

# M&A Academy

## Tax implications of business restructuring

25 February 2010

# Agenda

Context

European restructuring: the way forward to streamline your business in a beneficial way

Restructuring in practice: 3 case studies

Determination of optimal restructuring scenario

Questions

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## **Context**

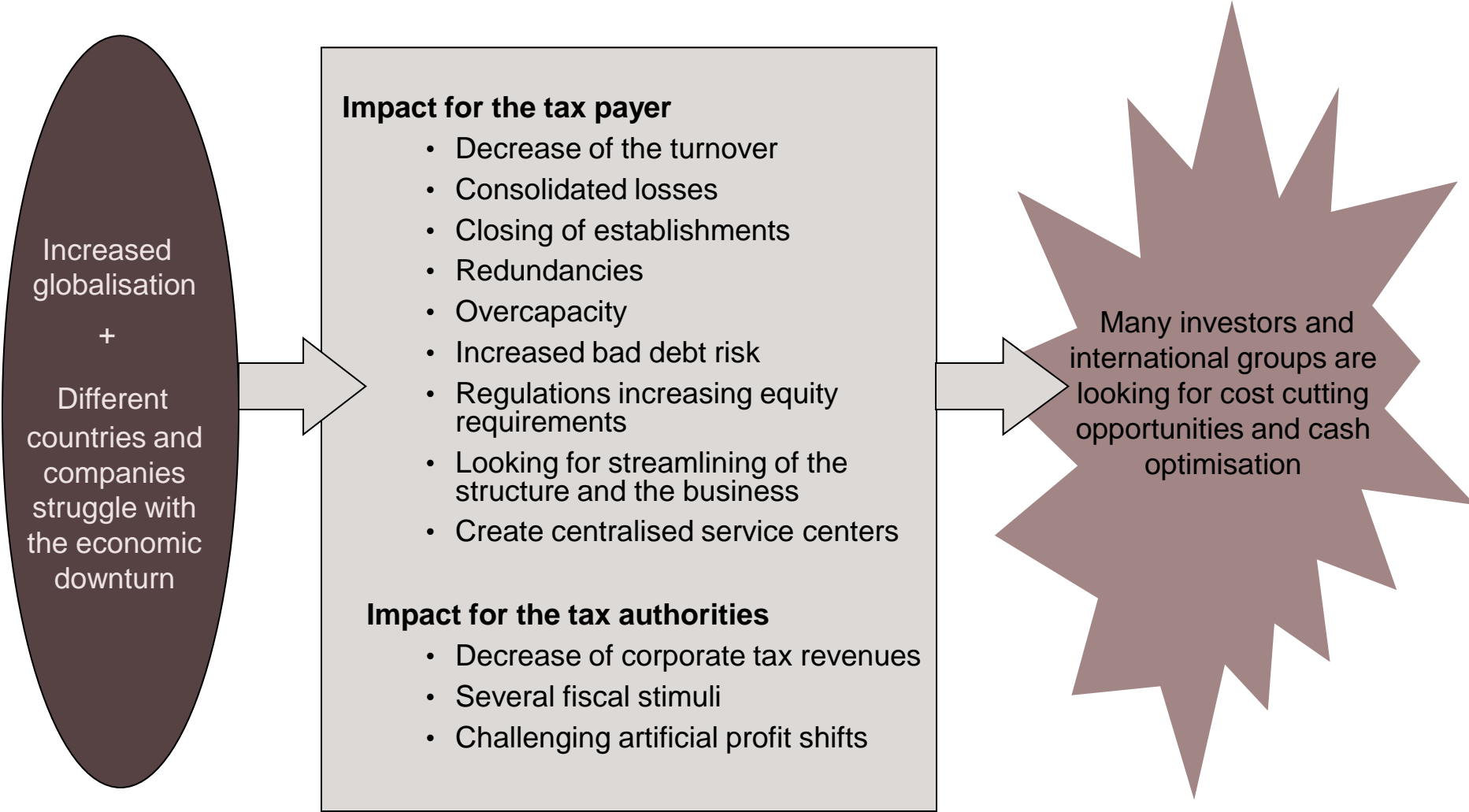
European restructuring: the way forward to streamline your business in a beneficial way

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**European restructuring: the way forward to streamline your business in a beneficial way**

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# European restructuring: the way forward to streamline your business in a beneficial way

## **Legal Restructuring: EU Merger Directive**

### **General principle: tax neutrality – in Belgium this means:**

- In the hands of the contributing (absorbed) company:
  - roll-over of capital gains and fiscal value;
  - transfer of tax free reserves;
  - transfer of losses → non discrimination.
- In the hands of the receiving (absorbing) company:
  - no step-up in value;
  - tax exemption of merger gain.
- In the hands of the shareholders:
  - tax-free exchange of shares.

### **Anti-abuse provisions**

# European restructuring: the way forward to streamline your business in a beneficial way

## **Legal Restructuring:** EU Merger Directive (Cont'd)

**Reshaping your conventional business model into a flexible international branch structure could provide the following benefits:**

- improvement of the business control e.g. reduced corporate governance requirements;
- simplification of intragroup arrangements e.g. less accounting complexity, more efficient cash management;
- optimisation utilisation of future tax losses;
- efficient upstreaming of cash and reserves leading to less legal requirements and no cash traps;
- realise cost efficiencies e.g. less audit mandates required;
- limit equity requirements imposed by the Regulator (e.g. Solvency II).

