Tax Due Diligence

ICAI – Seminar on Due Diligence

Direct Taxes

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Tax Due Diligence

When & Where ??? – Now & Here !!!

- Framework and Objectives
- Approach
- Typical issues and solutions
- Impact on transactions
- Case Study
- Summing Up
- Questions

Due Diligence – Framework and Objectives

Tax Due Diligence
Framework and Objectives

Although due diligence focuses on negative information, the aim is not to raise obstacles to transactions, but rather to facilitate transactions by identifying problems and risks and by devising solutions to problems or devices to reduce or manage the risks involved in corporate acquisitions.

Due Diligence plays an important role in identifying, quantifying and reducing the risks of an acquisition.

Tax due diligence
5 Golden questions

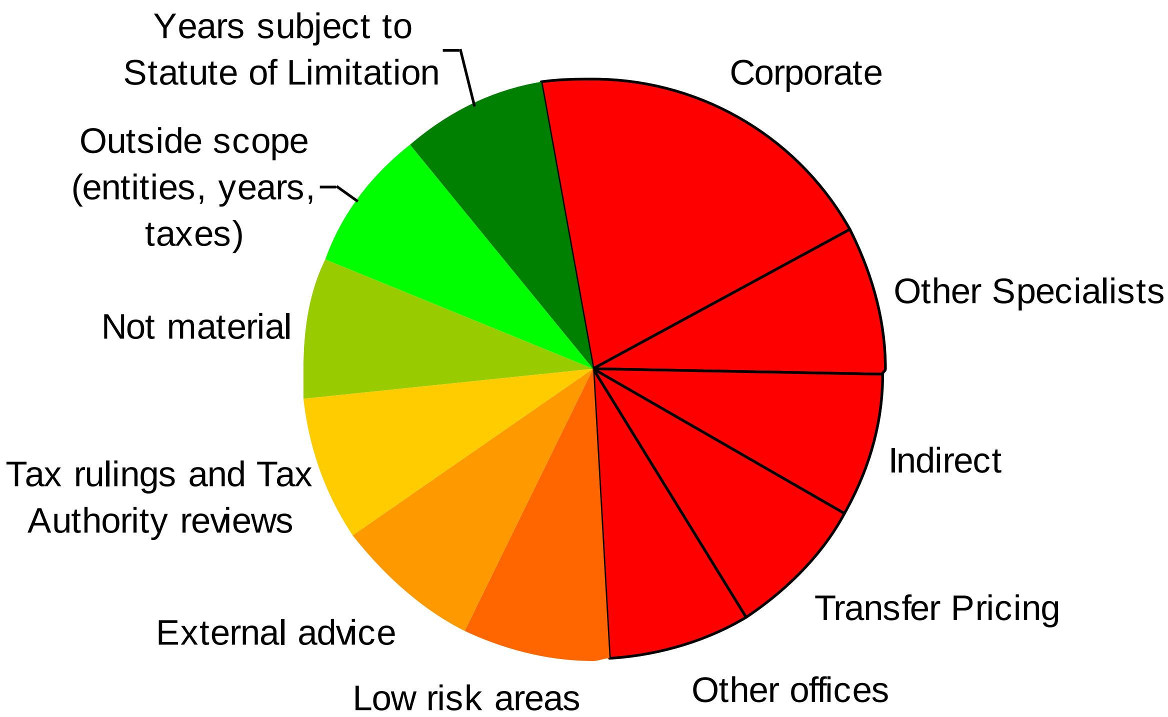
Purpose of a buyer tax due diligence

- Take historical information and look forward
- “Start with the end in mind”
- Keep in mind key bidder questions
    1. **Should I proceed with the deal? (no deal breakers)**
    2. **How much should I pay? (what are material tax impacts on tax balances and/or acquisition model/value?)**
    3. **Is there a risk I will need to pay more? If so how much and when?**
    4. **How can I best protect myself? (impact on negotiation and documentation)**
    5. **How can I improve the position? (what tax planning opportunities are there?)**

