Cross Border M&A tips and traps

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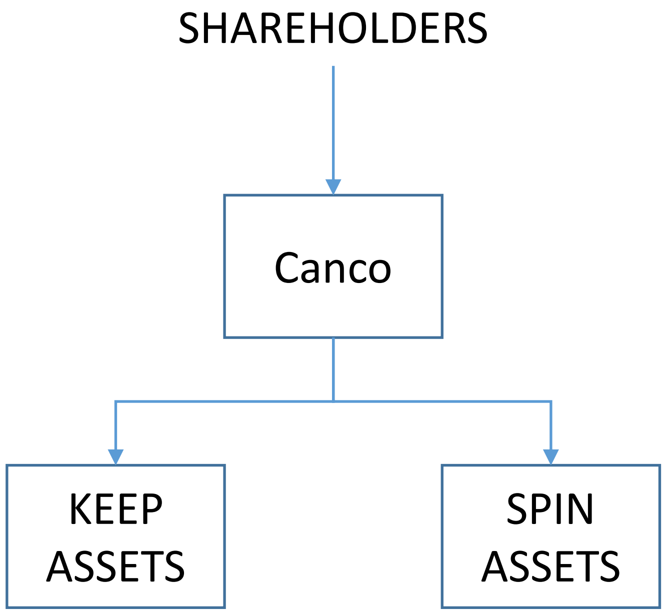
Cross Border Demergers & Spins

Canadian Spin-Off

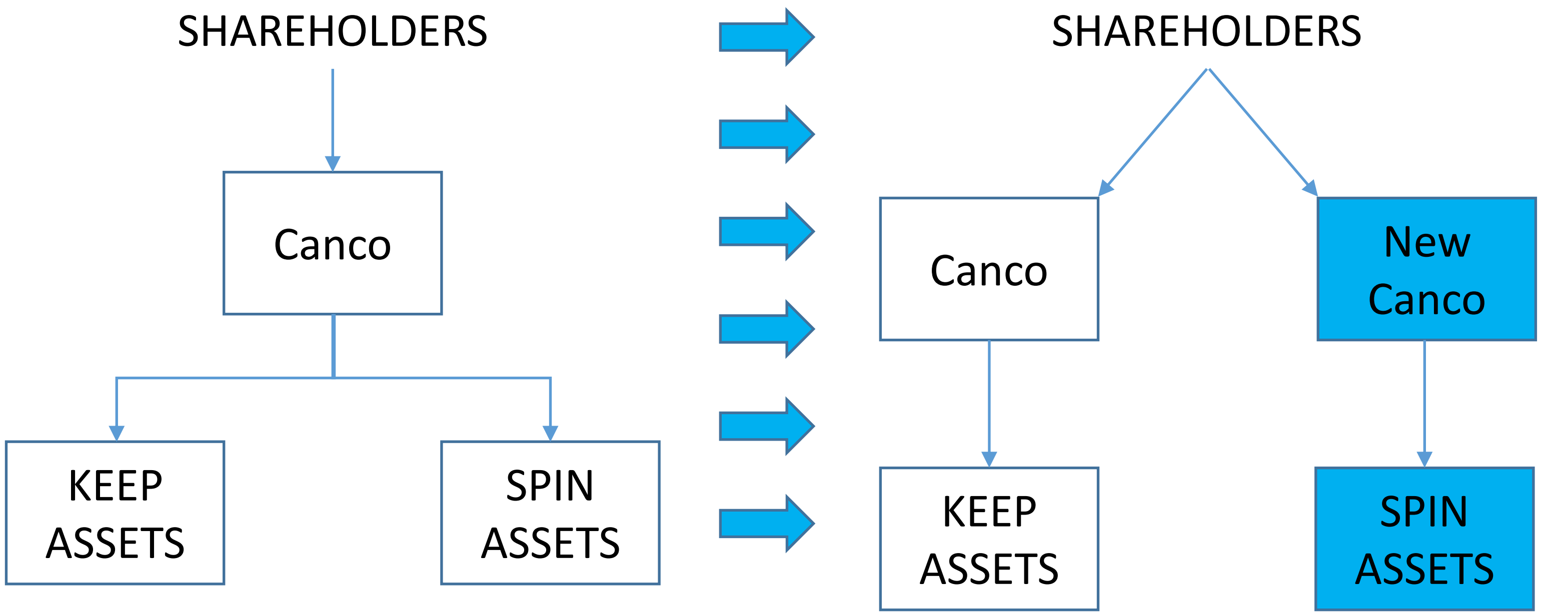
Canco desires to distribute its "Spin Assets" to its Shareholders



- Simplest form of transaction to complete the objective from a commercial perspective would be for Canco to make an in-kind distribution of the Spin Assets to its shareholders
- This would be <u>taxable</u>:
  - Canco would trigger any built-in gain in the Spin Assets and would be taxed in Canada on that gain
  - Canco would generally be viewed as having paid, and the shareholders as having received a dividend equal to the fair market value of the Spin Assets (unless Canco qualifies to effect the distribution as a return of paid-up capital, in which case the dividend amount could be the amount by which the fair market value of the Spin Assets exceeds the paid-up capital inherent in the shares on which the distribution is made) – income inclusion or withholding tax applicable

Canadian Spin-Off – Tax-Free "Butterfly" Reorganization

- Complex set of technical rules are available to accommodate a tax-free spin-off
  - Tax-deferral available if spin-off completed as a qualifying "butterfly" reorganization, with slightly relaxed rules in the context of a spin-off completed by a Canadian public corporation as compared to other corporations



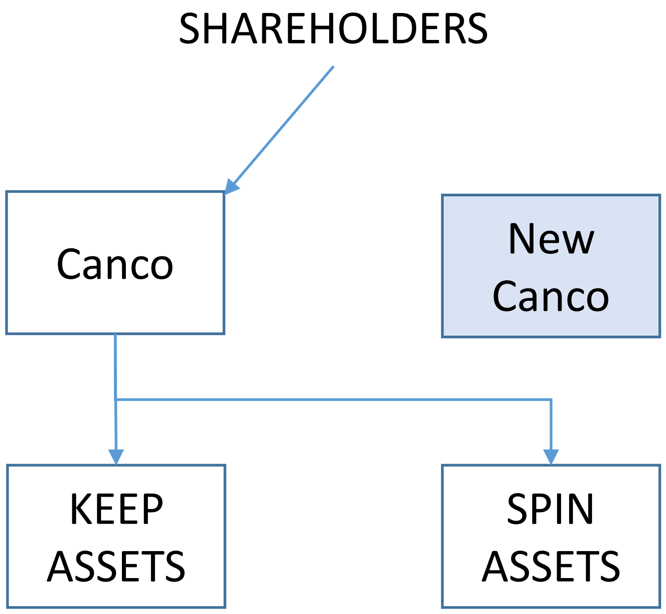
Why is it called a "butterfly"?

