaty benefits is one of the most common challenges for cross-border investment. The OECD has invested considerable resources in 2011 to help clarify the meaning of beneficial ownership. With increasing

investment in the region and the common use of multi-tier investment structures by groups to manage their global tax position, tax authorities in many jurisdictions are closely monitoring the use of conduit companies, which have little commercial substance and are merely created for the purpose of obtaining treaty benefits. Multinational companies and investment funds should not underestimate the importance of considering 'business purpose' and 'commercial justification' when establishing holding companies. It is becoming increasingly difficult to structure arrangements to take advantage of favourable treaty benefits unless there is genuine substance in the relevant holding company.

Tax authorities throughout the region are increasing their efforts to detect, inspect and tax indirect capital gains, as can be seen in the recent Vodafone case in India (although the court found in Vodafone's favour) and Guoshuihan [2009] No. 698 in China.

Countries in the region continue to enter into new double tax treaties and / or update / modify existing treaties. For example, Hong Kong had five double tax treaties at the beginning of 2010 and the number of double tax treaties has increased to more than 20 at the beginning of 2012.

Tax authorities of most countries in the region continue to enhance their scrutiny and strengthen of transfer pricing guidelines and documentation requirements. As an increasing number of multinational companies are expanding outside of their own jurisdictions to improve operational efficiency, company structures and intercompany transactions should be well planned and carefully monitored.

The *Mergers and Acquisitions – Asian Taxation Guide* (now renamed as '*Understanding Mergers and Acquisitions Tax in Asia*') was first released in 2002, providing our clients with some basic tools for understanding typical tax implications in M&A deals in the region. In this 2012 edition, our network of M&A tax professionals across the Asia Pacific region continues offering 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 the Asia Pacific region, highlighting key tax issues relevant to both purchasers and sellers in an M&A deal.

This guide has been written using the extensive technical knowledge and practical deal experience gathered by PwC's M&A Tax Services practice in Asia. We hope you find this publication an essential read when contemplating M&A transactions in the region. Meanwhile, we strongly recommend you to seek comprehensive tax advice from one of our local PwC teams.

Last but not least, I would like to express my sincere gratitude to PwC's 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 as well as Scott Lindsay and Sanlie Yeung of PwC Hong Kong.

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1. Introduction

1.1 General information on mergers and acquisitions in Australia

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 and amendments regarding ‘rights to future income’
- the introduction of a simplified imputation system
- the introduction of a new research and development (R&D) incentive
- reform of Australia’s tax treatment of employee share schemes
- reform of Australia’s international tax law
- reform of Australia’s tax treatment of financial arrangements
- the proposed introduction of the minerals resource rent tax (MRRT) and extension of the petroleum resource rent tax (PRRT), and
- the proposed introduction of a carbon pricing mechanism as part of draft legislation that has recently been introduced to implement the key elements of the government’s Securing a Clean Energy Future plan announced on 10 July 2011.

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 introducing a new streamlined tax incentive for R&D which replaces the existing R&D tax concession with effect from 1 July 2010. Under the new incentive, companies with a turnover of more than A\$20m will be entitled to a 40% non-refundable R&D tax offset for undertaking eligible R&D activities which can be used to reduce their tax liability. A 45% refundable R&D tax offset will be available for all other eligible entities (see section 1.8).

On 26 March 2009, the final stages of reforms to the taxation of financial arrangements were enacted. The reform process which had been under way for approximately 18 years was 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 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 needs to be considered in the structuring of any transaction.

Australia's international tax laws have continued to undergo significant reform. Legislation was enacted on 14 July 2010 which repealed the foreign investment fund (FIF) provisions and deemed present entitlement rules. On 5 January 2010, Treasury also released a consultation paper for public comment detailing the reforms to the controlled foreign company (CFC) rules. In February 2011, the Assistant Treasurer released exposure draft legislation setting out the proposed legislative details of the taxation laws to modernise the CFC rules and to implement new foreign accumulation fund (FAF) rules (see section 1.4).

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

In May 2010, the government released its interim response to the recommendations made following the comprehensive review of Australia's tax system (Henry Review) which commenced in May 2008. Since then, one of the key changes proposed by the government is that it will reduce the company tax rate from its current rate of 30% to 29% in the 2013/14 income year (or for small business companies from the 2012/13 income year), in conjunction with the introduction of a new MRRT applicable to iron ore and coal projects in Australia and an extension of the PRRT to apply to all Australian onshore and offshore oil and gas projects, including the North West Shelf. Exposure draft legislation in respect of the MRRT and PRRT was released by Treasury on 10 June 2011 and 26 August 2011 respectively. This is expected to be subject to extensive consultation prior to enactment.

The key features of the proposed new MRRT include:

- The MRRT will be at a rate of 30% reduced by an allowance for extraction of 25% to recognise the value of specialist skills miners employ to extract the resource and bring it to taxing point, i.e. an effective tax rate of 22.5%.
- The MRRT is applied to realised profits attributable to the condition and location of the resource at the taxing point, a point straight after extraction in the production chain, and will use an arm's length pricing method to ensure only the value of the resource extracted is taxed, reduced by certain MRRT allowances.
- Taxpayers (and their connected entities and affiliates) which have a mining profit of A\$50m or less in an MRRT year are entitled to reduce their MRRT liability to zero.

The MRRT is intended to apply from 1 July 2012 to all new and existing iron ore and coal operations.

On 13 September 2011, the government introduced a package of legislation which will put a price on carbon pollution, promote investment in renewable and clean energy technologies and support action to reduce carbon pollution on the land.

These important reforms are a central element in the government's policies to ensure that Australia reduces its carbon pollution in the most economically efficient manner while including extensive measures to support jobs and competitiveness.

The Bills implement the key elements of the government's Securing a Clean Energy Future plan announced on 10 July 2011. The proposed carbon pricing mechanism which is intended to be introduced from 1 July 2012 will embed a carbon price into the Australian economy. There are a number of income and indirect tax impacts of the proposed carbon pricing mechanism, both for those directly impacted by the carbon price and for those impacted by associated measures, such as changes to the fuel tax and excise rates, and small businesses and individuals impacted by the tax-related compensation measures.

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 Capital gains tax

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 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 by market value 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 taxation treaty. Please see 'capital gains tax' in section 7.2.1.

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 taxation agreement (DTA) with the recipient jurisdiction. In summary, the rates are usually as follows:

Type of income	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)	-	-

It should be noted that some Australian DTAs (such as the treaties with the US, the UK, France, Finland, Norway, South Africa, Japan and New Zealand) 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 tax, royalties may be 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 and fund payments made to foreign resident beneficiaries

Effective from 1 July 2008, a reduced withholding tax rate applies to fund distributions from Australian managed investment trusts (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, the UK, the US 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 applies.

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. On 3 June 2010, legislation was enacted which introduced a new irrevocable election to apply the CGT provisions as the primary code for taxing certain disposals of eligible investments held by MITs. The provisions 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 under 'capital gains tax' of section 7.2.1, 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 as mentioned in section 1.2.2. Whereas 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 or avoid Australian tax. Australia's attribution regimes include the CFC, and transferor trust 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. Broadly, the major changes recommended in the report were:

- 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
- 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 14 July 2010, legislation was enacted which repeals the FIF rules with effect from the 2010/11 income year, such that there is no longer a requirement to attribute FIF income where an interest in the foreign company or foreign trust was held at 30 June 2010.

On 17 February 2011, the government released Exposure Draft legislation for public comment setting out the legislative design of reforms to modernise the CFC rules and to implement new foreign accumulation fund (FAF) rules. The operative framework of the draft legislation remains broadly unchanged from the consultation papers previously released by the government.

Although it is the government's intention that the FIF and deemed present entitlement rules will be replaced by a FAF rule to ensure that Australian residents cannot defer or avoid a tax liability for income held in FAFs, no start date has yet been announced for these rules. Under the current proposals, where a foreign

entity is a FAF (i.e. the entity meets certain investment and accumulation test), the FAF attributable income will be based on the change in the market value of the interest in the FAF over the relevant period plus distributions received from the FAF.

Treasury has indicated that the new measures will apply for income years commencing on or after the date of Royal Assent.

1.5 Employee share scheme

Legislation setting out the new employee share rules was 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). In general, 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 ten to seven 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\$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 'dutiabale property'. In general, 'dutiabale 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 dutiabale property, or the consideration paid. A transfer of shares or units is subject to duty at the rate of 0.6% in some States until 1 July 2012 when this duty is scheduled to be abolished. 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) until 1 July 2012 when this duty is scheduled to be abolished.

While Australia has moved towards 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 8 September 2011, legislation was enacted which introduced the new R&D Tax Incentive Programme. Under the new rules, the current R&D tax concession was replaced with a simplified R&D tax credit, with effect from 1 July 2011.

The two core components of the new R&D incentive are:

- a 45% refundable R&D tax offset for eligible entities with a turnover of less than A\$20m (unless they are a tax-exempt entity or majority controlled by tax-exempt entities), and
- a non-refundable 40% R&D tax offset for all other eligible entities.

We note that the new rules are accompanied by a new definition of 'eligible R&D activity'. Eligible R&D activities are categorised as either 'core' or 'supporting' R&D activities. Core R&D activities are broadly experimental activities whose outcome cannot be determined or known in advance and are conducted for the purpose of acquiring new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services). Supporting R&D activities are activities directly related to core R&D activities or in the case of production activities (or activities excluded from being core R&D activities), undertaken for the dominant purposes of supporting core 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\$231m
- 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\$231m
- 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.

On 22 September 2009, the government introduced 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. As such, the threshold was increased to A\$231m on 1 January 2010.

On 12 February 2010, legislation was passed which widened the scope of the FIRB legislation that has been introduced into parliament. Broadly, the changes are operated 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.

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

1.11 Common forms of business

Common forms of investment vehicles that can be used in Australia are:

• Company

Foreign companies may establish an Australian subsidiary by registering a new company or by acquiring a recently incorporated shelf company which has not yet engaged in trade.

The most common form of business entity in Australia is a company limited by shares. Companies limited by shares are either proprietary companies or public companies. Only public companies may be listed on the Australian Securities Exchange Limited (ASX).

Proprietary companies are often used for private ventures or as subsidiaries of public companies. Public companies are often used for larger public ventures.

See section 1.2 for applicable corporate income tax implications applicable to companies.

- **Branch**

A branch is not treated as a separate legal entity.

From an income tax perspective:

- A foreign entity which establishes an Australian branch will be taxed only on Australian-sourced income attributable to the branch at the rate of 30%.
- The branch is required to prepare and lodge an Australian income tax return.
- Tax losses may be carried forward indefinitely for offsetting against future Australian taxable income of the branch.
- Tax losses cannot be grouped or transferred to other Australian entities for Australian tax purposes.
- There is no withholding tax on branch profits being repatriated from the branch to foreign head office (see section 1.9.1).

- A branch is not generally eligible for taxation incentives and government grants (such as R&D concession).

- **Trust and partnership**

Trusts and partnerships are other forms of investment vehicles that can be used. These entities are generally treated as ‘flow-through’ entities for tax purposes.

Following the finalisation of the MIT rules as mentioned in section 1.3.3, there is also scope for foreign investors to establish a MIT as the vehicle for acquiring assets in Australia. As noted in section 1.3.3, this gives rise to potential advantages of a combination of the deemed CGT treatment and a potential final 7.5% withholding tax.

Foreign investors making equity investments in relatively high risk start-up and expanding Australian companies may be eligible to use a

venture capital limited partnership (VCLP) as the investment vehicle under Australia’s VCLP regime. This regime is intended to increase foreign investment in the Australian venture capital sector.

In order to constitute a VCLP, an important condition that must be met is for the investment to be in Australian businesses with total assets of not more than A\$250m. A VCLP is required to be registered.

Registration as a VCLP entitles eligible foreign investors in the VCLP to be exempt from capital gains tax on their share of any profits made by the fund.

Companies that are incorporated outside of Australia that wish to carry on business in Australia must either incorporate a wholly-owned or partly-owned subsidiary company in Australia or register a branch office in Australia.

2. Acquisitions

2.1 The preference of purchasers: stock vs. assets deal

Whether a deal is structured as a stock 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% depending on the types of business assets acquired and where they are located. This is significantly higher than the stamp duty on a private company share purchase (generally 0.6% until 1 July 2012 when this duty is scheduled to be abolished), assuming that the company is not a 'land-rich' or 'landholder' entity.

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 cash flow 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 basis 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 rollover 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 and land tax on an adhoc basis and for limited periods.

See section 12 for the major tax incentives or grants provided in Australia.

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 Australia Property (TAP). In the context of an

asset acquisition, TAP would broadly include direct or indirect interests in real property situated in Australia (i.e. 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 Australia Real Property (TARP) 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.

Also see section 7.2.1.

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 Goods and services tax

Acquisition of shares

The supply of shares by an Australian entity to an Australian counterparty 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 exceeds either A\$50,000 (A\$150,000 effective from 1 July 2012) or 10% of the entities total input tax credits in any 12-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).

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 that are required 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

Acquisition of stock

Broadly, where there is a transfer of shares in a New South Wales (NSW) or South Australia registered company, or in a foreign company which keeps their share register in NSW or have their registered office in South Australia, 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. The other Australian jurisdictions have abolished share transfer duty. Share transfer duty in NSW and South Australia is scheduled to be abolished from 1 July 2012.

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

Acquisition of assets

Whether the acquisition of assets or property will be liable to duty, depend on the types of assets or property being transferred and their location. Where there is a transfer of a business, the transfer of land, goods, goodwill and intellectual property, among other things, is subject to duty in the majority of Australian jurisdictions. 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 mergers and acquisitions

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

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.

Goods and services tax

See section 2.4.1 on the GST 'going concern' concession.

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 a transfer of dutiable property even if the transfer occurs within a GST group.

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 'degroupping' 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. The return provided to the financier (such as an amount of interest) is not a borrowing cost and is deductible. See section 4.2.

3. Basis of taxation following stock / 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 covered in section 3.2.

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 for 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.

4.1.2 Debt / equity distinction

There are statutory tests to characterise instruments as debt or equity for income 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 ten 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), 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 ten year term to be structured as a debt interest.

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 or analysis.

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

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. 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), although subject to satisfying Australian corporations law requirements. This simplifies the repatriation of cash from operating companies to holding companies in the Australian group to service debt commitments.

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 or included in cost base under any other provision of the Act may be claimed for tax purposes over five 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 in the 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.

4.2.2 Asset deal

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.

See section 2.4.4 for the deductibility of other borrowing costs.

Acquisition expenses

See section 4.2.1.

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 even if the merger is occurring between two foreign entities which indirectly hold Australian assets. 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 and CGT 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).

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 in general. 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). A failure to pay such withholding taxes will prevent the deductibility of interest and / or royalty expenditure until such time that withholding taxes are paid.

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 as 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. See 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

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 special business test (SBT) (see section 2.2.3). 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 in general. 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.

While 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

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 12 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 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 in 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%).

Also see our comments in section 2.2.1.

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 four taxation determinations in relation to certain inbound investors into Australia. The first 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 determination focuses on whether a private equity fund holds their investments on revenue or capital account. The third determination explains an interpretation of Australian source rules for investments sold on revenue account. The fourth determination explains circumstances in which an ultimate investor can 'look through' interposed partnerships for the purposes of seeking tax treaty relief from Australian tax.

Scrip for scrip capital gains tax 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 rollover measures may restrict certain entities (joining a consolidated group) from obtaining a step-up in the tax basis of assets.

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 – the tax basis 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.

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.

See section 6.1 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', CGT generally 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 after a sale, will give rise to commercial complications which a vendor may wish to avoid.

7.3.2 *Distribution of profits*

See sections 1.3.1 and 6.1.

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 Goods and services tax

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 of the transaction. However, the parties of 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 mergers and acquisitions

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 Goods and services tax

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 (see 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 a 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). 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).

10. Demergers

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

- at least 80% of the demerger group's ownership interest in the demerged entity must be acquired by the group's shareholders
- each shareholder must receive an equal corresponding proportion of interests in the demerged entity (and no other consideration) equal to their interest in the group prior to the demerger, and

- the total market value of each shareholder's interests in the demerger entity and the group entity must at least equal the total market value of their interests in the group prior to the demerger.

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

Demerger dividends arising as a result of a demerger may be able to relieve from Australian tax.

Shareholders of the group apportion their basis across their existing shares plus the additional shares in the demerged entity.

11. Trade sale / Initial public offering

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 12 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 'capital gains tax' in section 7.2.1.

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. While CGT may also apply to the disposal, there is generally a mechanism which seeks to avoid double taxation.

In relation to GST, the supply of securities is treated as a 'financial supply', meaning that 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 and land tax on an ad-hoc basis and for limited periods.

The major tax incentives or 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 12 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 programme which provides funding of up to A\$200,000 for expenditure in the development of eligible export markets
- for income years commencing before 1 July 2011, a 125% deduction (increased to 175% for certain qualifying companies) for eligible R&D expenditure. A cash rebate may be available for small companies. For income years commencing on or after 1 July 2011 a non-refundable 40% R&D tax credit for companies with group turnover of more than A\$20m or a 45% refundable R&D tax credit for companies with a group turnover less than A\$20m, and
 - a refundable tax offset of 20 to 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 (PDV offset) for a film irrespective of where the film was shot. A taxpayer may only claim one of these tax offsets.

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1. Introduction

1.1 General information on mergers and acquisitions in the People's Republic of China

On an ownership transfer of a company, it is generally assumed that all sellers are the People's Republic of China (PRC) companies and all purchases are made either by a foreign enterprise (FE) or through a foreign-invested enterprise (FIE) in the PRC, unless otherwise indicated. A transfer of ownership of a PRC company may take the form of a disposal of shares or assets.

1.2 Corporate tax

Generally, PRC companies are taxed on a stand-alone basis. Taxation of a FIE is covered by a unified corporate income tax (CIT) law effective since 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 the PRC but derives profit, interest and other income from sources in the PRC is subject to withholding tax (WHT) at the rate of 20% on such income with a possibility of exemption or reduction. The WHT rate is reduced to 10% by the Implementation Regulations of the Corporate Income Tax Law of the People's Republic of China of the PRC's CIT Law.

The CIT law stipulates that the tax treaty rates shall prevail in case they are different from the statutory tax rates under the PRC income tax law. If the tax rate stated in a tax treaty is lower than the rate stated in the PRC tax law, the tax rate in the tax treaty shall be used. The use of a tax treaty will be of prime importance for foreign investors when deciding their investment structures into the PRC.

Below is a summary of the WHT on various types of passive income under some of the more favorable tax treaties and arrangements with the PRC:

Type of income	With no double taxation treaty (DTA) with China	Hong Kong	Mauritius	Barbados – 2000 DTA (enforced in the PRC on 1 Jan 2001)	Barbados – 2010 DTA (enforced in the PRC on 1 Jan 2011)	Singapore	US
Dividends	10%	5% / 10% ¹	5%	5%	5% / 10% ¹	5% / 10% ¹	10%
Interest	10%	0% / 7% ²	0% / 10% ²	0% / 10% ²	0% / 10% ²	0% / 7% / 10% ³	10%
Royalties	10%	7%	10%	10%	10%	6% / 10% ⁴	7% / 10% ⁴
Capital gains (non-property-rich Chinese company)	Taxable	Tax exemption with below 25% threshold ⁵	Tax exemption with below 25% threshold ⁵	Tax exemption	Tax exemption with below 25% threshold ⁵	Tax exemption with below 25% threshold ⁵	Tax exemption with below 25% threshold
Capital gains (property-rich Chinese company)	Taxable	Taxable	Taxable	Tax exemption	Taxable	Taxable	Taxable

Notes:

1. The lower rate applies if the dividend-receiving company holds at least 25% equity of the PRC company; the higher rate applies in all other cases.
2. The 0% rate applies to interest received by the government or the recognised institution; the higher rate applies in all other cases.
3. The 0% rate applies to interest received by the government or the recognised institution; the 7% rate applies to interest payable to banks or financial institutions, 10% rate applies in all other cases.
4. Low rate applies to lease payment regarding industrial, commercial or scientific equipment; the 10% rate applies in all other cases.
5. The DTA sets out the time frame for the 'below 25% threshold tax exemption' to be within 12 months before the disposal.

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) of 5% is generally 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 receives interest income from the PRC 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.

Aside from the turnover taxes mentioned above, effective from 1 December 2010, urban construction and maintenance tax and education surcharge are imposed based on 1% / 5% / 7% (depending on different locations) and 3% of the turnover taxes paid respectively. Furthermore, local education surcharge will also be imposed based on 2% of turnover taxes paid.

1.5 Stamp tax

Stamp tax 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.

1.7 Common forms of business

The principal forms in which a business may be commonly seen in China are as follows:

- foreign investment enterprise (FIE)
 - wholly foreign-owned enterprise (WFOE)
 - equity joint venture (EJV)
 - cooperative joint venture (CJV)
- state-owned enterprise (SOE)
- privately-owned enterprise (POE)
- partnership.

2. Acquisitions

According to the Provisions on Acquisition of Domestic Enterprises by Foreign Investors (Order No. 10) 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 (hereafter 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 (hereafter 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 the PRC 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 the PRC, has to issue a report to set out its professional opinion on the financial status for the foreign investor.

2.2 Stock acquisition

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 revalue 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 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 the PRC.

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).

2.2.1 Acquisition of stock in listed Chinese companies

The stock of domestic Chinese companies may be listed on one of the PRC's two stock exchanges located in Shanghai and Shenzhen.

Two classes of shares are tradable on these stock exchanges:

- Class A shares: restricted to domestic traders and qualified foreign institutional investors (QFII)
- Class B shares: restricted to foreign investors and individual Chinese investors

Two classes of shares that are not tradable on these stock exchanges:

- State-owned shares: owned directly by the State
- Legal person shares: 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 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 the PRC'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 a total of no more than 20% of a particular listed company's total issued shares. In addition, 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 M&A activities in the PRC.

Acquisition of non-tradable stock

Prior to 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 (MOF) 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 (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 the PRC) 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, if 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 results 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 acquisition

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, although that they have been sold. The seller is required to pay PRC taxes in respect of the transfer of the following assets:

Type of asset	Tax rate
Equipment	VAT: 2% / 17%
Intangibles	BT: 5%
Inventory	VAT: 3% for small-scale VAT payer / 17% for general VAT payer
Inventory – category of goods subject to CT	CT at various rates
Land and buildings	LAT at various rates from 30% to 60%; BT: 5%
Transfer contracts	Stamp tax 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 deal

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

Asset deal

From the 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 to the buyer. Therefore, VAT charged by the seller may be recovered by the buyer.

Depending on certain VAT related characteristics of the purchaser, 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 which is also subject to CT. Otherwise, the CT paid is a real cost to the purchaser.

If the transferor transfers its entire property right (including assets, receivables, liabilities and labour force), the disposal of movable assets involved can be considered as outside the scope of VAT in accordance with Circular GuoShuiHan [2000] No.420. Furthermore, Public Notice No.13, 2011 was issued by the SAT to further clarify that, effective from 1 March 2011, under asset reorganisations undertaken by VAT taxpayers, the transfer of all or part of the assets in kind along with their associated creditors' rights, liabilities and labour force in the course of merger, spin-off, sale of assets, exchange of assets, etc. should not be subject to VAT.

Moreover, similar to the treatment of VAT, although the sales of land use right and immovable properties is subject to BT, under the new Circular 51 issued by SAT, it clarifies that effective from 1 October 2011, assets restructuring transactions such as merger, spin-off, sale or swap of assets, etc. that involve the transfer of all or part of these assets along with their associated creditors' rights, liabilities and labour force shall not be subject to BT. This also applies to cases that had not been settled before the effective date.

2.4.2 Stamp tax and other relevant taxes

Stock deal

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 deal

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 buyer.

2.4.3 Concessions relating to mergers and acquisitions

According to the notices issued by the SAT and MOF, Caishui [2008] No.175 and Guoshuifa [2009] No.89, the deed tax concessions relating to M&A are:

- 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, where two or more enterprises combine into one enterprise with the existence of original shareholders, the merged enterprise taking over the land and real estate from the original parties shall be exempted from deed tax.
- 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 was extended from 1 January 2009 to 31 December 2011. In Caishui [2012] No. 4, it has further extended the above policy from 1 January 2012 to 31 December 2014.

2.4.4 Tax deductibility of transaction costs

The CIT law does not provide clear rules on the deductibility of transaction costs. Under the old Foreign Enterprise Income Tax (FEIT) law, Foreign-invested enterprises (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 CIT law also imposes 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. Basis of taxation following stock / asset acquisition

The Detailed Implementation Rules (DIR) to the 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. In addition, 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 vs. special tax treatments

3.1.1 General tax treatments

The general principle is that enterprises which undergo 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.

3.1.2 Special tax treatments

If all the following prescribed conditions under the Restructuring Rules are satisfied, it is possible for the parties involved in the corporate restructuring to choose a special tax treatment.

- The corporate restructuring has to be reasonable commercial and the main purpose of the corporate restructuring is not for tax reduction, avoidance or postponement of tax payment.
- 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.
- No change in the original actual business activities within 12 consecutive months (compulsory operating period) after the restructuring.
- The deal consideration should mainly comprise of equity (or shares) and the portion of equity-payment has to exceed 85% of the total consideration. 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.
- The original shareholder who received the equity-payment on the corporate restructuring must not transfer the shares received within the compulsory holding period.

3.2 Stock acquisition

3.2.1 General tax treatment

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

- The transferor shall recognise the gain or loss for the shares transferred.
- The tax basis of the shares acquired by the transferee shall be determined according to the fair value.
- The income tax matters of the target company shall, in principle, remain unchanged.

3.2.2 Special tax treatment

In an equity acquisition, when all the prescribed conditions mentioned in section 3.1.2 are fulfilled, the parties involved may elect to adopt the following treatment, provided that the acquiring enterprise acquires no 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:

- 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.
- 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.
- 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.

3.3 Asset acquisition

3.3.1 General tax treatment

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

- The transferor shall recognise the gain or loss for the assets transferred.

- The tax basis of the assets acquired by the transferee shall be determined according to the fair value.
- The income tax matters of the target company shall, in principle, remain unchanged.

3.3.2 Special tax treatment

In an asset acquisition, when all the prescribed conditions (see section 3.1.2) are fulfilled, the parties involved may elect to adopt the following treatment provided that the transferee enterprise acquires no 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:

- 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.
- 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.

Under the special tax treatment for share acquisition and asset acquisition, 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.

$$\text{Gain or loss arising from assets transferred corresponding to the non-equity payment} = \left(\text{Fair value of assets being transferred} - \text{Tax basis of assets being transferred} \right) \times \frac{\text{Non-equity payment}}{\text{Fair value of assets being transferred}}$$

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)	Minimum registered capital
$TI \leq \text{US\$}3\text{m}$	70% of TI
$\text{US\$}3\text{m} < TI \leq \text{US\$}10\text{m}$	Higher of US\$2.1m or 50% of TI
$\text{US\$}10\text{m} < TI \leq \text{US\$}30\text{m}$	Higher of US\$5m or 40% of TI
$TI > \text{US\$}30\text{m}$	Higher of US\$12m or 33.3% of TI

The 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-to-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-to-equity ratios, one for enterprises in the financial industry and another 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-to-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-to-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 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. Mergers

The general principle discussed in section 3 would similarly apply to a merger and the taxation basis of assets and liabilities acquired by the transferee (the merged enterprise) from the transferor (the enterprise being merged) would be determined based on their fair value transaction price.