Tax due diligence
The DD review

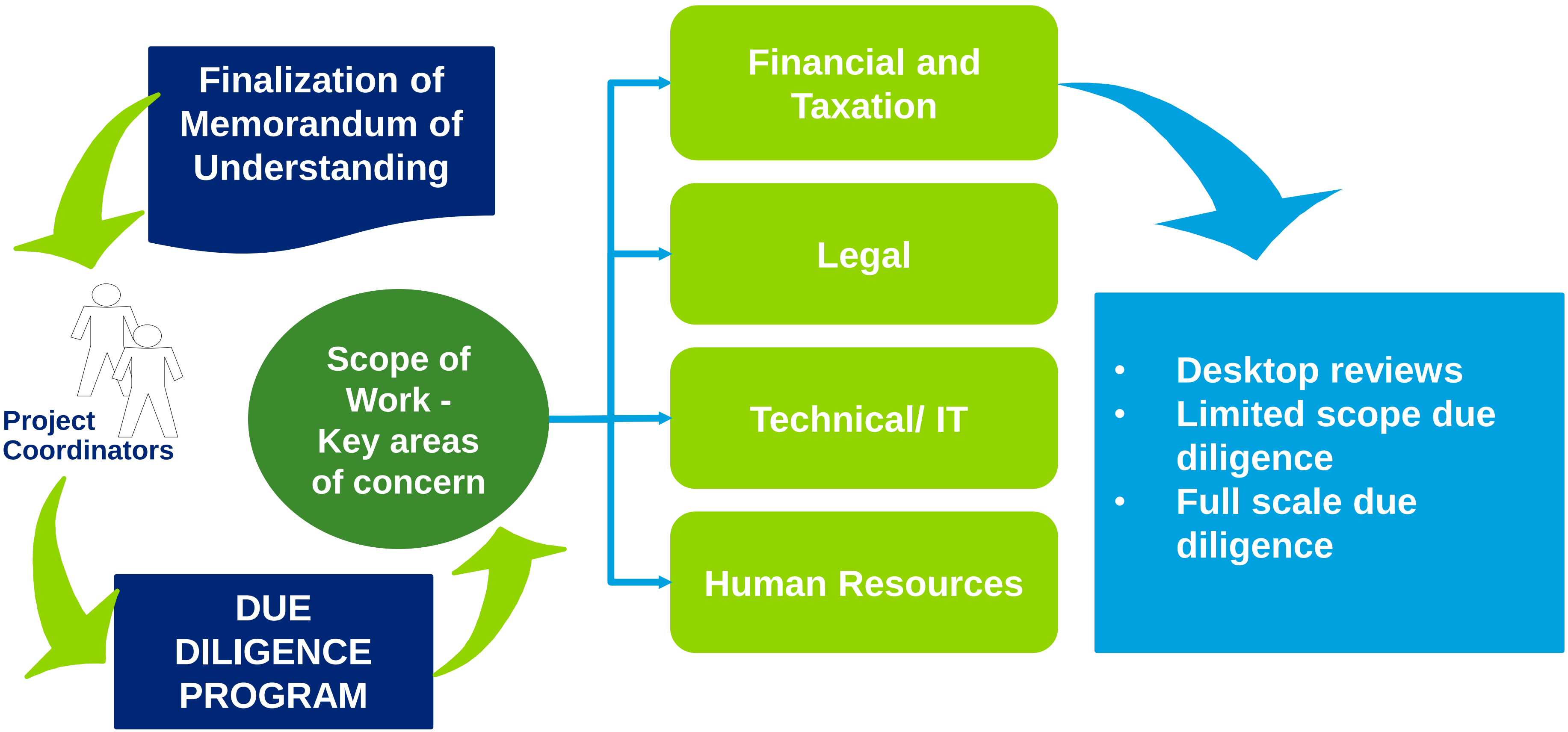
Focus on corporate risks

Controlling Tax Due Dilligence Risk



Approach

Scope of work



Approach

ENABLERS

Approach per acquirer's need

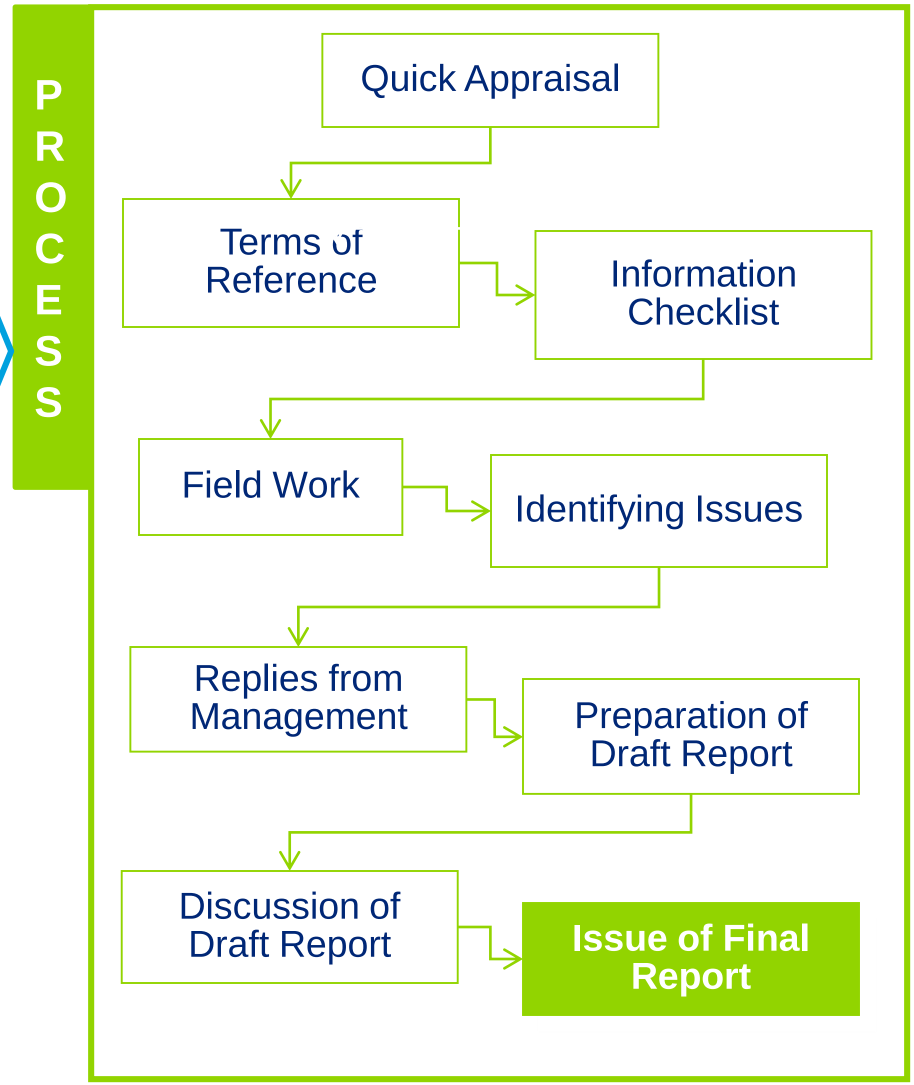
Quality service standards

A multi-disciplinary approach – as per task requirement

A clear plan of action

Deliverable timelines

"The steps involve an interface with the management and other advisors to ensure that all aspect of the project are duly considered and reviewed. This is a pre-requisite for a well informed decision."



Tax due diligence

Key areas

- Understanding the target
- Assessment of tax impact arising from “change in control”
- Assessment of historical tax exposures
- Assessment of current tax position
- Assessment of various modes of tax neutral deal structuring
- Identifying tax saving opportunities
- Identifying data required

Areas to be covered

Review of tax documents

- **Income tax returns**
- **Computations of income**
- **Tax audit reports**
- **Deduction related documents**

Tax position

No litigation existing

Validate tax position adopted by company

- Expenses booked
- Withholding tax positions
- Deduction claimed
- Restructuring exercise undertaken, if any.

Litigation existing

Thorough review of the tax positions:

- Validate tax position adopted by company
- Review tax position adopted by tax authorities
- Review of orders of assessment/ penalty passed by tax authorities

Assessment of degree of risk

Typical issues and solutions

Typical issues

- Tax benefits
- Contingent liabilities – disputed tax demands
- Tax Controversy Management
- Current assets
- Transfer of shares from residents to non residents
- Various tax compliances (including withholding tax)
- Typical areas prone to income tax litigation