⇒ now possible with recently implemented European Merger Directive

# European restructuring: the way forward to streamline your business in a beneficial way

## **Legal Restructuring combined with business restructuring: Transfer Pricing aspects**

- Migration of functions, risks and assets has an impact on the profit allocation between related entities and their taxable basis.
  - example: conversion buy-sell entity into limited-risk distributor
    - appropriate TP post conversion
    - exit payment?
    - disregarding transaction
- MNE have had until recently minimal guidance on how to manage business restructurings from a transfer pricing perspective, thus often resulting in disputes.
- Some tax authorities, like Germany, have taken steps to define their position.

# European restructuring: the way forward to streamline your business in a beneficial way

## **Legal Restructuring combined with business restructuring: Transfer Pricing aspects**

On 19 September 2008, the OECD published four related issue notes addressing transfer pricing issues that arise in connection with business restructurings

The issue notes address:

1. special considerations relating to the allocation of risks;
2. transfer pricing treatment of the restructuring itself;
3. remuneration of post-restructuring transactions;
4. recognition of actual transactions undertaken.

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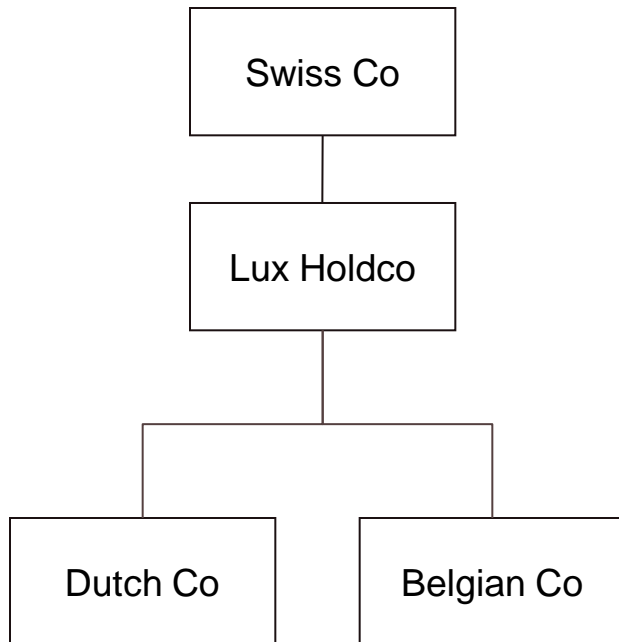
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# Restructuring in practice

## Case 1: Entity simplification



### Case 1: Setting the scene

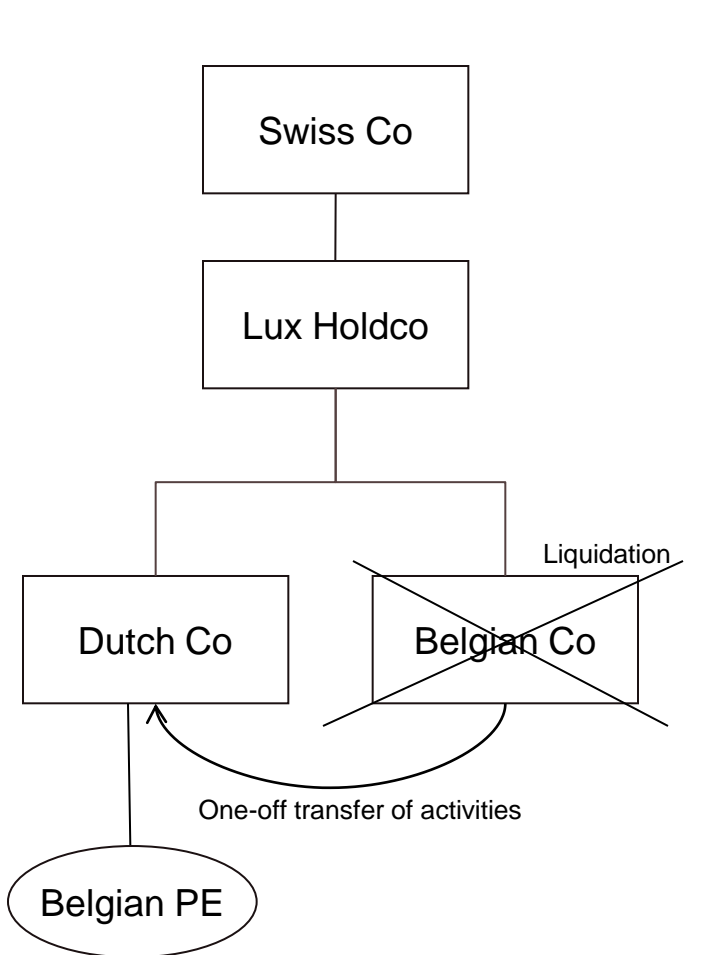
- Corporate head office is located in Switzerland and the holding company is located in Luxembourg.
- For the Benelux region, the head office disposes of 2 companies, i.e. Dutch Co in the Netherlands and Belgian Co in Belgium. The Belgian employees (administrative and sales personnel) all reside in Belgium and classify as Belgian tax residents.
- Stock of products for the Benelux region is held by Dutch Co in the Netherlands.
- Belgian Co acts as a fully fledged distributor on the Belgian market (i.e. performing all sales related functions and bearing all sales related risks).
- Due to the economic downturn the group wishes to restructure its business and perform all of its Benelux activities in the Netherlands through a Belgian branch.

