Tax Considerations in M&A Transactions: Part 1

Presented by:
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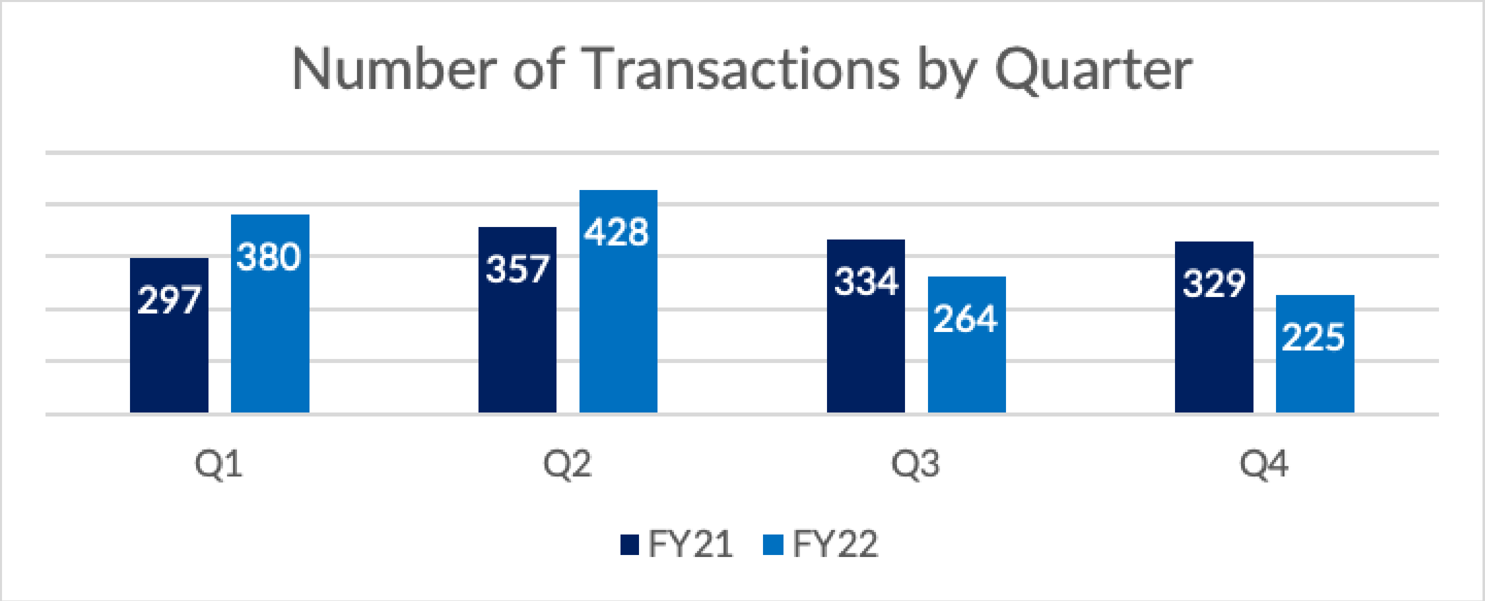
Agenda

1. M&A mid-market update
2. M&A structuring landscape
3. Managing the risks of tax considerations in M&A
4. The importance of expert tax advice in M&A

1. M&A mid-market update

Mid-market update

- M&A activity in FY22 was strong in Q1 and Q2 off the back of access to cheap capital and other macroeconomic factors
- Activity declined in Q3 and Q4 due to higher inflation, rising global political tension and tightening of fiscal policy
- We are seeing a strong and sustained level of deal appetite in the Australian mid-market in FY23
- Rising interest rates and inflation, tougher regulations and supply-chain pressures could affect this momentum
- We are observing acquirers who are becoming increasingly sophisticated and selective when approaching potential deals



Source: HLB Mann Judd - Mergers & Acquisitions Annual Report FY2022

2. M&A structuring landscape

1. Transactions occur in many different structures, including share sales, asset sales, and restructures. These structures will largely depend on the business being acquired and tax considerations.

2. Share sales will usually attract CGT, but not GST or stamp duty. Asset sales may attract GST, but not CGT. They may attract stamp duty if real property is involved.

3. Vendors and buyers should always aim to understand their tax consequences pre-transaction, as this will influence how they negotiate and structure the transaction.

