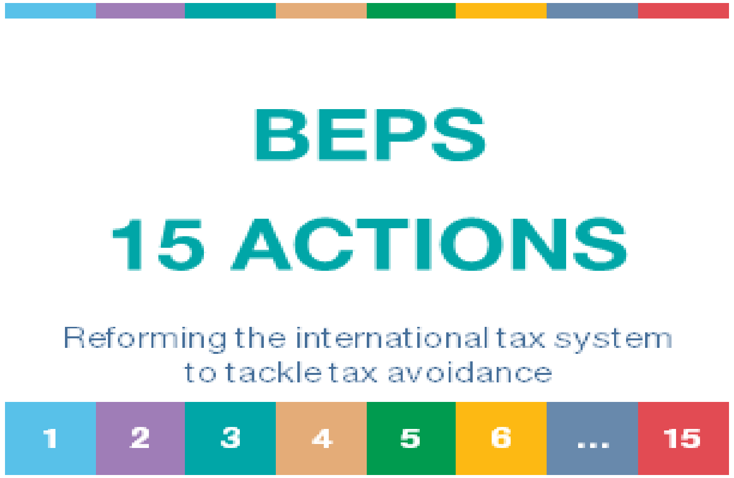
M&A OUTLOOK - POST BEPS

International Tax Refresher Course

WHY BEPS? AND BEPS IMPACT



NOT AGAINST:

- a low rate of tax;
- seeking to harmonize tax policy;
- directed against tax competition.

BUT ABOUT:

- Coherence – Alignment of different Jurisdictions
- Substance – "fair share of taxes"
- Transparency – Data of global activities

- Dell case (Spain SC)
  - Restructured to low-risk distribution: FAR transferred to Principal
  - Principal – no substance – no employees/office
  - No clear separation of FAR between AEs
  - "At the disposal" test met
  - Origination point for BEPS discussion
- Tokyo case
  - Warehouse as such preparatory / ancillary activity
  - Maintained with substantial capital investment
  - Quick delivery played an important role in online shopping = PE
  - Considered BEPS impact
- Pfizer merger with Allergen
  - Intended to transfer ownership of IP from US to Ireland i.e. HO of Allergen
  - Impact of BEPS – US introduced tax inversion
  - Deal went off

WHY BEPS? AND BEPS IMPACT

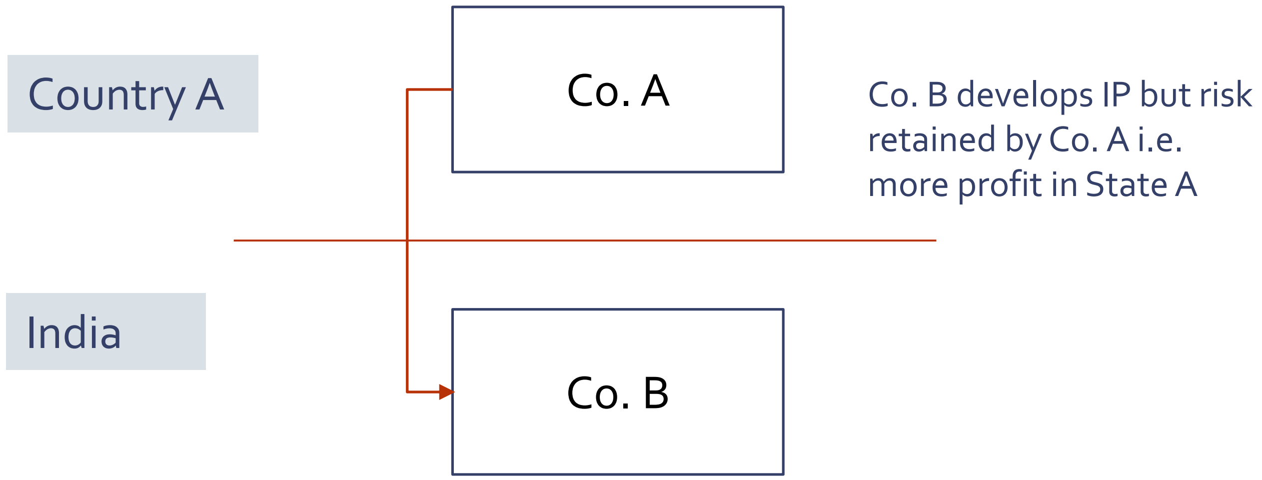
NOT AGAINST:

- a low rate of tax;
- seeking to harmonize tax policy;
- directed against tax competition.