#### ⇒ 2 options:

1. One-off transfer of all activities to the Dutch Co followed by the liquidation of the Belgian Co
2. Cross-border merger between Dutch Co and Belgian Co

# Case 1: Entity simplification

## Transfer of activities – Liquidation of Belgian Co

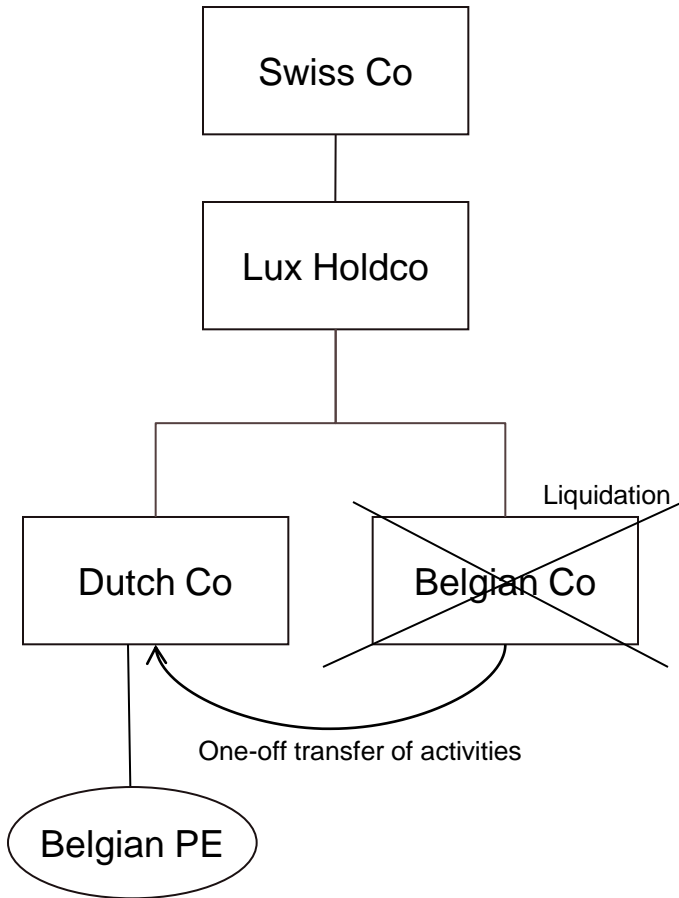


- **Achieve cost savings**  
The entity simplification will result in cost-savings: centralisation of certain activities / functions, reduction of rental costs buildings, ...
- **Potential goodwill exposure**  
As all tangible and intangible assets (e.g. client portfolio) will be transferred to Dutch Co (at fair market value), a substantial goodwill exposure might arise. Limited to no possibilities to reduce the goodwill amount.  
⇒ Taxable at 33,99%
- **Liquidation proceeds**  
Possible withholding taxes (10%) on liquidation proceeds (provided that no withholding tax exemption can be invoked).
- **Permanent establishment risk**  
Conducting active sales operations in Belgium via employees on the payroll of a foreign company and/or disposing of a home office in Belgium could give rise to a taxable permanent establishment in Belgium.