Typical issues

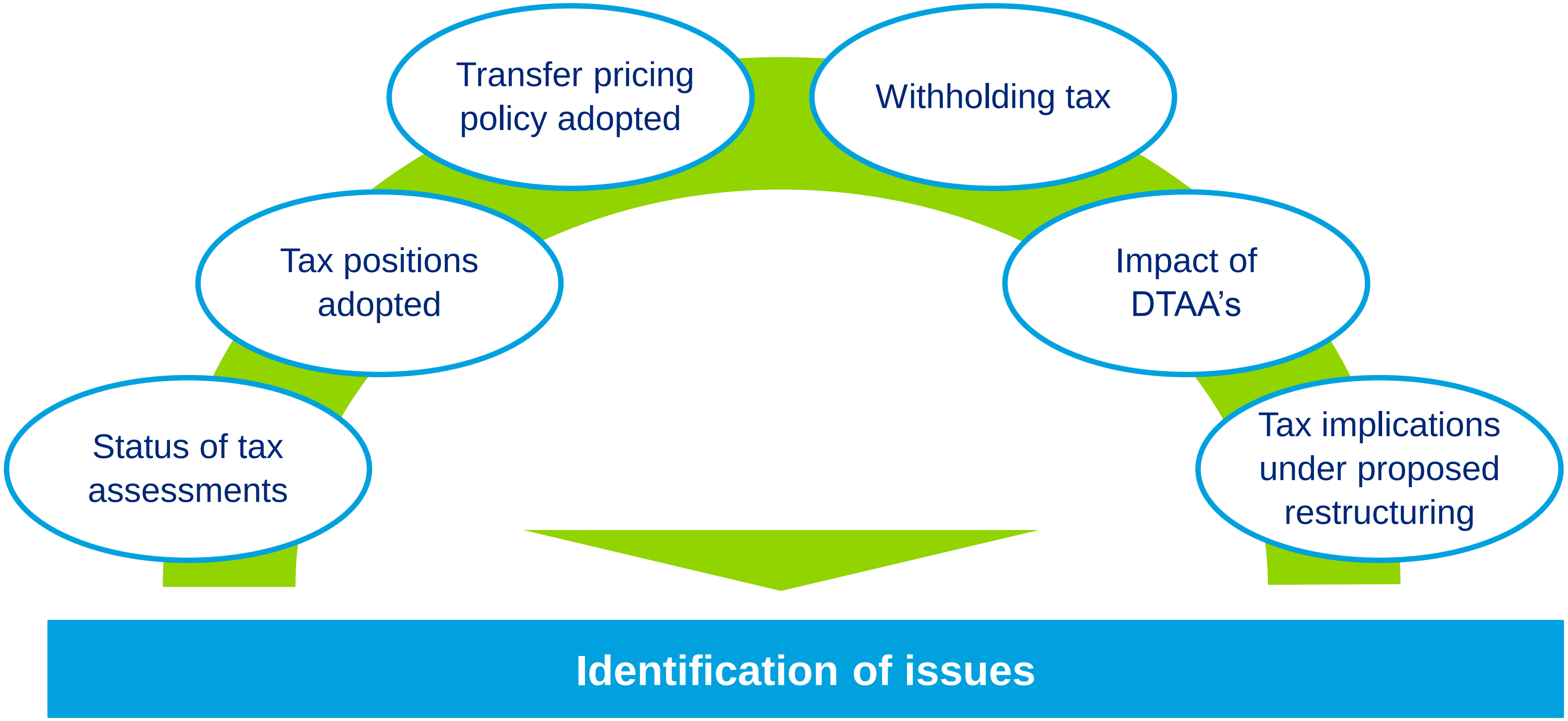
Certain areas typically prone to tax litigation

- Exemption provisions
- Levy of interest
- Levy of penalty
- Minimum alternate tax
- Presumptive tax provisions
- Disallowance of expenditure incurred in relation to exempt income
- Exemption provisions
- Treatment of tax losses
- Transfer pricing
- Non compliance of withholding tax obligations (especially payments to non-residents)
- Depreciation
- Taxability of capital gains
- Re-assessment provisions
- Search , seizure and block assessment provisions