5.1 General tax treatment

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

- 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.

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

5.2 Special tax treatment

In a merger, when all the prescribed conditions in section 3.1.2 are fulfilled, 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:

- 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.

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

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	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.
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- 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.

6. Other structuring and post-deal issues

- 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.

6.1 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)

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 WFOE is only required to provide GRF and SBWF, but 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.

6.2 Losses carried forward

Under 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, 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':

Tax losses of the enterprise(s) being merged that can be utilised by the merged enterprise in a given year	=	Fair value of the net assets of the enterprise being merged	x	Interest rate of the longest term treasury bonds issued by the State as at the end of the year of the merger
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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 the value of 'spun-off assets' to the 'value of total assets'. The unutilised tax losses should also be used within the original expiry period.

6.3 Continuity of tax incentives

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

Per Guofa [2007] No.39, the CIT regime does not provide tax incentives based on investment status, location of registration or operation, etc. Instead, tax incentives are granted based on industry (i.e. high-tech) and available to both FIEs and domestic companies. As such, 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 CIT regime. Beginning from 1 January 2008, companies which enjoy 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 took 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 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 before 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 be utilised before expiry.

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

6.3.2 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 are 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 to enjoy 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.

6.4 Group relief

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

7. Disposals

7.1 The preference of sellers: stock vs. asset deal

As mentioned in section 2.1, the adoption of an asset deal or a stock deal for an acquisition in the PRC 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.

7.2 Stock disposal

7.2.1 Profit on stock disposal

Gains on the disposal of stock of a Chinese company are regarded as being sourced in the PRC (PRC-sourced). Therefore, the PRC'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 the same amount of gains. Depending on the income law of such locality, where there is double taxation, relief may be provided by the local tax provisions or a double tax treaty (DTT) if that locality has concluded a DTT with the PRC.

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 investor	Type of tax	Shares in non-listed company	Type of 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 gains are subject to tax as follows:

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

Retained earnings in the entity being disposed is no longer a deductible item. Therefore, tax planning becomes important when acquiring and disposing of investments.

7.2.2 Distribution of profits

Companies

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

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.
- 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.

Circular Guoshuihan [2009] No.47 addresses 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).

7.2.3 Indirect equity transfer of PRC companies

It is not uncommon for multinational corporations to interpose a special purpose vehicle (SPV) as an intermediate holding company for their investments in China. It is imperative to note the recent trend that the Chinese tax authorities are scrutinising such SPV investment structures in the anti-avoidance combat.

Circular Guoshuihan [2009] No.698 addresses the tax issues regarding indirect transfer – indirect equity transfer undertaken by a non-tax resident enterprise (non-TRE) outside China. It demonstrates the Chinese tax authorities' strong determination to counter and counteract avoidance of China tax on gains derived from indirect transfer of Chinese companies' equity via disposing the equity of SPV offshore China.

Reporting obligations for indirect transfer

Within 30 days upon the transfer of SPV, non-TRE seller is obliged to report the indirect transfer to the Chinese local-level tax bureau in charge of the Chinese company, provided that SPV is located in a foreign tax jurisdiction with the following profiles:

1. an effective tax rate of less than 12.5%, or
2. does not tax foreign income of its TRE.

The requisite documents and information to be submitted by non-TRE seller are extensive and include:

1. equity transfer contract / agreement
2. documents illustrating the:
 - relationship between the non-TRE seller and SPV being transferred in respect of financing, operation, sales and purchase, etc.
 - operation, personnel, finance and properties of the SPV being transferred
 - relationship between SPV being transferred and the Chinese investee company in respect of financing, operation, sales and purchase, etc.
 - reasonable commercial purpose of the non-TRE seller in setting up SPV being transferred, and

3. other relevant documents required by the tax authority.

This reporting obligation is to help the Chinese tax authorities detect suspicious indirect transfers.

Obviously, the onus of proof that the interposing and disposal of SPV is not for tax-avoidance purpose should lie with non-TRE seller.

China tax implications

Based on the fact finding, the Chinese tax authorities will examine the true nature of the transfer, and may form the view that non-TRE seller indirectly transferred the equity in Chinese company through the use of abusive arrangement, i.e. interposing and disposing SPV for no reasonable commercial purpose, but just for avoidance of China WHT. If so, the Chinese tax authorities may recharacterise the equity transfer based on its ‘substance over form’ principle and disregard the existence of SPV. Once SPV is disregarded, the transfer should be effectively treated as non-TRE seller transferring the Chinese company’s equity, and thus the transfer gain is now PRC-sourced, which should be subject to China WHT.

7.3 Asset disposal

7.3.1 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 8.1.2).

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

In addition, some of the fixed assets of the seller may have been imported into the PRC 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.

7.3.2 Distribution of profits

The tax treatment for distribution of profits in an asset disposal is the same as a share disposal (see section 7.2.2).

8. Transaction costs for sellers

8.1 Value added tax and business tax

8.1.1 Stock disposal

Disposal of stock is not subject to VAT or BT.

8.1.2 Asset disposal

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 (i.e. technical know-how, trademarks, etc.).

8.2 Stamp tax and other relevant taxes

8.2.1 Stock disposal

Stamp tax is payable by both buyers and sellers on the disposal of shares (see section 2.4.2).

8.2.2 Asset disposal

Stamp tax is payable by both buyers and sellers on the disposal of certain assets (see 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.

8.3 Concessions relating to mergers and acquisitions

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, this is no longer available under the CIT regime since 2008.

Unlike the former tax regime, special tax treatments are available to 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 types relevant to foreign investors and FIEs which are related to equity acquisitions:

- equity acquisition between non-TREs
- 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 transferor to the non-TRE transferee. In addition to the prescribed five conditions listed in section 3, additional requirements are imposed on such cross-border equity acquisitions according to the Restructuring Rules:

- 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.

- The non-TRE transferor undertakes not to transfer the equity interest of the non-TRE transferee within three years subsequent to the transfer of the FIE.
- Other circumstances that are approved by the MOF and SAT.

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.

8.4 Corporate income tax

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

9. Preparation of a target company for sale

9.1 Declaration of dividend prior to sale

Under the former FEIT regime, where non-TREs transferred its equity in a Chinese investee company, the retained earnings could be deducted from the transfer price in calculating the gains. Circular 59 which has addressed CIT treatment for corporate restructuring is silent on this calculation. However, Guoshuihan [2009] No.698 which was issued in December 2009, clarified that, under the CIT regime, the retained earnings of the Chinese investee company being transferred cannot be deducted from the transfer price.

This will not be welcomed by non-TRE transferors because double taxation may arise where the retained earnings are effectively taxed upon equity transfer (as part of the transfer gain) and then may be taxed again later when they are distributed to the new shareholders (as dividends) after the transfer. An effective way to resolve the potential double taxation issue is to distribute the retained earnings before the equity transfer, where commercially viable.

9.2 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 PRC investment and the related tax and regulatory considerations.

9.3 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)
- 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. When the actual price has a difference of more than 10% as compared to the valuation result, the entities should provide a written explanation for the price difference to the responsible financial authorities (or the group company and other relevant authorities).

9.4 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
- 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.

10. Spin-off

The general principle discussed in section 3 would similarly apply to a merger and the taxation basis of assets and liabilities acquired by the transferee (the spin-off enterprise) from the transferor (the enterprise being spun-off) would be determined based on their fair value transaction price.

10.1 General tax treatments

In a spin-off transaction, the parties involved would be treated as follows:

- The enterprise being spun-off shall determine the gain or loss of the assets transferred based on their fair value.
- The spin-off enterprise shall determine the tax basis of the assets received based on their fair value.
- 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.

- 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 purposes.

10.2 Special tax treatments

In a spin-off transaction, when all the prescribed conditions as mentioned in section 3.1.2 are fulfilled, 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:

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

- 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 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.

11. Listing / Initial public offering

The tax status of a company being listed and its subsidiaries is generally unaffected by listing or initial public offering (IPO).

11.1 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.

11.2 Disposal of stock by existing shareholders

If the listing or IPO involves the disposal of stock by existing shareholders, the tax position for those shareholders is as outlined in section 8.1.

12. Tax incentives

The CIT law adopts the ‘Predominantly Industry-oriented, Limited Geography-based’ tax incentive policy. Key emphasis is placed on ‘industry-oriented’ incentives aiming at directing investments into those industry sectors and projects encouraged and supported by the state. The tax incentive policies mainly include the following and are applicable to both domestic and foreign investments.

12.1 Tax reduction and exemption

CIT may be reduced or exempted on income derived from the following projects:

Project / Industry	CIT incentive	Valid period
Agriculture, forestry, animal-husbandry and fishery projects	Exemption or 50% reduction	All years, as long as it is engaged in these projects
Specified basic infrastructure projects	3 + 3 years tax holiday ²	Starting from the first income-generating year
Environment protection projects and energy / water conservative projects	3 + 3 years tax holiday ²	Starting from the first income-generating year
Qualified new / high tech enterprises established in Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, and Pudong New Area of Shanghai after 1 January 2008	2 + 3 years tax holiday ¹	Starting from the first income-generating year
Newly established software production enterprises	2 + 3 years tax holiday ¹	Starting from the first profit-making year
Integrated circuits design enterprises	2 + 3 years tax holiday ¹	Starting from the first profit-making year
Integrated circuits production enterprises with a total investment exceeding RMB 8bn or which produce integrated circuits with a line-width of less than 0.25um, provided that its operation period exceeds 15 years	5 + 5 years tax holiday ³	Starting from the first profit-making year
Integrated circuits production enterprises which produce integrated circuits with a line-width of less than 0.8um	2 + 3 years tax holiday ¹	Starting from the first profit-making year
Qualified energy-saving service enterprises	3 + 3 years tax holiday ²	Starting from the first income-generating year

Notes

1. ‘2 + 3 years tax holiday’ refers to two years of exemption from CIT followed by three years of 50% reduction of CIT.
2. ‘3 + 3 years tax holiday’ refers to three years of exemption plus three years of 50% reduction of CIT.
3. ‘5 + 5 years tax holiday’ refers to five years of exemption plus five years of 50% reduction of CIT.

For income derived from the transfer of technology in a tax year, the portion that does not exceed RMB5m shall be exempted from CIT; and the portion that exceeds RMB5m shall be allowed a 50% reduction of CIT.

A CIT exemption applies to the dividend derived by a TRE from the direct investment into another TRE except where the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

A CIT exemption also applies to the income derived by recognised non-profit-making organisations engaging in non-profit-making activities.

12.2 Reduced tax rate

The CIT rate may be reduced under certain conditions for different industries.

12.3 Reduction of revenue

Where an enterprise uses resources specified by the state as its major raw materials to produce non-restricted and non-prohibited products, only 90% of the income derived is taxable.

12.4 Offset of certain venture capital investment

For a venture capital enterprise that makes an equity investment in a non-listed small to medium-sized new / high tech enterprise for more than two years, 70% of its investment amount may be used to offset against the taxable income of the venture capital enterprise in the year after the holding period has reached two years. Any portion that is not utilised in that year can be carried forward and deducted in the following years.

12.5 Investment tax credit

Enterprises purchasing and using equipment specified by the state for environmental protection, energy and water conservation, or production safety purposes are eligible for a tax credit of 10% of the investment in such equipment. Any unutilised amount can be carried forward and creditable in the following five years.

12.6 Other incentives

There are also tax incentives in relation to the deduction of expenses and cost (e.g. 50% additional research and development deduction, shorter tax depreciation period, and accelerated depreciation).

12.7 Foreign tax credit

A TRE is allowed to claim foreign tax credit in relation to foreign income tax already paid overseas in respect of income derived from sources outside the PRC based on a country-basket principle. The creditable foreign tax also includes foreign income tax paid by qualified controlled foreign companies. However, the creditable amount may not exceed the amount of income tax otherwise payable in the PRC in respect of the foreign sourced income. In addition, there is a five-year carry forward period for any unutilised foreign tax.

Hong Kong

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1. Introduction

1.1 General information on mergers and acquisitions 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.

1.2 Corporate tax

1.2.1 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.

1.2.2 Tax rates

The profits tax rate for incorporated businesses is 16.5% while that for unincorporated businesses is 15%.

1.2.3 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 rates of withholding tax are as follows:

Type of income	Tax rate
Royalties received where the payer and payee are related and the intellectual property was previously owned by a person in Hong Kong	16.5%
Royalties received for the right to use the intellectual property in Hong Kong and was not previously owned by a person in Hong Kong	4.95%*

* Assessable income deemed to be 30% of the gross receipts taxed at the profits tax rate of 16.5%.

The rate of withholding tax may be reduced if the recipient of the royalty is entitled to the benefits of the comprehensive double taxation 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 Goods and services tax / Value added tax

There are no goods and services tax (GST) / value added tax (VAT) or turnover taxes in Hong Kong.

1.5 Stamp duty

1.5.1 General 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 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.

1.5.2 Special stamp duty

Stamp Duty (Amendment) Ordinance 2011 was enacted and published on 30 June 2011. It imposes special stamp

duty (SDD) on top of the ad valorem stamp duty on short term sale and purchase of residential property effective from 20 November 2010. SDD will arise when three conditions are met:

1. the transaction involves the sale and purchase or transfer of a residential property
2. the property is acquired by the vendor or transfer on or after 20 November 2010, and
3. the property is disposed of by the vendor or transfer within 24 months from the date of acquisition.

Both vendor and purchaser are jointly and severally liable for the applicable SDD rates as follows:

Holding period	Tax rate
6 months or less	15%
More than 6 months but 12 months or less	10%
More than 12 months but 24 months or less	5%

1.6 Other 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. The capital duty will be abolished effective on 1 June 2012.

1.7 Common forms of business

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
- Sole proprietorship
- Partnership (limited and unlimited)
- Unincorporated joint venture.

Private Hong Kong companies and branches of foreign companies are the business entities most commonly used by foreign investors. From a Hong Kong profits tax perspective, the choice between the two is neutral.

2. Acquisitions

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 resetting 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 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
- simplified transaction formalities (e.g. contracts previously entered into by the target company may remain undisturbed).

2.2.1 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.

2.2.2 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 / loss for the year.

2.2.3 Tax incentives

There are no 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 fulfillment 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.

2.3.1 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.

2.3.2 Unutilised tax depreciation carried forward

There is no concept of unutilised tax depreciation in Hong Kong.

2.3.3 Tax incentives

There are no tax incentives in relation to an asset acquisition.

2.3.4 Others

Purchasers should be aware 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 Goods and services tax / Value added tax

There are 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 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).

For the sale and purchase or transfer of a residential property, acquired or transferred on or after 20 November 2010, within 24 months from the date of acquisition, the vendor and purchaser are subject to SDD (see section 1.5.2).

As stated above, stamp duty is also chargeable on the transfer of Hong Kong stock.

2.4.3 Concessions relating to mergers and acquisitions

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, as a result expenses incurred in generating 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 Hong Kong assessable profits
- 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 the 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. See section 4.2.2 regarding restriction of interest deduction.

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 may be allowed a tax deduction for interest on debt used for acquiring shares. Share dealers, venture capital and private equity funds which do not carry on business in Hong Kong should not be subject to tax on profits from the disposal of shares, and accordingly are not 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 / asset acquisition

3.1 Stock acquisition

In a share acquisition, there generally will 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 the 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 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 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 / 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 debt-to-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 borrowing 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.

5. Mergers

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.

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 regime 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. Disposals

For Hong Kong and foreign-based investors, 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.

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 should 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.

A buyer will mainly be 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 The 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 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.
- 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

Any 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.
- 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 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 sellers

8.3 Concessions relating to mergers and acquisitions

There are no concessions relating to M&As.

8.1 Goods and services tax / Value added tax

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

8.2 Stamp duty

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

8.4 Tax deductibility of transaction costs

See section 2.4.4.

9. Preparation of a target company 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. Demergers

Hong Kong has no specific regime for demerging a business to shareholders.

11. Listing / Initial public offering

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.

12. Tax incentives

There are no tax incentives in Hong Kong.

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1. Introduction

1.1 General information on mergers and acquisitions in India

Various international surveys and assessments suggest that India remains among the top five most favoured investment destinations in the world for almost a decade which is reflective of the confidence of the investing community in the strength of Indian economy and its future outlook in times of global uncertainty. After high growth during 2010-11, India's economic growth is expected to decelerate but remains close to the trend of about 8% in 2011-12. If global financial problems amplify and slow down global growth markedly, it would impart a downward bias to the growth projection of around 8%.

On the deals front, whether it is M&A, private equity deals or initial public offerings (IPOs), global players continue to strengthen their presence in India. At the same time backing on better balance sheets and stable outlook for the growth story, Indian business houses are exceedingly looking for outbound deals.

Recently, India has taken steps towards structural changes in direct taxes by releasing a draft bill of the proposed new Direct Tax Code (DTC). The proposed DTC will replace the existing income tax law upon enactment. The principal aim of the

new DTC is to moderate tax rates, remove exemptions and simplify tax laws in line with international tax principles. DTC Bill has been referred to Parliament Standing Committee for its comments. The new DTC is proposed to come into force on 1 April 2012.

Further, foreign investment has recently been permitted in a limited liability partnership (LLP) with subject to conditions. A LLP is a body corporate formed and incorporated under the LLP Act, 2008. It is a legal entity, separate from its partners, with perpetual succession. 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 and it can be a tax efficient vehicle for cash repatriation purposes.

On the capital markets front, the Securities and Exchange Board of India (SEBI) notified the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST 2011) which came into effect on 22 October 2011. SAST 2011 replaces the earlier SEBI Regulations of 1997. SAST 2011 intends to enhance disclosures, increase protection to investors by enhancing exit opportunities and transparency in the exit prices (see section 1.8).

1.2 Corporate tax

1.2.1 Income tax

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. 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 his worldwide income subject to double tax relief provided under the domestic laws and the relevant Double Taxation Avoidance Agreement (DTAA). A non-resident (NR) is only subject to India tax on income sourced or received in India subject to the relevant DTAA.

Taxable income is computed after adding certain disallowances, such as book loss on sale of assets as well as miscellaneous expenditure written off, and reducing certain allowances / benefits from book profits. 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 5% (2% for foreign companies) for companies with income over Rs.10m.

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

Type of company	Where taxable income exceeds Rs.10m	Other cases
Domestic company	32.5% (30% plus surcharge of 5% plus education cess of 3%)	30.9% (30% plus education cess of 3%)
Foreign company	42% (40% plus surcharge of 2% and education cess of 3%)	41.2% (40% plus education cess of 3%)

1.2.2 Minimum alternate tax

With the object of bringing zero tax companies under the tax net, minimum alternate tax (MAT) of 18.5% (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 18.5% of book profits. Pursuant to Finance Act 2011, MAT is now also applicable to developers of Special Economic Zones (SEZ) and units therein.

The effective MAT rates are as follows:

Type of company	Where taxable income exceeds Rs.10m	Other cases
Domestic company	20% (18.5% plus surcharge of 5% plus education cess of 3%)	19.1% (18.5% plus education cess of 3%)
Foreign company	19.4% (18.5% plus surcharge of 2% plus education cess of 3%)	19.1% (18.5% plus education cess of 3%)

A credit of tax paid under MAT provisions by a company is allowed against the tax liability which arises in the subsequent ten years under the normal provisions of the IT Act.

MAT is also 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 and dividends from Indian companies
- income of undertakings set up in SEZ claiming exemption under Section 10AA of the IT Act.

1.2.3 Dividends

Dividend income is exempt in the hands of shareholders in India. However, a dividend distribution tax (DDT) is levied on companies declaring dividends. The effective DDT rate is 16.22% (15% plus 5% surcharge and education cess of 3%). Pursuant to Finance Act 2011, DDT is also applicable on dividends distributed by 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.

Dividends received by an Indian company from a foreign company are taxable at 32.45% in India.

Pursuant to Finance Act 2011, dividend received by an Indian company during financial year 2011-12 from a foreign company in which the Indian company holds at least 26% equity shares shall be taxable at a concessional rate of 16.22%. Further, no deduction of expense incurred for earning such dividend income shall be allowed.

DDT does not apply on LLPs.

1.2.4 Capital gains

Any gain on the sale of assets is subject to tax at rates depending on the duration of ownership.

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). Long-term capital asset is one which is not a short-term capital asset.

Indexation of the cost of acquisition 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.

The rates are as follows:

Type of asset	Resident tax rate	Non-resident tax rate
a. Short-term capital assets other than 'b.' below	Normal corporate tax rates	Normal corporate tax rates
b. Short-term capital assets which are listed shares and units of equity oriented funds, that 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, that have been charged to STT	Exempt	Exempt
d. Long-term capital assets which are listed securities that have not been charged to STT (i.e. sold off-market)	20% (10% without indexation)	20% (10%*)
e. Other long-term capital assets	20%	20%

* There is a judicial controversy as to whether a non-resident is also entitled to a beneficial tax rate of 10% in respect of the sale of long-term listed securities or units or zero-coupon bonds not charged to STT. It is advisable to seek prior consultation on this matter.

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

1.3 Withholding tax

The following withholding tax rates are applicable for amount credited / payment made to residents during the financial year 1 April 2011 to 31 March 2012:

Section	Nature of payments	Rate (payments exceeding specified thresholds)
193	Interest on securities	10%
194A	Interest other than interest on securities (e.g. interest on loan)	10%
194C	Payment to contractors / Payment to advertising contracts / Payment to sub-contractors	2% (1% in case the payee is individual)
194D	Insurance commission	10%
194H	Commission / Brokerage	10%
194I	Rent for use of any machinery, plant / equipment	2%
	Rent for use of any land, building (including factory building) or land appurtenant to a building (including factory building), furniture or fittings	10%
194J	Professional / Technical Fees / Royalty / Non-compete fees	10%

For non-residents, tax withholding needs to be done at appropriate rates (subject to protection under the relevant DTAA) on the income chargeable to tax in India and the obligation to withhold tax is on the payer.

If deductee / recipient does not provide a Permanent Account Number (PAN), or provides an incorrect PAN, a higher tax rate of 20% is applicable on all the above payments.

1.4 Value added tax

1.4.1 Foreign Trade Policy 2009 - 14

Foreign Trade Policy (FTP) regulates the policy of physical importation or exportation of goods, issuance of licenses and grant of permission for imports or exports.

1.4.2 Customs duty

Customs duty is levied by the Central Government on the import of goods into, and export from India. The rate of customs duty applicable to a product to be imported / exported depends on its classification under the Customs Tariff Act. With regard to exports from India, duty is levied only on a very limited number of goods.

Customs duty is levied on the transaction value of the imported or exported goods. As per Section 14 of the Customs Act, the concept of transaction value is the sole basis for valuation purposes of import and export. While the general principles adopted for valuation of the goods in India are in conformity with the WTO agreement on customs valuation, the Central Government has established independent Customs Valuation Rules applicable to the export and import of goods.

India does not have one uniform rate of customs duty and the customs duty applicable to any product is composed of a number of components. The types of customs duties applicable are as follows:

- Basic customs duty (BCD) is the basic component of customs duty levied at the effective rate notified under the First Schedule to the Customs Tariff Act 1975 and applied to the landed value of the goods (i.e. the cost, insurance and freight or simply CIF value of the goods plus landing charges at 1%).
- Countervailing duty (CVD) is equivalent to, and is charged in lieu of the excise duty applicable on like goods manufactured in India. CVD is calculated on the landed value of the goods and the applicable BCD. However, the CVD on specific consumer goods intended for retail sale is calculated on the basis of the maximum retail price (MRP) printed on their packs. The general rate of excise duty is currently

pegged at 10% and consequently the rate of CVD is also 10%. In addition, education cess (EC) at 2% and secondary and higher education cess (SHEC) at 1% are also levied on the CVD.

- EC at 2% and SHEC at 1% are also levied on the aggregate customs duties (except safeguard duty, countervailing duty and antidumping duty). Goods attracting customs duties at bound rates under international commitments (e.g. IT Agreement, Indo-US Textile Agreement) have been exempted from these cesses.
- Additional duty of customs (ADC) at 4% is charged in addition to the above duties on all imports subject to a few exceptions. ADC is calculated on the aggregate of the assessable value of the imported goods, the total customs duties (i.e. BCD and CVD) and the applicable EC and SHEC.

1.4.3 Central excise duty

Central value added tax (CENVAT) is an excise duty levied by the Central Government on the manufacture or production of movable and marketable goods in India. The rate at which excise duty is leviable on the goods depends on the classification of the goods under the excise tariff. The excise tariff is primarily based on the eight digit HSN classification adopted so as to achieve conformity with the customs tariff.

Under the rationalised structure, the main slabs of duty rates for basic excise duty (BED) are zero, 4% and 10%. In addition, some goods, such as motor vehicles, attract higher CENVAT rates. Notifications granting partial or complete exemption to specified goods from payment of excise duties are also available. EC at 2% and SHEC at 1% are applicable on the aggregate excise duties.

The central excise duty is a modified VAT where a manufacturer is allowed credit of the excise duty paid on locally sourced goods and the CVD and ADC paid on imported goods. The CENVAT credit can be utilised for payment of excise duty on the clearance of dutiable final products manufactured in India. In light of the integration of goods and services tax initiated in 2004, manufacturers of dutiable final products are also eligible to avail CENVAT credit of the service taxes paid on input services used in or in relation to the manufacture of final products and clearances of final products up to the place of removal.

1.4.4 Service tax

Service tax is levied on specified taxable services identified under Chapter V of the Finance Act 1994 (the Act). At present, over 100 services are classified as taxable under the Act. The existing rate of service tax is 10%. In addition, EC of 2% and SHEC of 1% of the service tax have also been levied on taxable services. Thus effective rate of service tax is 10.3%.

The onus of payment of service tax lies on the provider of the services. However, for specified services, such as transport of goods by road and sponsorship services, the service tax liability rests with the recipient of the services.

Taxable services provided by service providers located outside India to a recipient in India are subject to service tax in terms of the Services Rules (Provided from Outside India and Received in India) 2006. In terms of these rules, where the taxable services are provided from outside India and received in India, the service recipient is required to register and pay the tax in accordance with the relevant provisions of law.

1.4.5 Value added tax/ Central sales tax

Sale of movable goods in India is chargeable to tax at the central or state level. The Indian regulatory framework has granted power to state legislatures to levy tax on goods sold within that state. Such sales are, therefore, chargeable to VAT at the rates notified under the VAT laws of the relevant state.

All goods sold in the course of inter-state trade are subject to CST.

Where goods are bought and sold by registered dealers for trading or for use as inputs in the manufacture of other goods or specified activities (such as mining or telecommunications networks), the rate of sales tax is 2%,

provided Form C is issued by the purchasing dealer. In the absence of Form C, the applicable rate would be the rate of VAT on such goods in the originating state.

State level sales tax was replaced by VAT with effect from 1 April 2005 in a majority of Indian states. Under the VAT regime, the VAT paid on goods purchased from within the state is eligible for VAT credit. The input VAT credit can be utilised against the VAT / CST payable on the sale of goods. It is thus ensured that the cascading effect of taxes is avoided and that only the value addition is taxed.

Currently, there is no VAT on imports into India. Exports are zero-rated. This means that while exports are not charged to VAT, VAT charged on inputs purchased and used in the manufacture of export goods or goods purchased for exports is available to the purchaser as a refund.