**Solution:**  
**Cross-border merger**

# Case 1: Entity simplification

## Transfer of activities – Liquidation of Belgian Co (Cont'd)

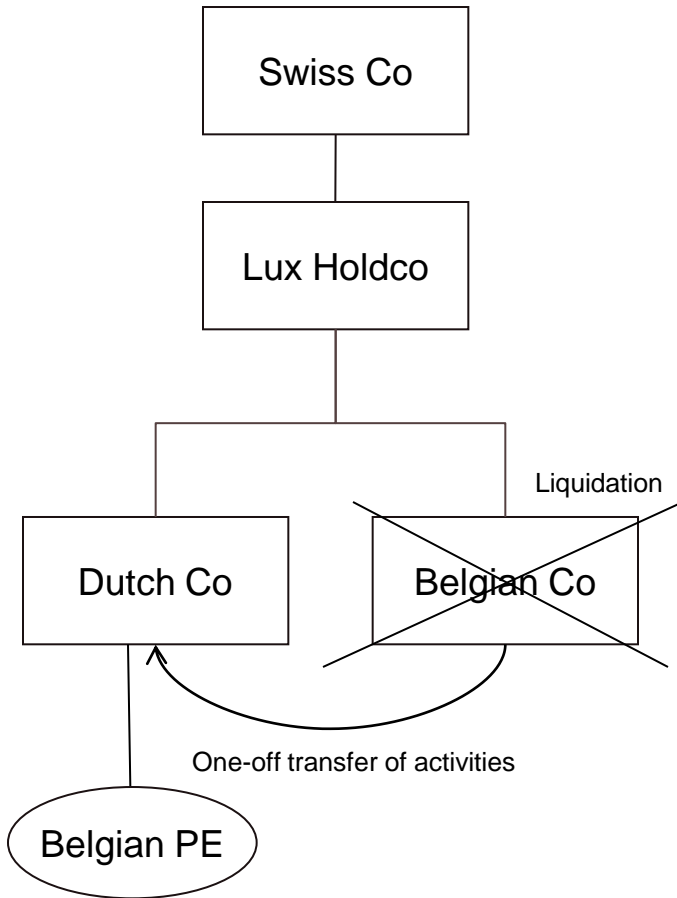


- **Transfer pricing aspects**

- When terminating or substantially renegotiating existing contractual relationships, the restructured entity may face various detriments which may need to be compensated:
  - restructuring costs (e.g. additional write-off of assets, termination of employment);
  - reconversion costs (e.g. adaptation of the operations to other customer needs).
- However, no presumption that compensation is always required:
  - profit potential is no assets that is transferred by itself but an indication of the value of assets being transferred;
  - does the restructuring imply a transfer of rights or assets carrying a valuable profit potential?
- Which entity should pay indemnification?
  - Swiss Holdco because termination with Belco will make it possible to obtain cost savings and the present value of expected cost savings is greater than the indemnification;
  - DutchCo as an entrance fee to obtain distribution activities from BelCo.

# Case 1: Entity simplification

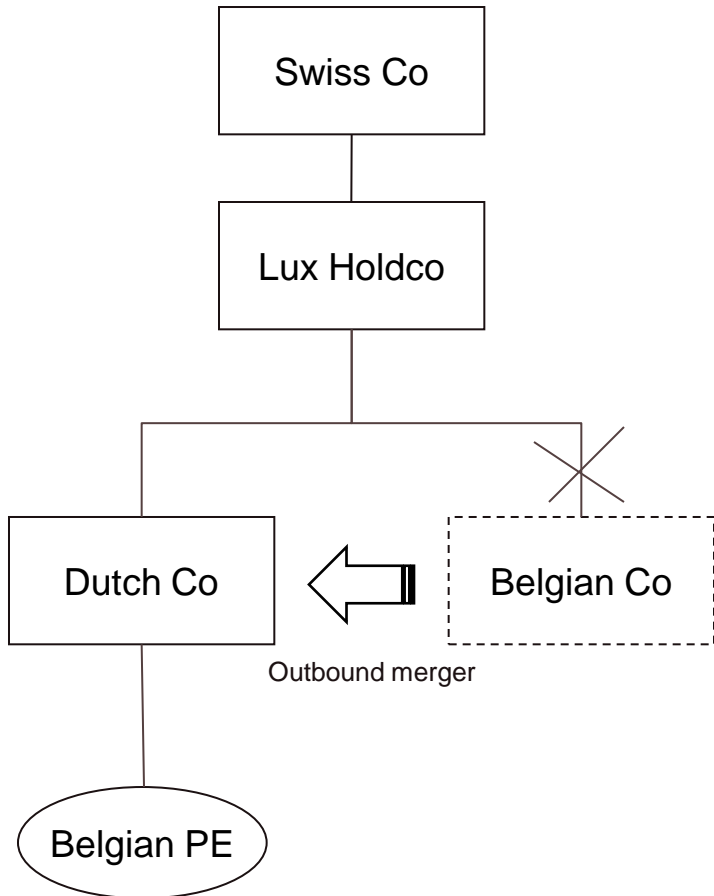
## Transfer of activities – Liquidation of Belgian Co (Cont'd)



- **Personal income tax consequences for the administrative personnel**  
The administrative personnel, who will be performing their activities in the Netherlands, will become taxable in the Netherlands on the salary related to Dutch working days. The income taxable in the Netherlands will be exempt (with progression) in Belgium .
- **Personal income tax consequences for the sales personnel**  
The sales personnel, who will remain working on the Belgian territory, will remain fully taxable in Belgium. In case of working days in the Netherlands, partial taxation in the Netherlands will arise.
- **Social security consequences for the administrative personnel**  
The administrative personnel, who will be performing their activities in the Netherlands, will become subject to the Dutch social security scheme
- **Social security consequences for the sales personnel**  
The sales personnel will continue to perform their duties in Belgium, thus remaining subject to the Belgian social security scheme.