4. Other tax consequences which may be considered as part of a transaction include cross-border tax issues, transfer pricing, tax consolidated groups, and capital gains losses.

3. Managing the risks of tax considerations in M&A

Before proceeding with any transaction, vendors and buyers should consider the potential risks associated with the transaction.

Some common tax risk considerations are:

1. Historical tax compliance position
2. Future tax compliance position
3. Deal structuring
4. Compliance with state and federal tax law
5. Consideration and earn-out remuneration tax consequences
6. Cross-border tax implications
7. Tax consolidation considerations

4. The importance of expert tax advice in M&A

Specialist M&A tax advisors are integral to transactions and we recommend their involvement in every transaction we do.

They provide vendors and targets with advice in relation to:

1. Tax consequences of the transaction
2. Potential future tax issues
3. Tax risk mitigation
4. Optimal operating structures
5. Due diligence pre and post-transaction
6. Transfer pricing issues
7. Tax consolidation issues

Tax Considerations in M&A Transactions: Part 2

Presented by:
David Early

Agenda

1. Transaction lifecycle
2. Preparing for sale:
   i. structuring for sale
   ii. vendor due diligence and remediation
3. Purchaser due diligence:
   preparing the control room
4. Documenting the deal
5. Post deal issues/management

1. The Transaction Lifecycle

	Phase	Considerations	Seller or buyer side
1	Thought/idea or other catalyst	• What is the key driver(s)?	Seller
2	Define the goal or objective	• Selling all or part of business? • Do existing owners want complete or partial exit? • Raise capital?	Seller
3	Understand the market/buyers	• Get the timing right	Seller
4	Preperation	• Structuring for sale • Vendor due diligence • Issue remediation - resolve/address issues before buyer raises issues	Seller
5	Going to market	• Appoint the right party	Seller
6	Expressions of interest	• Basis of evaluation, how to know if really interested	Buyer

	Phase	Considerations	Seller or buyer side
7	Purchaser due diligence	• Preparation of data room, know the questions and answers before they are asked • Access/confidentiality • Responding to purchaser queries (there is a balance and it depends on the deal)	Seller and buyer
8	Bids submitted/presented	• Basis of evaluation, other than simply on price (ability to do the deal, synergies etc)	Seller and buyer
9	Bid selection	• Negotiation • In-principle agreement	Seller and buyer
10	Documentation and deal execution	• Properly documenting the deal in a legally sound manner • Ensuring documentation supports the assumptions upon which tax advice was based • Agreement of representations and warranties, and indemnities – including term	Seller and buyer
11	Post-acquisition obligations	• Ongoing management • Earn-out arrangements	Seller and buyer

In this presentation, we will be focusing on the green phases

Why tax matters

01

Maximise post tax sale proceeds

02

Tax may influence preferred deal structure

03

Understand the tax cost and consequences of different transaction structures/deals

04

Whenever tax issues change the direction of a transaction, we find ourselves discussing anti avoidance rules.

05

Clean up legacy tax issues before sale

06

Ensure the deal documentation aligns with assumptions upon which tax advice was given

07

Control tax warranties and indemnities given

08

Don’t let tax issues kill the deal, particularly at the last minute – stay in front of them

2. Structuring for Sale

Share sale
or asset sale?

Decision often may be driven by whether there is to be a sale of all or part of business, and where a part of the business, the nature of that part or whether a discrete asset (e.g., intellectual property).