Issues

Crystallization & quantification

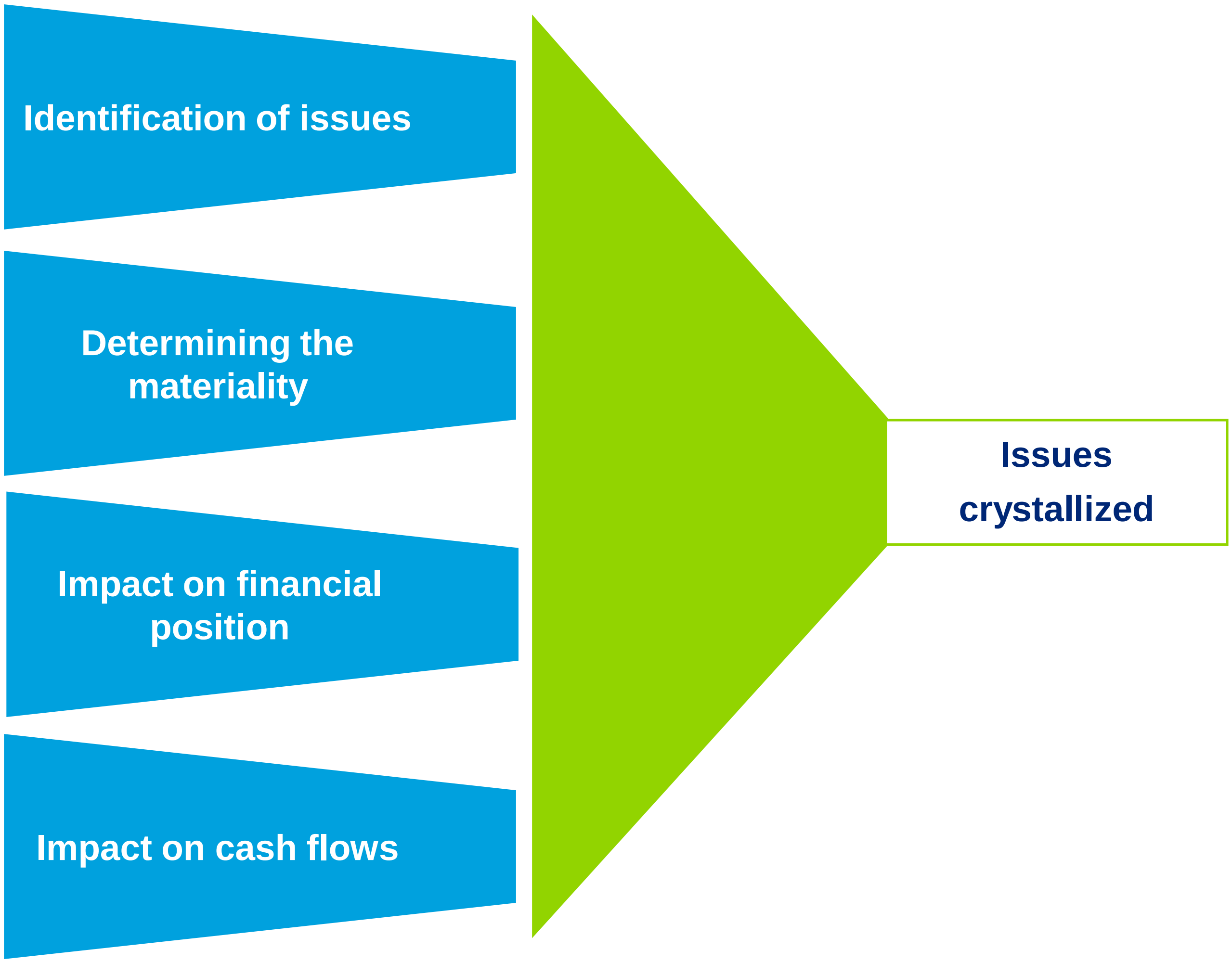
Crystallizing issues



Issues

Crystallization & quantification

Crystallizing issues – contd.



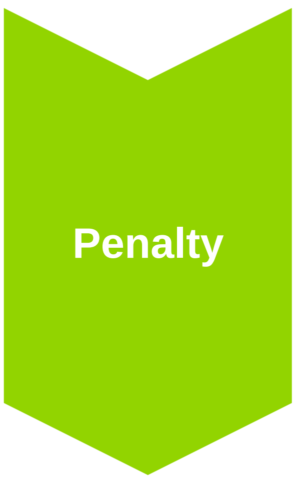
Issues

Crystallization & quantification

Quantifying issues

It begins with the analysis of the data pertaining to relevant assessment years and taking into account the appeal effects.

It is the discretionary power of tax authorities to impose the penalties



- In case it is apparent that the tax position adopted by the tax authorities is correct- penalties that could be imposed may range from 100% - 300%.
- In case a different view can be taken under different forums – penalties may not be imposed.
- In case it is apparent that the tax position adopted by the tax authorities is not correct - no penalties would be imposed

Indemnities

Personal guarantee

Promoter/ vendor gives guarantee in personal capacity to meet any future tax liability.

Indemnities

Adjustment to valuation

Deal value is arrived at after making adjustment on account the future tax liabilities.

Insurance policies against possible tax liability….

Impact on transactions

Due diligence findings

Discussions with other advisors on findings

Resolutions of issues identified

Paradigm Shift in Tax Reforms

Deal Breakers

- Those issues which would impediment the consummation of the proposed transaction

Negotiation points

- Those issues which would be necessary to consider in the valuation of business / negotiation of bid price

Issues for agreements

- Those issues which would warrant indemnities and identify conditions precedent for happening of the transaction

Commercial override

- Those risks and issues which are knowingly taken over as a calculated commercial decision.

Impact on future tax liabilities

- Assessment of various modes of tax neutral deal structuring
  - Demerger, amalgamation, slump sale, itemized sale, etc.
  - Assessment of tax consequences that could arise out of restated financials post the deal
- Identifying tax saving opportunities
  - Tax holidays availed / which could be availed
  - Continuity of existing tax holiday post the deal
- Generally, a litigation prone area (needs to be examined carefully)
  - Tax efficient capital infusion / debt push down - relevant exchange control guidelines to be kept in perspective
  - Review of transaction document

Case study

Case study

Facts

- Indian company (I Co) manufactures equipments
- I Co. has started with windmill business which is eligible for tax holiday. However, currently no benefit has been claimed on account of loss being incurred by the said units.