# Case 1: Entity simplification

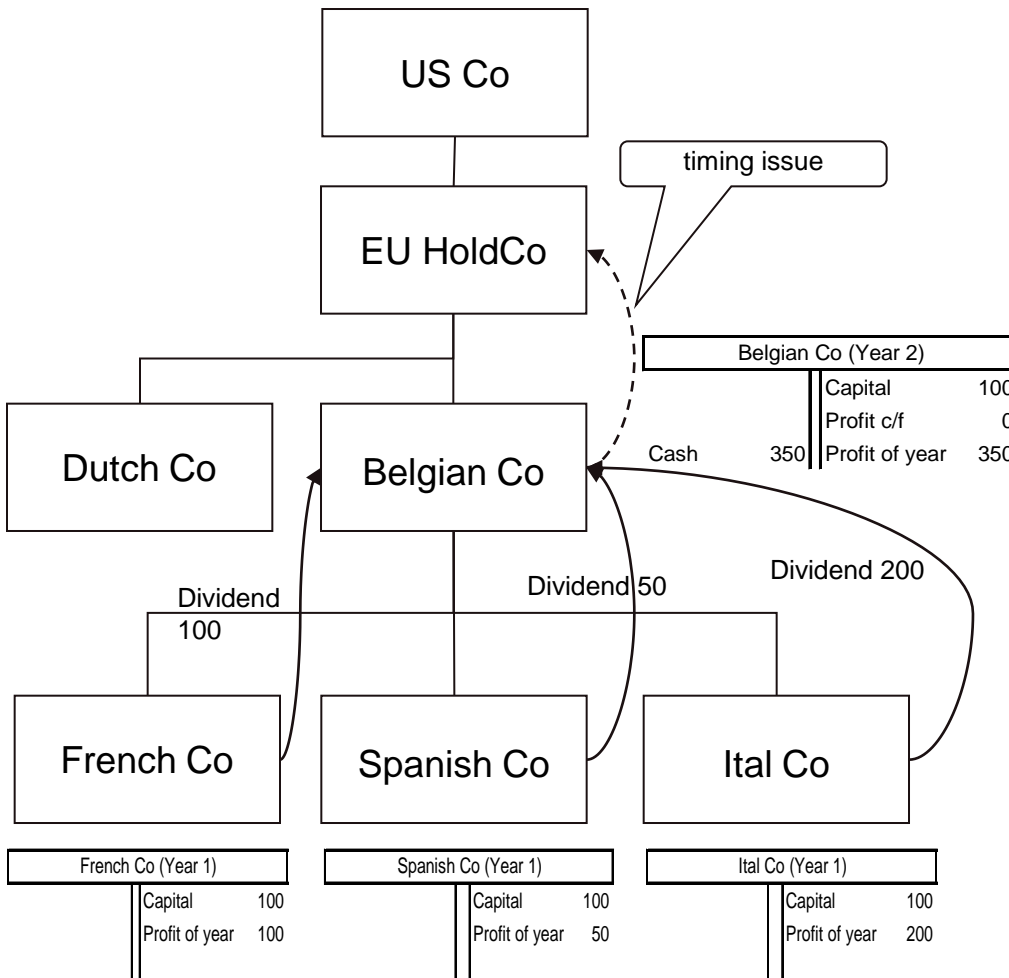
## Cross-border merger



- Cross-border mergers (and demergers) can in Belgium benefit from a **tax-neutral regime** under the following **conditions**:
  - The beneficiary company is a Belgian tax-resident company (or an intra-European company);
  - The operation is performed in accordance with Belgian company law or analogous provisions applicable in the other Member State;
  - The new anti-abuse provision (section 183bis BITC) is complied with. (i.e. the principal or one of the principal objectives of the merger cannot be tax evasion or tax avoidance).
- **Similar conditions** apply in the Netherlands and Luxembourg.
- No **goodwill** exposure.
- No **withholding tax** exposure.
- In order to perform the reorganization **tax free**, the Dutch Co will need to transfer all assets and liabilities received at the occasion of the merger from the Belgian Co to a taxable branch office in Belgium.