Early forms of simplified diagram depicting a qualifying divisive reorganization, including lines depicting the movement of assets, resembled the shape of a butterfly

Canadian Spin-Off – Tax-Free "Butterfly" Reorganization

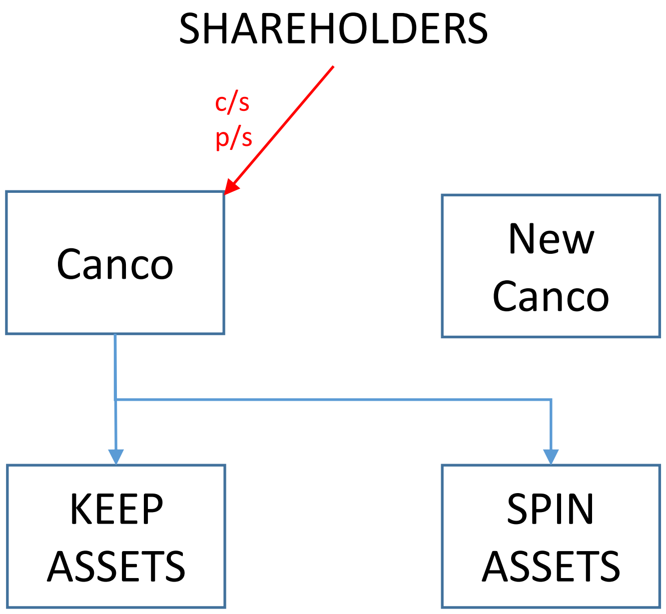
- From Point A to B in 6 General Steps

1. Incorporation of New Canco



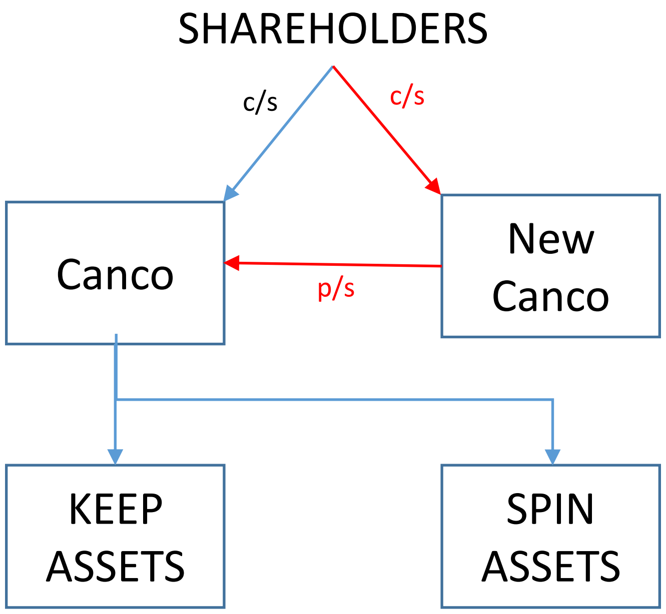
New Canco incorporated without share capital

2. Initial Share Exchange



Canco's articles amended to include new fixed-value preferred shares and new common shares; Shareholders exchange existing commons for new commons plus prefs with a redemption amount equal to net FMV of Spin Assets

3. New Canco Exchange

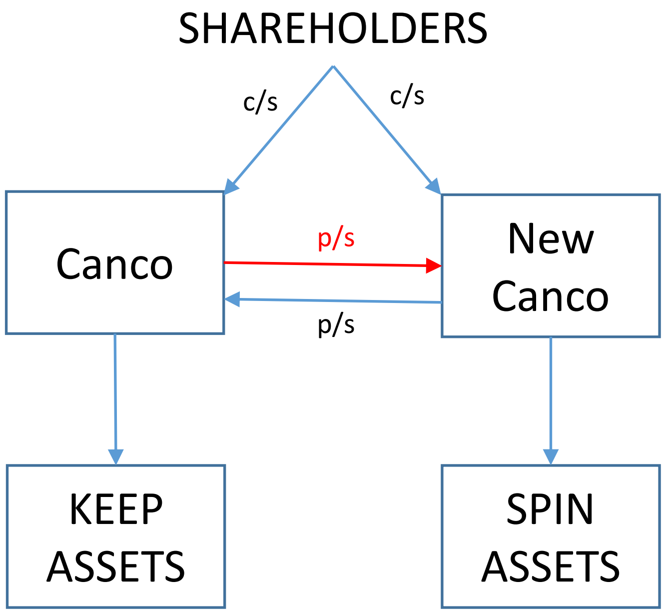


Shareholders exchange all of their Canco prefs with New Canco for New Canco common shares

Canadian Spin-Off – Tax-Free "Butterfly" Reorganization

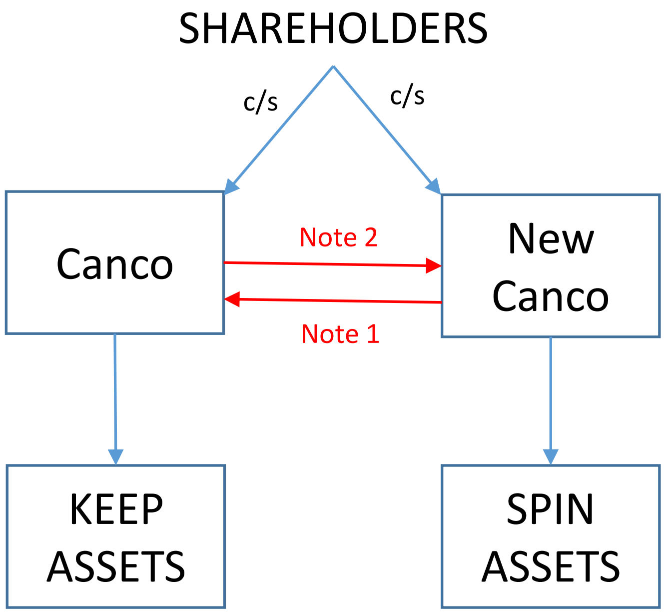
- From Point A to B in 6 General Steps (Cont'd…)

4. Transfer of Spin Assets



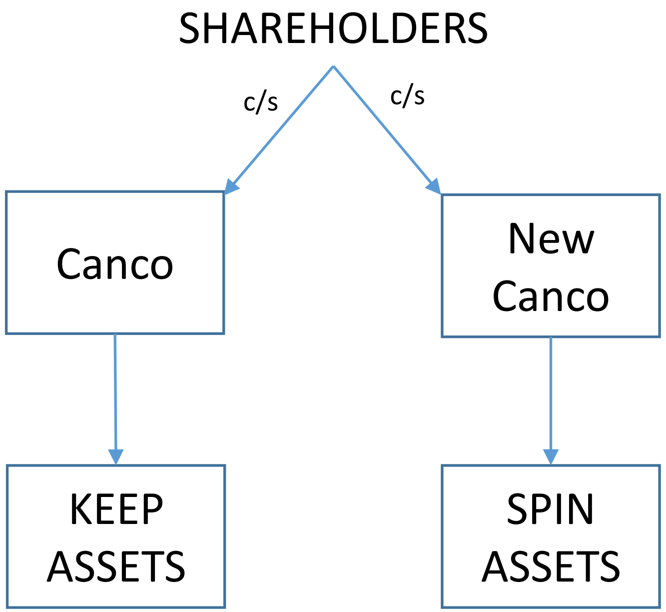
Canco transfers the Spin Assets to New Canco for New Canco Prefs (having a redemption amount equal to their net FMV) on a tax-deferred basis (section 85 election required)