1.4.6 Entry tax

This is a tax on entry of goods into a State which is payable by the importer / purchaser. The entry tax paid at the point of importation of goods into the State is generally allowed as an offset against the output sales tax / VAT.

In addition, there could be local levies by municipalities like octroi or local area taxes.

1.4.7 Goods and services tax

The Central Government took a major step towards the transition to a national integrated tax regime in 2006. The Indian Government is planning to introduce a new tax regime called GST in India that would subsume most of the indirect taxes.

The Empowered Committee of the State Finance Ministers (EC) in November 2009 released the First Discussion Paper on the proposed GST in India:

On the introduction of GST, most of the indirect taxes like excise duty, service tax, VAT / CST, and entry tax will be subsumed in GST. On introduction of GST, a Central GST (CGST) and a State GST (SGST) will be levied on goods and services. The legislation and related rates are yet to be finalised.

1.5 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, merger / demerger schemes 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 value of shares transferred. Stamp duty is levied on the transfer of immovable property and movable 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.

1.6 Other taxes

1.6.1 Individual tax — residents / not ordinary residents and non-residents

Maximum marginal tax rate for individuals is 30.9% (30% plus cess of 3%). Surcharge has been abolished for individuals and firms.

1.6.2 Firms and limited liability partnership tax

Maximum marginal tax rate for firms is 30.9%. A firm includes a LLP and thus, all provisions applicable to a firm apply to a LLP as well. Accordingly, a LLP will be taxed at the entity level and income of partners of LLP is exempt from tax.

Conversion of company into limited liability partnership

Any transfer of a capital asset by a company to a LLP or any transfer of share(s) held in the company by a shareholder as a result of conversion of the company into a LLP shall not be chargeable to tax, subject to fulfillment of prescribed conditions.

Alternate minimum tax on LLP

Pursuant to Finance Act 2011, Alternate Minimum Tax (AMT) of 18.5% (plus the applicable education cess) of adjusted total income is leviable on LLPs whose tax payable under normal income tax provisions is less than 18.5% of adjusted total income.

1.6.3 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 Rs.3m. The term 'net wealth' broadly represents excess of prescribed assets less debts. Prescribed assets include guest house or residential house, motor car, jewellery-bullion-utensil of gold and silver, etc., yacht, boat, 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'.

1.6.4 Tax losses

Business losses (other than unabsorbed depreciation) are allowed to be carried forward for offsetting 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 offset against any income (other than salary income).

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 in case of change of shareholding due to amalgamation or demerger of foreign companies subject to fulfillment of prescribed conditions.

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

1.6.5 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.

Type of transaction	Payable by	Tax 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.

1.6.6 Direct tax code

The Direct Tax Code (DTC) 2010 shall come into force on 1 April 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 30%.
- Domestic companies will continue to be liable to DDT at 15%.
- Profits of Indian branches of foreign companies are additionally subject to branch profits tax at 15%.

Minimum alternate tax

Minimum alternate tax shall be payable on book profits if the normal income-tax payable for a financial year by a company is less than the tax on book profit. The rate of MAT is proposed to be 20% on all companies.

Capital gains

- All capital gains are taxable at normal tax rates, removing the benefit of lower tax for long-term capital gains.
- Gains on the transfer of business capital assets are taxable as business income.
- In the case of a transfer of an investment asset (i.e. an equity share in a company or a unit of an equity-oriented fund), and such transfer is chargeable to securities transaction tax, the tax should be:
 - held for a period of more than one year and available for tax deduction (up to 100%)
 - held for a period of one year or less and be taxed only on 50% of gains at applicable rates.
- Fair market value substitution date is shifted to 1 April 2000 (as compared to 1 April 1981 in the extant Income Tax Act).

Wealth tax

Every individual, firm and company shall be liable to pay wealth tax on the net wealth on the valuation date of a financial year. Wealth tax is charged at a rate of 1% of the amount by which the 'net wealth' exceeds Rs.10m.

Carry forward of losses

- Loss of a specified business or special source is allowed only against subsequent years' profits of the same business or source.
- Capital losses cannot be offset against any other income.
- Losses can be carried forward indefinitely.

International tax

- General Anti Avoidance Rules (GAAR) have been inserted 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 DTAA's.
- The arrangements covered by GAAR include round trip financing, lifting of the corporate veil, etc.

- Provisions for controlled foreign companies (CFC) have also been inserted in Draft DTC Bill. The total income of a resident being assessed for a financial year shall include an income which is attributable to a CFC.

Transfer pricing

The DTC seeks to bring about certain far reaching changes within the Indian transfer pricing regime such as safe harbor rules and introduction of advance pricing agreement.

Amalgamation

- To include amalgamation of unincorporated bodies with companies.
- Tax neutral 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.

Demerger

- The DTC considers demerger between residents only.
- Requirement of business continuity for a period of five years is introduced for transfer of losses.
- The successor needs to hold at least three-quarters of the fixed assets' book value acquired for a period of five years.

Slump sale

Gains on transfer of any undertaking or division of a business will be liable to tax under the head capital gains.

Other provisions

- Indirect transfer of shares of an Indian company held by a foreign company would also be construed as income 'deemed to accrue' in India, if at any time in 12 months preceding the transfer, the fair market value (FMV) of the assets in India, owned directly or indirectly by the company and represent at least 50% of the FMV of all assets owned by the company.
- Company to be treated as resident of India if the place of effective management is in India at any time during the year.

1.6.7 Foreign direct investment

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.

India has an open arm policy for regulating FDI into the country. Under the current FDI policy, foreign investment is permitted in virtually all sectors without government approval, except for a few sectors of strategic importance (such as banking, defence, media, telecom) where policy prescribes equity caps or certain conditions for obtaining prior approval from the government.

Apart from those sectors which are of strategic importance and require government approval, there is a small list of sectors in which FDI is currently prohibited. This inter-alia includes:

- Atomic energy
- Lottery business / Gambling and betting
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, tobacco or any tobacco substitutes
- Agriculture (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture / aquaculture 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 and Nidhi companies which is involved in the trading of transferable development rights
- Real estate business (excluding construction development projects — housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure and townships) or construction of farm houses.

The FDI policy is framed by the Department of Industrial Policy & Promotion (DIPP), Ministry of Commerce & Industry and implemented by the Reserve Bank of India (RBI) for cases falling under the automatic route (i.e. not requiring prior government approval), while for cases falling under the government route, approval is granted by the Foreign Investment Promotion Board (FIPB), which includes representatives of various Central Government ministries and grants approval on a case-by-case basis. These are discussed in brief below.

Automatic route

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

- Specified sectors which require FIPB approval or for FDI beyond a prescribed cap such as defense, telecom, media, insurance, banking, etc.
- Investment for considerations other than cash, except for capitalisation of an External Commercial Borrowing (ECB) due for repayment and interest on such ECB, as well as technology royalties due for payment.
- Investments by citizens and companies of Bangladesh.
- Investments into Indian companies through issue of warrants and partly paid shares.

Foreign Investment Promotion Board 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 on 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.

Determination of foreign investment caps and downstream investments by Indian companies

Government of India issued guidelines in February 2009 for calculating the total FDI in an Indian company where sectoral caps apply. Under this policy, total FDI in an Indian company will comprise of the following:

- a. Direct investment by a foreign investor (fully counted towards the foreign investment limits).

- b. Indirect foreign investments through an Indian company which is 'owned' or 'controlled' by non-residents ('owned' means more than 50% shareholding and 'control' means the right to appoint majority directors of the company in this case).

Further, for the purpose of computing foreign indirect investment, 'foreign investment' would include all types of foreign investments i.e. FDI, investment by FIIs (holding as of March 31), non-resident Indians (NRIs), American depository receipts, global depository receipts, foreign currency convertible bonds and compulsorily convertible preference shares, compulsorily convertible debentures regardless of whether the said investments have been made under Schedule 1, 2, 3 and 6 of Foreign Exchange Management Act (FEMA) (Transfer or Issue of Security by Persons Resident Outside India Regulations).

Broadly, the principle emerging under this policy aspect is that in case an Indian company is owned and controlled beneficially by Resident Indian Citizens (RICs), any downstream investment made by such an Indian company would be considered as domestic investment and not counted towards foreign investment caps.

Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company, will require prior government / FIPB approval, regardless of the amount or extent of foreign investment.

Domestic funds cannot be leveraged by the foreign-owned Indian holding company for making downstream investments. However, downstream investments are permitted through either infusion of capital from overseas or use of internal accruals.

Further, such an Indian holding company, which fulfills the criteria prescribed under the Core Investment Companies (CICs) guidelines issued by Reserve Bank of India will have to comply with the norms prescribed therein.

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 is subject to the guidelines of 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. As per the new Takeover Regulations (effected on 22 October 2011), the thresholds of 15% and 20% have been increased to 25% and 26% respectively.

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 / SAST 2011
- the non-resident shareholding complies with sectoral limits under FDI Policy after the transfer, and
- the valuation norms prescribed by RBI are duly complied with.

Prior approval from FIPB is required 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 that either have a FDI cap such as defence production, air transport services, asset reconstruction companies, private sector banking, broadcasting, commodity exchanges, insurance, print media, telecommunications, etc. or require prior FIPB approval.

Acquisition by way of share swap is also permitted with prior approval from FIPB and is subject to valuation guidelines.

As per RBI valuation norms, in the case of listed companies, the acquisition price should not be lower than the price at which a preferential allotment of shares can be made under the SEBI Guidelines. Further, in a rights issue, the prices are to be determined by the company.

For unlisted companies, the acquisition price should not be lower than the fair value that is to be determined by a SEBI registered Category-I-Merchant Banker or a Chartered Accountant as per the discounted free cash flow method. Further, in case of rights issue, the price shall not be less than the price at which the offer is made to resident shareholders for the said issue.

Investment by Foreign Institutional Investors

Foreign Institutional Investors (FIIs) registered with SEBI and SEBI registered sub-accounts of FIIs are eligible to purchase shares and convertible debentures issued by Indian companies under the Portfolio Investment Scheme (PIS) except for Indian companies engaged in sectors like real estate, agriculture, Nidhi, chit fund business, etc.

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 and prior RBI approval.

Investment by non-resident Indians

NRI can invest in an Indian company as any other eligible non-resident investor and in such a case his investment would need to comply with FDI Policy provision outlined above.

Additionally, NRIs can also invest in shares of listed Indian companies in recognised stock exchanges under the PIS except for Indian companies engaged in sectors like real estate, agriculture, Nidhi, chit fund business, etc. NRIs under such window can invest both on repatriation and non-repatriation basis, up to 5% of the paid-up capital / debentures of listed

Indian companies. The aggregate paid-up value of shares / convertible debentures purchased by all NRIs cannot exceed 10% of the paid-up capital / debentures which can be raised to 24 % by passing a resolution of its board of directors followed by a special resolution to that effect by its 'general body' and subject to prior approval from the Reserve Bank.

Another window for investment by NRIs is under the non-repatriation route. NRIs can purchase shares / convertible debentures issued by an Indian company on non-repatriation basis without any limit. The amount invested under the scheme and the capital appreciation thereon will not be allowed to be repatriated abroad. The sale proceeds would need to be credited to non-resident ordinary (NRO) account.

Instruments with in-built options

Equity instruments, including compulsory convertible debentures (CCDs) and compulsory convertible preference shares (CCPS) issued or transferred to non-residents with in-built options of any type or supported by option sold by third parties would not qualify as eligible instruments for FDI and would have to comply with extant European Central Bank (ECB) guidelines.

1.7 Common forms of business

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

1. Operating as an Indian company / limited liability partnership

- **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 (including Income Tax 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.

- **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 formed strategic alliances with Indian partners. The trend in this respect is to choose a partner who has sufficient experience and expertise in the relevant line of business.

- **Limited liability partnership**

LLP is a new form of business structure in India. It combines the advantages of a company, such as being a separate legal entity having perpetual succession, with the benefits of organisational flexibility associated with a partnership. At least two partners are required to form a LLP and they have limited liability. The FDI policy for LLPs has been notified recently to allow foreign investments in an Indian LLP undertaking activities which are permitted with 100% foreign investments under the automatic route (i.e. without prior government approval) and no FDI linked conditionalities are prescribed. Any foreign investments in such an LLP would require prior approval from the Government of India.

Some other key features of the FDI policy for LLPs, are as below:

- Downstream investment by LLPs with FDI will not be allowed. However, an Indian company with foreign investment can make downstream investment into a LLP with prior FIPB approval, provided both the Indian company and LLP are engaged in activities eligible for 100 % FDI under automatic route.

- Only cash contribution will be permissible for FDI in LLPs.
- FIIs and Foreign Venture Capital Investments (FVCIs) cannot invest into LLPs.
- Further LLP cannot raise foreign currency loans.

2. Operating as a foreign company

- **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 / commercial activity in India and cannot, therefore, earn any income in India. To set up a liaison office in India, prior approval from RBI is required.

- **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 fulfillment 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.

- **Branch office**

Foreign companies engaged in manufacturing or 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.

Retail trading activities of any nature is not allowed for a branch office in India. In general, manufacturing activity cannot be undertaken through a branch office. However, foreign companies can establish branch office / unit in a SEZ for undertaking manufacturing activities subject to fulfillment of certain conditions.

1.8 Takeover code

SAST 2011 replaces the earlier SEBI Regulations of 1997. Key changes made by SAST 2011 are:

- The public announcement limit for open offers has been increased from 15% to 25%. The minimum offer size in an open offer has been raised from 20% to 26%. The offer price can now be settled by issue, exchange or transfer of the acquirer's listed equity shares. The issuing of listed equity shares can be made by the issuer as long as he complies with the listing agreement.

- The earlier regulations open offer requirements did not require that a change in control be approved by the existing shareholders of the target company by a special resolution. This requirement has now been imposed.
- The creeping acquisition limit has been increased from 55% to the maximum threshold for non-public shareholding, i.e. 75% or 90% as the case may be.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deals

Whether a deal is structured as a stock deal or asset deal is typically driven by commercial considerations. Although both the methods have their own tax consequences, a stock deal remains the most preferred method of acquisition as it can be implemented efficiently and it is also more cost effective as compared to an asset deal because of stamp duty implications.

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 needs to 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 buyer will have to consider the structure from current and future tax perspective.

2.2 Stock acquisition

2.2.1 Acquisition structure

In a share deal, the cost of the assets may not be revalued. Further, in the case of 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% (25% effected on 22 October 2011) 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.

2.2.2 Funding costs

Under the existing tax regime, funding costs are not tax deductible against the dividend income received from Indian companies 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-to-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 generally 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 1.6.4.

2.2.6 Repatriation of profits

Repatriation of funds may be structured in different ways like in the form of dividend, royalty, interest, fee for technical services, buy back of shares, capital reduction, etc.

The tax implications of dividend distribution have been dealt with under section 1.2.3. Payments in the form of royalty, interest, fee for technical services, buyback and capital reduction may be subject to tax in India and provisions of the double taxation avoidance agreements.

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 zero.

2.2.7 Other issues

Transfer of a capital asset by a company to another company by way of gift / contribution is exempt from capital gains tax. However, if shares of a closely-held company are received by another closely-held company by way of gift or inadequate consideration, then such transfer of shares shall be taxable in the hands of the recipient as 'other income'. Tax shall be levied on the difference between FMV of the shares transferred and the consideration for such transfer¹.

2.3 Asset acquisition

2.3.1 Acquisition structure

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

It should be kept in mind that the buyer is liable for stamp duty on the transfer of immovable and movable properties 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.

2.3.2 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 can be capitalised (for tax depreciation claim) till the assets are put to use and is considered as a tax-deductible expenditure to the Indian company after the asset has been put to use for business purposes.

2.3.3 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 tax 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.

2.3.4 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 is allowed under the tax laws.

¹ Current Income Tax Rules provide book net worth to be FMV of the shares transferred.

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

2.3.5 Treatment of goodwill

Goodwill to the extent regarded as intangible asset (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.

2.4 Transaction cost

2.4.1 Stock acquisition

Stock acquisition may involve cost on account of the following:

Buyer's perspective

- Stamp duty at 0.25% of the value of shares transferred. Stamp duty may not be applicable, if shares are in dematerialised form.
- STT, in case of listed securities as dealt with under section 1.6.5.

2.4.2 Asset acquisition

Asset acquisition may involve cost on account of the following:

Buyer's perspective

- An asset deal normally attracts stamp duty (potentially significant) at rates varying from state to state on the transfer of immovable and movable properties 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 on a going concern basis.

3. Basis of taxation following stock / asset acquisition

3.1 Stock acquisition

See section 7.2.

3.2 Asset acquisition

See section 7.3.

4. Financing of acquisitions

4.1 Thin capitalisation and debt / equity distinction

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.

4.2 Deductibility of interest (and similar costs)

See section 2.2.2 and 2.3.2.

5. Mergers

5.1 Tax neutrality

Mergers are tax neutral in the hands of the amalgamating company and the shareholders of the amalgamating company, provided certain conditions as prescribed under the Act are fulfilled.

Specified conditions in the case of an amalgamation of one or more companies into another 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.

Further, exemption to the shareholders is available if they receive shares of the amalgamated company in exchange of shares of the amalgamating company, pursuant to the merger.

5.2 Carry forward and offset of accumulated losses and unabsorbed depreciation allowance

Subject to certain conditions, the accumulated tax loss / unabsorbed depreciation of an amalgamating company having an industrial undertaking / ship / hotel / banking / operation of an aircraft business (restricted to public sector company) shall be considered as 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
- the manufacture of computer software
- the business of generation or distribution of electricity or any other form of power
- the business of providing telecommunications services, whether basic or cellular, including radio paging, domestic satellite services, network of trunking, broadband networks and internet services
- mining, or
- the construction of ships, aircrafts or rail systems.

5.3 Amortisation of the amalgamation expenses

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

5.4 Transfer of unutilised CENVAT credit

When one entity is merged in any other entity or one entity is acquired by other entity, then the option of transferring unutilised credit of the ceased entity to the amalgamated entity can be considered. The CENVAT Credit Rules 2004, allows for such transfers subject to documentation / procedural compliances.

5.5 Transferability of licenses obtained from Director General of Foreign Trade

Generally, companies avail benefits under the schemes under FTP. For example, Export Promotion Capital Goods (EPCG) Scheme allows import of capital goods at a concessional rate of customs duty subject to an export obligation equivalent to eight times of the duty saved on capital goods imported at the concessional rate. Export obligation is required to be fulfilled by export of goods manufactured by use of goods imported under the EPCG Scheme. Generally, these licenses are subject to actual user conditions and hence, the transferability of these licenses and goods imported under them needs validation.

5.6 Amendment in Importer-Exporter Code / excise duty / service tax / VAT registrations

After merger, all the premises of the ceased entity will come under the new entity. Hence, the new entity has to follow the process of amendment in its Importer-Exporter Code, central excise, service tax and VAT registrations to include premises of the ceased entity depending upon the nature of business transactions.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

See section 2.2.6.

6.2 Losses

See section 1.6.4.

6.3 Continuity of tax incentives

Typically, tax incentives / holidays are qua undertaking. Thus, a company may continue to avail the tax incentive for the eligible undertaking in case of acquisition of its shares by another company. The same principal may also apply in case of asset deal (slump sale).

Further, post-amalgamation or demerger, the amalgamated company or resulting company may continue to avail the tax incentive for the balance period as would have been available to the eligible undertaking of the amalgamating company or demerged company. However, this rule is subject to an exception that where any undertaking engaged in the development of infrastructure (claiming exemption under Section 80IA) is transferred to another company in a scheme of amalgamation or demerger, then the tax incentives available to such amalgamating company or demerged company shall not be available to the amalgamated company or demerged company.

6.4 Group relief

There is no concept of 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.

7. Disposals

7.1 The preference of seller: stock vs. assets deal

See section 2.1.

7.2 Share disposal

7.2.1 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 1.2.4). In case the 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 are complied with.

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 demerger, if at least 25% of the shareholders of the amalgamating company (at least 75% of the shareholders in demerged company) continue to remain as the shareholders of the amalgamated company (resulting company in case of demerger) and the transfer is exempt from capital gains tax in the country where the amalgamating company / demerged foreign company is incorporated.

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 Indian Rupee.

The income tax authorities in the recent past have attempted to tax the transactions involving indirect transfer of shares of Indian company and are litigating the matter. However, the Apex Court of India in a recent judgement² involving indirect transfer of shares of an Indian company has held that the same shall not be taxable in India. The Apex Court analysed the nature and character of the transaction and observed that transaction of transfer of shares of a foreign company by a non-resident to another non-resident fell outside the jurisdiction of Indian tax authorities and hence not taxable in India.

However, the applicability of the ratio of this judgement to the facts of each case involving indirect transfer of shares of an Indian company would need to be analysed. Further, the DTC contains a proposal to tax similar transactions involving indirect transfer of shares of an Indian company (see section 1.6.6). Hence, the impact of this judgement after the implementation of the DTC would also need to be considered.

² Vodafone International Holdings B.V. versus Union of India & Anr.

Thus, appropriate care may need to be taken in structuring transactions involving indirect transfer of shares of Indian company.

7.3 Asset disposal

7.3.1 Tax depreciation

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.

7.3.2 Gains on sale

If the consideration receivable for transfer of depreciable 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 (on assets held for less than 36 months) 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 zero.

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.

‘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.

7.3.3 Others

Non-compete fees payable to the seller for not starting / competing in the business which they have transferred, is business income and charged to tax at corporate tax rate.

7.3.4 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 section 1.2.3.

8. Transaction costs for sellers (other than capital gains)

8.1 Value added tax

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.

8.2 Stamp duty

See section 1.5.

8.3 Concessions relating to mergers and acquisitions

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

8.3.1 Amalgamations

The conditions for tax neutral amalgamation are dealt with under section 5.1.

8.3.2 Demergers

The conditions for tax neutral demerger are dealt with under section 10.

8.3.3 Transfer of capital asset by a holding company to its wholly-owned subsidiary and vice versa

The transfer of a capital asset by a holding company to its wholly-owned subsidiary company and vice versa is tax exempt.

However, the exemption shall be available subject to the following:

- Recipient is an Indian company.
- Subsidiary continues to remain wholly owned for eight years post transfer.
- Capital asset is not converted into stock in trade for a period of eight years after transfer.

8.4 Provisions relating to carry forward and offset of accumulated loss and unabsorbed depreciation allowance

8.4.1 Amalgamation

See section 5.2.

8.4.2 Demerger

See section 10.

8.5 Tax deductibility of transaction costs

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

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

This has been dealt with under section 7.3. Further, transactions with allied international parties / group companies need to be at arm's length (transfer priced). Currently, there are no provisions for applicability of arm's length principle to domestic transactions except certain transactions (like sale of immovable property, etc.)

9.2 Declaration of dividend prior to sale

See section 1.2.3.

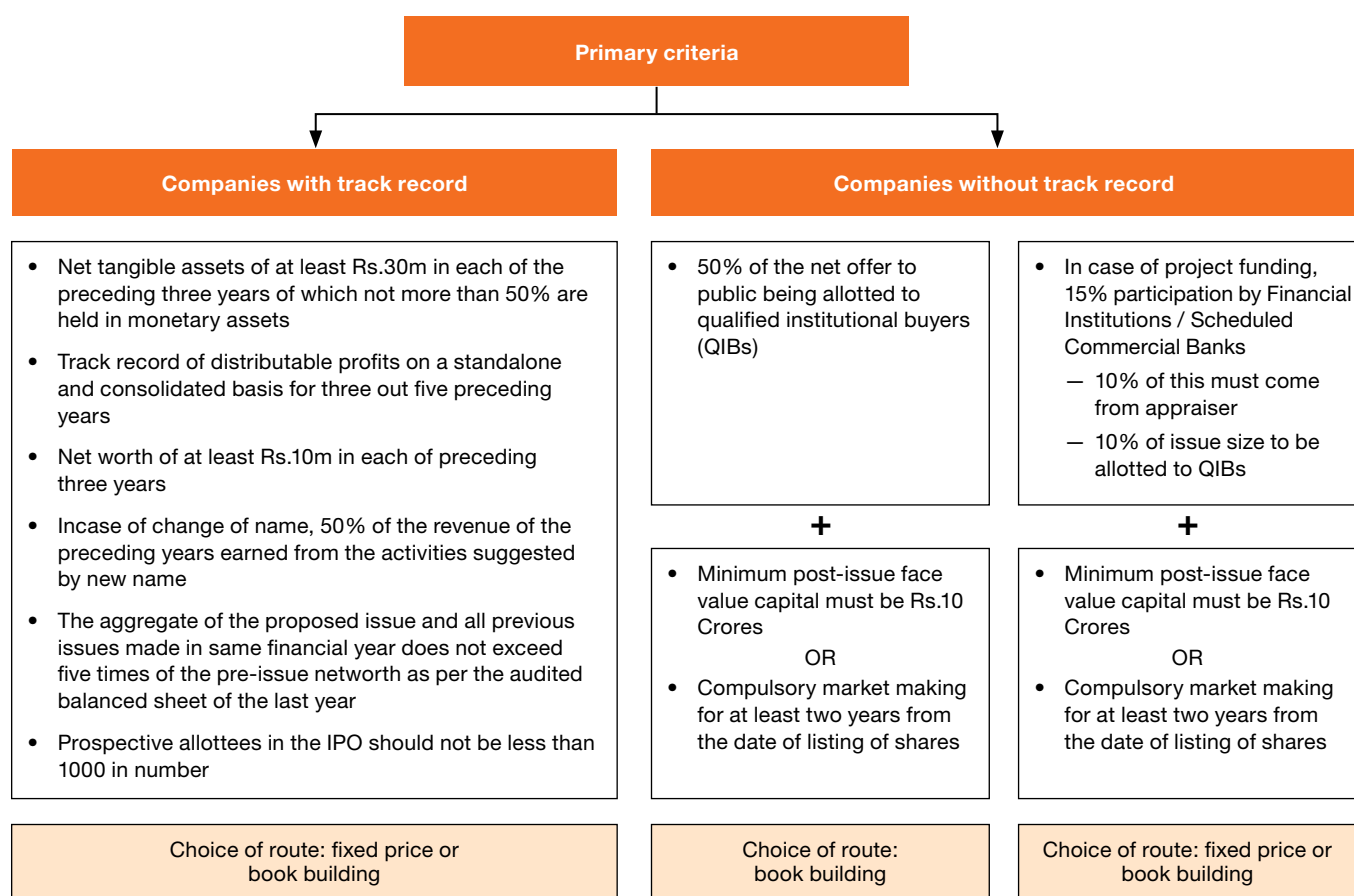
10. Demergers

A 'demerger' refers to a transfer on a going concern basis by a demerged company of one or more of its undertakings to the resulting company in such a manner that all the assets and liabilities of the undertaking are transferred by the demerged company to the resulting company. In consideration of the demerger, the resulting company issues its shares to the shareholders of the demerged company on a proportionate basis.

Demergers are tax neutral in the hands of the demerged company and the shareholders of the demerged company, provided the shareholders holding at least 75% in value of shares in the demerged company become shareholders of the resulting company and other prescribed conditions are fulfilled.

In the case of a demerger, the accumulated losses and unabsorbed depreciation directly relatable to the undertaking being transferred is allowed to be carried forward and offset by the resulting company. If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, it shall be apportioned between the demerged company and the resulting company in a ratio according to the value of the transferred asset.

11. Listing / Initial public offering



Further to the above, conditions mentioned in the listing agreement also needs to be complied with.