# Case 2: Optimisation dividend upstream

## Solving timing issue

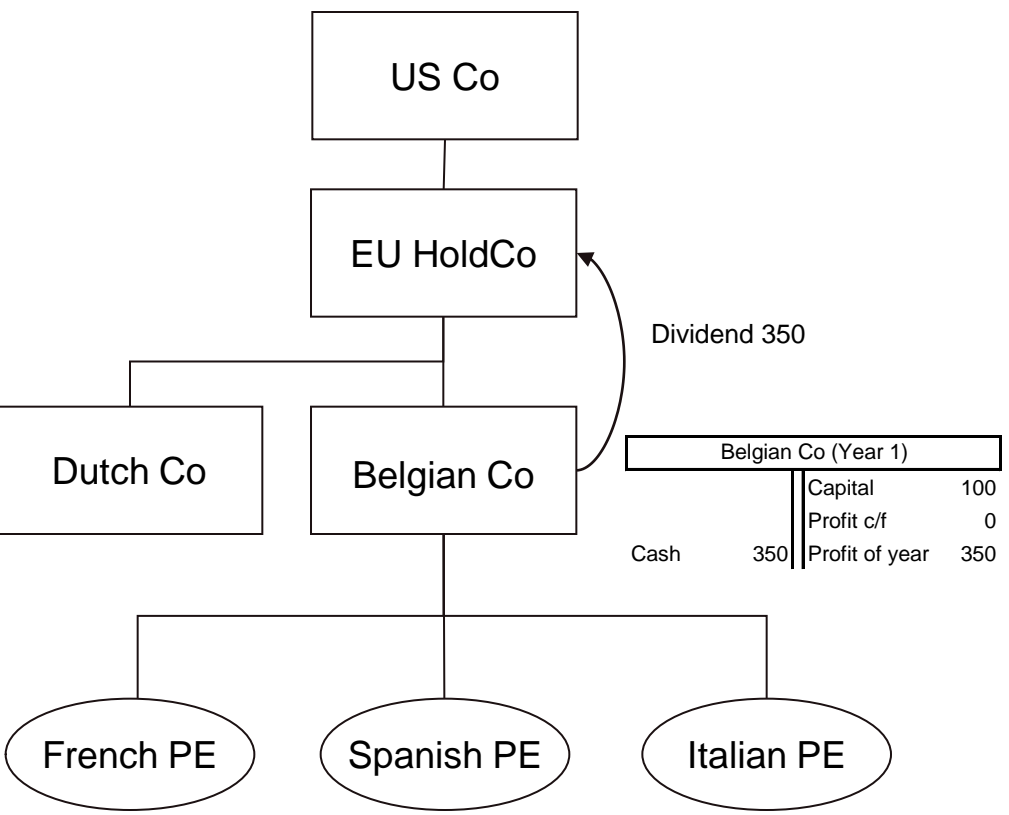


### Case 2: Setting the scene

- Check the box: Belgian company is a BVBA/SPRL
- In year 1 French Co, Spanish Co and Ital Co are profit making
- After year-end profits are distributed to Belgian Co
- Belgian company cannot distribute an interim dividend
  - ⇒ not possible to distribute profits within 1 year to EU HoldCo and Us Co (only possible after year 2)

# Case 2: Optimisation dividend upstream

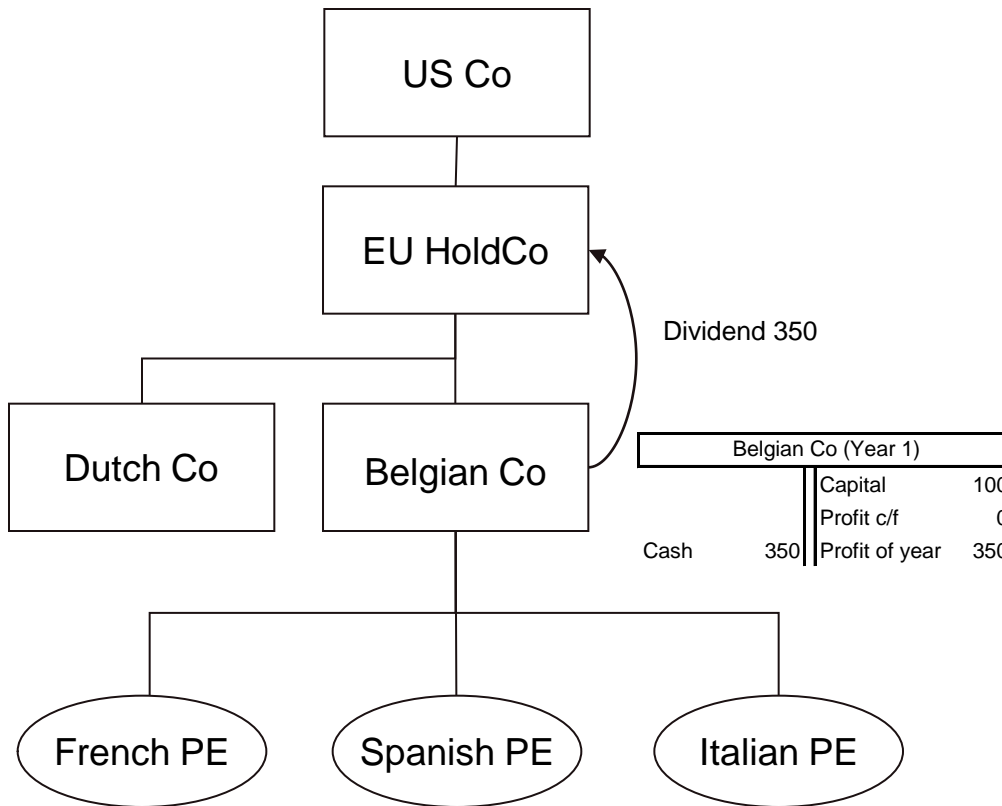
## Solving timing issue



- Check the box: Belgian company is a BVBA/SPRL
- In year 1 French, Spanish and Italian PE are profit making
- Profits are included in the profits of the year of Belgian Co
- Belgian company can distribute a dividend after year-end