5. Cross Pref Redemptions



Canco redeems the prefs held by New Canco for a Note ("Note 1") and New Canco redeems the prefs held by Canco for a Note ("Note 2")

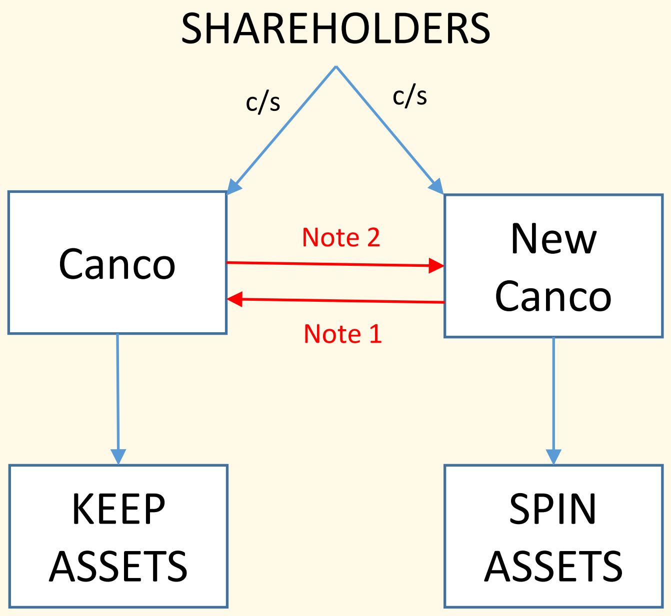
6. Note Set-Off



Note 1 and Note 2, having identical principal amounts (e.g. net FMV of Spin Assets) are set-off and cancelled

Canadian Spin-Off – Tax-Free “Butterfly” Reorganization

5. Cross Pref Redemptions



Canco redeems the prefs held by New Canco for a Note (“Note 1”) and New Canco redeems the prefs held by Canco for a Note (“Note 2”)

…The Key Step…

- Each redemption gives rise to a deemed dividend received by each shareholder (e.g. Canco and New Canco), which is generally deductible to the recipient corporation in computing income (e.g. tax-free intercorporate dividend)
- However, capital gains stripping rules can recharacterize the tax-free dividend as proceeds of disposition, leading to a taxable capital gain
- Provided that none of the technical butterfly denial rules apply and that the foregoing six steps are followed, each deemed dividend will not be recharacterized as proceeds
- Notes: (A) nothing in the rules currently requires any business purpose, (B) public company spin-offs are typically completed by way of a court-approved plan of arrangement, and (C) typical to proceed with a public company spin-off only after obtaining an advance tax ruling

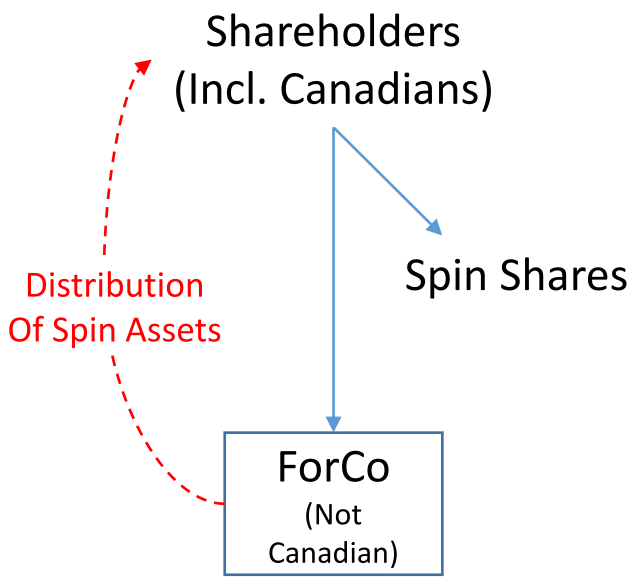
Canadian Spin-Off – Tax-Free "Butterfly" Reorganization

Three Broad Categories of Butterfly Denial Rules

Shareholder Continuity	Asset Continuity	Types of Assets & Anti-Stuffing

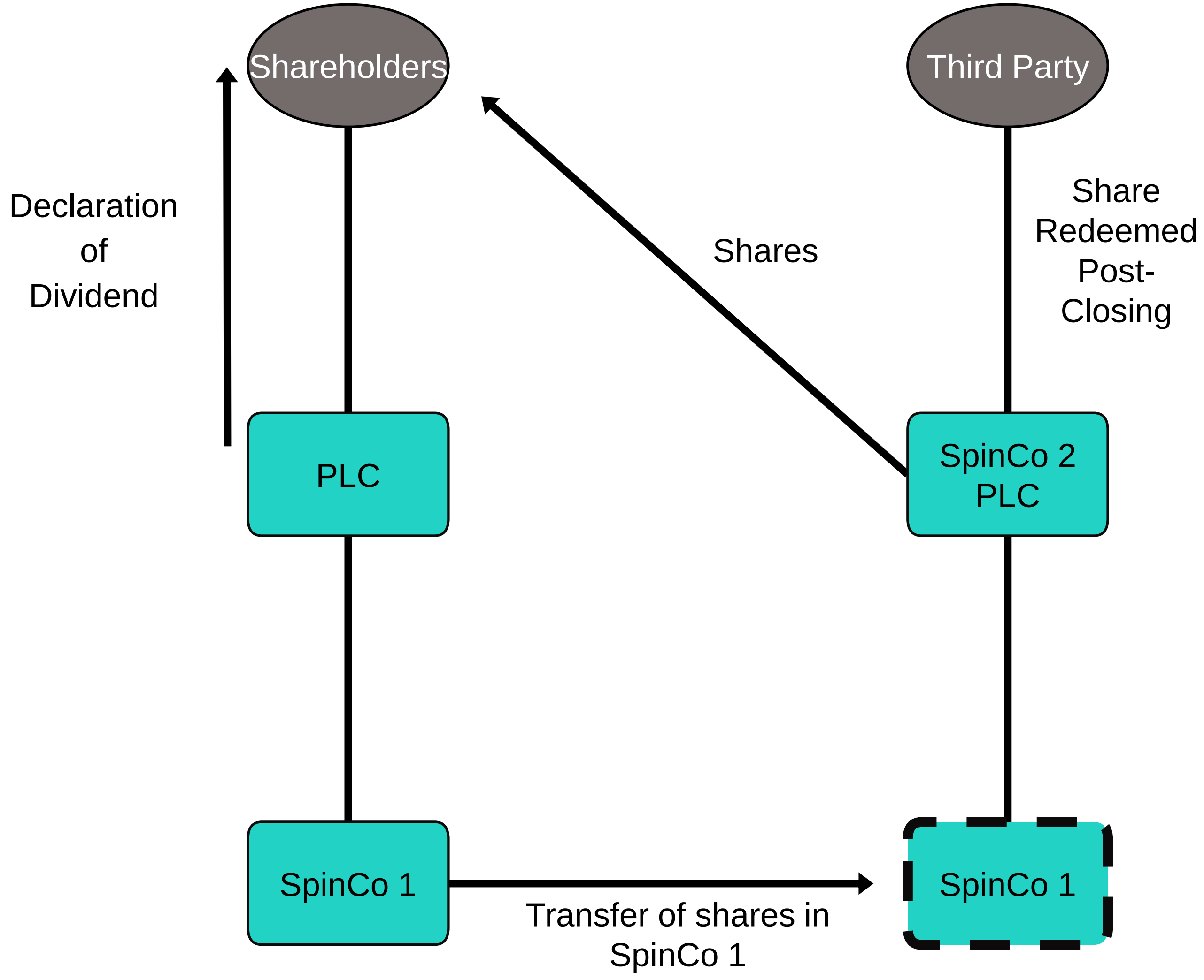
• Shareholders of the distributing corporation (e.g. Canco) and of the transferee corporation (e.g. New Canco) must remain substantially the same through the series of transactions that includes the reorganization
• In particular:
  • Generally, 10% shareholders of each cannot dispose of the shares to unrelated persons
  • There cannot be an acquisition of control of either Canco or New Canco
  • A transferee corporation cannot, very generally, acquire Canco shares from an unrelated person
	• Persons not related to Canco and Newco, as the case may be, cannot generally, as part of the series of transactions that includes the cross-redemption, acquire 10% or more of the assets remaining in Canco or the assets acquired by New Canco (including property the fair market value of which is wholly or partly attributable to such assets, as the case may be, and vice versa (e.g. the value of the keep or spin assets wholly or partly attributable to the property in question)	• A public corporation (or subsidiary) can spin-off any type of property (provided it is not split up within 3 years after) and the transferee corporation (e.g. New Canco in this example) does not split-up or spin-off for 3 years
		• Other corporations are further constrained in that they must spin-off a proportionate share of 3 types of property: (i) cash/near cash, (ii) investment property, and (iii) business property, to access the exception
		  • A further supporting rule generally prohibits these other corporations from acquiring property before and in contemplation of a spin-out in order to manipulate the proportions, except for on certain amalgamations, butterflies and internal related party transfers

