Introduction

- OECD has released and the G20 have endorsed the final reports on the BEPS Action Plan
- 15 focus areas reflect recommendations for significant changes in international tax law and treaties
- Impact on tax departments and tax compliance, but also on companies’ business models and strategic plans

Undeniable impact on International Groups’ M&A activities

AGENDA

1. What BEPS means for M&A-related tax risks
2. Why the traditional approach to tax due diligence should change
3. How M&A tax structuring should adapt
4. MARKET INSIGHTS
WHAT BEPS MEANS FOR M&A RELATED TAX RISKS?

Overview of BEPS
BEPS – a new global tax environment

**Objectives**

- Establishing international coherence in corporate taxation
- Restoring full effects and benefits of international standards
- Ensuring transparency while promoting certainty and predictability
- Turning tax policies into tax rules

**How?**

- **Action 1** – address challenges of digital economy
- **Action 2** – hybrid mismatches
- **Action 3** – CFC rules
- **Action 4** – limit base erosion
- **Action 5** – harmful practices
- **Action 6** – prevent treaty abuses
- **Action 7** – artificial avoidance of PE
- **Actions 8, 9 and 10** – value creation, intangibles, risk and capital, high risk transactions
- **Action 11** – data collection / analysis
- **Action 12** – disclosure of aggressive tax planning
- **Action 13** – TP documentation
- **Action 14** – dispute resolution mechanism
- **Action 15** – develop multilateral instrument
The new landscape is clear: across the world, every jurisdiction is amending its domestic tax legislation to implement BEPS inspired measures.
Typical tax due diligence process

- Vendor populates data room / releases VDD
- Advisor and Purchaser agree scope of DD
- Advisors reviews data-room / VDD and publicly available information
- Advisor organizes detailed review at a local country level
- Advisor asks questions of/meets with Vendor’s management and advisors
- Advisor collates individual country findings into a global report
- Advisor concludes that a Tax Indemnity is a good idea

The scope of the Tax DD is often driven by fee constraints rather than risk considerations

Focus is on historical events
Historical approach

Review what has happened
- Tax filings submitted on time
- Tax planning / transactions undertaken in the reviewed period
- Tax Authorities audits / enquiries

Identify errors / areas of uncertainty

Compare position to tax accounting

Seek protection for under-provisions / unrecognized tax risks

Elevate due diligence to more than just a « hygiene review »

Use due diligence to drive tax value into the M&A process:
- Assessment of enterprise value
- Risk allocation
- Post-deal integration

Why the traditional approach to tax due diligence should change?
A different approach is required

**Business model issues**
- Transfer pricing issues
- Permanent establishments

**Structural issues**
- Corporate residence
- Tax Treaties access

Focus as much on the future state as on historical periods & Challenge the Business Model
Flush out TP risks
Cast doubt on the substance of holding companies
Evaluate the use of special regimes
Evaluate the use of hybrids

**Re-shape the due diligence process to:**
M&A IN A POST-BEPS WORLD

BEPS – THREE KEY QUESTIONS

Are taxable profits being recognized in the right place?

Do taxable profits disappear?

Are tax reliefs abused?

Relevant BEPS actions

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<tr>
<th>PAST</th>
<th>FUTURE</th>
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<tr>
<td>Action 3 – CFC rules</td>
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<td>Action 4 – Interest expenses limitations</td>
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<td>Action 5 – Harmful tax practices</td>
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<td>Action 7 – Artificial avoidance of PE</td>
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<td>Action 8 to 10 – Transfer Pricing</td>
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<td>Action 2 – Hybrid mismatch arrangements</td>
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<td>Action 6 – Tax treaties</td>
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The tax due diligence approach must evolve
What does this mean for risk management?

<table>
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<tr>
<th>Requirement</th>
<th>Description</th>
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| Tax indemnity | - Financial limits  
- Time limits  
- Ongoing monitoring required |
| Deferred consideration / Escrow account | - Requires quantification of the issues  
- Requires mechanism to allow the issue to be resolved within a suitable time frame |
| Price reduction via:  
- Assessment of enterprise value  
- Locked box or completion accounts | - Requires close discussion with the deal team  
- Requires quantification / negotiation |
| Tax risk insurance | - Market still developing  
- May be cheaper than you think |
Insurance in M&A Deals

W&I insurance to cover unknown risks

- Good scope and quality of the tax DD process
- Coverage possible for specific tax indemnities

Overview of the Market

Coverage possible

- In M&A deals or not
- Coverage of identified tax issues
- Market updates
IMPACT ON DEAL STRUCTURING AND STRATEGY
M&A IN A POST-BEPS WORLD

Structuring an acquisition in a BEPS environment

The tax landscape governing financing and capital structures for international groups is changing. International groups will need to assess the impact, respond to change and report the impact.