# Case 2: Optimisation dividend upstream

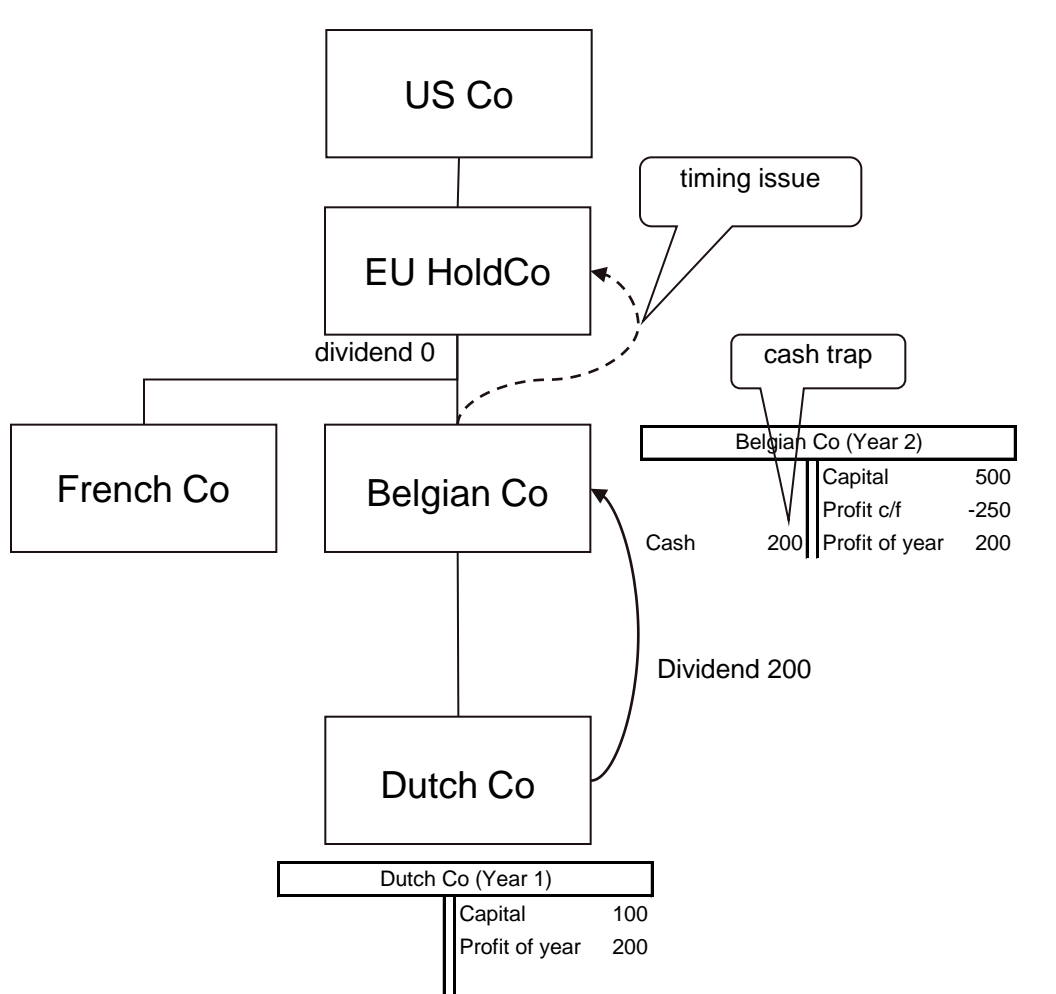
## Solving timing issue



- **Transfer Pricing aspects**
  - OECD Report on attribution of profits to permanent establishments
  - Functionally separate entity approach: Profits PE would have earned as a legally distinct and separate enterprise
  - Recognition of dealings between PE and rest of the enterprise
  - Allocation of free capital: under the arm's length principle, a PE should have sufficient capital to support the functions it undertakes, the assets it economically owns and the risks it assumes.

# Case 3: Optimisation dividend upstream

## Cash trap avoidance

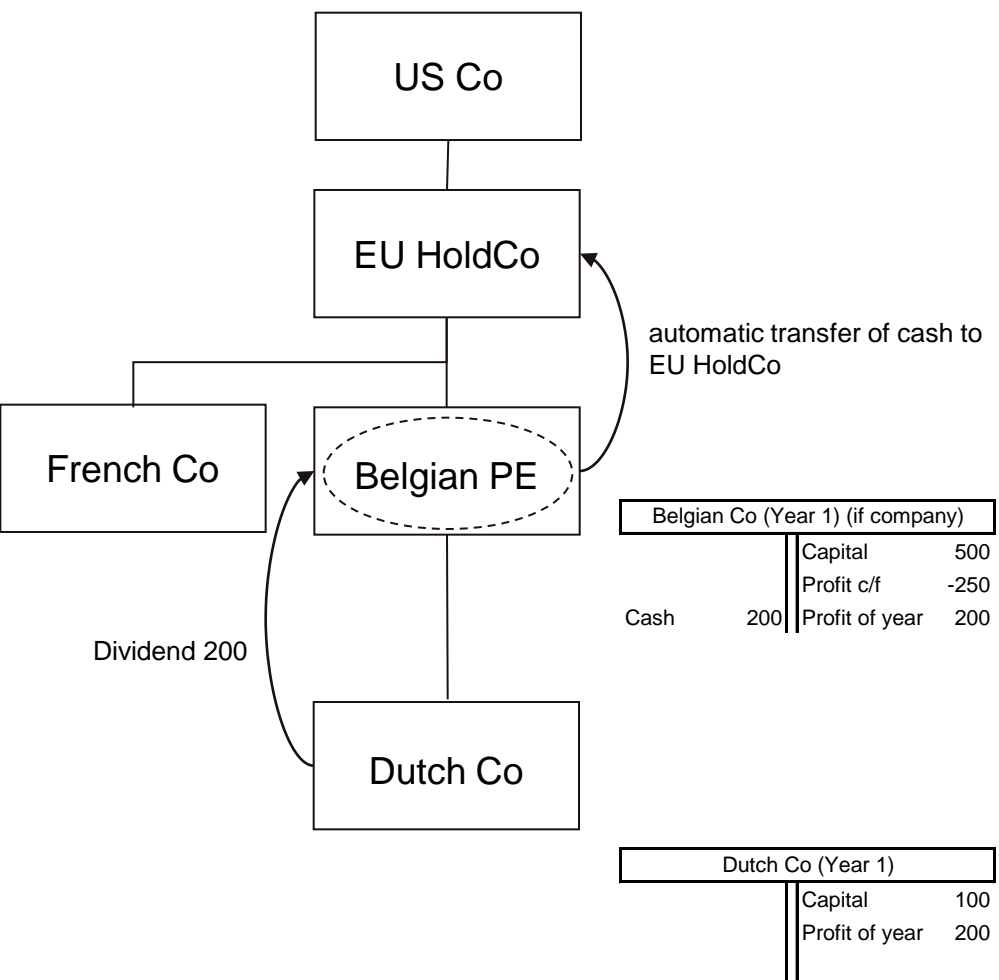


### Case 3: setting the scene

- Check the box: Belgian company is a BVBA/SPRL
- In year 1 Dutch Co is profit making and Belgian Co is in a loss position
- After year-end profits are distributed to Belgian Co
- Belgian company cannot distribute an interim dividend
  - ⇒ not possible to distribute profits to EU HoldCo and US Co up to 200
- Also cash trap as Belgian Co has not sufficient retained earnings to distribute