Canadian Participation in a Foreign PubCo Spin-Off



- Distribution on the equity of a non-Canadian corporation (ForCo) is generally treated as a dividend in-kind and is taxable to Canadian resident shareholders for Canadian tax purposes unless it qualifies as an "eligible distribution"
- Eligible Distribution:
  1. Distribution on all the taxpayer's common shares of ForCo
  2. Distribution consists solely of common shares of another corporation owned by ForCo
  3. Either: **(A)** both corporations (ForCo and SpinCo) are resident in the US, the common shares of ForCo are widely held and actively traded on a designated stock exchange in the US or are required to be and are registered with the SEC, and the distribution is not taxable under the *IRC* to US shareholders, **or** **(B)** both corporations are resident in the same country other than the US, the common shares of ForCo are widely held and actively traded on a designated stock exchange, the laws of the particular foreign country provides its residents are not taxable on the distribution, and the particular distribution is specifically prescribed by regulation
  4. ForCo provides certain information/details to the Minister in Canada regarding the distribution within 6 months after the first distribution
  5. Canadian taxpayer files an election with tax return

Template Irish Spin-Off Steps – Irish SpinCo



1. A newly formed company is established with its ownership held outside of the PLC group.

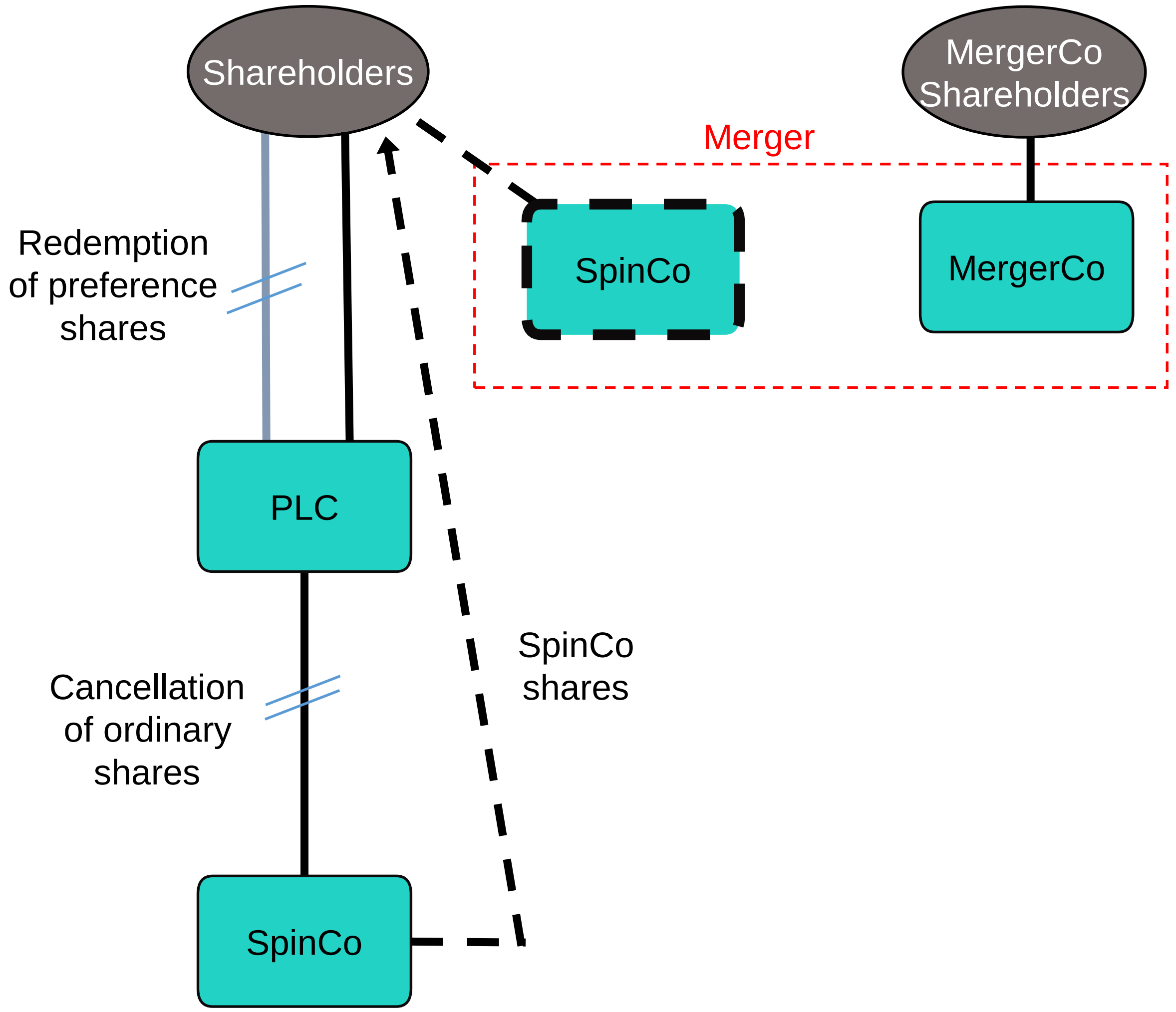
2. A pre-spin re-org is effected by plc group so as to separate the assets that are to form part of the spin transaction (held by SpinCo 1).

3. SpinCo 1 shares are transferred to SpinCo 2 Plc in exchange for the issuance of ordinary shares by SpinCo 2 Plc to the shareholders of PLC.