Issues

- Exemption provisions
- Levy of interest / penalty
- Minimum alternate tax
- Disallowance of expenditure incurred in relation to exempt income
- Treatment of tax losses
- Non compliance of withholding tax obligations (especially payments to non-residents)
- Depreciation
- Taxability of capital gains
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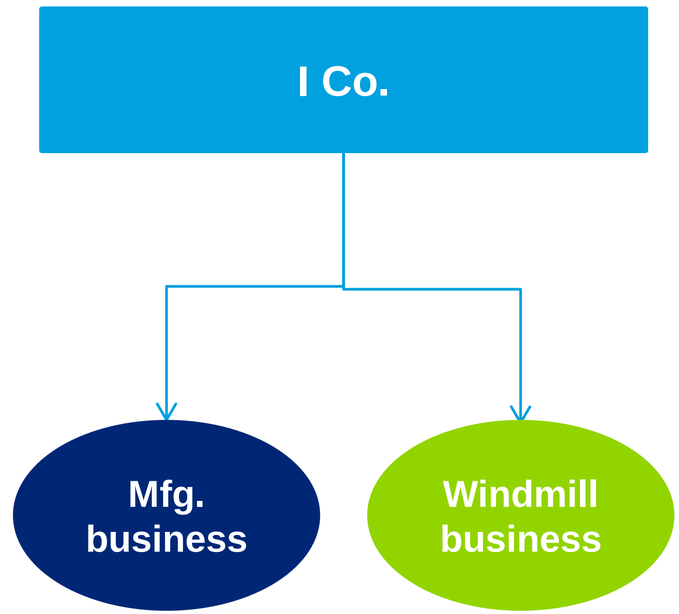
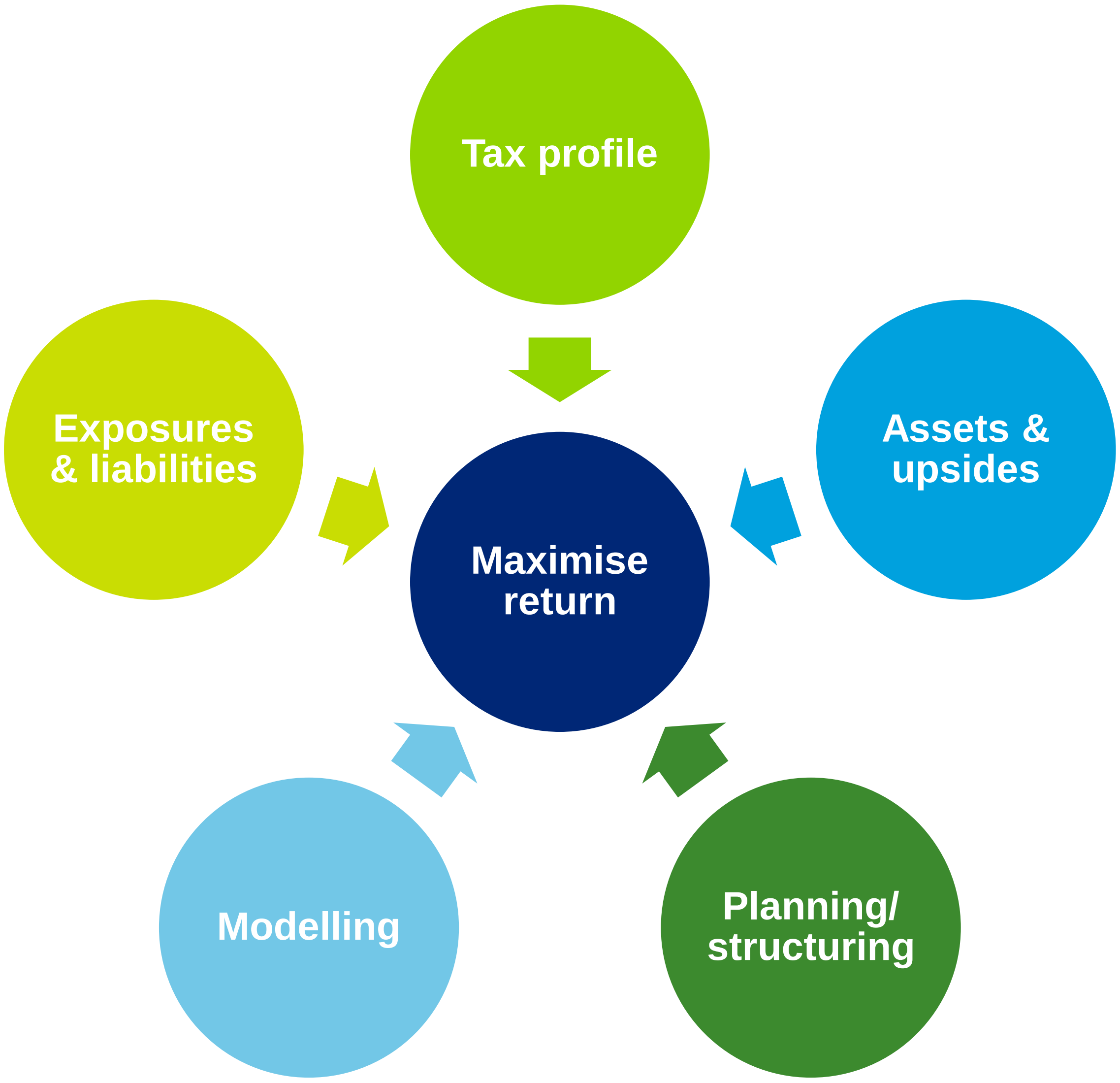