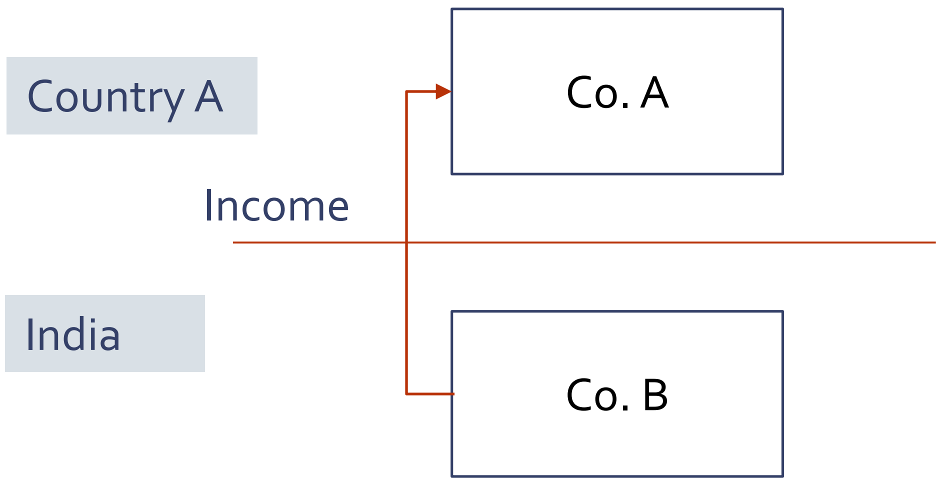
BUT ABOUT:

- Coherence – Alignment of different Jurisdictions
- Substance – “fair share of taxes”
- Transparency – Data of global activities

- UK Patent Box regime – OECD Challenged
- Apple/Google/Starbucks structure: US revenue but IP in Ireland with POEM in US.
- US MNC transferring senior employees to Ireland (IP ownership)
- Double Irish / Dutch Sandwich structure no longer applicable
- Cost Contribution Agreement for IP and treatment of risk – far from economic reality



TREATY ENTITLEMENT



Refer to pg. 23, 25, 26 of Final Report

Treaty Entitlement depends upon the following:

- Resident of one of the State
- Income recipient
- Person as defined in Treaty

Under BEPS, the above rule not applied anymore

New rules on Treaty Entitlement: [LOB+PPT rules]

- Qualified Person [all income from Source State]
- Qualified Activities [an item of income]
- Residuary [Equivalent Benefit]

Inbound Investment: LOB + PPT (if apply) / BO

Outbound Investment: GAAR and POEM (if apply)

Summary of the BEPS Anti-treaty abuse rules

Proposal	Conditions for treaty benefits	Exceptions
Limitation on benefits (LOB) – Art. 22 US TT	The resident person must • Be qualified person in relation to R Co.; OR • Pass an active trade or business test in R Co.; OR • Be more than 95% owned by 7 or fewer equivalent beneficiaries in other countries and pass a base erosion test ("derivative benefits rule")	Obtaining treaty benefits was not one of the principle purpose for establishing or operating the person (discretionary powers)
Principle Purpose Test (PPT)	Obtaining treaty benefits must not be one of the main purposes of the arrangement or transaction	Granting the benefit would be in accordance with the object and purpose of the relevant provisions of the treaty (discretionary powers)
3rd Country PE Test	For income earned via a 3rd country PE, the total tax rate in the residence and PE countries must be more than 60% of the residence country's general tax rate	For royalties: IP was developed through PE For others: PE passes the active trade or business test in the PE country