Irish tax reliefs available in respect of:

- Capital gains tax
- Stamp duty
- Dividend withholding tax

Spin Combined with Foreign Merger / RMT

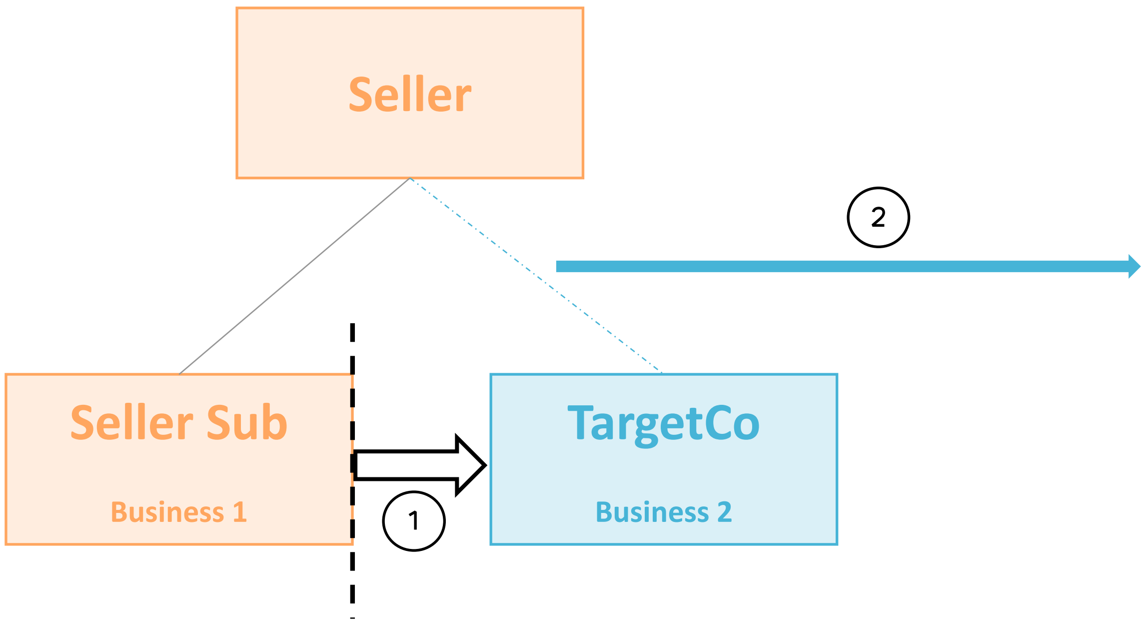


1. Preference shares are redeemed by PLC in exchange for SpinCo shares issued to shareholders.
2. SpinCo merges with foreign MergerCo

Irish tax considerations:

- SpinCo can be a foreign company
- Irish DWT treatment to be considered

Swiss Demerger/Spin



Seller Carve-out / Demerger

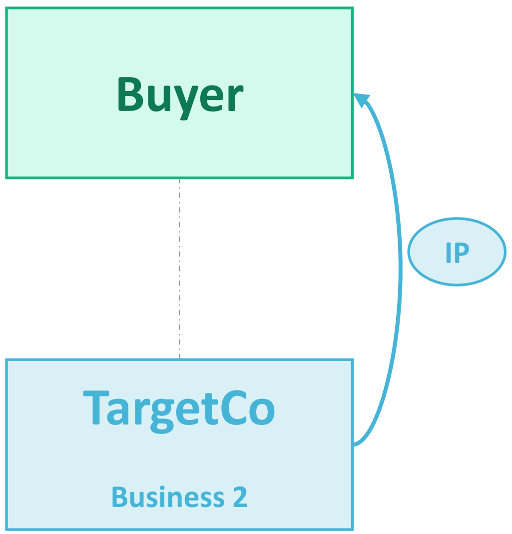
1

Demerger of Business 2 (Target business) to new TargetCo

2

Share Deal
SPA: Covenant to continue the operation of Business 2 for 2-3 years and tax indemnity

Swiss Demerger/Spin



Post-Closing Integration Buyer

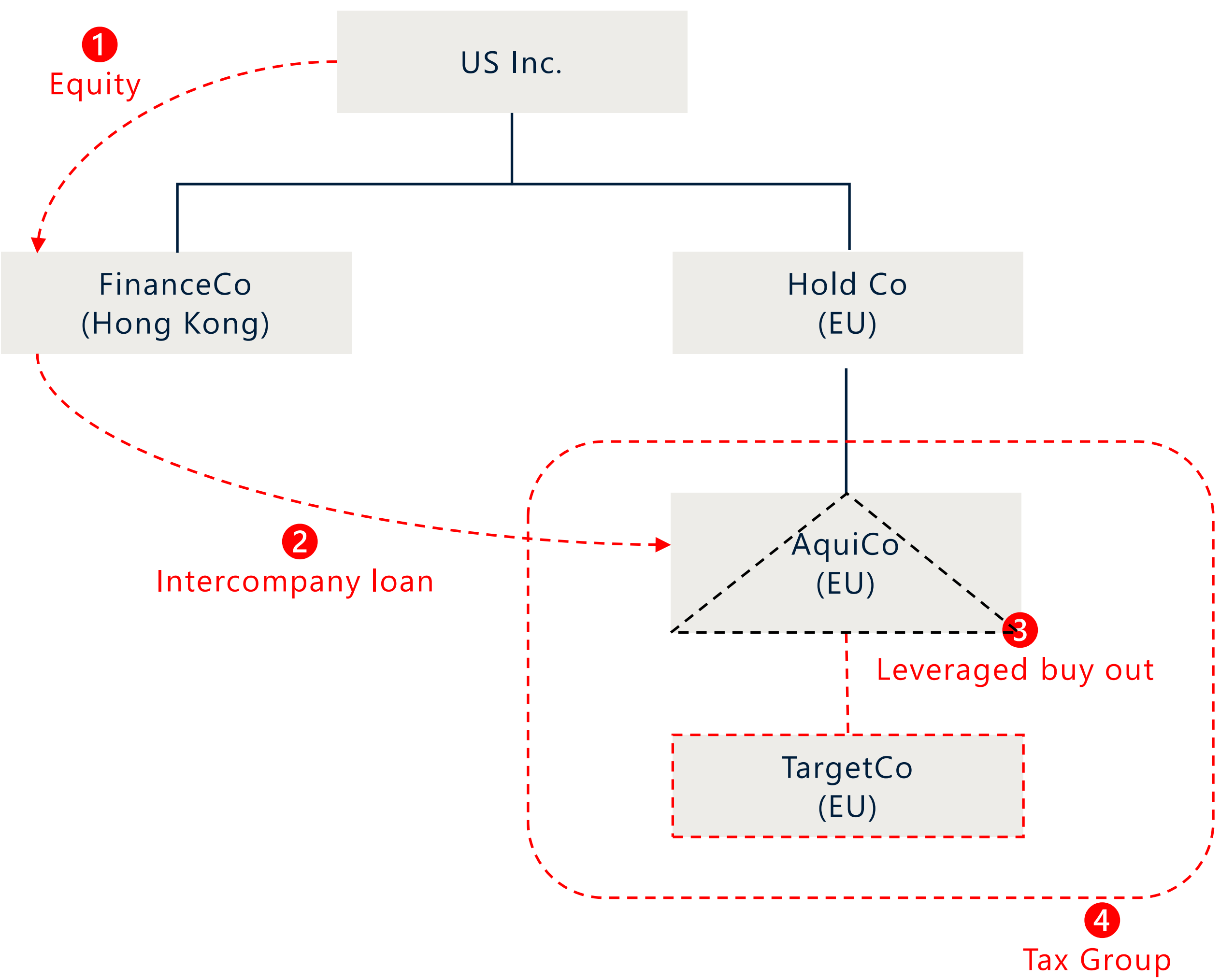
- Intragroup Transfer of IP at FMV
- Taxable gain TargetCo
- Step-up in basis Buyer