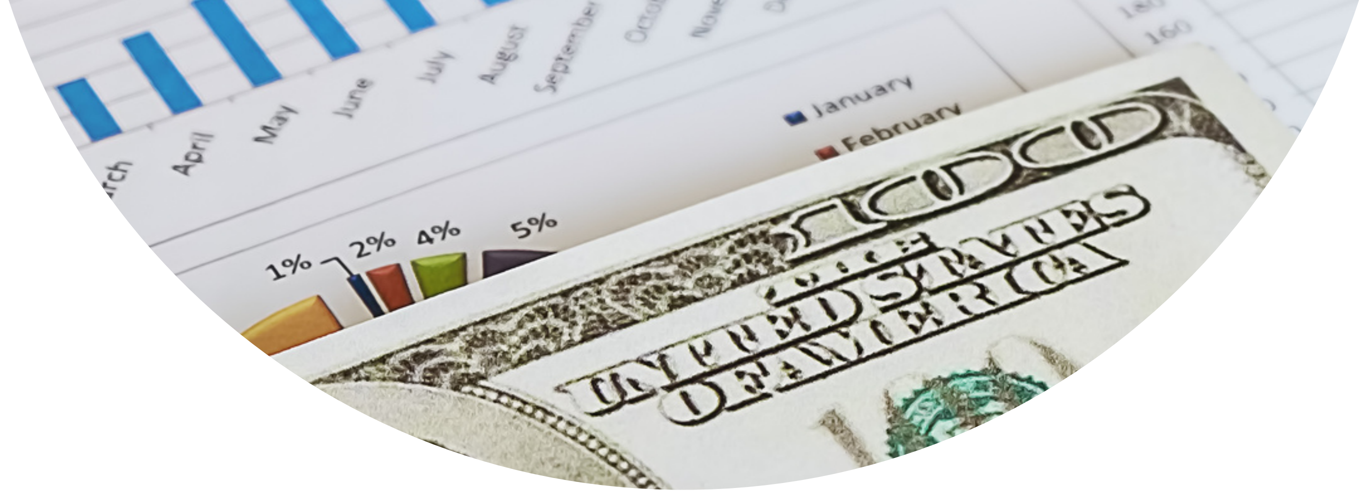
Depending on transaction, often there may be a natural tension between the vendor and purchaser, as:

- Asset purchase often preferred by purchaser (to avoid inheriting legacy legal and tax issues in company)
- Share sale often preferred by vendor (to access CGT treatment at shareholder level)

Share sale
Vendor considerations

- **CGT treatment - Sale of shares in holding company should generally be on capital account, enabling:**
  - Individual shareholders to escape tax on pre-CGT shareholdings
  - Australian resident individual shareholders to access 50% CGT discount
  - Non-resident shareholders to escape Australian tax (provided underlying assets of company sold not Australian real property)
  - Utilisation of capital losses at shareholder level

Share sale
Vendor considerations



An asset sale by a company will result in taxable gains for the company, with no CGT discount available, with such gains generally ultimately distributed as a taxable dividend (which may be franked).

So, in short, the 50% CGT discount is lost.

- Ongoing management of company – Generally no ongoing management/administration of remaining corporate entities (although warranties and indemnities will continue)
- Therefore, generally a share sale preferred
- Restructuring - Group may need to be restructured to bring entire business, or part being sold, under one single Sale Co, held directly by exiting shareholders. This would need to be achieved without triggering a tax liability, requiring consideration of:

	Issue	Technical reference and considerations
1	Are transfers within a tax consolidated group, and so ignored for tax?	Section 701-1(1) (single entity rule)
2	Does a tax consolidated group need to be established to facilitate the restructuring? • Complex to implement • Impact on cost base? • Impact on losses?	• Division 700 • Division 707-B - Available fraction rule may dilute utilisation of losses of joining entity
3	Is CGT rollover relief available for other group restructuring (if not a TCG) or at shareholder level	• Subdiv 328-G – restructuring relief for small businesses (< $10m turnover) • Division 615 restructuring relief – share restructure where no change in economic ownership – eg top-hatting • Subdiv 124-E – exchange of shares in same company • Subdiv 124-M –exchange of shares in one company for replacement shares in another • Subdiv 125 – Demerger relief (if need to split group)

4	Stamp and landholder duty	• State tax – although similar across states, there are differences, particularly relating to reorganisation relief and business transfers • Although share transfer duty has been abolished, if transferred companies or trusts hold (directly or indirectly) interests in land, landholder duty could be payable • Reorganisation relief is not available in certain jurisdictions if reorganisation is connected with a sale • Reorganisation relief may be subject to clawback upon a later degrouping
5	GST	• A sale of shares by a Resident Seller can be either an input taxed financial supply to a Resident Buyer or a GST-free supply of rights to a Non-Resident Buyer • Transaction costs that relate directly e.g., legal and advising fees, or indirectly e.g., operational overheads, to an input taxed financial supply may not give rise to GST credits subject to the application of the Financial Acquisition Threshold (FAT) and whether the transaction costs qualify as reduced credit acquisitions (RCAs) for GST purposes • Whether or not the entity, if a member of a GST group, can make a clean exit subject to an Indirect Tax sharing Agreement

Share sale

Purchaser considerations

Corporate history

- Purchaser inherits company history (issues and exposures)