Summing up

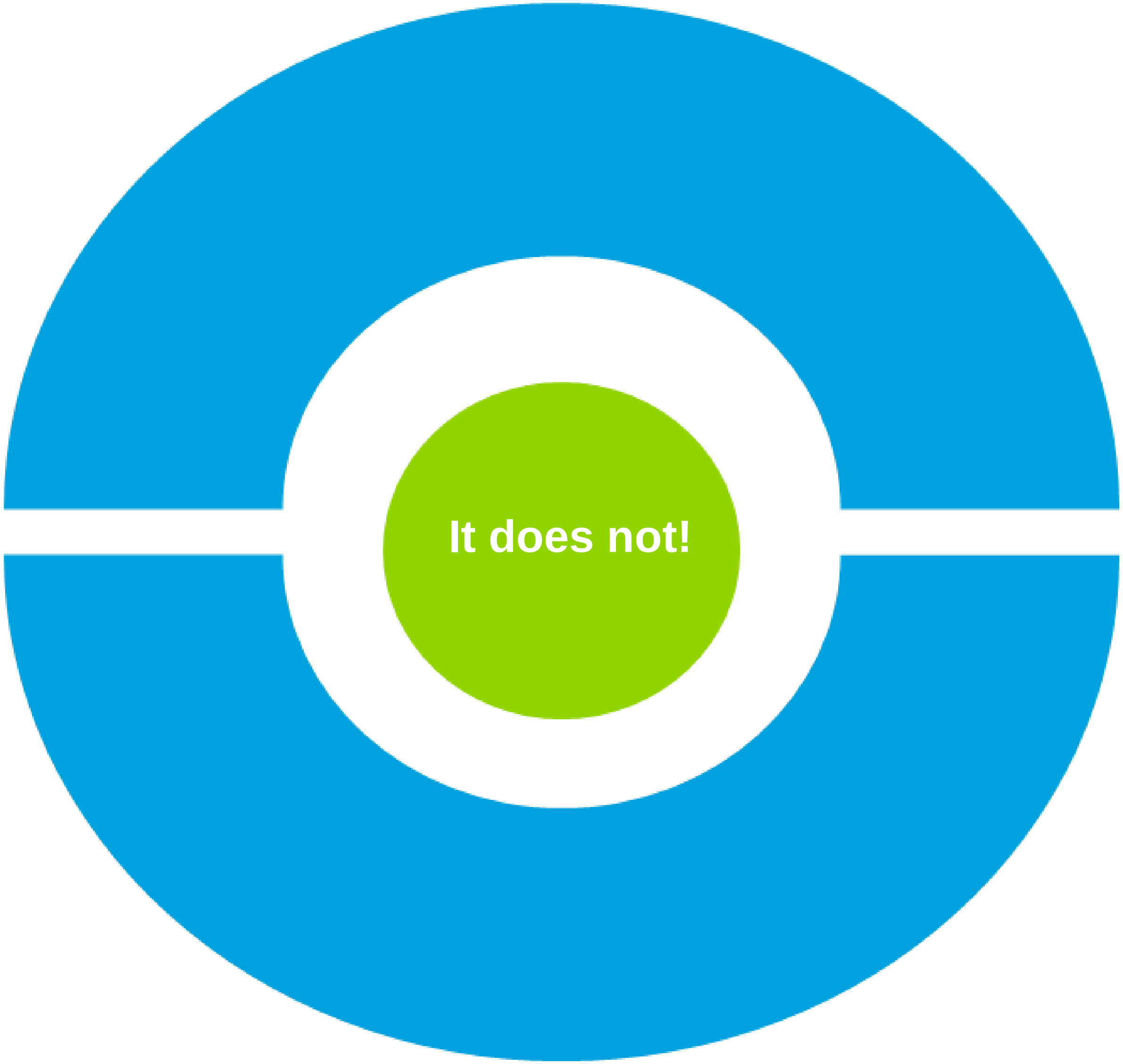
Tax Due Diligence
Why do it?