Further, shares of a company can be listed pursuant to a scheme of merger / demerger, without fulfilling the above conditions and subject to approval of stock exchanges and SEBI in the following cases:

- Demerger of an undertaking of a listed company to an unlisted company.
- Merger of a listed company into an unlisted company.

12. Tax incentives

Various incentives are available under the Income Tax Act (subject to fulfillment of prescribed conditions). Few significant ones are briefly discussed below:

12.1 Tax incentives for infrastructure development undertakings (80IA)

Enterprises engaged in the business of power generation, transmission, or distribution; making substantial renovation and modernisation of the existing network of transmission or distribution lines (between specified periods); developing or operating and maintaining a notified infrastructure facility, industrial park, or SEZ; are eligible to a tax exemption of 100% of profits for any ten consecutive years falling within the first 15 years of operation (20 years in the case of infrastructure projects, except for ports, airports, inland waterways, water supply projects, and navigational channels to the sea).

12.2 Tax incentives for exports by Special Economic Zone units

The export profits of a new industrial undertaking established in an SEZ, satisfying the prescribed conditions, is eligible for tax exemption of 100% of profits for the first five years, from the year of commencement of operations, followed by a partial tax exemption of 50% of profits for the next five years. A further tax exemption of 50% of the profits for next five years is also available, subject to an equal amount of profit being retained and transferred to a special reserve in the books of account.

12.3 Tax incentives for units in specified backward areas

New industrial undertakings located in specified 'backward' states and districts are entitled to full tax exemption of profits for the first three or five years of operation, followed by a partial tax exemption of 30% of profits for the next five years.

12.4 Tax incentive of capital expenditure on certain specified businesses

Full deduction of capital expenditure is allowed in the year of incurrence in respect of certain specified businesses like setting up and operating cold chain facilities, warehousing facilities for storage of agriculture produce, laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, etc.

12.5 Research and development expenditures

Weighted deduction of 200% is available in respect of expenditure incurred on scientific research in an in-house research and development facility approved by the prescribed authority to companies engaged in specified businesses.

A payment made to an approved research association undertaking research in social science or statistical research or to an Indian company to be used by it for scientific research is now eligible for a weighted deduction of 125% of the payment made.

Pursuant to Finance Act 2011, contributions made to the National Laboratory, approved scientific research associations, universities, and the Indian Institute Technology are 200% deductible.

Indonesia

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1. Introduction

1.1 General information on mergers and acquisitions in Indonesia

With a population of over 240m people and significant natural resources, Indonesia represents both a significant market and potential supplier to the world economy. The Indonesian government 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 dedicated 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 have 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 by 6% in 2010, aided by robust domestic consumption.

In 2010, M&A activities increased to approximately 572 deals (US\$13.7bn) from previously 442 deals (US\$8bn) in 2009. However, M&A activity has been slowing down in 2011, with only 157 deals worth US\$7.3bn up to October 2011.

The transactions took place in various sectors with the resources sector having become one of the most attractive areas for investment in Indonesia. It is expected that the infrastructure sector, including power, will see an increase of interest from investors.

1.2 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 rate is 25%. Public companies that satisfy a minimum listing requirement of 40% with other conditions are entitled to a tax discount of 5% off the standard rate, giving them an effective tax rate of 20%.

Certain business sectors (e.g. drilling and shipping) are required to use the deemed net taxable profit basis to calculate 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.

1.3 Withholding tax

Indonesian income tax is collected mainly through a system of withholding taxes. Where a particular income item is subject to withholding tax, the payer is generally held responsible for withholding or collecting the tax.

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:

Type of income	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 Withholding tax rate of the gross amount payable

² Dividend payment to individual tax resident

³ Rental fees for assets other than land / buildings

⁴ Rental fees for land / buildings

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. There are exceptions, such as 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:

Type of income	Non-treaty rate ¹	Treaty rate ¹
Dividends	20%	5 - 20%
Interest	20%	0 - 15%
Royalties	20%	0 - 15%
Branch-profit tax	20%	5 - 20%
Insurance / reinsurance premiums	1% / 2% / 10%	—
Fees for services	20%	— ²

¹ Withholding tax rate of the gross amount payable

² Exceptions: fees for technical, management and consulting services payable to residents of Switzerland, Germany, Luxembourg and Pakistan are subject to withholding tax at 5%, 7.5%, 10% and 15% respectively.

At present, Indonesia has signed tax treaties with more than 60 countries.

Indonesia has now introduced stringent rules on the access to tax treaty benefits. Investors investing into Indonesia or dealing with Indonesian residents should take this into consideration.

1.4 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 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 certain stipulated services from Indonesia is also zero-rated.

1.5 Stamp duty

Stamp duty is nominal and is payable as a fixed amount of either Rp.6,000 (US\$0.6) or Rp.3,000 (US\$0.3) on certain documents, such as letters of agreement, proxy letters, statement letters and notarial deeds.

1.6 Other taxes

1.6.1 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 rate of luxury sales tax ranges from 10% to 200% depending on the type of goods.

1.6.2 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.

1.6.3 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, and thus it cannot be treated as a prepayment of corporate tax.

1.6.4 Duty on the acquisition of land and building rights

An 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 a credit and therefore represents an additional cost of such acquisition. The duty payable on the acquisition of the 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.

1.7 Common forms of business

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. Otherwise, it is a domestic investment company.

- **Partnership**

Partnership is 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 distributed to partners is not taxable in the hands of the partners (and not tax deductible to the partnership). 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.

1.7.1 Foreign ownership restrictions

A foreign investor may acquire shares in an existing foreign investment company or convert a locally-owned company to a foreign investment company. 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 the activity undertaken. Four broad categories of business restrictions exist:

- Business closed to all investors including local investors (e.g. harmful chemical production).
- Business open only to domestic investors (e.g. natural forest concessions and radio / television broadcasting services).
- Business where a foreign investor may be a joint venture party (e.g. shipping, electricity production, transmission and distribution).

- Business open to all investors, but subject to certain restrictions (e.g. 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 investments. 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).

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

Generally, an asset acquisition is preferred in Indonesia due to the difficulties in determining the undisclosed liabilities of the target as unpaid taxes or unrecorded liabilities of the company being acquired remain with the company. However, in most cases, an asset acquisition is not possible due to legal and commercial constraints.

2.2 Stock acquisition

Most share acquisitions are structured as direct investments from outside Indonesia. The acquirer generally seeks to hold Indonesian target companies through a company located in a country which has entered into a double tax treaty agreement with

Indonesia to minimise dividend withholding tax and / or capital gains tax. The choice of a suitable jurisdiction depends on the acquirer's own tax considerations and the extent of its operations in the preferred holding jurisdiction.

Note that the Directorate General of Tax is now focusing on beneficial owner issues on passive income (i.e. dividends). It has issued regulations implying that special purpose vehicles, conduit companies and pass-through companies located in tax treaty countries cannot enjoy tax treaty benefits. 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.

2.3 Asset acquisition

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

As mentioned above, an asset acquisition is generally preferred from the purchasers' perspectives due to the difficulties in determining the undisclosed liabilities (i.e. 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 7.1, sellers usually prefer stock / share deals for various reasons, as such, there is a limited number of asset deals in Indonesia.

2.4 Transaction costs for purchasers

2.4.1 Value added tax

The transfer of shares is not subject to VAT. The transfer of assets is subject to 10% VAT which is collected by the transferor company and is payable by the purchaser. Specific concessions may be available, for example, where the transferor company is not required to be registered for VAT purposes. VAT paid by the purchaser 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.

2.4.2 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, which is not creditable against corporate income tax.

2.4.3 Stamp duty

Nominal stamp duty is payable on the issue of shares certificates and the asset transfer agreement (i.e. Rp.6,000 per document).

3. Basis of taxation following stock / asset acquisition

3.1 Stock acquisition

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 ability to step up or increase the asset value to reflect the purchase price. The acquisition of shares in a tax loss company in theory provides flexibility in loss utilisation due to the lack of provisions on continuity of ownership or business.

3.2 Asset acquisition

In an asset acquisition, 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 the acquisition.

Purchased goodwill and the cost of intangible property may be amortised under Indonesian accounting principles using the declining-balance or 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 (a useful life of 20 years) and non-permanent (a useful life of ten 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.

4. Financing of acquisitions

4.1 Thin capitalisation

There is no general 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.

4.2 Deductibility of interest

4.2.1 Stock acquisition

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 (see section 6.1).

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 in the cost base.

4.2.2 Asset acquisition

The buyer in an asset acquisition is entitled to deduction 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. 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 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 has 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 out 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 not attract 10% VAT, provided that the merging companies are VAT entrepreneurs (i.e. taxpayers subject to VAT).

6. Other structuring and post-deal issues

6.1 Repatriation of profits

6.1.1 Dividend payments

Dividends received by an Indonesian corporation from other Indonesian corporations are assessable at the normal corporate income tax rate of 25%. 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.

Dividends received by resident individual taxpayers are subject to final income tax of 10%. For the taxation of dividends payable to non-resident parties (see section 1.3).

Dividends are non-deductible to a payer for corporate income tax purposes.

6.1.2 Other payments

Profits may also be repatriated in other types of payments, such as royalties, interest, technical or service fees, 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. Such payments received by resident taxpayers are assessable at the normal income tax rate. If the payments are received by a non-resident, they will be subject to withholding tax of 20% (which may be reduced by a tax treaty).

6.2 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 backward. Indonesia does not have continuity of ownership or continuity of business tests that operate to restrict tax loss utilisation. Generally, one company's tax losses may not be transferred to another company.

6.3 Continuity of tax incentives

In general, tax incentives are granted to a specific company and are not transferable. Therefore, tax incentives enjoyed by a target company are generally preserved under a stock deal. Tax incentives enjoyed by a target company would normally be lost when a business is transferred under an asset deal. The purchaser would need to obtain new approval from the relevant authority granting the incentive.

6.4 Group relief

There is no group relief concept in Indonesia. Related companies are taxed separately.

7. Disposals

7.1 The preference of sellers: stock vs. asset deal

The sale of shares is likely to be the preferred approach for the seller, as the tax liability is a one-off income tax on the profit on disposal. In many cases, offshore elements are introduced into share transactions to further limit the Indonesian tax on disposal. However, Indonesia has 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.

7.2 Share disposal

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.

Under the 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 of 25%.

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

7.3 Asset disposal

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 normal corporate tax of 25%.

The transfer of land and / or buildings will attract final income tax of 5% of the proceeds, and hence no more corporate tax on capital gains or losses is to be accounted for in the transferor's annual income returns.

8. Transaction costs for sellers

8.1 Value added tax

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

8.2 Stamp duty

Nominal stamp duty is payable on the share / asset transfer agreement (i.e. Rp.6,000 per document).

8.3 Concessions relating to mergers and acquisitions

See section 5.

8.4 Tax deductibility of transaction costs

Deductibility of transaction costs would follow the normal deductibility rules. Where the gains derived from the transaction are assessable at the normal income tax rate, the corresponding transaction costs are deductible. Where the gains derived from the transaction are subject to final tax (e.g. sale of shares listed on the Indonesia stock exchange), the corresponding transaction costs are not deductible.

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

Under the Indonesian transfer pricing rules, the transfer of assets to another group company must be conducted using the arm's length principle (i.e. market value). Any gains derived by an Indonesian company on the transfer of

assets are taxed as ordinary income (after utilising any carry forward tax losses) and are subject to the normal corporate tax of 25%. The transfer of land and / or buildings will be subject to 5% final income tax from the proceeds.

9.2 Declaration of dividend prior to sale

One way of extracting surplus cash in a company identified for sale is through distribution of dividends (see section 6.1.1).

10. Demergers

There are no specific provisions in relation to demergers. A demerger may be achieved by way of a business spin-off. A business spin-off which constitutes part of an initial public offering (IPO) may enjoy the same tax concessions as tax-neutral mergers discussed in section 5. In this case,

within one year of the Director General of Tax's approval for tax-neutral business spin-off being given, the company concerned must have made an effective declaration about registration for an IPO with the Capital Market and Financial Institution Supervisory Agency (Badan Pengawas Pasar Modal-Lembaga Keuangan / BAPEPAM-LK). In the event of complications beyond the company's control, the period can be extended by the Director General of Taxes for up to four years.

11. Listing / Initial public offering

Another exit route for investors may be through a listing / IPO on the Indonesia Stock Exchange (IDX). The transfer of shares listed on the IDX is subject to final tax of 0.1% from the gross proceeds (0.6% for founder shares).

12. Tax incentives

The major income tax incentives provided in Indonesia include:

- income tax holiday for qualified new corporate taxpayers operating in certain business sectors, or
- a reduction in net income of up to 30% of the amount invested, acceleration of fiscal depreciation

deductions, extension of tax loss carry forward for up to ten years and a reduction of the withholding tax rate on dividends paid to non-residents to 10%, for companies investing in certain designated business areas or in certain designated regions, and

- 5% corporate tax cut for qualified public companies.

There are other incentives provided in relation to import duty and import taxes.

Japan

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1. Introduction

1.1 General information on mergers and acquisitions in Japan

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).

1.2 Corporate tax

1.2.1 General tax regime

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

Income	Tax rate
Corporations with paid-in capital of over ¥100m	30%
Corporations with paid-in capital of ¥100m or less ¹ :	
• First ¥8m of taxable income	18%
• Over ¥8m of taxable income	30%

¹Except for a company which is 100% directly or indirectly owned by a company which has paid-in capital of ¥500m or more.

Inhabitants tax is a local tax consisting of prefectural and municipal taxes. It is levied on a corporation in each prefecture where 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 and months during which the corporation has its 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 where the corporation has offices to carry on its activities. For a corporation with paid-in capital of ¥100m 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 and months during which the corporation has its offices. The rates vary depending on the amount of the corporation's taxable income. For a corporation with paid-in capital exceeding ¥100m, 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 tax and inhabitants taxes) is generally around 40% to 42% depending on whether the company is subject to three factor enterprise tax or income-based enterprise tax only. 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 April 2001. Currently, the tax loss carry back provision is suspended but is applicable under a limited situation (e.g. where a corporation whose paid-in capital is ¥100m or less and is not 100% owned directly or indirectly by a company which has paid-in capital of ¥500m or more). The tax loss carry back is applied to the previous one year.

A majority change in the ownership of shares in a company followed by the occurrence of a specified triggering event within a certain period of time may give rise to the expiration or limitation on the use of tax losses or latent tax losses in Japan. Latent tax losses (e.g. the difference between the Japanese tax bases of assets and their actual market value) are generally not realised until a taxable event has occurred (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 its related 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 when 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 when 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 mentioned attributable financing costs which should be considered. For dividends paid within a 100% owned group, the allocation of financing costs is not required.

Exclusion from taxable income is not permitted for dividends on shares that were acquired within one month before the year end of the company paying the dividends concerned and sold within two months after the same year end.

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 when 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 a lower percentage of ownership threshold for indirect foreign tax credit for taxes paid by the foreign company on the profits out of which the dividend is paid (e.g. 10% shareholdings under the Japan-Australia Tax Treaty), such lower percentage will apply as threshold for the above exemption.

1.3 Withholding tax

Japanese-sourced dividends, interest, royalties, personnel 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 the remittance of branch profits are not subject to withholding tax.

Type of income	Tax rate
Dividends	20% ¹
Interest	20% ²
Royalties	20%
Personnel service fees	20%
Rental income	20%

1. An exceptional rate of 7% is applicable to dividends from certain listed companies.
2. An exceptional rate of 15% is applicable to interest on bank deposits and certain designated financial instruments. Interest on loans however is taxed at 20%. A special exemption from WHT applies to certain long-term corporate bonds issued to non-residents in foreign countries.

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 Japan-sourced income mentioned above would be subject to tax under the same procedure as applicable to a resident entity.

Under the Japan-US Tax Treaty, all royalties paid by residents of one contracting State to residents of the other may be exempt from 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 have been included in the treaty in order to substantiate treaty entitlements. 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 treaties that Japan has recently entered into contain similar tests.

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

1.4 Consumption tax

Japanese consumption tax (currently 5%) applies to goods sold and services rendered in Japan (excluding shares or securities but including goodwill). Exports 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 ¥200 to ¥600,000 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.

1.7 Common forms of business

- **Kabusiki Kaisha**

A Kabusiki Kaisha (KK) is the most common Japanese business entity selected for significant business operations in Japan. It is the entity most likely to be respected by potential Japanese partner companies, contractors, customers and employees.

- **Godo Kaisha**

A Godo Kaisha (GK), similar to a US limited liability company, is taxed as a corporation for Japanese tax purposes, but may be treated as a pass-through entity by other countries (e.g. a GK is eligible for check-the-box treatment for US tax purposes).

2. Acquisitions

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 recognise 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 losses carried forward 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 US, Netherlands, Switzerland or Germany as the Japanese tax treaties with these countries provide exemptions from Japanese tax on gains derived 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 losses carried forward 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. Such premium is capitalised as acquisition costs of the target's shares for tax purposes and taken for deduction in the future if the target's shares are disposed of.

The target's tax basis in its assets remains unchanged in connection with a share purchase, as there are no changes 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.

Tax losses of the target incurred in the pre-acquisition periods 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 as many industry sectors are subject to comply with one or more forms of regulation or licensing. Obtaining consent to transfer licenses (or to obtain 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) requires each transferring employee's individual consent.

From a tax perspective, an asset purchase above historical 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 goodwill should be considered to avoid any issues being raised at a future 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 they are 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

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 mergers and acquisitions

No consumption tax is imposed on 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 information.

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

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 / 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 recognise goodwill for premium paid to the seller which is 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 will allow the purchaser to record goodwill and take deductions for amortisation of such goodwill.

4. Financing of acquisitions

4.1 Thin capitalisation

The Japanese thin capitalisation rules provide for a 3:1 debt-to-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. The excess interest however 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 its foreign-controlling shareholder (who owns at least a 50% direct or indirect ownership interest) or its subsidiary 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 capitalisation 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 subject 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 and 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 is generally deductible to the extent that the interest rate follows the arm's length principle and the thin capitalisation rules are not triggered. In addition, if a dividend is paid to a Japanese recipient company by another Japanese company (except for a dividend paid within a 100% owned group), interest attributable to such dividend is not deductible while such dividend is partially or entirely not taxable (see section 1.2.3).

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 (section 4.1) to maximise the interest deduction.

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

5. Reorganisations / Mergers

5.1 Corporate reorganisations

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 – qualified reorganisations. 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 reorganisations:

- qualified corporate spin-off and drop-down
- qualified contribution in-kind
- qualified dividends in-kind
- qualified merger
- qualified share-for-share exchanges or transfer.

The 2010 tax reform introduced the group taxation regime, where certain assets can be transferred on a no gain / no loss basis among 100% domestic group companies, irrespective of the corporate reorganisation rules (see section 2).

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 in the subsidiary or the parent company may be accomplished on a tax-free basis (see section 5.1.3). 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 with the following conditions satisfied:

- only shares in the subsidiary or the parent company are issued (see section 5.3)
- 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
- in the case of spin-offs and drop-downs, the principal part of the business assets and liabilities used in the transferred business unit will be transferred to the transferee corporation, and
- in the case of spin-offs and drop-downs, 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. In the case of a spin-off, the tax losses will remain with the transferor corporation.

5.2.2 Contribution in-kind

A contribution 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 a business unit and the requirements discussed above are met.

5.2.3 Qualified dividends in-kind

Prior to the 2010 tax reform, where a company satisfies an obligation to pay a dividend to its shareholder(s) through the transfer of a non-cash asset, this was considered to be a taxable disposal of the asset by the company, thus requiring the recognition of a gain or loss. Following the 2010 tax reform, where the company and shareholder are both domestic group companies within the same 100% group, the gain or loss from the transfer of a non-cash asset in

satisfaction of a dividend (or deemed dividend) should be deferred to the dividend paying corporation (i.e. such non-cash assets are, for tax purposes, transferred at their tax basis in the hands of the dividend paying corporation immediately prior to the distribution). The company should not have any withholding tax obligations in respect of a qualified dividend in-kind.

5.2.4 Mergers

In general, a tax-free merger may be accomplished if the conditions mentioned above are satisfied. All assets and liabilities of the merged company are transferred to the surviving company at the tax basis. Upon a tax free merger, no taxable gain or loss will arise. There will be no deemed dividend with respect to the liquidation of the merged company. Note that a cancellation loss on the merged corporation shares held by the surviving 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 losses that arose while both

companies were owned by the same interests may be carried forward in a tax-free merger. There are limits placed on tax 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.

A 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:

1. the parent directly owns, and will continue to own, 100% of the shares in the Japanese acquiring corporation prior to, and after, the reorganisation, and
2. any one of the other requirements for a tax qualified reorganisation are met (see 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 either:

- 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, in general, certain assets of Company B must be marked to market and any revaluation gains and losses are included in the taxable income computation of Company B. However, such mark to market is not required in the case of a share-for-share transfer between companies within a 100% group even if one of the conditions for the tax qualified treatment is breached.

Recognition of the capital gain that would be realised 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 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 Corporation 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 Corporation 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 royalties 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 more information.

6.2 Losses carried forward and unutilised tax depreciation carried forward

See 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. These tax incentives would generally be lost when the business is transferred through an asset deal.

6.4 Group relief

6.4.1 Consolidated tax regime

Japanese tax law allows consolidated corporate tax filing 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% owned subsidiaries are subject to consolidation without exception.

Parent companies should file tax returns and pay taxes on their consolidated corporate income. The system applies only to the national corporation tax. The local inhabitants taxes and the 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 may seek tax reimbursement from its subsidiaries later, or record it as a credit on its books until receipt of payment from the subsidiaries.

The taxable income of the consolidated group is computed on a consolidated basis by aggregating the taxable income or losses of each member of the consolidated group followed by the consolidation adjustments. Profits from intra-group transactions, except for transfer of certain assets as defined, should be included in the aggregate taxable income. Gains or losses from the intra-group transfer of certain assets are deferred.

Pre-consolidation tax losses of certain subsidiaries can be carried forward into a consolidated tax group but may only be offset against taxable income of the subsidiaries for the calculation of consolidated income.

Upon joining a consolidated tax group, subsidiary companies will generally be required to separately recognise gains or losses and pay tax on the built-in gains on certain assets held immediately before joining the

consolidated tax group. This rule will not apply to the parent company or to the 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.

6.4.2 Group taxation regime

As of 1 October 2010, a new group taxation regime became effective. This new regime is applicable to domestic companies that are wholly-owned by a domestic company, foreign company or individual (group companies). Unlike the consolidated tax regime, the group taxation regime automatically applies to group companies.

The key points of this regime are summarised as follows:

- The recognition of capital gains or losses from the transfer of certain assets (including the transfer of assets as a result of a non-qualified merger) between group companies is deferred until the asset is transferred to another group company or a non-group company. The scope of assets is the same as stated under the tax consolidation system (i.e. fixed assets, land, securities, monetary receivables and deferred expenses, excluding securities for trading purposes and assets with tax basis of less than ¥10m).

- Where a donation occurs between group companies, there are no tax implications for either the donor or recipient (i.e. no deduction for the donor and no taxation for the recipient). Note that this treatment is not applicable to a group company owned by an individual. This is consistent with the treatment of a donation between members of a consolidated tax group.
- A dividend received from a group company can be fully excluded from taxable income without any reduction for allocable interest expense. This is consistent with the treatment of dividends between members of a consolidated tax group.

A group company that would otherwise qualify as a small or medium-sized enterprise (SME) on a stand-alone basis is not eligible for SME benefits (e.g. reduced corporate tax rate, preferable allowable ratios for deductible portion of bad debt provisions, partial deductibility of entertainment expenses and carry back of tax losses) if all of their outstanding shares are owned by one or more corporations with capital ¥500m or more (large corporation) in the same 100% owned group.

7. Disposals

7.1 The 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 carried forward which are available to shelter gains on appreciated assets, the seller may be willing to dispose 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.

A capital gain arising from the sale of a Japanese corporation derived by a non-resident company having no permanent equipment in Japan is subject to corporate tax in Japan at the rate of 30% under the Japanese domestic tax laws if:

1. the non-resident company owns at least 25% of the shares in the Japanese corporation at any point of time three years before the end of the fiscal year in which the sale of the shares takes place, and
2. the non-resident company sells at least 5% of the shares in the Japanese corporation, commonly referred to as the '25% / 5% rule'.

Gains derived by a foreign seller on the disposal 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 2013, 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, 1.3 and 6.1).

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 / loss for Japanese tax purposes based on the difference between the proceeds received from 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, 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, 1.3 and 6.1).

8. Transaction costs for sellers

8.1 Consumption tax

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 an agreement.

8.3 Concessions relating to mergers and acquisitions

No consumption tax is imposed on a merger or 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). See section 5 for more information.

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 merger or spin-off.

8.4 Tax deductibility of transaction costs

Transaction costs may generally include legal fees, arrangement fees and any costs required to conclude the sale, etc. Such costs should generally be deductible to the seller.

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

For assets that will be retained, the seller may want to transfer (e.g. via spin-off and drop-down) the target's assets (which will not be sold to the purchaser) to another Japanese affiliate and then sell the shares in the target to the purchaser. 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.

9.2 Declaration of dividend prior to sale

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 distributing dividends 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 may stipulate in its 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 as they want during the fiscal year, 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 the same. However, the law stipulates that regardless of the size of the capitalisation, companies with net assets of less than ¥3m may not pay dividends to shareholders even if they have enough retained earnings to do so, in order to protect the interests of creditors.

See section 6.1 on repatriation of profits.

10. Demergers

A demerger usually takes place through the sale of assets or a business. The implications of a demerger should be the same as an asset deal as discussed in sections 2.3 and 7.3.

11. Listing / Initial public offering

After acquiring a target, a financial buyer generally looks for an exit route either through a sale or an initial public offering (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.

12. Tax incentives

The 2011 tax reform introduced inbound investment incentives for international foreign corporations, including the special tax treatment for designated international strategic area and tax incentives for Asian headquarters.

12.1 Special tax treatment for designated international strategic area

Qualifying corporations doing business in certain designated metropolitan areas (Designated International Strategic Area) will be granted the following tax incentives:

1. If qualifying corporations are engaged in specified businesses in the Designated International Strategic Area, certain capital expenditures (¥20m or more for machinery and equipment and ¥100m or more for building and construction) incurred for the specified businesses will be eligible for either (i) a deduction equal to 50% of the capital expenditures (building is limited to 25%) or (ii) a tax credit equal to 15% of the capital expenditures (building is limited to 8%) with the maximum credit amount in any given tax year being equal to 20% of the tax liability before the credit with one year carry forward.

2. If qualifying corporations are engaged primarily in specified businesses in the Designated International Strategic Area, they will be entitled to an income exclusion of up to 20% of income for five years provided they are incorporated in the Designated International Strategic Area and incur certain capital expenditures. If qualifying corporations claim the 20% income exclusion, they will not be entitled to the tax credit regime described in 'i.' above.

Qualifying corporations will be eligible for the tax credit regime described in 'i.' above with respect to capital expenditure incurred from the effective date of the law concerning this regime through 31 March 2014. Corporations will be eligible for the 20% income exclusion regime for five years once they are specified as qualifying corporations during a period from the effective date of the law concerning this regime through 31 March 2014.

12.2 Tax incentives for Asian headquarters

A qualifying corporation filing blue form tax returns that will be primarily engaged in the operational management or research and development activities established by an international foreign corporation will be entitled to claim 20% income exclusion over five years from the date it is specified (during the period from the effective date of the law concerning this regime through 31 March 2014) as a qualifying corporation pursuant to the relevant law.