Tax losses

- Tax losses within target group may be lost (thus need to be discounted for valuation purposes):
  - Sale triggers breach of continuity of ownership test (“COT”)
  - Satisfying continuity of business test can be challenging
  - Available fraction for utilisation of available losses within the purchaser’s tax consolidated group may result in losses having minimal real value

Share sale

Purchaser considerations

Share sale

Purchaser considerations

Stamp duty/landholder duty

- Generally, purchase of shares produces better stamp duty result than asset purchase
- No duty applies on acquisition of shares unless the company holds, directly or indirectly, land or an interest in land (e.g., leases of any value
- Should there be land or an interest in land, landholder duty may apply at rates of up to 5.75% on the value of the land. Where this arises, “land” includes buildings, other fixtures, and any items “fixed” to the land in any way
- Common trap - landholder duty is payable on the gross value of the land held by the company, not the net value of the company acquired
- Common trap - Queensland has a “trust-look-through” regime for private trusts: watch out

Share sale

Purchaser considerations

GST

- Purchase of shares by a Resident Buyer from a Resident Seller would be an input taxed financial (acquisition) supply for GST purposes which could result in denial of some or all of the GST credits for transaction related costs
- The purchase of shares giving the Buyer a controlling interest in the Seller’s entity or entities does not result in a transfer of the underlying business i.e., as a supply of a going concern for GST purposes
- Similarly, for GST purposes, such a purchase of shares doesn’t result in the separate supply of real property by the target entity that owns or leases the property
- GST treatment of costs relating to borrowings to finance purchase of shares

Asset sale
Vendor considerations

- **No CGT discount – gain on sale taxable to corporate group, with no CGT discount**
- Utilisation of losses within corporate group – where group has tax losses, any gain may be sheltered by carry forward tax losses
- Extracting the gain from the corporate group can be tricky:
  - Dividend – taxable to shareholder, and can it be franked?
  - Capital return – results in dilution of CGT cost base, and potential capital gain

Corporate history

- Not inheriting corporate history and legacy issues/risks – No corporate due diligence required

Asset sale

Purchaser considerations

Simpler or more complex?

- Simpler for discrete asset purchases – simple discrete acquisition of asset, but tricky for full business acquisition (including liability assumption and transfer of employees)

Asset sale

Purchaser considerations

Asset sale

Purchaser considerations

Stamp duty

- No historical duty exposures inherited
- Duty on intangible business assets - Qld, WA and NT continue to impose duty on goodwill and IP at up to 6% of asset value
- Duty payable on GST-inclusive price, so need to consider if going-concern exemption is available to remove GST cost
- If duty is payable, there may be structuring options available to reduce the duty
- Often missed – business goodwill is treated, for stamp duty, as located in every State/Territory into which sales are made/customers are located – even if the business is only in one jurisdiction

Asset sale

Purchaser considerations

GST

- What is the GST treatment of supplies e.g., GST-free as a supply of a going concern, separate taxable or input taxed supplies?
- Potential effect of GST gross-up clause in Sale and Purchase agreement
- GST treatment of costs relating to purchase of business assets
- GST treatment of any costs relating to any borrowings to finance purchase of business assets
- GST registration, reporting and compliance obligations of Buyer's acquisition entity

3. Vendor due diligence and issue remediation

Understanding vendor due diligence and issue remediation

- Where a share sale, need to conduct full tax due diligence review on Sale Co/group (as if a purchaser) to identify all material issues/risks
- Implement remediation plan so all issues are fully resolved, or if not appropriate, properly evaluated
- Need to assume purchaser will identify all issues
- Don’t understate time required to remedy issues with ATO
- A due diligence checklist is attached as Appendix 1, one for a share sale, the other for an asset sale

4. Preparing the DD control room

The scope or information required differs materially for a share sale v asset sale

An example of the scope of work, and information requirements, for conducting a due diligence is attached at Appendix 1 – one for a share sale, the other for an asset sale.

Don’t underestimate the time to gather, complete, and have all the data in a fit state for the control room.

5. Documenting the deal

Does the legal deal match the commercial deal?

Get the documentation wrong and you may lose the tax outcome you were counting on.