➔ **Pillar 2**

- FMV transfer ok (i.e. no tax neutral reorganization) [Sec. 6.3.1]
- Transition rule: no step-up for transfers during transition period, i.e. 2022 and 2023 [“basis = carrying value”, Sec. 9.1.3; subject to discussion…]

Cross Border Leveraged Buyouts

Cross border LBOs in an anti-leverage environment
Case study (1/2)



- US resident, public company acquires indirectly all shares in EU-resident TargetCo.
- Acquisition financing is provided through an intercompany loan bearing a fixed interest which is granted by FinanceCo which itself is fully equity financed.
- FinanceCo is solely tax-resident in Hong Kong, but low on substance in Hong Kong (no employees, directors, agents, bank accounts, physical office or other place of business in Hong Kong).
- Activities in relation to the intercompany Loan (reviewing, approving, signing and monitoring) are generally carried out by FinanceC outside Hong Kong in a U.S. branch.
- The interest income received by FinanceCo is not taxable in Hong Kong due to the territorial source tax regime, but included as GILTI or as "regular" CFC income in the tax base of US Inc.
- AcquiCo and TargetCo establish a tax group such that interest expenses incurred by AcquiCo can be off-set against operating income of TargetCo.

Cross border LBOs in an anti-leverage environment
Case study (2/2)

- Anti-hybrid rules: OECD Action 2 proposal and Articles 9 and 9b EU Anti Tax Avoidance Directive)
- Deduction/non-inclusion ("D/NI") mismatch?
  - Is GILTI (Global Intangible Low-Taxed Income) a relevant form of taxation that precludes a D/NI mismatch?
  - Does GILTI constitute a low taxation for purposes of ATAD rules?
- If there is a D/NI mismatch: Is it attributable to the "hybrid" characterization of the loan or taxpayer or allocation or attribution of the the interest income?
  - Intercompany loan is a plain-vanilla loan and viewed as debt instrument under all tax laws concerned.
  - FinanceCo is a corporation under all tax laws concerned.
- Transfer pricing rules
- Delineation of intercompany as debt or (hidden) equity injection?
- Limitation to "risk free return" if lender is "low function/risk" vehicle?
- Outlook: "tax haven blacklist" and"Debt Equity Bias Reduction Allowance (DEBRA)"

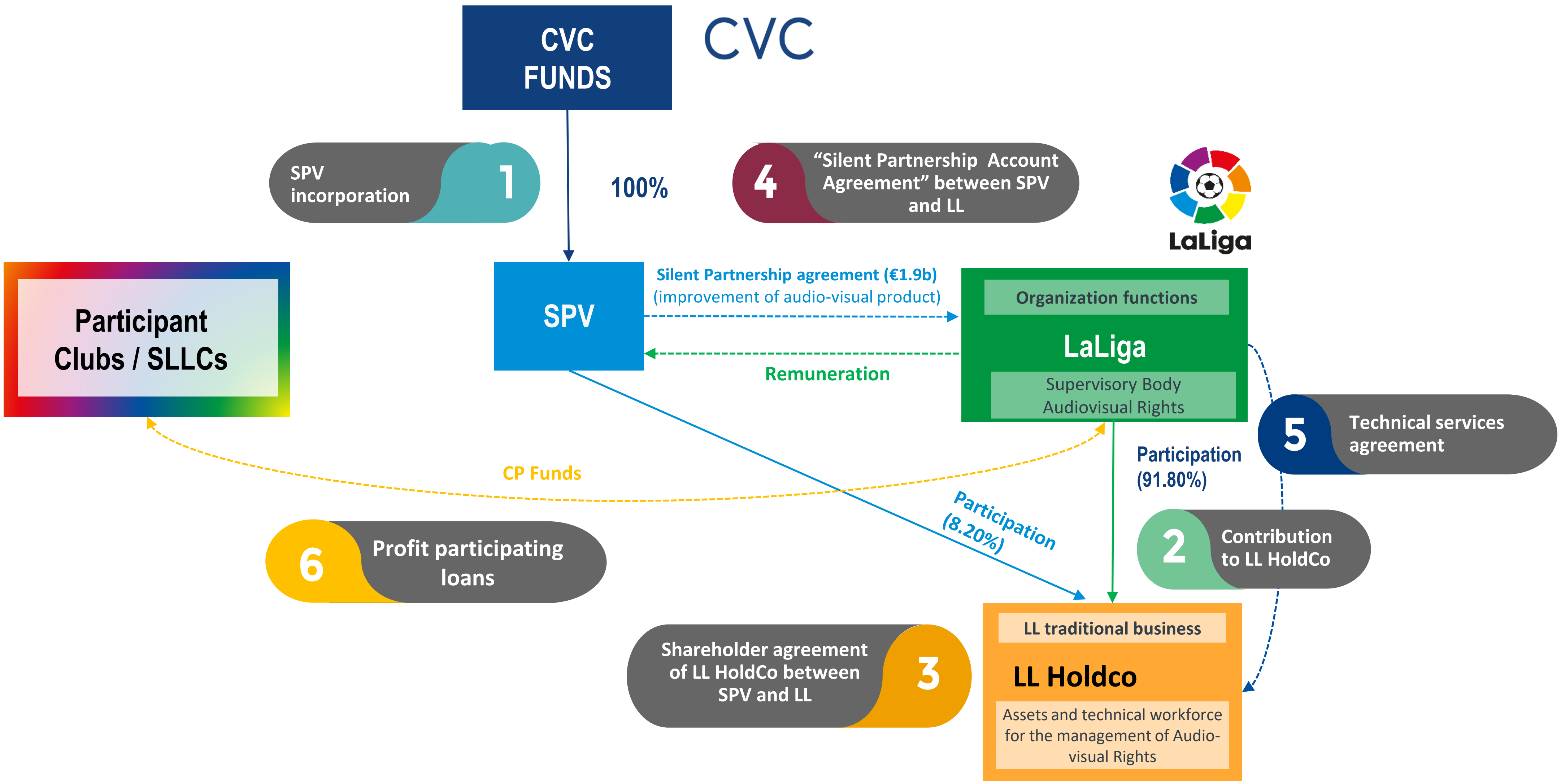
Cross Border JV’s

JV's Generally

Impact of Pillar 2 (P2) on joint venture structures and other cross border M&A

- Pricing/modelling
  - Impact of target becoming subject to/ceasing to be subject to P2
  - Standalone <€750m group more attractive to PE bidder than MNE bidder?
  - Beneficial impact of jurisdictional ETR blending
- Deal structure
  - Choice of TopCo jurisdiction
    - P2/non-P2
    - US tax rules + P2
  - Deal form: cherry picking assets
- Deal protection/allocation
  - Allocation of P2 tax cost in JVs
    - Should P2 tax cost in JV "caused" by JV partner be allocated to JV partner?
    - Should P2 tax cost arising in JV partner related to JV activity be reallocated to JV?
  - Recapture of deferred tax liabilities on private M&A sales
  - Conduct of disputes and information sharing

Alternative M&A / JV Investment Structure: LaLiga and CVC (1)



Alternative M&A / JV Investment Structure: LaLiga and CVC (2)

1

THE INVESTMENT FUND INCORPORATES A COMPANY (“SPV”)

- Domiciled in Luxembourg.
- Funds aimed to (i) the “Silent Partnership agreement”, and (ii) the equity in LL HoldCo.