LOB clause

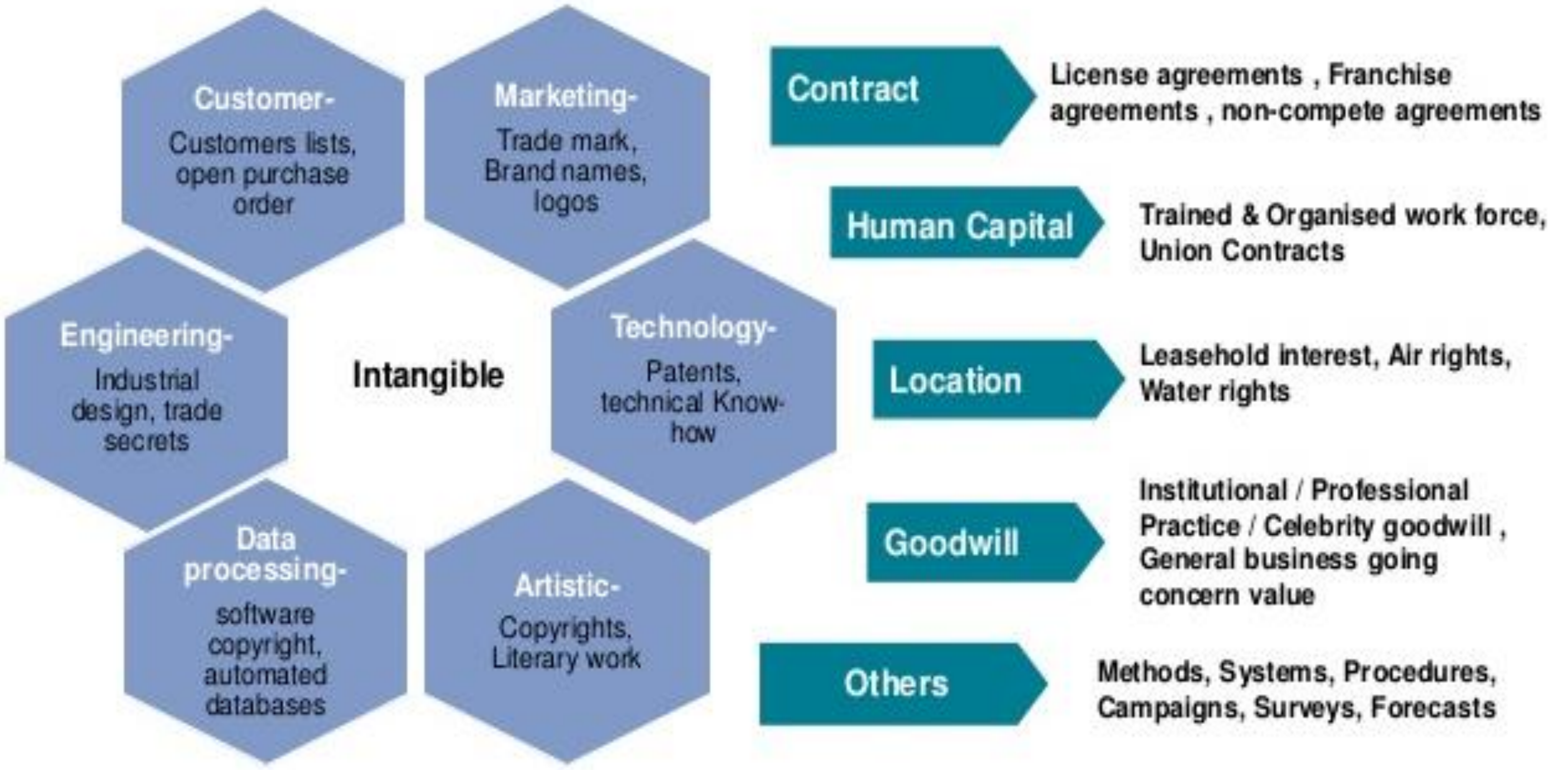
Concept	Summary		
Qualified Person	Type A	Type B	Type C
	Resident individuals, government entities, charities and pension funds (a, b, d) R Co. listed on RSE and primarily traded / managed in R State (c(i))	R Co. Subsidiary (50%) of qualified listed company (c(ii))	R Co. and satisfying ownership and base erosion test (e)
Active Trade or Business Test	• The resident is engaged in active conduct of trade or business in R Co. (making or managing investments is generally insufficient) • Income is unconnected with or incidental to that trade or business and • R Co. activities are substantial relative to S Co. activities of the resident person/affiliates Note: activities conducted by connected persons are also taken into account		
Derivative benefits	Resident of 3rd country (equivalent beneficiary) would be entitled to the same or better relief under the 3rd country's treaty with S. Co. (compared with R Co. with S. Co.) and a base erosion test is passed		
Base erosion test	Resident and qualified shareholder (50% ownership) and deduction of not more than 50% to non-qualified person in third state		