1. Legal documentation must support the assumptions that the tax advice was based upon

2. Bad drafting has consequences

3. Earn-out arrangements, may be a simple instalment sale

4. Whether a condition is a condition precedent versus condition subsequent impacts the timing of CGT events

5. CGT rollovers are prescriptive, so you need to tick off the conditions

6. Tax is transaction focussed, that extra step has a tax consequence

Managing identified risks

The completeness and outcome of the due diligence will drive the scope of warranties and indemnities.

- Pick and choose from standard warranty lists
- The kitchen sink approach by Purchasers, may be tactical in a negotiation sense but will be negotiated
- Know what truly matters to you and trade away the rest if you need to
- If risk built into price, do you need/should you give an indemnity

It is impossible to be 100% protected.

Warranties and indemnities

1

Warranty

Is assurance within the contract. Designed to encourage disclosure of information and provide a contractual safety net if there is a loss as a result of breach.

2

Indemnity

Is a contractual obligation to reimburse the other party of a specific liability arising. Usually covers specific risks.

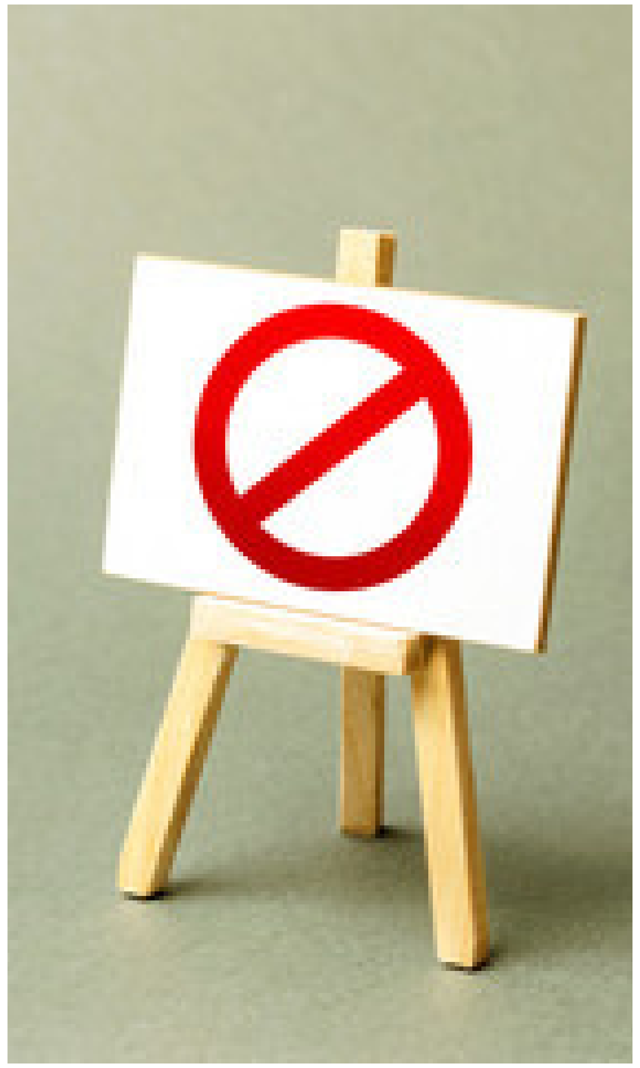
3

What's the difference?

- Proving loss
- Duty to minimise loss
- Limitations
- Takeaway: NEGOTIATE!! and consider allocation of risk

Limitations and enforceability

- Practical issues around claiming, including guarantees
- Warranty / indemnity payments –
  - Structured as purchase price adjustment?
  - Document retention, access & timing
  - Management of tax disputes re historical issues
  - Transitional arrangements (e.g., responsibility for compliance)
  - Multiple vendors – joint vs several liability



6. Post-acquisition

Housekeeping

1

Stamp duty

2

Complicance

- Notification to join income tax consolidated group and GST group
- Accession to Tax Sharing and funding agreements
- Ensure GTRM framework has been followed
- Document transaction in readiness for ATO review
- Payroll tax grouping
- GST treatment of transaction costs

3

Entity reduction

Delivering on the tax strategy

Tax Consolidation

1

- Valuations are key
- Differences between accounting and tax positions
- Timing matters

Aligning operating and legal structures

2

- Stamp duty
- Pre and post association tests

Q&A

Thanks for listening!