2

CONTRIBUTION FROM LALIGA TO LL HOLDCO

- Traditional economic activity (excluding non-delegable activities); and
- Assets and technical workforce for the management of Audio-visual Rights.

3

DIRECT INVESTMENT BY SPV IN LL HOLDCO

- Cash capital increase – 8.2% participation in LL HoldCo.
- Shareholder’s agreement LL – SPV.
- Investment return as a dividend.

Alternative M&A / JV Investment Structure: LaLiga and CVC (3)

4

SILENT PARTNERSHIP ACCOUNT ("*CUENTAS EN PARTICIPACIÓN*") BETWEEN LALIGA (MANAGER) AND SPV (PARTNER)

- Disbursement in 6 instalments (including advance payment).
- 50 seasons.
- Variable annual return – approx. 8.2% of the net distributable income derived from the joint commercialization of Audio-visual Rights in each season.
- Non-participant clubs, RFEF and CSD receive for the Audio-visual Rights an amount equal to what they would have received if the Silent Partnership Accounts did not exist.

5

SERVICE AGREEMENTS BETWEEN LL AND LL HOLDCO

- Management support and technical advice services for the management of the Audio-visual Rights provided by LL HoldCo to LaLiga.

6

PROFIT PARTICIPATING LOANS TO CLUBS AND FINAL LIQUIDATION

- During the life of the Silent Partnership Agreement, funds are allocated to profit participating loans granted to the Clubs.
- Remaining funds for clubs rising up to 2nd Division and for 1st RFEF ("3rd division") clubs.

In-kind contribution to LL HoldCo

ACCOUNTING TREATMENT

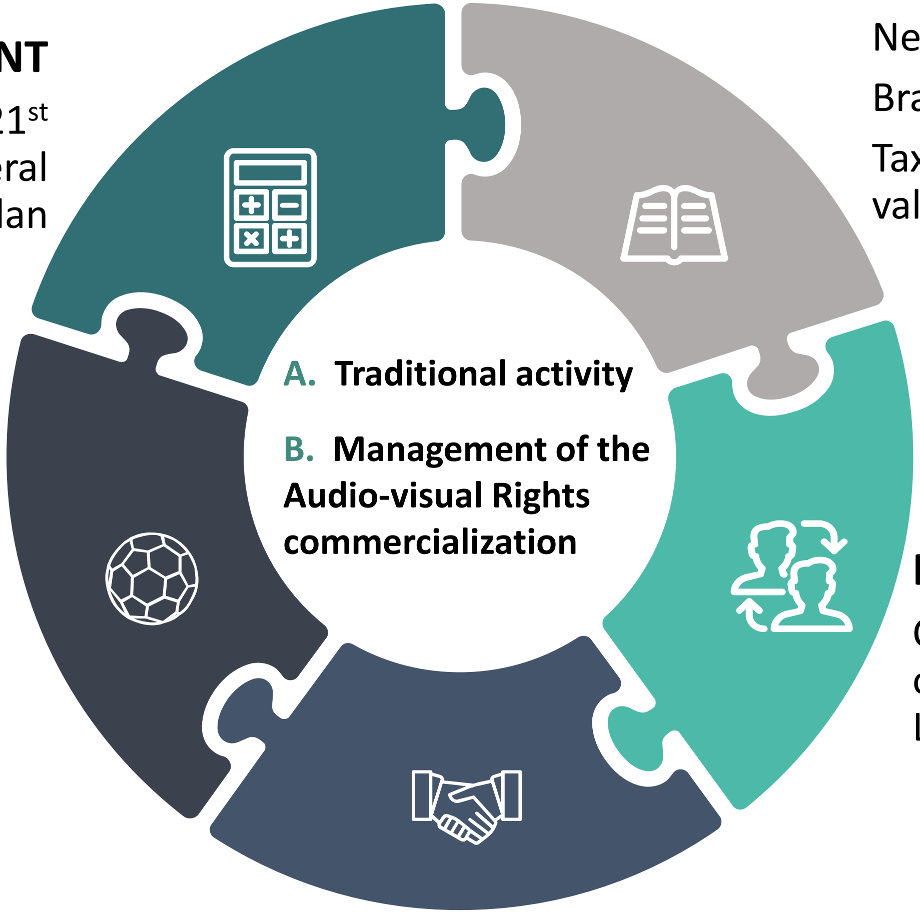
Recording and Valuation Rule 21st of the Spanish General Accounting Plan

CIT

Neutrality special tax regime

Branch of activity?

Tax on increase in urban land value?



VAT

Transfer of a going concern?

Binding ruling request to the Spanish General Directorate of Taxes

Spanish VAT group regime (simplified)

BUSINESS SUCCESSION

Certificates ex. article 175(2) of the Spanish General Tax Law

OTHER TAXES

Not subject to Capital Duty

Exempt from Transfer Tax and Stamp Duty

LL HoldCo, after the contribution

- **Shareholder’s agreement**: CIT consolidation regime.
  - *Tax sharing agreement*

- **Transactions LaLiga – LL HoldCo**: arm’s length principle + transfer pricing documentation.
  - Services agreements
  - Trademark license.

- **Shareholder’s remuneration**: dividends.
  - LaLiga: Participation exemption ex. article 21 CIT Law.
  - SPV: art. 14(1)(h) Non-Residents Income Tax Law — Anti-abuse clause?

Accounting treatment for LaLiga of the Silent Partnership Account

- **Recording and Valuation Rule 9ª of the Spanish General Accounting Plan / Institute for Accounting and Auditing Resolution of 5 March 2019.**
  - Financial liability (account 419 or similar), at cost.
  - Pending disbursements.
  - "Periodic settlements/liquidations" – Annual periodicity (8.2%).
    - Straight-line depreciation in 50 years.
    - Excess (or shortage) - **Remuneration**: operating expense (or income) — (accounts 651/751).
- **Institute for Accounting and Auditing (ICAC) ruling request.**
  - General remuneration criteria.
    - On the basis of compliance with the Business Plan of Reference.
  - Special criteria for the first 4 periods.
  - Accounting of the remuneration along the life of the Joint Venture Accounts Agreement?

Tax treatment of the Silent Partnership Account

CREATION

Exempt from Capital Duty

Not subject to VAT

REMUNERATION

LALIGA – CIT.

- Deductibility limitations

SPV – NRIT.

- ✓ Exempt ex. art. 14(1)(c) NRIT Law? — Withholding taxes?
- ✓ "Danish Cases" EU Court of Justice.