12.3 Employment promotion taxation

The following tax measure is implemented for the enhancement and creation of employment and subsequent economic development.

If qualifying corporations increase the number of employees subject to employment insurance by 10% or more and by five people (two in case of small and medium corporation) or more from the end of the prior tax year, the qualifying corporations will be eligible for the tax credit equal to the increased number of the employees multiplied by ¥200,000 with the limitation of 10% (20% in case of small and medium corporation) of the tax liability before the credit subject to certain conditions for the tax years which commences from 1 April 2011 (excluding years ending before 30 June 2011) to 31 March 2014.

Korea

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1. Introduction

1.1 General information on mergers and acquisitions in Korea

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 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 foreign source 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 ₩200m and 24.2% (including resident surtax) over ₩200m for the fiscal year starting in 2010.

The current corporate tax rates are summarised below:

Income	Corporation tax	Resident surtax ¹	Total
₩0 - 200m	10%	1%	11%
Over ₩200m	22%	2.2%	24.2%

¹Resident surtax is a local tax which is levied at 10% of corporation tax.

Note: Based on the 2012 corporate income tax law reform proposal released in September 2011, the top rate of corporate income tax, which is currently 24.2%, should be maintained and a lower middle income tax bracket will be created in order to benefit small and medium enterprises.

The proposed new rates are summarised below:

Income	Corporation tax	Resident surtax ¹	Total
₩0 - 200m	10%	1%	11%
₩200m - 50bn	20%	2%	22%
Over ₩50bn	22%	2.2%	24.2%

Korea has specific tax provisions dealing with transfer pricing, thin capitalisation and tax havens.

1.3 Withholding tax

Foreign corporations with income derived from sources in Korea are subject to corporate income tax. In case the foreign corporation does not have a 'domestic place of business' in Korea, it will be subject to tax on its Korean source income on a withholding basis pursuant to Korean corporate income tax law or relevant tax treaty, if applicable. Any Korean sourced income attributable to a foreign corporation's domestic place of business will be subject to Korean corporate income tax law.

Reduced withholding tax rates may apply pursuant to a tax treaty concluded between Korea and a foreign corporation's resident country.

Withholding tax rates for dividends, interest and royalties:

Type of income	Non-treaty rate ²	Treaty rate ³
Dividends	22%	0 - 15%
Interest	22% / 15.4% ⁴	5 - 25%
Royalties	22%	0 - 15%

²Inclusive of resident surtax which is 10% of withholding tax.

³Whether resident surtax is included or not varies depending on each tax treaty.

⁴15.4% rate applies on interest of bonds issued by Korean companies or government bodies.

1.4 Value added tax

Value added tax (VAT) is levied on the provision of goods and services in Korea and on imported goods. VAT payable to the relevant tax office is the amount of output VAT less input VAT.

Export goods and services are subject to VAT of 0%.

VAT law prescribes VAT exempt transactions in which case relevant input VAT is not eligible for a credit.

Business transfers that satisfy certain conditions may be VAT free.

1.5 Stamp duty

Stamp tax is levied on a party that prepares certain documents certifying establishment, transfer or change of rights to property in Korea.

1.6 Other taxes

1.6.1 Partnership taxation

Entities including Hapmyong Hoesa, Hapja Hoesa and certain Yuhan Hoesa (YH) engaged in rendering personal services can elect to be treated as a partnership, for Korean tax purposes, 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 their share of the partnership's taxable income in computing their income tax.

Note: 2012 tax reform proposal allows a Hapja Johap, a newly introduced legal entity type (effective as of 15 April 2012) under the Korean Commercial Act, to elect to be treated as a partnership.

1.6.2 Branch profits tax

No branch profits tax is imposed except for foreign parents located in Australia, Brazil, Canada, France, Indonesia, Kazakhstan, Morocco and the Philippines.

Branch profits tax rates are as follows:

Country	Treaty rate	Country	Treaty rate
Australia	15%	Indonesia	10%
Brazil	15%	Kazakhstan	5%
Canada	5%	Morocco	5%
France	5%	Philippines	10%

1.7 Common forms of business

The following forms of business entity are available in Korea. A Chusik Hoesa (CH) is by far the most common form of business entity, although recently Yuhan Hoesa has been used by some US companies as it may be used to benefit from 'check-the-box' rules under the US tax code.

- **Chusik Hoesa**

Chusik Hoesa (CH) is the only Korean business organisation permitted to publicly issue shares or bonds.

- **Yuhan Hoesa**

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 that of a CH.

For US tax planning, one advantage of using a YH is that it may be possible to obtain 'flow-through' tax

treatment in the US. At present, a Korean YH is an eligible entity under the US 'check-the-box' regulations and as such it may make an election to be treated as a partnership or 'disregarded entity' for US tax purposes. By contrast, a Korean CH is on the list of 'per-se' corporations under the US 'check-the-box' regulations, and thus it 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.

- **Yuhan Chaekim Hoesa (limited liability company)**

Yuhan Chaekim Hoesa (YCH) is a newly introduced legal entity type under the Korean Commercial Act (KCA) effective as of 15 April 2012. YCH formation and structure is similar to that of a YH, however, YCH may issue debentures and no limitation exists on the number of shareholders.

- **Hapja Johap (limited association)**

Hapja Johap is also a newly introduced legal entity type under the KCA effective as of 15 April 2012. The attributes of the Korean limited association are similar to the US limited partnership.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

An acquisition may be achieved through an asset or stock acquisition. Buyers often prefer an asset deal over 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.

2.2 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 more than 50%, 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.

2.3 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 as 'a comprehensive business transfer'. However, in many cases it may be difficult to clearly differentiate between an 'asset transfer' and a 'business transfer'.

2.4 Transaction costs

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

2.4.1 Acquisition tax

Stock deal

When a purchaser acquires more than a 50% 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. Through careful planning, it may be minimised.

Asset deal

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.

2.4.2 Registration tax

Stock deal

Registration tax is not levied on the acquisition of shares.

Asset deal

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.

2.4.3 Capital registration tax

Stock deal

Capital registration tax is not levied on the acquisition of shares.

Asset deal

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.

2.4.4 Secondary tax liability

Stock deal

An acquirer is liable for a secondary tax liability of a target company as a majority shareholder (i.e. a holder of more than 50% 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. However, such secondary tax liability is limited to the

tax liabilities remaining after appropriation of the target's property. A secondary tax liability on a majority shareholder is born to the extent of his or her share ownership ratio.

Asset deal

An acquirer of a complete business (comprehensive business transfer) bears a secondary tax liability for national taxes, penalties, interest on deferred payments and expenses for the 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.

2.4.5 Tax deductibility of transaction costs

Stock deal

Transaction costs generally form part of the capital cost base for calculating the gain or loss on future disposals.

Asset deal

Acquisition expenses generally 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.

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.

3. Basis of taxation following stock / asset acquisition

3.1 Stock acquisition

The acquisition price of stock forms the tax basis of the acquirer's stock in a target company. There is no election available to step up the tax basis of the underlying assets.

3.2 Asset acquisition

If a comprehensive business is transferred at fair market value, the acquisition cost of the target businesses' assets may be stepped up or down, as the case may be to its 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 principle which is over five years or longer (but not longer than 20 years) using the straight-line method.

4. Financing of acquisitions

4.1 Thin capitalisation and debt / equity distinction

4.1.1 Thin capitalisation

A Korean subsidiary or a Korean branch of a foreign corporation is subject to thin capitalisation rules, known as 'thin-cap rule'. Under the thin-cap rule, if loans from overseas controlling shareholders (OCSs) 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 where one party has substantial control or influence over the other through one of the methods prescribed in the tax law.

4.1.2 Debt / Equity distinction

In Korea, there is no statutory test to characterise instruments as debt or equity for tax purposes.

4.2 Deductibility of interest (and similar costs)

Interest incurred in relation to a trade or business is generally deductible. However, interest expenses attributable to a non-business asset are non-deductible.

4.3 Others

4.3.1 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.

4.3.2 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 the Foreign Investment Promotion Act (FIPA).

Also, under the Foreign Exchange Transaction Act, if a Korean resident company takes a loan from a non-resident, the transaction should generally be reported to a designated foreign exchange bank in advance. If the loan amount exceeds US\$30m, the reporting should be made to the Ministry of Strategy and Financial through a designated foreign exchange bank.

5. Mergers

Mergers are legally allowed in Korea, but only between Korean domestic companies.

5.1 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 as a 'qualified' merger for Korean tax purposes, as further outlined below:

- 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, 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, an upstream merger between a parent company and its wholly-owned subsidiary is considered as a 'qualified' merger (according to the tax reform proposal released in September 2011, a downstream merger is also a 'qualified' merger).

5.1.1 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. However, in a 'qualified' merger, tax on such income may be exempt.

5.1.2 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.

5.1.3 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 five years. However, in a 'qualified' merger, the corporate income tax on the 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 shortened 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 five years of the merger.

5.2 Others

Unfair mergers

If the stock exchange ratio between related companies is manipulated in such a way that one of the shareholders obtains a disproportionate economic advantage, the transferor of the benefit (donor) is subject 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.

6. Other structuring and post-deal issues

6.1 Repatriation of profits

6.1.1 Taxation of dividends

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.

Dividends paid on stock are not tax deductible to the company paying the dividends.

Dividend income received by a Korean company constitutes to the 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 depending on ownership ratio and other conditions.

6.1.2 Capital redemption

According to Korean corporate income tax law, in case consideration received by a shareholder due to capital redemption exceeds the shareholder's acquisition cost of the relevant shares, the excess is deemed as dividend distributed to the shareholder.

Such deemed dividend paid to a non-resident shareholder will be subject to withholding tax at the rate of 22% or reduced treaty rate.

6.2 Losses

In general, from 1 January 2009, tax losses may be carried forward for ten years without having to satisfy any tests. The carry back of tax losses is generally not allowed, except for a one year carry back of losses which is available to small and medium size companies.

6.3 Continuity of tax incentives

In the form of an asset transfer, tax losses and tax incentives of a target company are not allowed to be transferred to the acquiring company. As for a share transfer, there are no regulations restricting tax incentives or tax credits of a target company due to a change in shareholder.

6.4 Group relief

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 consolidated tax return system.

Book-to-tax adjustments shall first be made for each entity in the consolidated group and additional tax adjustments relating to the consolidated group are also made to calculate the consolidated tax base. Additional tax adjustments are triggered by the consolidation to reflect the eliminated profits / losses from certain intercompany transactions, recalculation of the tax limit on donations and entertainment expenses, etc.

Consolidated tax losses carry over, non-taxable income and income deductions will be subtracted to calculate the consolidated tax base. In this context, tax losses of an entity in the consolidation group, which were incurred prior to the consolidation election, can be utilised only against taxable income from the concerned entity. There are various limitations on using tax losses within consolidated group.

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 at the entity level to be summed up before being subtracted from the consolidated income tax liability.

7. Disposals

7.1 The preference of sellers: stock vs. asset deal

Generally from a seller's point of view, a share deal is preferred due to simplicity and a low tax rate (for individual shareholders) is applicable to capital gains from a share transfer.

7.2 Share disposal

7.2.1 Capital gains tax

A domestic corporate shareholder, including a taxable permanent establishment (PE) or branch of a

foreign entity, will generally be subject to 24.2% 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 sale 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 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.

7.2.2 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.

7.3 Asset disposal

7.3.1 Corporate income tax on capital gains

Corporate income tax will generally apply to any taxable gains realised by the seller in an asset disposal. 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.

7.3.2 Value added tax

Generally, the seller in a 'comprehensive business transfer' is not required to charge 10% 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 subject to VAT.

7.3.3 Corporate income tax on liquidation income

If the transferor company is liquidated after a business transfer, the liquidating company may be subject to corporate income tax on the 'liquidating income'.

7.3.4 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.

8. Transaction costs for sellers

8.1 Value added tax

As shown in section 1.4, the VAT rate is 10%. However, certain goods or services such as the transfer of shares are exempt from VAT as it is not regarded as supply of goods from VAT law perspective. As for an asset transfer, the seller in a ‘comprehensive business transfer’ is not required to charge 10% 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.

8.2 Stamp duty

Stamp tax is levied on a party that prepares certain documents certifying establishment, transfer or change of rights to property in Korea.

8.3 Concessions relating to mergers and acquisitions

As stated in section 5.1, qualified M&A provide the merged company and surviving company with exemption or deferral of corporate income taxes or local taxes.

8.4 Tax deductibility of transaction costs

Transaction costs incurred by a seller are generally deductible for the purpose of calculating the gain or loss on the transaction.

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

In case certain assets are transferred between a parent company and its wholly-owned subsidiary which form a consolidated tax group, then capital gains / losses generated from the transfer of assets are deferred until they are realised, as the consolidated tax group is viewed as one economic entity under the consolidated tax regime.

For example, capital gains / losses derived from transferring certain type of assets, including fixed assets, intangible assets, accounts receivables, etc. are deferred until they are sold to third parties, except for inventory due to its high frequency and volume of the transaction.

Under the Korea Corporate Income Tax Law for transactions between Korean related parties, the transaction price and fair market value should show limited discrepancies. In case the discrepancy between the transaction price and fair market value exceed 5% of the fair market value or ₩300m, then the transaction will not be considered arm’s length and will be subject to assessment. If the counterpart is an overseas related party, the Law for the Coordination of International Tax Affairs (LCITA) shall apply.

9.2 Declaration of dividend prior to sale

Before the sale of a company, dividends may be paid in order to extract surplus cash. This may reduce the deal price of the company, however there is no specific rule regarding this type of dividend for tax purposes. Where dividends are paid to non-residents, withholding tax will be applied.

10. Demergers

Demerger structures may involve various tax implications and must be carefully designed to minimise potential 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, and
- 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.

10.1 Types of demergers

Split-off (Injuk-boonhal)

A split-off is defined as the separation of a company's business division to a new entity as a 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 a subsidiary of the company.

10.2 Split-off

10.2.1 Acquirer

Deemed dividend income applies to shareholders of a split-off company which receives compensation of a split-off.

Deemed dividend income is generally calculated as the difference between the value of shares or other assets in return for split-off and the acquisition cost of shares.

10.2.2 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 'five 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 shortened 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 five 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.

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.

10.2.3 Target (from which a new company is split-off)

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.

10.3 Spin-off: tax and other considerations

10.3.1 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.

10.3.2 Target (from which a new company is spun-off)

In 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.

11. Listing / Initial public offering

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 number of tax issues to the seller, whereas a share deal may be structured more tax efficiently.

Therefore, by selecting an appropriate acquisition vehicle for a Korean target, a foreign investor may exit Korea with a relatively reduced tax cost. An investor may also consider the exit route through an initial public offering.

The Korea Exchange (KRX) has attracted more foreign companies for their listings since its first (foreign company) listing in 2007. To be listed on the Korean market, a company must satisfy requirements in the following five categories:

- size of the company
- distribution requirements
- financial condition
- soundness of company
- requirements to protect investors.

The Korean Securities Dealers Automated Quotations (KOSDAQ) market has less stringent listing requirements than the stock market. The KOSDAQ market has three market sections: general business, venture business and growth venture business. The listing requirements for venture are less stringent than the general section.

12. Tax incentives

The Korean government provides various incentives and benefits for inducing foreign investment under the FIPA which include the followings:

- Foreign invested companies that engage in certain qualified high-technology businesses can apply for 100% exemption from corporate income tax for five years, beginning from the first year of profitable operations (from the fifth year, if not profitable until then) and a 50% reduction for the following two years in proportion to the foreign shareholding ratio.

An exemption from withholding tax on dividends is available for foreign investors in the same manner as above during the same period. In addition, the taxpayer can apply for 100% exemption from local taxes, such as acquisition tax, registration tax and property tax on assets acquired for their business for five years after business commencement date and 50% reduction for the following two years. For local tax exemption, some local government grants a longer exemption period

(up to 15 years) in accordance with their local ordinances. Qualified foreign investment can also be eligible for the exemption from customs duties, VAT and special excise tax on imported capital goods for the first three years.

- Foreign investors satisfying specified criteria are provided with tax incentives and other benefits for investment in specially designated areas including foreign investment zones (FIZ), free economic zones (FEZ), free trade zones (FTZ) and strategic industrial complexes exclusively developed for foreign invested companies. The tax incentives for qualifying foreign investors in FIZ are similar to those of the above foreign invested high-technology companies. Qualifying investors in FEZ, FTZ and strategic industrial complexes may receive a 100% exemption from corporate or individual income tax as well as local taxes for the first three years and a 50% reduction for the next two years. An exemption from withholding tax on dividends is granted to qualifying foreign investors in FEZ, FTZ and such industrial complexes in the same manner as above during the same period. They also receive an exemption from customs duty on imported goods for the first three years.

Malaysia

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1. Introduction

1.1 General information on mergers and acquisitions in Malaysia

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 thin capitalisation requirements, may also impact a transaction.

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 the country. However, resident companies (except for those carrying on banking, insurance, sea or air transport operations) and resident individuals are exempt 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) is 25%. However, resident companies in Malaysia with paid-up capital not exceeding RM2.5m 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. However, 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 RM2.5m will not be eligible for the concessionary tax rate. The basis of income assessment is on a current year basis. Malaysia has a self-assessment system of taxation.

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 property (i.e. land and buildings) and shares in real property companies. With effect from 1 January 2010, where the disposal of real property (i.e. land and buildings) and shares in real property companies are made within five years from the date of acquisition of the property or shares, RPGT will be imposed at a fixed rate of 5% on any gains. Disposals made after five years will be exempt from RPGT.

1.2.1 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 (Section 108 credit) and its distributable reserves. If the company does not have sufficient tax franking credits (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 credits as at 31 December 2007 are given a six-year transitional period (from 1 January 2008 to 31 December 2013) to utilise the Section 108 credits for the 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 credits.

Under the imputation system, Malaysian-sourced dividends received by shareholders are deemed to have suffered tax 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 their 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 franking requirement mentioned above. 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:

Type of income	Non-treaty rate	Treaty rate
Interest	0 - 15%	0 - 15%
Royalties	10%	0 - 10%
Management / technical fees ¹	10%	0 - 10%
Rental of movable property	10%	0 - 10%
Other gains or profits ²	10%	10%

¹Effective from 21 September 2002, payments to non-residents in respect of management / technical services rendered outside Malaysia will not be subject to withholding tax.

²Effective 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 (other than reimbursements or disbursements on hotel accommodation in Malaysia), or the rental of movable 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 (nil, 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
- with effect from 1 January 2011, service tax is increased to 6% (from 5% previously) 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 property transferred under the instrument. Stamp duty is payable by the buyer.

Specific relief from stamp duty is available provided stipulated conditions are met (see section 2.4.3).

1.6 Capital gains tax

There is no general capital gains tax regime in Malaysia.

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 (i.e. land and buildings) situated in Malaysia or shares in real property company (RPC) a controlled company, the major assets of which consist substantially of real properties or RPC shares. Depending on the period of ownership, these gains will be subject to RPGT at rates ranging from 5% to 30%.

With effect from 1 January 2010, where the disposal of real property and shares in RPC are made within five years from the date of acquisitions of the real property / shares in RPC, RPGT will be imposed at a fixed rate of 5% on any gain. Disposals made after five years will be exempt 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.

1.7 Common forms of business

The following are the common forms of business entities in Malaysia:

- **Limited liability company**

A limited liability company is regulated by the Companies Act, 1965. A limited liability company is a tax resident in Malaysia for the basis year for a year of assessment if control and management of its business or affairs are exercised in Malaysia at any time during that basis year. A limited liability company is required to have a registered office and at least two resident directors in Malaysia.

- **Branch**

Foreign corporations are allowed to register branches in Malaysia with the exception of certain industries where there are foreign ownership restrictions. A branch is not considered as a resident in Malaysia for tax purposes because the management and control of a branch would generally be exercised outside Malaysia. A branch would be required to have a registered office in Malaysia and one or more persons resident in Malaysia to accept on its behalf the service of process and any notices required to be served on the branch.

- **Limited liability partnership**

A limited liability partnership is a body corporate and has legal personality separate from its partners. A limited liability partnership is allowed to carry on a business and acquire, own or develop property and does and suffers any acts or things as a body corporate may lawfully do and suffer. A limited liability partnership is required to have a registered office in Malaysia and it may carry on business with fewer than two partners for a period not exceeding six months or a longer period as may be determined by the

Registrar provided such extended period does not exceed one year. Although this has been introduced, it has not been gazetted to date.

- **Partnership and / or unincorporated joint venture**

Partnerships and unincorporated joint ventures (JV) are not treated as separate legal entities. Tax is assessed on the partners or JV partners for their share of taxable income.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset 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 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 accumulated tax losses, unutilised tax depreciation, 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 accumulated 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 year of assessment 2006, accumulated tax losses and unutilised tax depreciation of a target company which is dormant shall be disregarded in the event when 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 above, 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 accumulated tax losses, unutilised tax depreciation, 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 accumulated tax losses and unutilised tax depreciation carried forward**

Generally, accumulated 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 tax exemptions currently enjoyed by the target company is not likely to be able to be transferred to the acquiring company. Generally, the buyer will have to submit a new application for tax incentives or tax exemptions upon acquiring the business, if it is eligible.

- **Others**

In an asset acquisition, the buyer has the choice of determining the assets and / or 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 costs

2.4.1 Goods and services tax / Value added tax

As mentioned in section 1.4, Malaysia does not currently have a GST / VAT system, however one is likely to be implemented in the foreseeable future. However, 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 (see section 1.5).

Service agreements attract ad valorem stamp duty at the rate of 0.5%. With effect from 1 January 2011, the stamp duty was reduced to 0.1% pursuant to a stamp duty remission order.

Specific stamp duty relief is available provided stipulated conditions are met (see section 2.4.3).

2.4.3 Concessions relating to mergers and acquisitions

The Malaysian Income Tax Act and Stamp Act provide some concessions when a company is being reorganised.

- For income tax purposes, the 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 their 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 value 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 five year period provided the stipulated conditions are met. For instance, the acquisition is for the purpose of acquiring high technology for production within Malaysia 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 a manufacturing, or trading / marketing activities. 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. Some of the pertinent conditions are:
 - 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 shareholding relationship between the transferee and the transferor).

2.4.4 Tax deductibility of transaction costs

Generally, transaction costs incurred during M&A transactions 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 / asset acquisition

3.1 Stock acquisition

Acquisitions that result in a parent-subsidiary relationship are accounted for either at cost or fair value in the parent's separate financial statements.

There are no tax implications on the acquisition or subsequent disposal of the subsidiary by the parent. There is no general capital gains tax regime in Malaysia. Real property gains tax would apply on the gains arising from the subsequent sale of the subsidiary only if the subsidiary is a real property company.

3.2 Asset acquisition

The accounting treatment of an asset acquisition is dependent on whether the acquisition is considered to be a business combination or an acquisition of assets for accounting purposes based on certain tests.

a. Business combination

The governing standard for business combinations, Financial Reporting Standard 3 (FRS 3), focuses on the substance of a transaction. A business combination is a transaction in which the acquirer obtains control of one or more businesses. A business is defined in FRS 3 as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in form of dividends, lower cost or other economic benefits directly to the investors.

FRS 3 requires all business combinations (other than business combinations under common control) to be accounted for using the acquisition method where the acquiree's identifiable assets (including intangible assets which were not recognised previously), liabilities and contingent liabilities are generally measured at fair value. Any difference between the consideration transferred and the fair value of the identifiable net assets acquired is recognised as goodwill.

The tax treatment of assets and liabilities acquired in a business combination is dependent on the accounting treatment and is based on general tax principles. Property, plant and machinery would generally qualify for capital allowances while some intangible assets may qualify for tax deduction under specific tax rules. No tax deduction is available for the amortisation of goodwill acquired.

b. Asset acquisition

Asset acquisitions on the other hand, are accounted for at cost in accordance with the underlying nature of the assets (e.g. property, plant and equipment, investment property, inventories, etc.). The tax treatment of assets acquired is similar to that as accounted for under a business combination.

4. Financing of acquisitions

4.1 Thin capitalisation

Thin capitalisation rules have been introduced under a new anti-avoidance provision relating to transfer pricing. However, the guidelines on thin capitalisation have not been issued and there are no specific 'safe harbour' rules specified in the legislation. The implementation of the thin capitalisation rules is expected to take place after December 2012.

4.2 Deductibility of interest

4.2.1 Stock deal

In a stock deal where dividends are paid under the tax imputation system, an 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 therefore not tax deductible.

For example, assume 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.

Type of income	Tax imputation (RM)	Single-tier dividend (RM)
Dividend	100	75
Interest expense	40	
Net taxable dividend income	60	
Tax on net taxable dividend income at 25%	15	
Tax paid (imputation system) at 25% on gross dividend	(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 tax refund. It should be noted that excess interest costs are not eligible to offset against other income, nor can they be carried forward to offset against future dividend income.

Under the single-tier dividend system, dividends receivable (net of tax at source of 25%) 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 for intercompany loans will not be tax deductible. Therefore, the level of inter company debt used to fund the acquisition of a business should be monitored. There are also specific industries in Malaysia which are required to maintain a certain minimum level of paid-up share capital.

5. Mergers

In Malaysia, there is no statutory concept of a 'merger'. The mode of merger in Malaysia involves either an 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 coordination 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. FIC approval for property transactions will now only be required where:

- it involves a dilution of Bumiputra or government interests for properties valued at RM20m 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 RM20m.

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 shareholders without having to satisfy the franking requirement.

There is no restriction for exchange control purposes on dividend distributions by a Malaysian subsidiary.

Payments of interest and royalties to non-residents are subject to withholding tax at rates which may be reduced under the relevant double tax treaty. 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.

6.2 Tax losses carried forward and unutilised tax depreciation carried forward

As explained in section 2.2, 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. 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

For a stock deal, the conditions attached to the tax incentives granted should be examined to ensure that a change in ownership will not affect the target company's entitlement to such incentives or exemptions.

Under an asset deal, any tax incentives or exemptions 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.

Any unutilised tax incentives 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 the year of assessment 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 from the year of assessment 2009) of the current year's unabsorbed tax losses of the surrendering company. The following conditions need to be satisfied before the tax losses may be surrendered:

- the claimant and surrendering companies each must have a paid-up capital in respect of ordinary shares of more than RM2.5m

- 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. Disposals

7.1 The 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 accumulated 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 general capital gains tax regime.

7.2.2 Distribution of profits

Provided 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 property (i.e. land and buildings) and shares in real property companies are made within five years from the date of acquisition of the property / shares, RPGT will be imposed at a fixed rate of 5% on any gains. Disposals made after the five-year period will be exempt from RPGT.

However, if the company trades in real property or develops real property, the gain 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 (provided stipulated conditions can be met) on the transfer of assets between companies in the same group if the assets are transferred to bring greater efficiency in the 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 categories mentioned above.

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 are 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 or 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 in section 7.2.2 on stock sale, the gain arising from the disposal of assets may be distributed as a dividend to the shareholders provided there are sufficient retained earnings in the company.

8. Transaction costs for sellers

8.1 Goods services tax / Value added tax

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 or 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 mergers and acquisitions

The Malaysian Income Tax Act provides some concessions when a company is being reorganised.