Please feel free to ask us a question


smart sensor systems
LIT05808.08
Microsystem Technol
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Fritzsche
Nanotechnology
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2nd Edition
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05804.08
LIT05803.08
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Fazel
Kaiser
Multi-Carrier and
Systems

Appendix

Appendix 1: Due Diligence Scope of Work (Share sale)

<table>
<tr><th>Area</th><th>Scope of work & objective</th><th>Information requireements</th></tr>
<tr><td>Tax Risk Management Framework</td><td>Review and comment on the current tax risk management framework in place, including the scope and appropriateness of the documentation in line with ATO guidance.
Review and comment on the outcome of any internal tax risk management audits and the overall appropriateness of policies in place.
Provide comment on the appropriateness of the overall tax risk management framework.</td><td>Copies of tax risk management framework documentation, including policies on how tax risk is identified and dealt with internally.
Copies of any internal tax risk management audits that have occurred to test the tax risk management framework.
Copies of any correspondence with the ATO in relation to the tax risk profile of the Australian business and operations.</td></tr>
<tr><td>Income tax</td><td>Review last four years income tax returns and work papers for material tax issues and summarise key findings.
Review lodgement history and confirm all tax filings are up to date.
Analyse accounts for material transactions, acquisitions or disposals in the last four years and summarise key findings.
Analyse tax planning or minimisation strategies adopted in the last four years and summarise key findings.
Review franking account calculations, the franking rate applied on dividends paid and summarise balances.
Consider whether tax losses carried forward are available for recoupment and comment on requirements to be satisfied in order to apply losses against taxable income in subsequent years.
Obtain and review any tax advice received over the last four years and summarise key findings.
Review treatment of acquisitions of other entities, including any tax consolidations (where applicable).
Obtain and review correspondence with the ATO in relation to non-routine matters including any disputes, investigations or audits in the last four years and summarise key findings.
Summarise any material outstanding assessments involving objections or appeals with the ATO.
Review the treatment of any government grants received during the due diligence period.
Provide commentary on stamp duty implications that may arise for Client as part of the Proposed Transaction.</td><td>Last four years income tax returns and work papers.
Management accounts for the last four years.
Details of major transactions, acquisitions or disposals in the last four years and summary of tax treatment and copies of any tax advice received.
Franking account work papers for the last four years.
Copies of tax advice received in the last four years.
Copies of any written tax elections made outside of those contained in the tax returns.
Copies of non-routine ATO correspondence received in the last four years.
Copies of integrated client accounts and income tax account for the last four years.
Lodgement status extract from tax agent portal.</td></tr>
</table>

GST	• Review sample BAS's for the last four years and summarise key findings. • Review and comment on the GST treatment of material items or transactions in the last four years. • Review lodgement history and confirm all filings are up to date. • Obtain, review and provide comment on any GST advice received in the last four years. • Obtain and review correspondence with the ATO in relation to non-routine matters, including any disputes, investigations or audits in the last four years and summarise key findings. • Summarise any material outstanding assessments involving objections or appeals with the ATO.	• Sample BAS's for each of the last four years including supporting work papers. • Copies of any GST advice received in the last four years. • Tax Agent Portal extract showing current Integrated Account Balance and transactions for the past four years. • Copies of non-routine ATO correspondence received in the last four years.
Payroll tax, FBT & Superannuation	• Review payroll tax reconciliations for the last four years and comment on the treatment of key items (including grouping and treatment of contractors). • Obtain and review any payroll tax advice received in the last four years and summarise key findings. • Obtain and review correspondence with the state revenue authority in the last four years in relation to non-routine matters, including any disputes, investigations or audits and summarise key findings. • Summarise any material outstanding assessments involving objections or appeals with the state revenue authorities. • Review compliance with Superannuation Guarantee Obligations, primarily by enquiry with management. • Review FBT returns and workpapers for the last four years and summarise key findings. • Obtain and review any FBT advice received in the last four years and summarise key findings. • Obtain and review correspondence with the ATO in relation to non-routine matters, including any disputes, investigations or audits in the last four years and summarise key findings.	• Copies of annual payroll tax reconciliations and supporting work papers for the last four years. • Copies of payroll tax advice received in the last four years. • FBT returns and workpapers for the last four years. • Copies of FBT advice received in the last four years. • Copies of non-routine state revenue authority correspondence received in the last four years. • Details of the nature, eligibility and amounts of any government grants, rebates or concessions received in relation to Payroll tax, FBT or superannuation.
Government grants and concessions	• Confirm whether any R & D Tax incentive claims during the due diligence period have been made and whether advice had been sought in relation to that claim. • Confirm whether any other state or federal grants or income assistance has been claimed and whether appropriate advice was sought in relation to those claims.	• Copies of records of the self-assessment made as to the eligibility of R & D activities to the tax incentive, and their categorisation as either core or supporting R & D activities. • Registration confirmation of R & D activities with the Department of Industry, Innovation and Science. • Work papers supporting amounts disclosed in the Research and Development tax incentive schedule, as part of the company tax return • Details of the nature, eligibility and amounts of any government grants, rebates or concessions received, including confirmation on whether any external advice was received.