Tax Due Diligence
Where do we start?

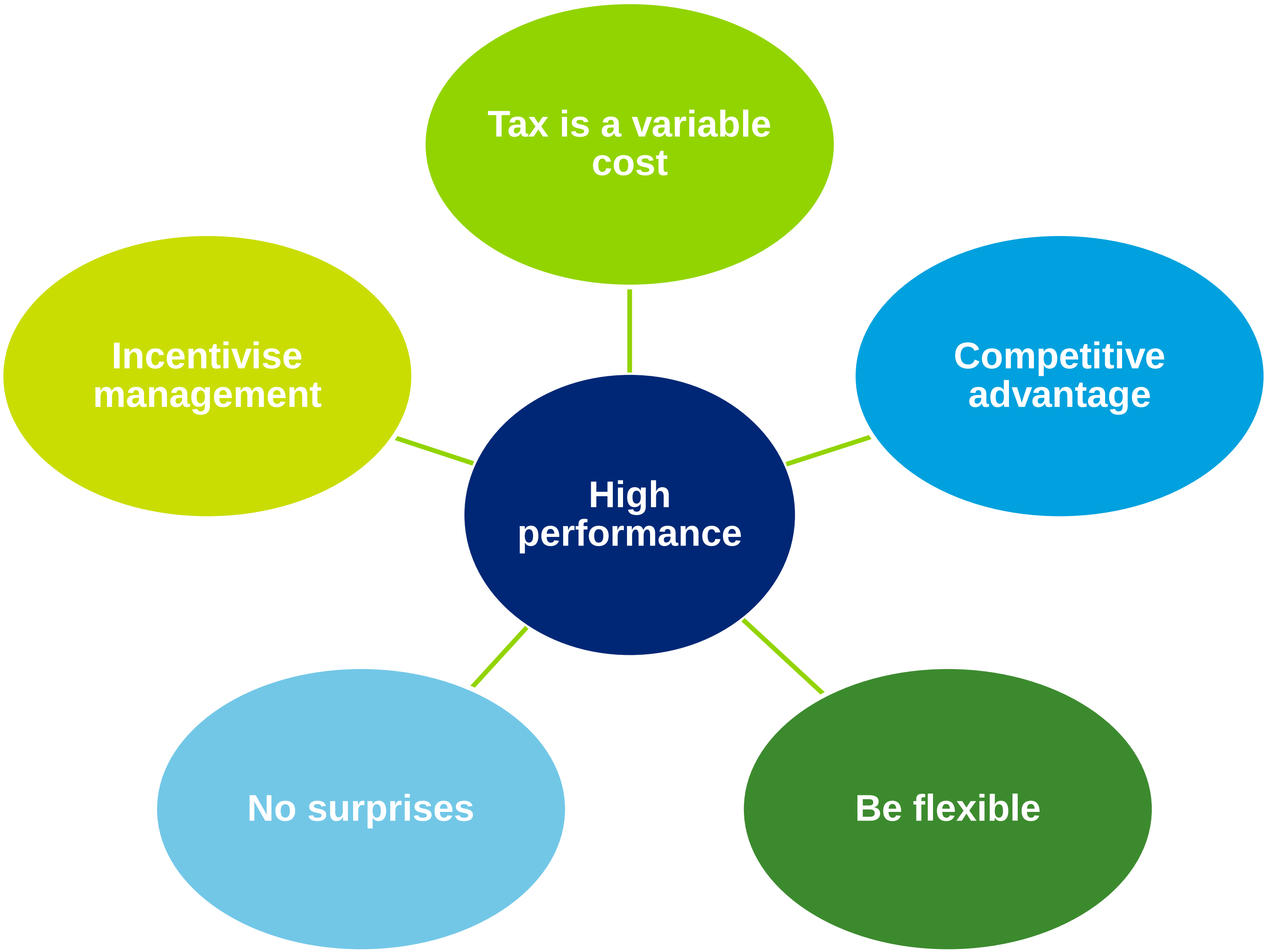
Structure of target	Group	Division	Stand-alone
Location of target	Jurisdictions	Branches	States
Location of tax information	Vendor tax team	Target tax team	Advisors

Tax Due Diligence
When does it finish?



Tax Due Diligence

Why we bother ?

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