- For income tax purposes, the 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 M&A 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 transactions 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 a target for sale

In preparing for a deal, it is appropriate for the seller to identify the income tax impact 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 the value of tax shelters (e.g. the availability of carry forward accumulated tax losses, unutilised tax depreciation and availability of tax franking credits – available to be utilised until 31 December 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 on 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 are no adverse tax implications arising from a distribution of pre-sale dividends.

10. Demergers

There is no statutory concept of a 'demerger' in Malaysia. The mode of demerger in Malaysia typically involves either a disposal of shares or assets to another party or a distribution in specie of the shares or assets to the shareholders either via a dividend distribution or a capital reduction exercise, which requires Court approval.

The tax treatment of a disposal is covered in section 7.

From 1 January 2008 onwards, where the demerger is by way of a dividend in specie of assets, the dividend paid is considered as single-tier dividend (see section 1.2). This dividend is exempt in the hands of the shareholders.

Where the demerger is effected by way of 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

On IPO, there should be no tax implications to a seller if the shares have been held as a long-term investment.

12. Tax incentives

There are a number of tax incentives granted for doing business in Malaysia. These include the followings:

- pioneer status or investment tax allowance for promoted products or activities
- tax exemption:
 - approved Regional Distribution Centre (RDC)
 - International Procurement Centre (IPC)
 - international trading company
 - Real Estate Investment Trust (REIT)
 - Property Trust Fund (PTF)
 - venture capital company
 - closed-end fund company
- Islamic fund management company
- Islamic stock broking company
- food production company
- research and development companies
- companies located in development regions such as:-
 - i. Multimedia Super Corridor (MSC)
 - ii. Iskandar Development Region
 - iii. Northern Corridor Economic Region
 - iv. East Coast Economic Region
 - v. Sarawak Corridor of Renewable Energy
- reinvestment allowance
- tax allowance for increased exports, approved services projects and infrastructure
- approved operational headquarters.

New Zealand

Country M&A team

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1. Introduction

1.1 General information on mergers and acquisitions 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.

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 '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 '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
- introduction of limited partnership rules
- change in company tax rate (from 30% to 28% effective from the 2011/2012 income year) and personal income tax rates
- removal of loss-attributing qualifying company and introduction of the look through company.

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 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 companies that are at least 66% commonly owned (without forming a tax consolidated group).

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. Inland Revenue has a strong compliance focus on avoidance for 2011 and 2012, including a focus on offshore and international issues. Any structuring transaction aimed at achieving tax efficiency should be reviewed in light of the general anti-avoidance provision and current Inland Revenue focus.

1.2 Corporate tax

1.2.1 Income tax

Income tax is currently levied at the rate of 28% on a New Zealand resident company's worldwide income. The company tax rate has been reduced from 30% to 28% starting from the 2011/2012 income year. 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.

While 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

Dividends are generally taxable unless paid between companies that are members of a wholly-owned group. Dividends include cash distributions and other transfers of value to shareholders (or associates of shareholders).

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 New Zealand income tax by the company and may be carried forward by companies from year to year provided a minimum of 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. Dividends are taxed at the investors' marginal tax rate but a tax credit is given for any attached imputation credits.

Under the foreign investor tax credit regime, the withholding tax in certain instances may be funded effectively by payment of a supplementary dividend.

Legislation has been introduced which removes the general availability of the foreign investor tax credit and replaces it with a zero-rate withholding tax on fully imputed dividends paid to non-portfolio shareholders.

1.3 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 taxation agreement with the recipient entity's country of residence. New Zealand currently has double taxation agreements in force with 37 countries.

General withholding tax rates:

Type of income	Non-treaty rate	Treaty rate
Interest	15%	10 - 15%
Royalties	15%	10 - 15%
Dividends	15 - 30%	15%

New Zealand has ratified double taxation agreements with Australia, Singapore and the US to allow for lower withholding tax rates. For Australia and the US, the withholding tax rate for dividends is 0% to 15% (subject to certain conditions), for interest is 10% (or 0% on interest paid to government or financial institutions provided that 2% AIC is paid) and for royalties is 5%. For Singapore, the withholding tax rates are 5 to 15% for dividends, 10% for interest (or 0% on interest paid to government) and 5% for royalties. A double taxation agreement with Hong Kong came into force on 9 November 2011 and the agreement will apply for income years beginning on or after 1 April 2012. A double taxation agreement with Turkey came into force on 28 July 2011. The agreement is effective for withholding taxes from 1 January 2012 and other provisions for income years beginning on or after 1 April 2012.

Fully imputed dividends paid to non-portfolio shareholders are subject to 0% withholding tax (irrespective of the treaty rate). In respect of fully imputed dividends paid to portfolio investors, the withholding tax may be funded at no additional cash cost to the company if sufficient imputation credits are attached.

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, file annual income tax returns and account for any additional tax (i.e. in excess of the withholding tax) although costs relating to the income are also deductible. The rate of withholding tax can also be reduced to zero 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 consideration when determining eligibility for 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.

1.4 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 15% (12.5% prior to 1 October 2010), although some supplies are taxed at 0% (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. Taxpayers may elect into the GST business-to-business 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.

1.5 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 has been abolished with effect from 1 October 2011.

1.6 Common forms of business

In New Zealand, there are several common forms of business:

- **Limited liability company**

The most common form of business entity used in New Zealand is a limited liability company. A company can be incorporated with relative ease with the New Zealand Companies Office, which offers an online incorporation service.

- **Branch**

Another popular investment vehicle is a branch. Unlike the company, a branch is not a separate legal entity. If operated by a non-resident, a branch is treated as a non-resident company for New Zealand tax purposes that enables profits to be repatriated free of withholding tax. Another benefit of a branch structure is the potential to utilise branch losses to offset other income in the head office. 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 a foreign-owned New Zealand 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.

- **Partnership**

Other investment vehicles include partnerships (general and limited liability), 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 partners' / participants' share of income.

Limited partnerships have separate legal status but flow-through tax treatment for income and expenditure in the same way as general partnerships. Registration of limited partnerships is generally straight forward and partners are not necessarily required to contribute capital to the limited partnership.

- **Look-through company**

New Zealand also has a look-through company regime that allows qualifying companies to have flow-through status. The legislation applies from 1 April 2011 for income years commencing on or after that date. This regime is fairly restrictive as a look-through company must be a New Zealand tax resident company, all the company's shares can only be owned by individuals, trustees or another look-through company, and the look-through company must have five or fewer 'look-through counted' owners who ultimately receive any loss or income from the look-through company.

1.7 Foreign ownership restrictions

Irrespective of which structure is utilised, a non-resident may need to obtain consent from the Overseas Investment Office to establish or acquire a 25% or more ownership or control interest in either one of the following:

- business or non-land assets worth more than NZ\$100m
- 'sensitive land'
- fishing quotas or entitlements.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset 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. The use of warranty and indemnity insurance is becoming more common.

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 provided the companies have a minimum of 66% commonality of shareholding for the time the losses were incurred to the time the losses were utilised. There is no 'same business test' in New Zealand for the use of losses brought forward.

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.

New Zealand tax rules allow certain research and development costs to be capitalised in certain circumstances. This allows the benefit of their costs to be utilised by any purchaser.

Special concessionary rules apply to allow mining expenditure losses to be carried forward irrespective of shareholder changes (subject to specific conditions).

2.2.2 Imputation credits and other memorandum accounts

Imputation credits and other memorandum account credits require a minimum of 66% continuity of ownership to be satisfied from the time the credits arose 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.

Most foreign dividends (not including deductible foreign equities or fixed rate foreign equities) are tax exempt. The conduit tax relief regime was repealed effective from the first income year beginning on or after 1 July 2011. Up to 30 June 2011, New Zealand had a conduit tax credit regime which allowed foreign income to be distributed to foreign shareholders by a New Zealand company. From 1 July 2011, conduit tax relief cannot be attached to dividends, additional conduit tax relief dividends cannot be paid and fully credited conduit relief dividends are not exempt income. The repeal of branch equivalent tax accounts will apply from the first income year beginning on or after 1 July 2012. However, a restriction on elections to use branch equivalent tax accounts' debit balances applies from 1 July 2009.

2.2.3 Tax incentives and concessions

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. There are concessions for investors that are known as the venture capital tax related reforms. These limited concessions are available where certain foreign equity investors derive gains from the sale of shares in New Zealand unlisted companies. These rules apply to foreign investors that undertake specific activities and are generally tax exempt.

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 taxation agreement (except Switzerland) and who invest into New Zealand venture capital opportunities.

2.2.4 Research and development 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 and the ability to defer certain R&D costs.

2.3 Asset acquisition

There is no blanket rule that allows assets to be treated as being disposed of at market value. Although there are specific rules applying to certain assets and anti-avoidance rules that can be invoked by Inland Revenue. Generally, where the vendor and the purchaser are unrelated and acting on an arm's length basis, Inland Revenue accepts the prices agreed between the parties (subject to anti-avoidance).

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 sales 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, the purchaser generally wishes to attribute as much of the purchase price as possible to depreciable assets and inventory. A third party purchaser should be able to step up the value of depreciable assets to maximise depreciation claims but it is advisable for the step-up to be supported by a valuation and for the vendor and purchaser to have the purchase price apportionment agreed.

Depreciation deductions are no longer allowed for buildings with an estimated useful life of 50 years or more for the 2011/12 income year. Also included in the budget was a change to depreciation loading where businesses are no longer able to claim 20% accelerated depreciation on new plant and equipment.

2.3.2 Goodwill

Generally, the disposal of goodwill is not subject to income tax. In most cases, the vendor would therefore be motivated to attribute as much of the selling price as possible to goodwill. If the vendor is a company, capital gains derived from transactions with unassociated persons can be distributed to New Zealand or foreign non-corporate shareholders free of New Zealand tax on liquidation.

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 Goods and services tax

The transfer of shares is 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 the 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 has been abolished with effect from 1 October 2011. There remain administrative processes that need to be completed to effect a gift.

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 (see section 5).

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, transaction costs is generally a non-deductible capital item. However, transaction costs incurred for the purpose of obtaining debt funding for the transaction may be deductible. By comparison, transaction costs incurred in effectively an asset acquisition can be allocated across the assets purchased. A tax deduction should be available over time for the acquisition costs to the extent that those assets are depreciable or otherwise deductible (e.g. inventory).

3. Basis of taxation following stock / 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.

3.2 Asset acquisition

Under an asset deal, the purchaser's tax cost base will generally be determined by the price paid. Accordingly, a step-up in the tax base of assets is possible if the price paid for the assets exceeds the vendor's tax base of those assets.

4. Financing of acquisitions

4.1 Thin capitalisation

New Zealand resident companies and other entities controlled by non-residents (with 50% or greater ownership interest or by any other means) are subject to the inbound thin capitalisation rules. Under the inbound thin capitalisation rules, a deduction for interest is denied to the extent the taxpayer's total interest bearing debt-to-total asset ratio exceeds:

- 60% (75% for the 2010/2011 and prior income years) 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.

The outbound thin capitalisation rules apply where a New Zealand company holds an income interest in a controlled foreign corporation (CFC). Under the outbound thin capitalisation rules, a deduction for interest is denied to the extent the taxpayer's total interest bearing debt-to-total assets ratio exceeds:

- 75% of the New Zealand group debt percentage, and
- 110% of the worldwide group debt percentage.

The value of CFC investments is excluded from the asset amount included in the group debt percentage. If a New Zealand resident company is subject to both the inbound and outbound rules, the 60% safe-harbour applies.

Other changes that apply to income years beginning on or after 1 July 2011 are:

- extending the thin capitalisation rules to New Zealand residents with foreign investment fund (FIF) interests that use the FIF income method or the exemption for Australian resident FIFs
- introducing a restricted interest cover ratio safe harbour (applying a ratio of interest expense to pre-tax cash flows)
- removing the application of the thin capitalisation rules to non-resident companies that do not carry on a business through a fixed establishment in New Zealand, if all their New Zealand-sourced income that is not relieved under a double taxation agreement is non-resident passive income.

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.

Costs incurred in the course of raising debt 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.

Also, stapled debt securities rules, where debt instruments are 'stapled' to equity instruments, have been introduced. Interest paid on stapled debt securities is treated as a dividend and is therefore non-deductible.

4.3 IFRS and taxation of financial arrangements

The International Financial Reporting Standards (IFRS) include 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. Mergers / Amalgamations

New Zealand's company law allows companies to amalgamate with each other and there are concession rules dictating tax consequences. 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 resident's restricted 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 filing 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, although a company's liability can be limited by election in certain circumstances.

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, share repurchase or share repatriation. 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, withholding tax on repatriation of any surplus cash is likely to be a key consideration. Common profit registration methods include:

- Payment of a fully imputed dividend resulting in 0% withholding tax.

- 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 (being in broad terms, the amount of capital originally invested by shareholders in the company).
- Migration of the company. New Zealand's company law legislation allows a company to be removed from New Zealand's register if it is

being transferred to an overseas company 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, which can crystallise some deferred tax liabilities and assets) 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 company's available subscribed capital and capital gains (subject to certain conditions). 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

Legislative changes to the taxation of offshore investments are ongoing. One change is the application of the CFC active / passive attribution rules to non-portfolio FIFs. We expect this legislation to be passed in March 2012 with retrospective effect for income years beginning on or after 1 July 2011.

7. Disposals

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 exposure to the target's historic tax liabilities.

Generally with an asset sale, the vendor will be motivated 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. Allocation of value to inventory and depreciated assets each crystallise tax liability on sale.

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 on liquidation in certain instances) generally attracts withholding tax unless imputation credits are attached. If a dividend is fully imputed, there will be no withholding tax payable. The sale itself generally will not generate imputation credits as the gain is usually a non-taxable capital gain.

New Zealand's double taxation agreements with Australia and the US also provide 0% withholding tax on dividends in certain circumstances.

Other methods of distribution, which allow shareholders to receive sale proceeds tax free if certain requirements are met, are often possible (see section 6.1).

7.2 Asset deal

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, capital gains (including goodwill) can be distributed tax free on liquidation (other than to corporate shareholders holding 50% or more).

8. Transaction costs for sellers

8.3 Concessions relating to mergers and acquisitions

See section 5.

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.

8.1 Goods and services tax

As mentioned 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.

9. Preparation of a target company 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

If a company forfeits any brought forward tax losses and imputation credits on a breach of the relevant shareholder continuity tests, consideration should be given to utilising any tax losses and imputation credits 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) to generate additional available subscribed capital. 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 fully impute the dividend.

10. Demergers

New Zealand's income tax legislation contains no specific provisions relating to demergers or spin-offs. A demerger is normally achieved by the sale of assets to a new entity and sale of that entity. 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. Generally, an exit event occurs 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

For companies that are contemplating undertaking an initial public offering (IPO) or otherwise listing on a stock exchange, there are 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 that 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. Tax incentives

There are no general tax incentives in New Zealand.

Philippines

Country M&A team

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1. Introduction

1.1 General information on mergers and acquisitions in the Philippines

M&A activity in the Philippines has picked up despite last year's global recession. Major acquisitions involved fast-food companies and restaurants, business process outsourcing companies, financial institutions, power companies and telecommunication companies.

The Philippine 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 certain entities (see section 12).

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 the 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 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 and payable quarterly. As with regular corporate income tax, the quarterly MCIT payments are creditable against the annual income tax due.

Further, in computing corporate tax, 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 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 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:

Type of income	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 permanent establishment

The Philippines has a comprehensive network of double taxation agreements which operate to exempt or reduce withholding tax on certain payments by a company. The availment of treaty benefits must be preceded by an application for tax treaty relief filed with the tax authorities.

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 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 20,000 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 the recipient of the relevant income. Below are some of the payments, which are subject to EWT and the applicable EWT rates:

Nature of payments	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

1.3.4 Timing of withholding

Under the withholding tax rules, the obligation of the payor to deduct and withhold the tax arises at the time a payment is paid or payable, or a payment is accrued or recorded as an expense or asset, in the payor's books, whichever comes first.

1.4 Value added tax

In general, 12% value added tax (VAT) is imposed on the sale of goods and services. 0% VAT applies only to specific transactions.

Payments to non-residents for services rendered in the Philippines are 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 validated VAT return, however, shall be used to support the input VAT claim 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 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 an 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%, is 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 for a specific period which has been granted certain tax incentives provided certain conditions are met.

1.6.3 Real property tax

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, is imposed on the assessed value of the real property and fixed machinery 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.

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

In general, 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 land and / or buildings, 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 sale or receipt of certain corporations engaged in activities or industries which are not subject to 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.

1.7 Common forms of business

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. A partnership is a business organisation composed of two or more persons, which bind themselves to contribute money, property of industry to a common fund while a joint venture is an association of persons or companies jointly undertaking some commercial enterprise.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

The Philippines has no restrictions on acquisitions, mergers or consolidations, unless they will result in unfair competition, restrain trade to artificially prevent free competition in the market, or violate the foreign ownership limitation as provided under the Constitution or the FINL.

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 will 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% corporate income tax, payable by the seller, in the case of an asset deal. Sale of shares listed on the stock exchange is subject to 0.5% STT. An exemption under a relevant tax treaty may be availed of. However, there are tax treaties where an exemption from STT is not covered.

Documentary stamp tax (DST) 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, the phrase 'change in ownership' applies 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. 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. In general, 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 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 a 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 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 their 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 Value added tax

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 mergers and acquisitions

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 (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).

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.

The transfer of property via a merger or consolidation shall not be subject to VAT. However, the transfer of property used in business or held for sale or lease in a tax-free exchange transaction shall be subject to VAT. Such transfers are not subject to DST.

2.4.4 Tax deductibility of transaction costs

Stock deal

In the case of a stock deal, acquisition costs such as professional fees and taxes passed on to the buyer, relating to the acquisition are generally not deductible for income tax purposes. Costs however may be capitalised or form part 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, transaction costs may be attributed to various 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 / 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 that 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. 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. In the case of companies registered with the Board of Investments and Philippine Economic Zone Authorities, a 3:1 debt-to-equity ratio is required to be maintained.

4.2 *Deductibility of interest*

4.2.1 *Stock acquisition*

In general, for interest to be deductible, it should arise from an indebtedness which is utilised in connection with the taxpayer's business.

4.2.2 *Asset acquisition*

Interest incurred on funds used to acquire a business under an asset deal is tax deductible.

5. Mergers

As mentioned earlier, there are no restrictions on mergers or consolidations in the Philippines unless these will result in unfair competition, will restrain trade to artificially prevent free competition in the market, or will violate the foreign ownership limitations as provided under the Constitution or the FINL.

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 normally also require approval from the appropriate government agency.

In a merger, the assets (including the tax assets) and liabilities of the absorbed company 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

The 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% 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.

The foreign company investor may also be entitled to the reduced rate under a relevant tax treaty. The availment of the benefit must be preceded by an application for tax treaty relief filed with the tax authorities.

6.2 Losses carried forward

Net operating losses may be carried forward for a period of three consecutive years immediately following the year of incurrance 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. Disposals

7.1 The preference of seller: 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 Share disposal

7.2.1 Profit on sale of stock

In general, 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 is 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 exempted under a relevant tax treaty depending on the residence of the holding company of

the Philippines target company. For instance, any gains derived by residents of the Netherlands and Singapore from the sale of shares of the Philippine target company, are not subject to capital gains tax in the Philippines. However, in respect of gains derived by the Singapore investors, the exemption would apply provided that the target company's major assets do not consist of immovable property. The availment of exemption must be preceded by an application for tax treaty relief filed with the tax authorities.

When acquiring a target company in the Philippines, the residence of the holding company should be considered. Setting up a holding company in the Philippines may no longer be tax efficient due to the imposition of the 10% improperly accumulated earnings tax (IAET) on unreasonable retained profits.

Retention due to reasonable business needs must be proven to avoid this tax. Reasonable business needs is defined to be 100% of the paid-up capital or the amount contributed to the corporation representing the par value of the shares of stock.

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 disposal

7.3.1 Profit on sale of assets

Gains / profits on the sale of inventories or tax depreciable assets are subject to income tax in the hands of the seller. The gain is the difference between the selling price and the cost of the asset.

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 offset 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 a case of 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 sellers

8.1 Value added tax

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 party.

The sale / transfer of assets / business may also be subject to documentary stamp tax if it involves real property.

8.3 Concessions relating to mergers and acquisitions

No gain or loss shall be recognised in connection with transfer of properties via a merger, consolidation or tax-free exchange transaction. Such transfers are not subject to DST.

In addition, the transfer of property via a merger or consolidation shall not be subject to VAT. However, the transfer of property used in business or held for sale or lease in a tax-free exchange transaction shall be subject to VAT.

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. On the other hand, transaction costs involving the sale of shares do not form part of the cost basis of the shares. Nevertheless, the gain or loss from the sale of shares subject to capital gains tax shall be determined by deducting from the amount of consideration, the transferor's cost basis of the shares plus expense of sale / disposition, if any.

9. Preparation of a target company 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 issues identified during such review. In a stock deal, any outstanding tax liability and potential tax exposures remain with the target company.

10. Demergers

A business spin-off is the most common demerger 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.

Either way, the tax effect of this procedure are similar to that of an asset sale or a tax-free exchange as discussed previously.

11. Listing / Initial public offering

Another exit route for investors may be through 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.

In general, 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.

Proportion of shares sold to total outstanding shares of stock	Tax rate
Up to 25%	4%
Over 25 to 33.3%	2%
Over 33.3%	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 stock transaction tax (STT) under the relevant tax treaty. However there are tax treaties where an exemption from STT is not covered. The availment must be preceded by an application for tax treaty relief filed with the tax authorities.

12. Tax incentives

The following entities are granted certain incentives:

- Board of Investment registered enterprises
- Philippine Economic Zone Authority registered enterprises (PEZA)
- Subic Bay and Clark Freeport registered enterprises and Poro Point Economic Zone
- regional headquarters, and
- regional operating headquarters.

Entities carrying on approved activities may take advantage of reduced / preferential tax rates or a 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). They may also receive tax and duty exemptions or reduced rate on imported capital equipment and accompanying spare parts.

Five additional special economic zones were created under separate special laws. These are the Cagayan Special Economic Zone Authority (CEZA), Zamboanga Economic Zone Authority (ZEZA), Bataan Economic Authority, and Tourism Infrastructure and Enterprise Zone Authority (TIEZA) and Aurora Special Economic Zone. The incentives granted to those that will locate in these ecozones are similar to the incentives granted to PEZA registered enterprises.

Singapore

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1. Introduction

1.1 General information on mergers and acquisitions in Singapore

A transfer of ownership of a Singapore business can take the form of a disposal of assets or stock. 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 exempted 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 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 three years of operation for new start-up companies.

The first S\$100,000 of a start-up company's taxable profits is fully exempted during this period, while half of the next S\$200,000 profits is exempted from tax.

- **Singapore dividends**

Singapore dividends are exempted 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 been taxed 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 subject 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 exempted from tax when they meet certain qualifying criteria or investment structures prescribed by the authorities.

• **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 the 2009 income year 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:

Type of income	Tax rate
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

¹ The payee may opt to be taxed at 20% on net income.

Divided payments make to non-resident shareholders are not subject to withholding tax.

Singapore has a comprehensive network of tax treaties which operates 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, whether or not the payment are cost reimbursements. This treatment is extended to management service fee payments² 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 were recharged at cost were excluded, unless they were protected under a treaty.

Furthermore, interest and royalty payments may be exempted from tax under tax incentive schemes or tax concessions granted to the payer.

² Refers to the earlier of either:

- a. the contractual due date or the date of invoice in the absence of a contractual date
- b. when the fees are credited to the account of a non-resident person
- c. the actual date of payment of the fees

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 subject 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 out business in Singapore for at least two 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.

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 subject 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 a 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:

Type of transaction	Tax rate
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. There are no 'look-through' provisions in respect of land rich companies.

As the tax is levied on documents, stamp duty is payable even though the transaction may subsequently be aborted.

1.6 Common forms of business

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

- **Company incorporated in Singapore**
 - exempt private
 - private
 - public (normally listed on the Stock Exchange of Singapore)
- **Partnership**
 - limited liability
 - limited
 - general
- **Trust**
 - business trust
 - registered business trust
- **Branch of a foreign company**
- **Representative office of a foreign company**

Private Singapore companies are the business entities most commonly used by foreign investors, since limited liability is usually desirable. Increasingly, LLPs are also used subsequent to the enactment of the Limited Liability Partnerships Act on 25 January 2005. An LLP is a business structure that allows businesses to operate and function as a partnership while giving it the status of a separate legal person. An LLP will come into existence upon registration with the

Registrar of LLPs. From a Singapore tax perspective, an LLP is treated as a tax transparent entity. This will mean that no tax is paid by the LLP. Instead, each partner of an LLP will be chargeable with tax on his or its share of the income from the LLP.

Some investors may prefer to use an LLP due to the ease of repatriation of partnership profits while dividends can only be paid out of available accounting profits for shareholders of private Singapore companies. Also, there may be a home country advantage for some foreign investors.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

Other than a proposed new tax framework for corporate amalgamations (see 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 rate for a transfer of real property under an asset deal is as high as 3%.

2.2.1 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 provided the company continues to carry on the same business as the one that created the losses.

See section 6.2 for more details on the utilisation of unabsorbed tax losses and capital allowances and section 6.5 for group relief transfer rules.

2.2.2 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 Goods and services tax

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 exempted 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 clawback 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. Certain strict tests must be fulfilled for a transfer of a business to be qualified as a going concern. 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.

- c. Corporate reconstructions and amalgamations may be exempted 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.

Tax framework for corporate amalgamation

The tax framework for corporate amalgamations which was effective from 22 January 2009 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, or other items arising from the activities of the amalgamating companies would be available to the amalgamated company.

In general, 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.

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 tax framework is elective. The amalgamated company must make an election in writing or by completing and submitting a prescribed form to the Inland Revenue Authority of Singapore (IRAS). The election must be made within 90 days from the date of amalgamation.

Subject to the approval of the Minister for Finance, the 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.

New mergers and acquisitions 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.

The tax framework for corporate amalgamation allows for the tax features of the amalgamating companies to be transferred to the amalgamated (surviving) entity. However, borrowing and transaction costs incurred to finance the acquisition of a company which was then amalgamated remain non-deductible, even though the outcome would be that the buyer had acquired the income producing assets of the target.

A new M&A tax allowance and stamp duty remission has been introduced for qualifying M&A deals to encourage Singapore companies to grow through M&A. To an extent, these measures help alleviate the continuing restrictions for interest costs outlined above though 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% of the value of the acquisition, subject to a cap of S\$5m 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% rate of corporate tax, this effectively gives the 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.

3. Basis of taxation following stock / 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. See section 4.2.1 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 or 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 remaining 25% in the second year.

A Singapore company that 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 of 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\$2m or more (for unrelated party transactions) or S\$0.5m 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 if 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, although there are transfer pricing guidelines. 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 exempted, 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 have the debt/equity financing mix of each particular entity structured appropriately to maximise interest deductibility.

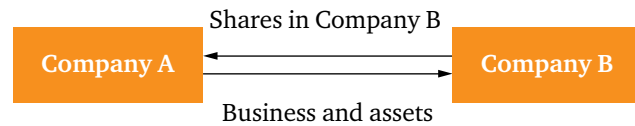
5. Mergers and acquisitions

In a Singapore context, the following options are available:

a. Transfer of trade and assets from one company to another company

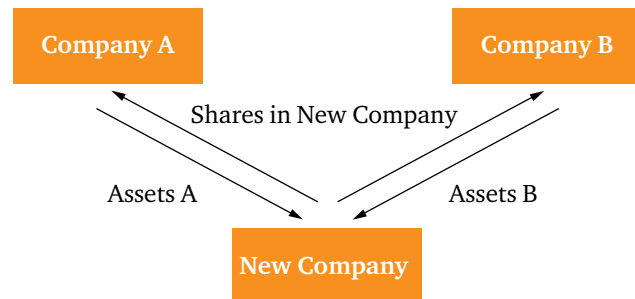
Example 1

Business and assets of Company A are transferred to Company B in consideration for shares in Company B being issued to Company A.