M&A OUTLOOK

- Model Treaty
  - Treaty Entitlement
  - PE Constitution
- TP guidelines
  - Stripping FAR within Group
  - Refine ALP concept
  - Cost Contribution Agreement
- Other recommendations (Local)
  - Country by Country Reporting*
  - Interest Deductibility
  - Hybrid Mismatches
  - Harmful tax practices

- BEPS changes the tax landscape by bringing changes to the fundamental transformation of M&A transactions and Transfer Pricing of intangibles/data
- BEPS highlights Tax Governance, Risk Assessment and Tax Data Communication
- In M&A - Due Diligence, Transaction Structuring, Deal Valuation, Implementation of Combined Operating Models
  - Structure that aggressively reduce tax may increase cost to acquisition
  - Impacts future financial results and thus, forecast Effective Tax Rate (ETR) and Earnings Per Share (EPS)
  - Understand financing structure of the acquisition: Factor-in possible restrictions
  - Target's supply chain is organized in present and in future
  - Preparation of internal controls to mitigate risk
  - Commissionaire Agent Model to be converted to Buy-Sell Model

TRANSFER OF INTANGIBLES



M&A OUTLOOK

Value Creation nexus referred to in BEPS Action 8-10

- If the company earns "super normal profits", it must be able to demonstrate that they are performing or controlling (managing and partaking risks) all DEMPE functions
- Mere holding / funding of IP may only be eligible for a risk free rate of return
- In order to reassess value creation, the OECD appears to be focusing on all human activities that result in the creation of value, albeit with a particular emphasis on activities relating to research and development (R&D), while it seeks to disregard intra-group transfers of risk
- This is focused on Patent Box without nexus approach

DAPE referred to in BEPS Action 7

- Includes additional statement "plays a principal role leading to conclusion of contracts that are routinely concluded without material modifications by the enterprise"
- All about who convinced the buyer

M&A OUTLOOK

Country by Country Reporting

- Revenue, Tax Income, Taxes paid/accrued, Number of employees and assets value held
- Identifying its economic function

Financial cost deduction referred to in BEPS Action 4

- Fixed Ratio Rule
- Company should demonstrate that the finance vehicle not only has the financial capacity to control risk but also has the functional capacity to manage risk

Holding Structure referred to in BEPS Action 6

- Minimum standard of LOB and Principal Purpose Test
- Results in denial of DTAA benefits
- PPT has significant level of subjectivity

BEPS will affect all aspects of the deal processes:

- Due diligence
- Transaction structuring
- Deal valuation

And in the post-transaction period:

- Integration
- Compliance and reporting
- The operation and maintenance of structures

M&A OUTLOOK

- All functions need to work with the tax function to consider the implications that BEPS reforms will have for business operations. Current supply chain, HR, treasury and other policies and strategies may now bring tax risks.
- All Functions within the organization needs to be aligned with tax policy and needs to be BEPS compliant

Research and Development function

- Ownership based
- Value creation based (DEMPE*)

People and Resources function

- Significant People Functions**
- Mobility of employees/assets

Treasury function

- Financing cost

Sales function

- Commissionaire agent model to Buy-Sell model
- Increase infrastructure and have revenue recognition in each country

Inter-group Services / Construction function

- Fragmented activities to be clubbed

Inventory Management / Marketing / Promotion function

- Toll Manufacturer PE
- Delivery agent PE
- Warehouse PE

*   Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE). Whether S that bears cost of development under Cost Contribution Agreement with P in lieu of profit share arising from that IP?