Not subject to **VAT**, if cash.

PERIODIC SETTLEMENTS

1% Capital Duty

Profit participating loans granted by LaLiga to its associates

- **Related parties: LaLiga - Clubs**
  - Only with the members of the Delegated Commission (management body).
  - Valuation at arm's length.
  - Internal comparable: remaining Clubs.
- **CIT**
  - For LaLiga, financial income.
    - It compensates the "financial" expense on the Silent Partnership Account.
  - For the Clubs, financial expenses. Deductibility limitations ex. art. 16 CIT Law.
- **VAT**
  - Pro-rata of LaLiga – Ordinary financial activity?
  - Alternatives: differentiated sectors of activity (*sectores diferenciados*) or Spanish VAT group regime (advanced).
- **Other taxes**
  - Not subject to Stamp Duty – they are not registrable.

Migrations

Migrations / Cross-Border Conversions

- Transfer of registered office between (EU member) states:
  - Regulation 2157/2001 on the Statute for a European company (SE)

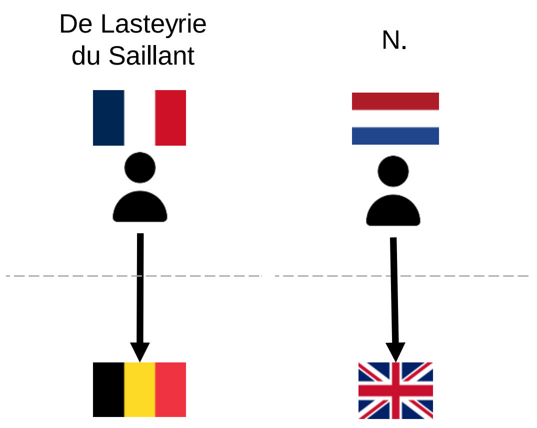
    Article 8: *"The registered office of an SE may be transferred to another Member State […]. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person."*

- Further important Secondary EU Law on Cross-Border Transactions:
  - Directive 2009/133/EC ("Merger Tax Directive")
    - Common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the cross-border transfer of the registered office of an SE/SCE
  - Directive 2016/1164 ("Anti Tax Avoidance Directive")
    - Article 5 – Exit Taxation
  - Directive 2019/2121 ("Mobility Directive")
    - Amending and expanding Directive 2017/1132 on cross-border conversions (resulting in the transfer of at least the registered office to the destination Member State)
    - Adoption by Member States until 31 January 2023

EU Case Law (CJEU) on Exit Taxation

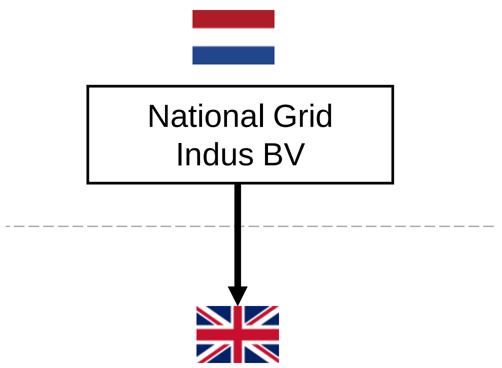
- Exit tax regimes are an expression of the European Member States' sovereignty in the field of direct taxation. The requirements for exit taxes, however, need to be compatible with EU law, especially the **Freedom of Establishment** as laid down in Article 49 Treaty on the Functioning of the European Union.

  - The "**De Lasteyrie du Saillant**" and the "**N.**" cases:
    - French and Dutch exit tax regimes applying to individuals were not in compliance with the freedom of establishment. Even restrictions of minor importance are prohibited by Art 49.
    - Discrimination (as in a domestic situation increases in value would have become taxable only when, and to the extent that, they were actually realized) can be justified by the need to preserve the allocation of the power to tax between Member States, but proportionality requires suspension of payment (1) without guarantees and (2) must take full account of post-exit decreases in value (losses).



EU Case Law (CJEU) on Exit Taxation

- The “**National Grid Indus BV**“ case:
  - In this case, the CJEU was for the first time in a position to clarify whether EU law was compatible with the exit taxes applicable to companies moving from one Member State to another.
  - The Netherlands applied an exit tax to companies transferring their place of effective management abroad. The taxation was determined at the time of the transfer without deferral and without the possibility to take into account subsequent decreases in value.
  - The CJEU considered that the Exit State may tax the profits and capital gains generated on its territory and is not obliged to take into account the decreases of value that may arise after the transfer of residence. However, an immediate recovery of the tax at the time of transfer is not proportionate. The Court instead preferred a system in which the Exit State grants the company the choice between either an immediate payment or a deferred payment of the amount of tax.



EU Case Law (CJEU) on Exit Taxation

- Subsequent decisions by the CJEU:
  - In "**Commission v. Portugal**", the Court reconfirmed that the Exit State has to grant exiting companies an option either to pay immediately the exit tax or to defer the payment, possibly with an interest charge.
  - In "**Commission v. Netherlands**", the Court confirmed the prohibition of an exit tax regime providing exclusively for immediate payment of the tax. In "**Commission v. Spain**", the Court held that the Exit State has to grant the tax deferral automatically. Both cases related to business assets / companies.
  - In the "**DMC**" case, which can now be considered the lead case, the CJEU upheld an exit tax system granting exiting companies the choice between immediate taxation or to spread the tax over a period of five years. The Exit State may charge interest and require the taxpayer to provide a guarantee, however, under the condition that the risk of non-recovery is real and assessed. Similar situation and decision by the CJEU in the case "**Verder LabTec**" (ten years).

Overview - Exit Taxation Situations

Individuals moving from one State to another	▪ The change in tax residence changes the taxation rights between states. ▪ Gains from the alienation of assets (except immovable property) are typically taxed in the State the taxpayer is resident.
Transfer the Place of Business	▪ Business profits of an enterprise are typically taxable only in the state of residence unless the enterprise carries on business in another state through a permanent establishment.
Moving Business Assets from one State to another	▪ Since profits related to permanent establishments abroad are typically taxable in that foreign state (and not in the state of residence) the (permanent) transfer of business assets to another state often restricts the taxation rights of the state of residence.
Companies transferring its seat / POEM to another State	▪ The transfer of the registered office (statutory seat) from one state to another state may change the taxation rights between states. Even if no simultaneous transfer of assets between states is taking place, the company is deregistered in the Exit State. In case of a transfer of the place of effective management, taxation rights between states usually change.

Overview - Exit Taxation Situations

Assets that remain attributable to a PE	▪ Since profits related to permanent establishments are typically taxable in the state where the PE is located, a change of the state of residence without transferring assets to another state should not restrict the taxation rights of the former state of residence.
Assets not attributable to a PE	▪ Such assets are typically taxable only in the state of residence. Practical examples could be a goodwill or IP rights. Such assets usually trigger an exit tax.
Real Estate	▪ Since profits related to real estate are typically taxable in the state in which the real estate is located, the taxation rights of the former state of residence should not be restrict.
Participations	▪ Since such assets are usually not attributable to a PE, the taxation rights between states are usually allocated to the state of residence. Accordingly, this usually results in a restriction of taxation rights of the former state of residence (always for foreign participations). ▪ Participation exemptions to be analyzed, according to which an exit gain may be exempt.