Example 2

Shares in New Company are issued to Company A and Company B in proportion to the respective value of the assets transferred.

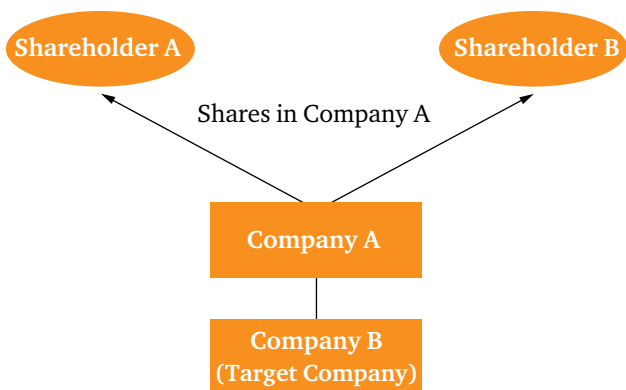


The tax implications would generally be the same as the case of an asset deal.

b. Share swap

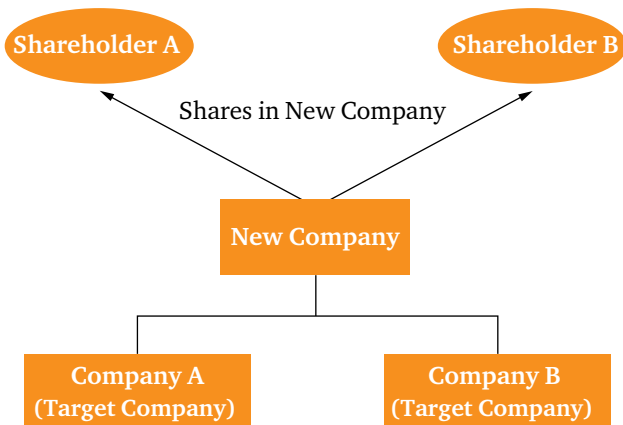
Example 1

Shares in Company B are transferred to Company A, which will issue new shares to the existing shareholders of Company A.



Example 2

Shares in New Company are issued to shareholders of Company A and Company B in proportion to the respective value of the shares transferred.



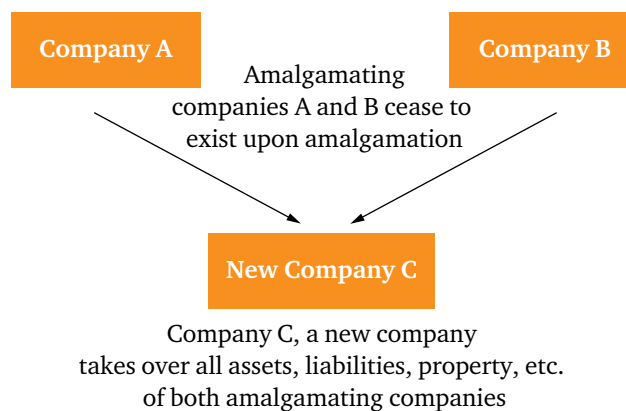
The tax implications would generally be the same as the case of a stock deal.

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.

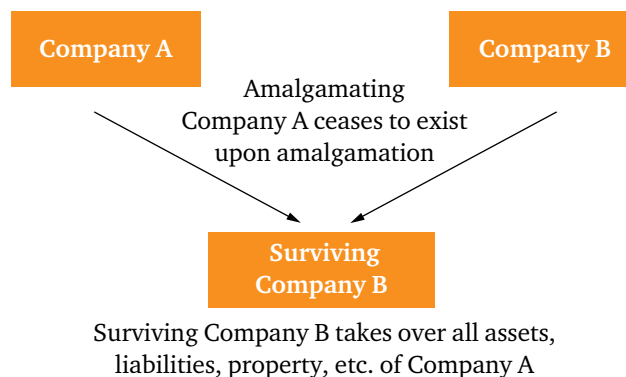
Example 1

Amalgamating companies cease to exist after the merger.



Example 2

Only one of the amalgamating companies ceases to exist.



A 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).

6. Other structuring and post-deal issues

6.1 Repatriation of profits

6.1.1 Dividend payments

Singapore does not impose any restrictions on repatriation of profits. In addition, dividends are generally exempted 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

The payment of royalties, interest, technical or management fees may be subject to withholding taxes and where a relevant treaty applies, the tax rate will be reduced accordingly (see section 1.3).

6.2 Substance requirements

There are generally two requirements to be met for a Singapore recipient company to be qualified for the reduced foreign withholding tax rates provided under a treaty. They are:

- to produce a certificate of residence (COR) as a proof of tax residence in Singapore, and
- to substantiate that a company is the beneficial owner of the income.

6.2.1 Tax residency

A company is considered resident in Singapore if its control and management is exercised in Singapore. Generally, in determining whether or not the management and control of a company is exercised in Singapore, the IRAS would take into consideration whether the board meetings are held in Singapore and whether the strategic and policy decisions for the business of the relevant company are made during such board meetings or where the business of the company is undertaken.

The IRAS will take into consideration several factors in issuing the COR including the followings:

- residence of individual directors
- whether the board of directors' meetings are held in Singapore and the presence of other related companies (tax resident or with business activities) in Singapore
- whether all decisions are made in board meetings
- whether certain directors have greater decision-making authority than others
- whether any other person besides the directors has de facto powers
- place where the business of the company is located
- place where the accounts and books are kept
- what the articles of association of the company actually prescribe
- whether support and administrative services are received from a related company in Singapore
- whether at least one director is based in Singapore, holds an executive position and is not a nominee director
- whether at least one key employee (i.e. managing director, chief executive officer, chief financial officer) is based in Singapore
- whether there is any discernible corporate management policy, and
- whether any specialist or consultant appointed wields policy making powers.

In addition, the IRAS emphasised the need to take into consideration the actual circumstances and not just ostensible formal arrangements. The central control and management hinges on the characterisation of the factual circumstances in each case. In deciding whether a company is resident in a particular jurisdiction, all the factors must be considered together.

6.2.2 Beneficial owner

Beneficial owner is the true owner of an income constituting dividends, interests and / or royalties, being a corporate or individual taxpayer having a full right to enjoy directly the benefits of such income. Certain factors that support a Singapore company to be regarded as the beneficial owner of an income are:

- ability to obtain a tax residence certificate from the IRAS
- sufficient commercial justification for the use of the Singapore company and commercial reasons (must be backed by documentation and circumstantial evidence) should be the primary driver for the structure (an example of commercial reasons to have a Singapore company as a financing centre are the time zone, banking facilities, resources, etc.)
- commercially justifiable level of equity funding for the Singapore company
- Singapore resident cannot be acting as a mere agent, nominee, administrator or conduit
- Singapore resident should have control over its funds and bear the risk of default on its debt security

- resources and extent of business activities in Singapore – the greater the resource and business activities available in Singapore, the better it is. This can be in terms of bank accounts, service providers, staff, directors and activities, etc.

6.3 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 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 on the first day of the year of assessment in which the unabsorbed allowances were 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.

6.4 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 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.

6.5 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:

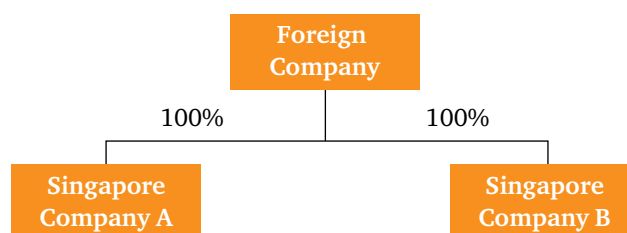
- at least 75% of the ordinary share capital of one company is beneficially held, directly or indirectly, by the other, or
- at least 75% of the ordinary share capital in each of the two companies is beneficially held, directly or indirectly, by a third Singapore company.

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.

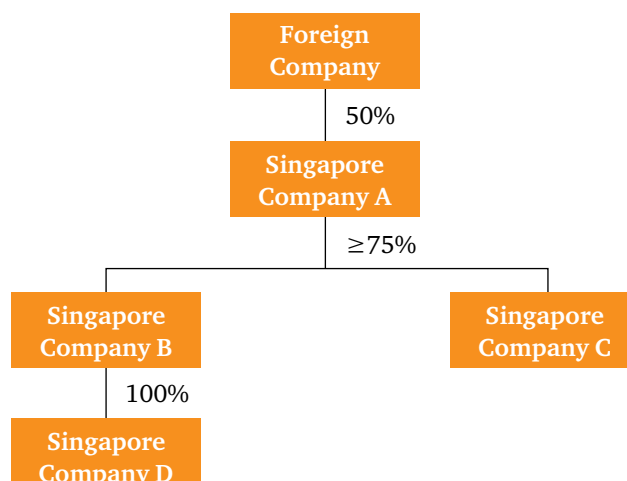
To be eligible for group relief, the companies in question must have a common year end and the shareholding requirement must be fulfilled for a continuous period that ends on the last day of the common accounting period. If the above continuous period ends on the last day of the accounting period, but 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:

i. No group relief



ii. Group relief available to Singapore Company A, Singapore Company B, Singapore Company C and Singapore Company D



7. Disposals

7.1 The preference of vendors: 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 for vendors

8.1 Goods and services tax

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 mergers and acquisitions

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 expenses which may be attributed to the sale of inventory.

9. Preparation of a 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. Demergers

There are no specific provisions in relation to demergers. A demerger 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 demerger would generally be the same as for an asset deal.

11. Trade sale / Initial public offering

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 for the acquisition.

12. Tax incentives

Here are a number of tax incentives granted for doing business in Singapore:

- 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 five to fifteen years) on specified income, depending on the particular tax incentive and the outcome of negotiations with the relevant government agency.

Sri Lanka

Country M&A team

Hiranthi Ratnayake (country leader)

Nissanka Perera

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1. Introduction

1.1 General information on mergers and acquisitions in Sri Lanka

A transfer of ownership of a Sri Lanka business entity can take the form of a disposal of stock or 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. Many fiscal incentives are available to industrial and other business activities promoted by the government (see section 11).

1.2 Corporate 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 directly or through an agent from services rendered in the country, from property in Sri Lanka or business transacted in Sri Lanka.

A resident company, for income tax purposes, 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 28%, effective from the year of assessment 2011/2012. Lower rates of 10%, 12% or 15% apply to some specific activities.

The corporate income tax rates for the years of assessment 2010/2011 and 2011/2012 are as follows:

Category	Tax rate in 2010/2011	Tax rate in 2011/2012
Companies engaged in non-traditional exports, promotion of tourism, construction work and for overseas management activities paid for in foreign currency	15%	12%
Companies with taxable income not exceeding Rs5m (other than a unit trust mutual fund, venture capital company, holding company or subsidiary of a group company)	15%	12%
Specialised housing banks	20%	28%
Existing or new venture capital companies not qualified for tax exemption	20%	12%
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	0%	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 five years of assessment from the year of assessment which it becomes a quoted company	33.3%	28%
Others	35%	28%

Social responsibility levy was payable at 1.5% for the years of assessment commencing before 1 April 2011 of the amount of income tax, dividend tax and remittance tax payable. Social responsibility levy has been abolished effective from the year of assessment 2011/2012.

1.2.1 Taxation of dividends

Dividends are generally subject to withholding tax at 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 (BOI) of Sri Lanka under Section 17 of the BOI Law No. 4 of 1978, before 6 November 2002 or a company qualified for an exemption before 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, before 31 December 1994, with 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 paid 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.

1.3 Withholding tax

Dividends, interest, rent, royalties and management fees paid by a person or partnership to another person or partnership are subject to withholding tax. The rates are as follows:

Type of income	Paid to resident person	Paid to non-resident person
Dividends	10%	10%
Interest	10%	20% ¹
Royalty / annuity > Rs50,000 per month or Rs500,000 per annum	10%	20% ¹
Management fees	5%	5%
Non-residential rents	0%	20%

¹ 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 recipients, provided such income is included in their taxable income.

1.4 Value add 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	Tax rate	Item	Input tax allowability
Zero-rated	0%	<ul style="list-style-type: none">• Export of goods, services connected with international transportation of goods and passengers, and with any movable or immovable property outside Sri Lanka• Services provided to a person outside Sri Lanka to be consumed outside Sri Lanka, where payment is received in full in foreign currency through a bank in Sri Lanka.	Full
Standard rate	12%	Items not included under the zero-rated category, and other than exempt and excluded supplies	Full, but restricted to 100% of the output tax and balance to be carried forward, if any.

1.5 Stamp duty

Stamp duty was re-imposed under the Stamp Duty (Special Provisions) Act, No. 12 of 2006, effective from 4 April 2006. Stamp duty is chargeable on every specified instrument:

- executed, drawn or presented in Sri Lanka, or
- executed outside Sri Lanka which relates to property in Sri Lanka at the time of such instrument presented in Sri Lanka at rates prescribed in the Gazette.

1.6 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 Rs25m in the relevant quarter. The maximum ESC chargeable is Rs30m for a quarter.

ESC rates applicable for any quarter commencing on or after 1 April 2011 are as follows:

Category	ESC rate
Enterprises of apparel exporters, Board of Investment houses and manufactures of textiles for apparel exporters	0.1 %
Persons granted exemptions / concessionary rates / others who are:	0.25 %
<ul style="list-style-type: none"> a. exempt from income tax (including tax holiday companies) b. incurring losses during certain periods c. subject to tax under concessionary rates d. engaged in wholesale or retail trade other than products manufactured or produced by the seller (excepting distributors or dealers in motor vehicles or liquor) e. carrying out primary conversion of any tea, rubber or coconut plantation including desiccated coconut, coconut oil or fiber, copra and sheet rubber, but excluding any conversion which produces any alcoholic beverages 	
Advertising agents:	
<ul style="list-style-type: none"> • Prior to 1 April 2011 • On or after 1 April 2011 	1% 0.25%
Other business (e.g. dealers in motor vehicles, liquor, tobacco and petroleum) of which the turnover is defined by notice published in the Gazette	1%

ESC may be set off against the total income tax payable for the relevant year. Any remaining balance may be set off against the total income tax payable for the next four succeeding years. ESC is non-refundable.

1.7 Share transaction levy

Share transaction levy at the rate of 0.3% is imposed on the buyer and the seller on the turnover of the listed share transactions (the rate was 0.2% prior to 1 January 2011).

1.8 Stamp duty on unlisted shares

Stamp duty of Rs5 for each Rs1,000 or part thereof on the market value of unlisted shares is payable at the time of the issuance, transfer or assignment of such shares. Stamp duty is payable by the buyer or assignee of the shares.

1.9 Nation building tax

Nation building tax (NBT) is chargeable to every person (includes company, body of person or partnership) who is an importer of any article, carries on the business of manufacture of any article, carries on the business of providing services, or carries on wholesale and retail trading activity. NBT is payable at 2% on the liable turnover.

1.10 Other taxes

Excise duties and special excise levies are charged on tobacco, cigarettes, liquor, motor vehicles and selected petroleum products.

Customs duty as well as ports and airport development levy on imports.

1.11 Common forms of business

Business may be conducted in Sri Lanka in any of the following forms:

- Company incorporated in Sri Lanka as:
 - 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 entity carried out in Sri Lanka.

1.11.1 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 become a citizen of Sri Lanka:

- money lending
- pawn broking
- retail trade with a capital of less than US\$1m
- coastal fishing
- provision of security services including security management, assessment and consulting to individuals or private organisations.

1.11.2 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.

1.11.3 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
 - industry manufacturing poisons, narcotics, alcohols, dangerous drugs and toxin, hazardous or carcinogenic materials
 - industry producing currency, coins or security documents
- large scale mechanised mining of gems
- lotteries.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

Sri Lanka does not have specific 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 should be structured as a stock 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, 0.3% 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 33.3%

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 carried forward losses may only be set off against the profits derived from the same business.

The amount of losses incurred by a company in any year of assessment in any trade, business, profession or vocation, including any brought forward losses, may be set off only up to 35% of the total statutory income excluding any non-assessable income.

However, any losses incurred on or after 1 April 2007 from the business of life insurance can be set off against the profits from the business of life insurance included in the total statutory income. Similarly, from 1 April 2008 any losses 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 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%. If the asset is used in the business, the input VAT that is liable could be claimed, provided the asset is purchased from a VAT registered person.

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 Rs100,000 of the consideration and 4% on the balance of the consideration (or market value in the absence of a consideration) in excess of Rs100,000.

2.4.3 Share transaction levy

A levy at 0.3% is imposed on both the buyer and seller on the sale and purchase of listed shares.

2.4.4 Tax deductibility on 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 group companies is restricted in computing profits and income, for income tax purposes, in the debt-to-equity ratio of 3:1 for manufacturing companies and 4:1 for other companies.

3.2 Deductibility of interest

Stock deal

Prospective buyers can utilise domestic loans to fund an acquisition. However, restrictions are 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.

Asset deal

Interest incurred on loans used to acquire assets under an asset deal is tax deductible, provided such assets are used to generate income.

4. Mergers

There are no specific provisions relating to mergers. Specifically, the transfer of carry forward losses and unabsorbed capital allowances may not be made from the merging entities to the merged entity. Thus, when a company has substantial tax losses or unutilised capital allowances, subject to commercial considerations, the profit making company should 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 capital profits. 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 can be set off is restricted to 35% of the total statutory income, excluding any non-assessable income. Any losses 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 losses incurred in any business of finance leasing can 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 tax incentives, the business has to be acquired via a stock deal to ensure continued applicability of the incentives.

5.4 Group relief

No group relief system is available in Sri Lanka.

6. Disposals

6.1 The preference of sellers: stock vs. asset deal

From a seller's point of view, 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 Lankan company, the investor will not be exposed to income tax liability on any gains arising from sale of unlisted stocks.

However, listed stocks would attract a share transaction levy of 0.3% on the sale / purchase price from both the buyer and the seller. Unlisted stocks would attract a 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 on subsequent transfers of stock.

If the exit is via a sale of assets, the seller will be liable to income tax on the profits from 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

Gains from sale of listed and unlisted stocks are not liable to income tax.

6.2.2 Distribution of profits

See section 6.3.2

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 subject 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 unutilised 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 at 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, before 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, before 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 such 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. The 10% dividend tax paid will be the final tax applicable to any dividends distributed.

7. Transaction costs for sellers

7.1 Profit on sale of assets

An asset deal could involve the disposal of assets where depreciation, for tax purposes, has been deducted and the disposal of assets where 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%. 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. There is also a general restriction where the total allowable input tax can be claimed only up to 100% of the output tax with provision for the balance to be carried forward.

7.3 Stamp duty

Stamp duty 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 for certain expenses which may be attributed to the sale of inventories.

8. *Preparation of a target company for sale*

One way 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. *Demergers*

There are no specific provisions in relation to demergers. A demerger usually takes place through the sale of assets or a business. It is important to note that any brought forward losses and unabsorbed capital allowances may not be transferred. The implications for a demerger would be the same as an asset deal as discussed in section 2.

10. Listing / Initial public offering

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 Lankan company, the investor will not be subject to income tax liability on any gains arising from such sale.

However, listed stock would attract a share transaction levy of 0.3% on the sale / purchase price from both the buyer and the seller. Unlisted stocks would attract a 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 on subsequent transfers of shares.

If the exit is via a sale of assets, the seller will be liable to income tax on the profits from sale. From a tax efficiency perspective, a share deal is the preferred route.

Avenues where profits of the target company could be repatriated to the home country (other than by way of dividends), including interest, royalties, and technical and management fees. However, the tax authorities may not allow payments in excess of what is considered reasonable and commercially justifiable.

11. Tax incentives

Sri Lanka offers private investors fiscal incentives designed to stimulate investment, with the expectation that more investment in the Sri Lanka economy would enhance 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 currently offered by the BOI follow substantially similar incentives offered under the tax statute. Summarised below are the current fiscal incentives offered under the tax statute and under the BOI:

- agricultural and industrial projects
- infrastructure projects
- research and development
- new industrial undertakings in less developed areas
- new or upgraded cinemas
- new undertakings located in any lagging region
- undertakings in Eastern province
- agricultural undertakings

- new undertakings engaged in any prescribed activities under Inland Revenue Act:
 - agriculture or forestry
 - animal husbandry
 - manufacture
 - services (i.e. tourism, hotel services, development of any warehousing or storage facility, urban housing or town centre development, etc.)
 - any other manufacture of products or supply of services which could be considered as having economic benefits to the country and approved by the Minister of Finance
- dividend exemption
- other tax concessions (i.e. ship repair, ship breaking, repair and refurbishment of marine cargo containers, etc.) under the tax statute
- other tax incentives (i.e. export trading houses, export oriented services, regional operating headquarters, information technology, training institutes, etc.) under BOI regime.

Taiwan

Country M&A team

Steven Go (country leader)

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1. Introduction

1.1 General information on mergers and acquisitions in Taiwan

Since the new government took office in 2008, it has been encouraging foreign investment and promoting the domestic economy by the liberalisation of capital markets and relaxation of cross-strait relations with the People's Republic of China. A comprehensive tax reform programme has been implemented with the focus on simplifying tax administration and increasing global competitiveness. It is expected that these policy changes will create a more friendly business environment for prospective investors and encourage M&A activities.

Last year, Taiwan's Tax Reform Committee introduced a number of anti-tax avoidance measures. One of which is the newly announced Thin-cap Assessment Rules, effective from 1 January 2011. Under these new rules, the deductible interest expense on inter-company debt is capped at a prescribed inter-company debt-to-equity ratio of 3:1 (see section 4.1).

Rules for anti-treaty shopping were also introduced. Under the provisions, tax reduction benefits / exemptions provided under tax treaties will only be granted to the actual ultimate beneficial owner. The concept of substance-over-form was also officially introduced in the rules for the collection authority to adopt when assessing the applicability of a treaty benefit and other related regulations (see section 1.3).

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 their 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 (normally in the form of withholding tax).

Taiwanese and foreign corporations operating in Taiwan through branches are subject to progressive corporate tax rates depending on their level of taxable income prior to 2010. Starting from 2010, a single tax rate has been adopted and the corporate income tax rate is reduced to 17%.

Before 2010:

Taxable income	Corporate tax rate
NT\$50,000 and below	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 above	25% of taxable income, less NT\$10,000

After 2010:

Taxable income	Corporate tax rate
NT\$120,000 and below	Exempt
NT\$120,001 and above	17 % of taxable income

Pursuant to the Income Basic Tax (IBT) Act, companies (which are residents in Taiwan and foreign companies having a PE in Taiwan) and resident individuals have to calculate an IBT amount, also known as alternative minimum tax (AMT) under the relevant formula and compare such amount with regular income tax payable. If IBT / AMT is more than the regular income tax, taxpayers have to pay IBT / AMT.

Corporate vs. individual income taxes:

Item	Corporate	Individual
AMT rate	10 - 12%	20%
Tax exempt amount	NT\$2m	NT\$6m
Taxable base	Regular taxable income with adjustments for the following items: Plus <ul style="list-style-type: none"> 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 Enterprise Merger & Acquisition Law (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 <ul style="list-style-type: none"> losses deriving from domestic securities and futures transactions losses incurred by OBU 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 <ul style="list-style-type: none"> non-Republic of China-sourced as well as Macau and Hong Kong-sourced income over NT\$1m tax-exempt life or annuity insurance proceeds paid for death over NT\$30m tax-exempt capital gain on sale of non-listing and non-OTC (over-the-counter) 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 other tax-free income or deduction announced by the MOF Minus <ul style="list-style-type: none"> loss on sales of non-listed shares and non-OTC shares, private-placement shares, mutual funds, etc. 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.

1.2.1 Dividends

Taiwan adopts an imputation tax system in relation to the taxation of dividend income. The system is designed to reduce the overall tax liability of a shareholder in respect of dividends which have effectively suffered both corporate and individual income taxes. Under this system, 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 underlying corporate tax paid against their individual 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 a resident individual shareholder would, in turn, carry an 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 a dividend. This rule also applies to foreign investment approved (FIA) subsidiaries. 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 with no PE in Taiwan will normally be subject to withholding tax at the following rates:

Type of income	Tax rate
Dividends	20% (provided that foreign investment approval is obtained)
Interest	20%
Royalties	20% or 0% for approved royalties
Service fees / Rental	20% or 3% for approved technical services / equipment lease / construction
Commission	20%
Others	20% or 2% for approved international transportation services 20% for gain on sale of property

The 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 31 October 2011, tax treaties have been signed and come into effect with the following countries:

- Australia
- Belgium
- Denmark
- France
- Gambia
- Hungary
- India
- Indonesia
- Israel
- Macedonia
- Malaysia
- Netherlands
- New Zealand
- Paraguay
- Senegal
- Singapore
- Slovakia
- South Africa
- Swaziland
- Sweden
- UK
- Vietnam

As part of Taiwanese government's tax reform scheme, the MOF has issued the revised version of the Regulations Governing of Assessment Rules for the Application of Double Taxation Agreements (DTA Assessment Rules) in 2010. The DTA Assessment Rules stipulate, among other rules, a substance-over-form approach when assessing the income recipient's eligibility of any tax treaty benefits, despite the fact that all the necessary required documents may be in place. However, the revised DTA Assessment Rules failed to provide any further relevant explanations or guidelines in regards to the substance requirements.

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). VAT is applicable to general industries whereas non-VAT 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%, however it is anticipated that the rate may be increased by 1 to 2% in 2013. However, revenues derived exclusively from 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.

Type of business transaction document	Stamp duty rate
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 Taiwan companies, mutual funds issued by Taiwan 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 is 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\$5m per annum without obtaining prior approval from the Central Bank of China. However, if any single remittance in excess of US\$1m, 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\$50m 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). Any overseas investment of more than US\$50m requires prior approval from the ICMOEA. Any investment in the PRC (even if the investment is made through a third country) requires prior approval from the ICMOEA.

1.8 Common forms of business

Prospective investors intending to develop a business and conduct activities in Taiwan may choose to establish a business presence in the form of a company, branch office, representative office, job-site office partnership or sole proprietorship.

• Company

The Company Act of Taiwan provides four corporate forms of business to be established:

- unlimited liability company
- unlimited company with limited liability shareholders
- limited liability company
- company limited by shares.

There is no minimum capital requirement for limited companies under the Company Act, but a capital requirement may apply in certain sectors, such as banking. Except in certain restricted industries, foreign investors are generally allowed to set up companies in Taiwan after obtaining approval from the ICMOEA.

- **Branch office**

A foreign company may establish a branch office to conduct business in Taiwan. Unlike the corporate, a branch office is not deemed to be an independent legal entity. A company incorporated outside of Taiwan must first apply for recognition with the Department of Commerce of the Ministry of Economic Affairs (MOEA) and then complete the procedures for branch office registration.

- **Representative office**

Representative offices are generally easier to establish than a corporate subsidiary or branch office as they do not engage profit-seeking activities. A representative office is basically a legal agent of a foreign company that is permitted to engage in price negotiations, provide quotations, participate in tender and sign procurement agreements in Taiwan. There is no capital requirement for representative offices, but only businesses recognised by the MOEA as legally established companies in a foreign country may set up a representative office in Taiwan.