Appendix 1: Due Diligence Scope of Work (Asset sale)

Area	Scope of work & objective	Information requireements
Stamp duty & transfer duty	• Confirmation of the applicable Duty cost, in each state, for the transfer of the business and underlying assets on acquisition. • Confirm and comment on the location of assets subject to transfer duty and the accompanying lodgments required as a result of the transfer of the business and underlying assets. • Assess and comment on the outcome of any internal tax risk management audits and the overall appropriateness of policies in place. • Provide comment on the appropriateness of the overall tax risk management framework.	• Details of the value and the location, by state, of each underlying physical assets included as part of the transfer of the business and underlying assets. • Breakdown of revenue, by state, for the last three years of operations. • Details of any leases in place, together with agreements, over property, including the applicable state in which the property is situated.
Income tax	• Review last two years income tax returns and work papers for material tax issues and summarise key findings. • Obtain and review any business related tax advice received over the last two years and summarise key findings. • Obtain and review correspondence with the ATO in relation to non-routine matters including any disputes, investigations or audits in the last two years and summarise key findings. • Review the treatment of any government grants received during the due diligence period.	• Last two years income tax returns and work papers. • Management accounts for the last two years. • Copies of tax advice received in the last two years. • Copies of non-routine ATO correspondence received in the last four years. • Confirmation of assets being transferred to purchaser
GST	• Review sample BAS's for the last four years and summarise key findings. • Review and comment on the GST treatment of material items or transactions in the last four years. • Obtain, review and provide comment on any GST advice received in the last four years. • Obtain and review correspondence with the ATO in relation to non-routine matters, including any disputes, investigations or audits in the last four years and summarise key findings. • Summarise any material outstanding assessments involving objections or appeals with the ATO.	• Sample BAS's for each of the last four years including supporting work papers. • Copies of any GST advice received in the last four years. • Copies of non-routine ATO correspondence received in the last four years.

PAYG W, Payroll tax, FBT & Superannuation	• Review appropriate PAYG W is being withheld from employees' wages. • Confirm payment of PAYG W is occurring on time for the expected amounts. • Review payroll tax reconciliations for the last four years and comment on the treatment of key items (including grouping and treatment of contractors). • Obtain and review any payroll tax advice received in the last four years and summarise key findings. • Obtain and review correspondence with the state revenue authority in the last four years in relation to non-routine matters, including any disputes, investigations or audits and summarise key findings. • Summarise any material outstanding assessments involving objections or appeals with the state revenue authorities. • Review compliance with Superannuation Guarantee Obligations, primarily by enquiry with management. • Confirm compliance with choice of fund and stapled fund requirements, primarily by enquiry with management. • Review FBT returns and workpapers for the last four years and summarise key findings. • Obtain and review any FBT advice received in the last four years and summarise key findings. • Obtain and review correspondence with the ATO in relation to non-routine matters, including any disputes, investigations or audits in the last four years and summarise key findings. • Confirm compliance with Single Touch Payroll (STP) regime.	• Copies of payroll reports for the last four years. • BAS containing PAYG W and Integrated Client Account extract for the past four years. • Copies of annual payroll tax reconciliations and supporting work papers for the last four years. • Copies of payroll tax advice received in the last four years. • Copies of non-routine state revenue authority correspondence received in the last four years. • Confirmation from management on payment of superannuation guarantee contributions • Copies of standard choice of fund form completed by new employees • FBT returns and workpapers for the last four years. • Copies of FBT advice received in the last four years. • Evidence of completion of employee business use declarations • Details of the nature, eligibility and amounts of any government grants, rebates or concessions received in relation to Payroll tax, FBT or superannuation. • Enquiry with management on STP reporting and confirmation of payroll software used.