** "Where are your value-adding significant people functions for logistics, manufacturing, R&D, production, sales and marketing?"

POST BEPS OUTLOOK

Treasury

- Increased costs of capital may need to be incorporated into your forecasts
- BEPS is likely to impact your forecast ETR, EPS, and other key financial metrics
- The cost effectiveness of a centralised treasury function could be affected by BEPS
- Cross-border financing may no longer be tax efficient
- Your treasury function will need to be flexible in the short to medium term as countries implement BEPS measures to different timetables

Operating Model

- The cost of debt funding for your investment pipeline could increase as a result of BEPS changes
- The way you contract with customers and suppliers could create new tax obligations
- Your centralised functions (e.g. Treasury, Procurement) must have the appropriate substance and autonomy
- The profits arising from your intangibles must align with the activities undertaken in relation to those intangibles
- Your intercompany agreements/ contracts must properly reflect the underlying reality of the transactions

People and Resource

- Your group's LTIP performance could be adversely affected to the extent that BEPS results in a reduced EPS
- Your group will need dedicated resource to manage the business model changes brought about by BEPS
- You will need a full and accurate record of where all your internationally mobile employees are
- The location of your senior executives and market-facing representatives at the time they make important decisions could increase the taxes and costs for your group
- There must be appropriate (local) resource to manage your material assets and activities

M&A

- Deal values must incorporate the potential impact of BEPS
- A complete understanding of a target's value chain (through a post-BEPS lens) will be critical in pricing a deal
- BEPS will impact the forecast ETR and EPS of any multinational target
- The cost of raising debt could increase as a result of BEPS changes
- Your acquisition structure must be BEPS proof - consider both funding and substance

Public Profile

- Your tax affairs will face increased scrutiny, which could impact on your reputation
- Your global tax footprint should correlate with your global operating footprint
- You will have access to increased data on your competitors (and they on you)
- There will be an increase in publically available information about your group
- Your communications with stakeholders must reflect the increasingly transparent environment

SUMMARY

BEPS will affect all aspects of the deal processes:

- Due diligence
- Transaction structuring
- Deal valuation

And in the post-transaction period:

- Integration
- Compliance and reporting
- The operation and maintenance of structures

Others:

- Value for financing costs (leveraging merger)
- Treaty access
- Transparency (CBCR)
- A need for sustainable and durable structures
  - Single tax structure or multiple
- A downward impact on deal pricing
- A need to consider reputational tax risk
- Understand decision making Personnel to determine value creation (Strategy, Manage, Implement, Support / Supervisory services)

SUMMARY

- Impact 1: Companies which rely on the use of representative offices or third parties as their in-country representative may have to adapt their structure if the OECD recommends a change to the exemptions surrounding the creation of a permanent establishment.
- Impact 2: It may be necessary to demonstrate a stronger association between the owner of an intangible asset and any activity which has a material effect on the value of that intangible. In theory, activities including (but not limited to); the control of budgets, the control of strategic decisions and the control of research programs, may need to be linked to the place of ownership of the intangible
- Impact 3: The need for more transparency in transfer pricing documentation and the request for country-by-country reporting may result in more tax audits and potential disputes over where profit should be allocated for tax purposes
- Impact 4: The collection and use of structured and unstructured intangible (e.g. patient data, suppliers list, etc.) may begin to constitute an intrinsic value generating intellectual property in the country in which it is collected; this may result in a taxable nexus.
- Impact 5: The Holding / Financing Structure needs substantial activity and income derived therefrom must be in connection or incidental to such activity

THANK YOU