Assess the impact
- Identify potential Hybrids and analyse local variation
- Model impact/consider strategy
- Anticipate potential changes in regulations
- Assess the impact taking into account potential tax reform scenarios
- Assurate group forecasts will allow effective modelling (include impact of responses to other BEPS actions)
- Understanding variation in jurisdiction's responses in key – scenario planning

Respond to change – Resset the Strategy
- Respond in line with group tax policy, strategy and governance, and group risk appetite
- Align with group profit forecast, other potential acquisitions
- Likely to be a short term (planning opportunities) or a long term strategy

Report the impact
- Groups will have to communicate their strategy to stakeholders and be ready for any further questions
- Verify solidity of holding structures
- Identify the communications (transfer of rulings, CBCR, TP)
- Evaluate the reputational risks attached to a structure

Actions 2 and 4
Interest deductibility / hybrids
Actions 5 and 6
Treaty abuse
Actions 11, 12, 13
Transparency disclosures

Overlay
CBCR
MLI
CFC rules
CASE STUDY

- Acquisition of a group of infrastructure assets
- Proposed acquisition of the entire share capital of UK HoldCo (Target Group in Green)
- Assets physically located in various EU jurisdictions
- Centrally managed investment, financing and services from UK HoldCo
M&A IN A POST-BEPS WORLD

Investor 1 (Jersey)

Investor 2 (Cayman)

Investor 3 (Holland)

Third Party Funder (UK)

PlatformCo (UK)

TopCo (UK)

HoldCo 1 (UK)

HoldCo 2 (UK)

HoldCo 3 (UK)

HoldCo 4 (UK)

Solar SPV 1 (UK)

Solar SPV 2 (France)

Solar SPV 3 (Germany)

Wind SPV 4 (Spain)

Share ownership
Debt Flows
Management Service Agreements
KEY BEPS RISK AREAS

- Tax residency of entities – do the activities of the Holding Company and associated directors impact on the potential tax residency of the overseas SPVs?
- Anti-hybrid arrangements - will the ownership structure of the ultimate investors and the provision of the intra-group financing fall within the anti-hybrid arrangements, either at a UK or overseas SPV level?
- Transfer pricing – the provision of the services through the MSA, and the associated financing through shareholder debt down to the overseas SPVs. What are the transfer pricing basis for the current treatments applied? What if any supporting documentation is prepared, including at a wider group level?
- Interest deductibility – beyond the application of the anti-hybrid and transfer pricing arrangements, what are the implications of the interest deductibility rules in the different jurisdictions and how have these been assessed?
- Controlled Foreign Companies – All within the EU for the purposes of the target group but do any other risks arise?
- SPA or other protections against risks arising?
- What about other taxes outside of Corporation Tax?
TAX STRUCTURING POINTS

For the acquirer there are a number of look forward considerations which will impact on the preferred structure:

- Existing transfer pricing policy?
- Local jurisdiction operation of SPVs vs centralised operation
- Nature of financing of the purchase – external funding, debt funding, capitalisation of existing financing – impact/importance of the tax shield
TAX STRATEGY

Is the bigger risk the historic risk or the future risk? The implementation

- Does the acquisition impact on the BEPS risk approach of the wider organisation?
- Does the acquisition structure need to change to fit the wider group tax risk profile or vice versa?
- Global footprint of the existing group and whether the post-acquisition re-structuring would provide efficiencies
- Are there BEPS specific areas which would need to be re-assessed in the light of the acquisition- for example transfer pricing policies for intra-group service provision.
INSIGHT INTO INFRASTRUCTURE

- Unprecedented levels of liquidity in the market creates increased pressured on deployment of capital, with a lack of supply of available opportunities
- Impact of wider organisational response to BEPS on commercial arrangements
- Trend towards consolidation of assets into larger portfolios – therefore a greater risk from BEPS
- Still not a great awareness in some commercial teams - Organisational disconnect
- Focus remains on historical risks and transactional costs from a tax perspective within commercial discussion – greatest cash impact is the integration within the organisation’s existing tax arrangements
- Growing requirement from our clients on sell side mandates to “get their house in order”.
About Mazars

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