- **Job-site office**

A company intending to contract long-term construction work in Taiwan may find it preferable to set up a job-site office to coordinate all aspects of the projects, as well as for tax purposes. A job-site office need only apply to the local tax authority for business registration, not corporate registration, and is allowed to make purchases and issue government uniform invoices. However, it has the usual tax withholding obligations and must pay business tax and income tax.

- **Partnership / Sole proprietorship**

A foreign individual may invest in Taiwan by setting up a general partnership with one or more other individuals. A foreign national may also establish a sole proprietorship in Taiwan to conduct business. There is no minimum capital requirement for a partnership or sole proprietorship.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset deal

The Enterprise Merger and Acquisition Law (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 or asset deal depends on commercial considerations. In terms of tax costs,

a stock deal may be preferable as it generally incurs less tax costs than an asset acquisition.

2.2 Stock acquisition

2.2.1. Tax loss carried forward

The target company may continue to enjoy unutilised taxes losses carried forward that have been granted before the stock deal.

2.2.2 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.

2.2.3 Tax incentives

The target company may continue to enjoy unused tax incentives (i.e. investment tax credit, tax holiday, etc.) after a stock acquisition.

2.2.4 Others

Generally, as 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 the same after the acquisition.

2.3 Asset acquisition

2.3.1 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 17%. If the target company has tax losses carried forward, gains may be offset against the tax losses for corporate income tax purposes. The gains may be exempt if certain requirements are met pursuant to the EMAL.

2.3.2 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 not less than ten years and the goodwill shall be amortised over not less than five years.

2.3.3 Tax incentives

Generally, tax incentives (i.e. investment tax credits on qualified machinery and equipment, 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 / payable attributed to the target company.

2.4 Transaction costs

2.4.1 Value added tax

Stock deal

The transfer of stock falls outside the scope of VAT.

Asset deal

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 deal

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 deal

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 (i.e. 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 deal

Title deed tax is not applicable in respect of a stock deal as there is no transfer of the title of real estate.

Asset deal

The acquiring company should pay 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 deal

Land value increment tax is not applicable in respect of a stock deal as there is no transfer of land.

Asset deal

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 deal

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 not deductible to a Taiwan acquiring company.

Asset deal

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 it is 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 / asset acquisition

3.1 Stock acquisition

A stock deal does 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 does 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 15 years.

4. Financing of acquisitions

4.1 Thin capitalisation

The amended Income Tax Act was announced in January 2011, introducing the thin capitalisation rules. Subsequently, on 22 June 2011, the MOF promulgated the 'Thin-cap Assessment Rules' for implementation of the thin capitalisation rules, which is effective from 1 January 2011 and onwards. The salient points of the Thin-cap Assessment Rules are briefly discussed below:

- **Prescribed inter-company debt-to-equity ratio**

Tax deductible interest expense on inter-company debt is capped at a prescribed inter-company debt-to-equity ratio of 3:1.

- **Definition of related parties**

The term 'related parties' is consistent as defined under the Assessment Rules for Non-Arm's Length Transfer Pricing of Profit-Seeking Enterprises (TP Assessment Rules).

- **Scope of inter-company debt**

Such as loans provided by related parties and other types of financing directly or indirectly provided / extended by related parties.

- **Scope of 'equity'**

'Equity' is defined as 'interest-free' working capital for a branch where the foreign head office is located outside of Taiwan; whereas for an enterprise whose head office is located in Taiwan, 'equity' is defined as 'total equity' or 'paid-in capital plus additional paid-in capital', whichever is higher.

- **Disclosure requirements**

Except where the safe harbour rules apply, companies are required to disclose information related to their inter-company debt when filing their annual income tax return.

4.2 Deductibility of interest

4.2.1 Stock deal

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. For such 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 corporate income tax payable.

When a foreign loan is obtained, the payment of interest may be subject to interest withholding tax.

4.2.2 Asset deal

Interest incurred on funds used to acquire fixed assets generally needs to be capitalised and amortised in accordance with the nature of the assets. Since capital gains arising from the sale of land and marketable securities are exempt from income tax, the interest relating to the purchase of land and marketable securities is not deductible for corporate income tax purposes.

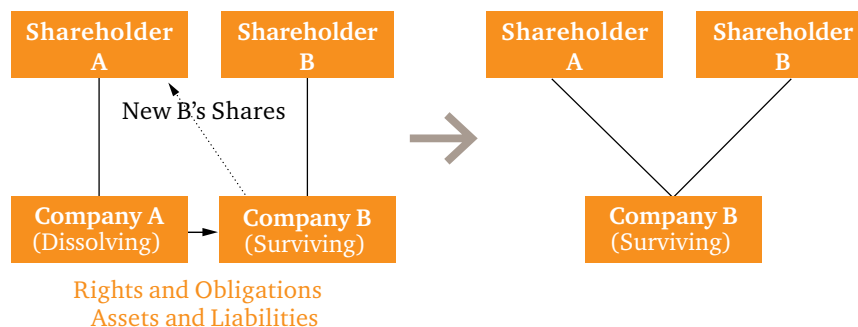
5. Mergers

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 (which expired at the end of 2009, and is replaced by the ‘Statute for Innovating Industries’ issued on 12 May 2010), 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 Financial Holding Company Law (FHCL) and Financial Institution Merger Law (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.

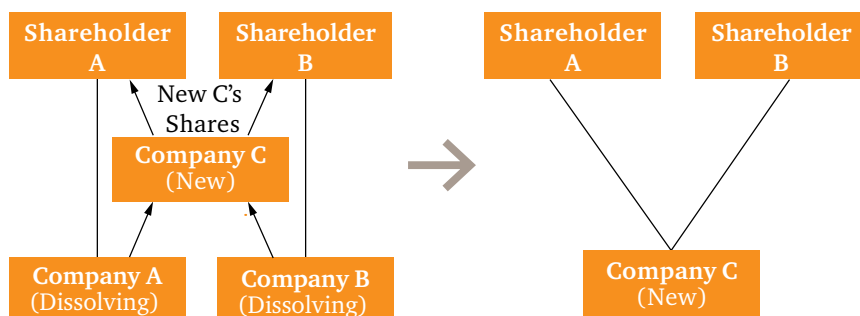
In the Taiwan context, a ‘merger’ could take place as follows:

Merger



In 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



Rights and Obligations
Assets and Liabilities

In 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.

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 profits. 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 these 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 their 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. As of 31 October 2011, Taiwan has entered into comprehensive tax treaties with Australia, Belgium, Denmark, France, Gambia, Hungary, India, Indonesia, Israel, Macedonia, Malaysia, Netherlands, New Zealand, Paraguay, Senegal, Singapore, Slovakia, South Africa, Swaziland, Sweden, the UK and Vietnam.

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 various means other than dividends. These include the payment of license fees, royalties, interests and management fees. However, the payment of such amounts may be subject to withholding taxes, which in general 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.
- 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.
- 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 are abolished at the end of 2009, except for tax incentive for the R&D tax credit which will continue to be available under the Statute for Innovating Industries.

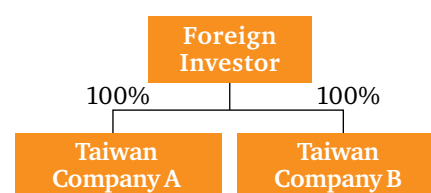
6.4 Group relief

After a 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.

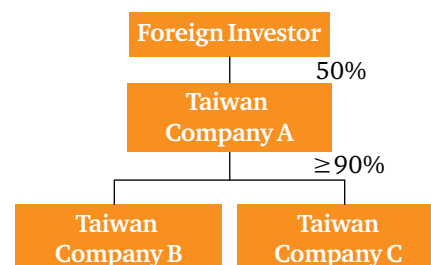
The group relief regime only applies to Taiwan companies and is not applicable to foreign companies.

Group relief may be diagrammatically illustrated as follows:

- No group relief available to Taiwan Company A and Taiwan Company B



- Group relief applies to Taiwan Company A, Taiwan Company B and Taiwan Company C



7. Disposals

7.1 Preference of sellers: stock vs. asset deal

A seller generally favours a stock deal for the following reasons:

- stock sale procedures are simpler
- gains on the sale of shares of companies limited by shares, are currently exempt from tax unless the seller is taxed on an AMT basis
- asset sales may result in corporate income tax on gains from the sale of assets.

7.2 Stock disposal

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, a 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 of 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 disposal

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 17% (25% prior to 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

See section 7.2.2.

8. Transaction costs for sellers

8.1 Value added tax

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 (i.e. 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 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 land value increment tax on 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, 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 (expired at the end of 2009 and is replaced by the 'Status for Innovating Industries' issued on 12 May 2010) 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 mergers and acquisitions

The EMAL provides for certain transaction tax concessions on mergers, spin-offs and acquisitions (see section 12.1). Furthermore, the FIML, the FHCL and the Statute 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 exempted from income tax.
- Deed tax for the purchase of buildings should be included in the purchase cost.

9. Preparation of a target company for sale

9.1 Declaration of dividend prior to 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 sale

Another means of extracting original investment cash in a company is by a capital reduction. Return of the principal investment amount will generally be exempted from tax. However, the company may lose qualification to enjoy some unutilised tax incentives due to the capital reduction.

10. Demergers

There are no specific provisions in relation to demergers. A demerger usually takes place through the sale of assets or a business.

11. Listing / Initial public offering

The sale of shares is exempt 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.

As long as the foreign businesses meet the relevant requirements, they can apply to list on the Taiwan Stock Exchange or the over-the-counter GrTai Securities Market. Both initial public offerings 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 EMAL and Statue for Upgrading Industries (replaced by the 'Statue for Innovating Industries') on Taiwan's M&A activities.

12.1 Tax incentives provided by the Enterprise Merger and 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 ten 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 / assets in subscription or the exchange of shares of another company is amortised over 15 years
- group taxation is available
- 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 under the Statue for Upgrading Industries, before it was abolished by the end of 2009, 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 centre
- withholding tax exemption granted for royalties paid to use technological know-how, trademark or patent of a foreign profit-seeking enterprise
- investment tax credit granted on expenditure for research and development and personnel training.

Currently, the only income tax incentive granted for doing business in Taiwan under the Statue for Innovating Industries issued, is the investment tax credit granted on expenditure for research and development.

Thailand

Country M&A team

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1. Introduction

1.1 General information on mergers and acquisitions in Thailand

As with most countries, M&A transactions in Thailand can take the form of an asset or stock acquisition. These transactions may give rise to a number of taxes in Thailand, including corporate income tax, value added tax (VAT), specific business tax (SBT) 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

– Old regime

If certain conditions are met, a ROH is subject to corporate income tax at a rate of 10% on certain income. A tax exemption is also granted for dividends received from its domestic and overseas affiliated companies.

– New regime

If certain conditions are met, a ROH is subject to corporate income tax at a rate of 0% and 10% on certain income streams for ten years (extended to 15 years with conditions). A tax exemption is also granted for dividends received from its domestic and overseas affiliated companies.

b. International Procurement Centre (IPC) established in Thailand

If certain conditions are met, an IPC is subject to corporate income tax at a rate of 15% for five consecutive accounting periods on qualified income.

c. Companies which applied for listing between 1 January and 31 December 2008 and are duly listed on or before 31 December 2009. They are subject to the following tax rate:

- 25% for companies listed on the Stock Exchange of Thailand (SET)
- 20% for companies listed on the Market for Alternative Investment (MAI)

These rates will apply for three 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. Other listed companies:

Companies listed on the SET

Net profit	Tax rate
฿0 - 300m	25%
Over ฿300m	30%

Companies listed on the MAI

Net profit	Tax rate
฿0 - 20m	20%
Over ฿20m	30%

These rates apply for three accounting periods commencing from the accounting period beginning on or after 1 January 2008.

Exemptions / reductions of corporate income taxes may also be granted to enterprises promoted by the Board of Investment (BOI). See section 12 for further details.

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 that 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 three 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.

A tax exemption is also available for dividends received from companies which have been granted a tax holiday by the BOI, 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 five accounting periods to offset against profits from all sources. There is no provision for loss carry back. Extended loss carry forward (effectively up to 13 years) is available under privileges granted by the BOI. Each company's losses are dealt with separately with 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:

Type of income	Tax rate
Dividends	10%
Brokerage, fees for provision of services	15%
Royalties	15%
Interest	15%
Rent from property	15%
Capital gains	15%

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 a tax holiday.

1.4 Valued added tax

VAT is levied on the import and supply of most goods and services. VAT is levied at a rate of 7% (from 1 October 2010 to 30 September 2012) on the total price of the goods delivered or services provided / 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 the 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. They are all subject to duty of 0.1% (without limit) and loan documents, subject to duty of 0.05% (limited to ฿10,000).

1.6 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 3.3% SBT (including municipal tax).

1.7 Common forms of business

Business in Thailand can be conducted in various forms:

- **Branch office**

A foreign company may conduct its business in Thailand in the form of a branch office. There is no special requirement for registration of a branch of a foreign company to carry out a business in Thailand. Nevertheless, certain business activities are restricted under the Foreign Business Act.

- **Joint venture**

A joint venture is a contractual relationship between two or more parties, one of which is a juristic person. It is normally organised to conduct a particular business project within a limited period. The joint venture is not recognised as a legal entity other than under the tax law where it is treated as a taxable entity in its own right. Hence, a joint venture is not separate from its partners, but considered as an unincorporated partnership for all legal purposes.

- **Limited partnership**

A limited partnership is a juristic person consisting of two groups of partners. One of which comprises those whose liabilities are limited to the capital contributed and the other comprises those who are, jointly and without limit, liable for all of the partnership's obligations. Only an unlimited liability partner can manage a limited partnership. If a limited liability partner participates in the management, then he becomes an unlimited liability partner.

- **Limited company**

There are two types of limited companies – private or closely held companies and public companies. The first type is governed by the Civil and Commercial Code and the second by the Public Company Act.

Private limited companies in Thailand are the most popular vehicles used to establish a permanent business in Thailand. A private limited company requires a minimum of three individual promoters. Although there is no established minimum level of capitalisation, the private limited company's capital must be sufficient to accomplish its objectives. All of the shares must be subscribed to and at least 25% of the subscribed shares must be paid up. The private limited company is required to have a capitalisation amount of ฿2m, fully paid up for each work permit of the company.

A private limited company may be wholly-owned by non-Thai nationals. However, in those activities reserved for Thai nationals, non-Thai nationals' participation is generally allowed up to 49%. Meetings of shareholders and directors must conform to the requirements set forth in the Civil and Commercial Code and / or the Articles of Association of the company.

2. Acquisitions

2.1 The preference of purchasers: stock vs. asset 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 an asset or stock 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, if 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 a recovery (with certain exceptions) of 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 and hire purchase contracts, etc.).

2.4.3 Specific business tax

Stock deal

A transfer of shares is not subject to SBT.

Asset deal

The sale of immovable property is generally subject to SBT at 3.3% 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 an entire business may be exempt from:

- corporate income tax
- VAT
- stamp duty, and
- SBT for the sale of an immovable property.

The main conditions for the exemption are:

- As per the Civil Code, there must be an amalgamation 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 business transfer, the transferor company must enter into 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 516) provided the partial business transfer is executed from 1 January 2011 onwards in accordance with the criteria, methods and procedures announced by the Director General of the Revenue Department.

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 the transferee company or vice versa, and includes cases where the transferor company holds not less than 50% of the shares with voting rights of another company which in turn holds not less than 50% of the shares with voting rights in the transferee company.

The status of an affiliated company must continue to exist for a period of at least six months from the fiscal year end in which the partial business transfer took place.

2.4.5 Tax deductibility of transaction costs

Acquisition expenses are typically not 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 stock / asset 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. However, 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 Thai target would continue to be liable to corporate income tax on the same basis as before the sale, i.e. there is no cost base step-up on the assets owned by the Thai 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 Thai 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 period to the purchaser.

Maximum tax depreciation rates are imposed by statute. The maximum rate for certain categories of asset are illustrated below.

Asset depreciation rates

Type of asset	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% per 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 research and development 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.
- Computer hardware and software may be depreciated within three accounting periods.

3.2.1 Goodwill

Goodwill purchased as a separately identifiable asset may be capitalised for tax purposes and depreciated over a period of not less than ten years.

No goodwill may be recognised for tax purposes on a tax free amalgamation or an entire business transfer.

3.2.2 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 from 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 the transfer pricing rules and civil law.

Certain debt-to-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.

Under 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. Mergers

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 from 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).

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 BOI.

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 BOI.

6.4 Group relief

There is no group relief or consolidated filing in Thailand.

7. Disposals

7.1 The preference of sellers: stock vs. asset 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 from Thailand, and is not subject to Thai taxation. If the exit route is a sale to a Thai resident or via SET, 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 an 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 section 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 may apply to a statutory merger of companies and the transfer of a company's entire business (see section 8).

7.3.2 Distribution of profits

Profits including capital gains may be distributed to shareholders as a dividend (see section 7.2).

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 if certain conditions are met.

8. Transaction costs for sellers

8.1 Valued added tax

See section 2.4.

8.2 Stamp duty

See section 2.4.

8.3 Specific business tax

See section 2.4.

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 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 a target for sale

In preparing for a deal, the seller should identify tax costs arising from the asset or stock deal. Tax concessions relating to mergers and acquisitions should be taken into account in order to minimise the tax costs. Positive tax attributes and the 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. Demergers

There are no specific provisions in relation to demergers. A demerger usually takes place through the sale of assets or a business. It is important to note that any brought forward losses may not be transferable. The implications for a demerger would be the same as an asset deal as discussed in section 2.3 and section 7.3.

11. Listing / Initial public offering

After acquiring a target, a financial buyer generally looks for an exit route either through a sale or an initial public offering (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 7.2.1.

12. Tax incentives

Tax incentives in certain industries eligible for promotion under the Investment Promotion Act and the announcements of BOI include the followings:

- Exemption or reduction of import duties on imported machinery.
- A reduction of up to 90% of import duties on imported raw or essential materials imported for manufacturing for domestic sale.
- Exemption from corporate income tax equal to the investment excluding the cost of land and working capital for up to eight years depending on the promoted activity and location.
- Exclusion of dividends derived from promoted enterprises from taxable income during the period of exemption from corporate income tax.
- Exemption from import duties on imported raw materials and components imported for manufacturing for export.
- Exemption from import duties on items imported for re-export.

Additional incentives for enterprises located in an industrial estate or promotion zone include the followings:

- Reduction of 50% of corporate income tax for five years after the termination of a normal income tax holiday or from the date of earning income if no tax holiday is granted.
- Double deduction from taxable income of the cost of transportation, electricity and water supply.

Vietnam

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1. Introduction

1.1 General information on mergers and acquisitions in Vietnam

In Vietnam, M&A transactions take the form of either share or asset acquisitions. Corporate income tax (CIT), value added tax (VAT) and capital assignment profits tax (CAPT) implications should be considered when structuring a M&A transaction.

The Vietnam tax environment is developing rapidly. The new CIT and VAT laws were introduced effective on 1 January 2009 with frequent updates and amendments to the tax regulations over the subsequent years.

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 that are involved in exploitation of precious minerals are subject to tax at rates ranging from 32% to 50% depending on the specific project.

1.2.2 Taxation of dividends

Dividends received by a Vietnamese company from another company in Vietnam are exempt from tax.

1.2.3 Tax losses

Taxpayers may carry forward tax losses fully for a maximum of five years.

Losses from non-incentivised activities can be offset against profits from incentivised activities and vice versa.

The carry back of losses is not permitted. There is no provision for any form of consolidated filing or group loss relief.

1.3 Withholding tax

Foreign companies carrying on business in Vietnam or having contracts with Vietnamese customers without establishing a legal entity in Vietnam are subject to 'foreign contractor withholding tax (FCWT), which includes VAT and CIT elements. FCWT 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 year 2009, certain services performed outside Vietnam are exempt from FCWT. Tax rates for some typical business activities are as follows:

Type of income	Effective VAT rate	Deemed CIT rate
Royalties	Exempt	10%
Interest	Exempt	10%
Transfer of securities	Exempt	0.1%
General services	5%	5%

There is currently no withholding tax on dividends paid by a Vietnamese company to overseas corporate investors.

Vietnam has currently signed double tax agreements (DTAs) with numerous countries which may provide some preferential withholding tax rates on the above.

1.4 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 as they pay import duties.

VAT rates are 0%, 5% and 10%. Certain goods and services are VAT exempt.

1.5 Stamp duty / Registration fees

Vietnam does not have stamp duty. Registration fees are applicable to transfers of certain assets and are generally born by the purchaser. Generally, the rates are as follows:

Type of asset	Stamp duty / Registration fee rates
Land and housing	0.5%
Ships and boats	1%
Deep-sea fishing boats	0.5%
Motorcycles	1 - 5%
Automobiles	2 - 20%
Shotguns and sports guns	2%

1.6 Capital assignment profits tax

Gains on transfers of interests (as opposed to shares) in a foreign invested or Vietnamese enterprise 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. Where the seller is a foreign company, the tax withholding and filing obligations rest with the purchaser (or the target if both seller and purchaser are foreign companies).

Gains earned by a foreign company (not incorporated in Vietnam) from transfers of securities (i.e. bonds, shares of public joint stock companies, etc.) are subject to CIT on a deemed basis at 0.1% of the total disposal proceeds.

Resident individuals are subject to 20% personal income tax (PIT) on gains from capital assignment and 20% PIT on the net gain or 0.1% on the sales proceeds from transfer of securities. Non-residents are taxed at 0.1% on the sales proceeds. Proceeds or profits from sales of securities will be entitled to a 50% PIT reduction from 1 August 2011 to 31 December 2012.

DTAs may provide protection from the above taxes.

1.7 Common forms of business

- **Single member limited liability company**

This is a limited liability company (LLC) owned by a single natural or legal person, such as another LLC, a joint stock company or a state-owned enterprise.

The owner's liability is limited to the extent of the amount of the charter capital of the company.

- **Limited liability company with two or more members**

This form of LLC may have up to 50 members. Members may be legal or natural persons.

A member's liability is limited to the amount of their capital contribution.

- **Joint stock company**

A joint stock company (JSC) issues shares and has a minimum of three shareholders but no maximum. It may be either private or public (listed or unlisted).

A shareholder's liability is limited to the total amount of subscription for the company's shares.

- **Partnership**

This involves at least two people who jointly conduct business under one common name either as limited or unlimited partners.

Unlimited partners are individuals who are liable for the obligations of the partnership without limit while limited partners are only liable for the debts of the partnership to the extent of the amount of capital they have undertaken to contribute.

2. Acquisitions

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 The preference of purchasers: share vs. asset deal

For a share deal, the purchaser will take over the target as is and generally retain all existing tax attributes (e.g. losses and incentives) in the target. Under an asset deal, the tax attributes are normally lost and the transfer procedures are more cumbersome and time-consuming (i.e. licensing of the new company's establishment, re-registration of ownership of certain assets and employees, etc.). For these reasons and subject to management of any risks remaining with the target, a share deal is generally the preferred option.

2.2 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.

2.3 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 to be effected at market value for tax purposes.

Tax recapture may be applicable under an asset deal, whereas there will be no such implications under a share deal.

2.4 Transactions costs

2.4.1 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.

2.4.2 Registration fees

Share deal

No registration fees are imposed on the transfer of shares.

Asset deal

For asset deals, registration fees are applicable to the transfers of certain assets as mentioned in section 1.5.

3. Basis of taxation following stock / asset acquisition

3.1 Share deal

A foreign investor who acquires shares of a domestic company bears no tax consequences. However, 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:

Type of asset	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 when certain conditions are met).

4. *Financing of acquisitions*

4.1 *Thin capitalisation*

Vietnam currently has no thin capitalisation rules for tax purposes (although there is a proposal to introduce a 5:1 debt-to-equity thin capitalisation rule in 2012).

The debt-to-equity ratio is specified in the business registration certificate, specifying the charter and loan

capital. There is no statutory minimum equity requirement except in certain sectors (e.g. banking).

4.2 *Deductibility of interest*

Interest on loans granted by lenders other than credit institutions and economic organisations 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. *Mergers*

Under Vietnamese regulations, one or more companies of the same type can be merged into another company by way of transferring all assets, rights, obligations and interests to the merged company and, at the same time, terminate 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. However, 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 if 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. Disposals

7.1 The preference of sellers: stock vs. asset deal

As noted above, a share deal entails less onerous transfer procedures without significant interruption to the target's operation or loss of tax attributes and this may provide a higher immediate value. A share deal may also enable proceeds to be paid offshore. Under an asset deal, the seller may need to be liquidated and the procedures involved may take several years to complete.

7.2 Stock sale

Gains on transfers of interests (as opposed to shares) in a foreign invested or Vietnamese enterprise 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. Where the seller is a foreign company, the tax withholding and filing obligations rest with the purchaser (or the target if both seller and purchaser are foreign companies).

Gains earned by a foreign company (not incorporated in Vietnam) from transfers of securities, (i.e. bonds, shares of joint stock companies, etc.) are subject to CIT on a deemed basis at 0.1% of the total disposal proceeds.

Resident individuals are subject to 20% PIT on gain from capital assignment and 20% PIT on the net gain or 0.1% on the sales proceeds from transfer securities. Non-residents are taxed at 0.1% on sales proceeds. Proceeds or profits from sales of securities will be entitled to a 50% PIT reduction from 1 August 2011 to 31 December 2012.

DTAs may provide protection from the above taxes. Use of dual tier holding structures may also provide a method to mitigating CAPT costs.

7.3 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 at the standard rate of 25%. 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 less transfer expenses.

8. Transaction costs for sellers

8.1 Value added tax

See section 2.4.1.

8.2 Registration fees

See section 2.4.2

8.3 Concessions relating to mergers and acquisitions

There are no concessions specifically for M&A transactions.

8.4 Tax deductibility of transaction costs

Transaction costs such as legal fees, costs to conclude the sale agreement, arrangement fees, and others that are supported with valid documents should be deductible against the sales proceeds.

9. Preparation of a target company for sale

9.1 Transfer of certain assets to another group company

Generally, the transfer of assets between group companies must be made at market value.

9.2 Declaration of dividend prior to 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. Demergers

There are no specific provisions in relation to demergers. A demerger 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 demerger would be the same as an asset deal.

11. Listing / Initial public offering

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 or 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 7.2.

12. Tax incentives

Tax incentives are granted based on regulated encouraged sectors and difficult socioeconomic locations. The sectors which are encouraged by the Vietnamese government include education, healthcare, sport / culture, high technology, environmental protection, scientific research, infrastructural development and computer software development.

The two preferential rates of 10% and 20% are available for fifteen years and ten years respectively, starting from the commencement of operating activities. When the preferential rate expires, the CIT rate reverts to the standard rate.

Taxpayers may be eligible for tax holidays and reductions. Tax holidays take the form of a complete exemption from CIT for a certain period beginning immediately after the enterprise first makes taxable profits, followed by a period where tax is charged at 50% of the applicable rate. However, where the enterprise has not derived profits within three years of the commencement of operations, the tax holiday or tax reduction will start from the fourth year of operation. Criteria for eligibility to these tax holidays and reductions are set out in the CIT regulations.

Additional tax reductions may be available for engaging in manufacturing, construction and transportation activities which employ female staff or ethnic minorities.

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