# Case 3: Optimisation dividend upstream

## Cash trap avoidance



Belgian Co (Year 1) (if company)		
	Capital	500
	Profit c/f	-250
Cash	200	Profit of year 200

Dutch Co (Year 1)		
	Capital	100
	Profit of year	200

- Merger of Belgian Co into EU HoldCo
- In year 1 Dutch Co is profit making and Belgian PE is in a loss position
- Dutch Co distributes dividend of 200 to Belgian PE
- Belgian PE has losses; however the cash trap is solved as Belgian Co is a PE as a consequence of the merger.

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# Determination of optimal restructuring scenario

## Tax modelling as an easy tool

- Today, more than ever, effective tax management is key in case you are dealing with situations such as:
  - determining a bid price in an acquisition process;
  - reallocation of existing bank debt and intercompany debt;
  - reorganizing your current group structure;
  - understanding the impact of taxes on your cash position;
  - a complex supply chain with multiple countries and entities;
  - valuation of deferred tax assets;
- Effective tax management can result in decreasing the effective tax rate, maximising the use of available tax assets, optimising the existing leverage, improving the cash flow and reducing compliance costs.
  - ⇒ Modelling your taxes helps you to better understand, anticipate and further optimise your direct and indirect tax charges and to obtain an improvement of your working capital based on your business plan.
  - ⇒ Depending on your needs, such tax model can provide you a fair and better understanding of the tax impact of maintaining your current group/financing structure as opposed to implementing alternative scenarios, allowing you to decide on such restructuring/refinancing scenarios in a more informed manner.

# Determination of optimal restructuring scenario

## Tax modelling as an easy tool

Scenario 1	Fiscal year 2009	Fiscal year 2010	Fiscal year 2011	Fiscal year 2012	Fiscal year 2013	Fiscal year 2014	Fiscal year 2015
EBITDA Consolidated	7.653	7.145	8.679	10.856	12.909	15.129	17.606
- EBITDA	-6.002	-6.096	-6.284	-6.485	-6.696	-6.915	-7.147
EBITDA	1.651	1.049	2.395	4.371	6.213	8.214	10.459
- Depreciations	-3.625	-2.894	-4.374	-5.527	-6.652	-7.857	-8.638
- Exceptional result	1.531	482	482	0	0	0	0
EBIT	-443	-1.364	-1.497	-1.156	-439	357	1.821
- Financial costs (external)	-1.846	-1.846	-1.689	-1.689	-1.689	-1.689	-1.689
+ Financial Income (external)	0	0	0	0	0	0	0
- Financial costs (internal)	-487	-487	0	0	0	0	0
+ Financial income (internal)	0	0	0	0	0	0	0
Profit before tax	-2.775	-3.696	-3.187	-2.845	-2.128	-1.332	132
+ Disallowed expenses	257	262	267	273	278	284	289
- Notional interest deduction*	0	0	0	0	0	0	0
- Tax losses utilised	0	0	0	0	0	0	-421
Taxable basis	-2.518	-3.434	-2.919	-2.573	-1.850	-1.048	0
- Taxes	0	0	0	0	0	0	0
Profit after tax	-2.775	-3.696	-3.187	-2.845	-2.128	-1.332	132
Effective tax rate	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%

Losses							
NOL b/f	1.696	4.214	7.648	10.568	13.140	14.990	16.039
Incurred in year	2.518	3.434	2.919	2.573	1.850	1.048	0
Utilised in year	0	0	0	0	0	0	421
NOL c/f	4.214	7.648	10.568	13.140	14.990	16.039	15.617

### Summary

#### Effective tax cash-out - Scenario 1

Scenario 1	Fiscal year 2009	Fiscal year 2010	Fiscal year 2011	Fiscal year 2012	Fiscal year 2013	Fiscal year 2014	Fiscal year 2015
Company X	799	921	903	918	952	986	1.021
Company Y	0	0	0	238	286	326	371
Company Z	0	0	0	0	0	0	0
Company U	245	245	245	245	245	245	245
Total tax cash-out	1.044	1.166	1.148	1.400	1.482	1.557	1.636

#### Effective tax cash-out - Scenario 2

Scenario 2	Fiscal year 2009	Fiscal year 2010	Fiscal year 2011	Fiscal year 2012	Fiscal year 2013	Fiscal year 2014	Fiscal year 2015
Consolidated	974	882	1035	1385	1702	2049	2628
NewCo	0	0	0	0	0	0	0
Total tax cash-out	974	882	1.035	1.385	1.702	2.049	2.628

# Determination of optimal restructuring scenario

## Transfer Pricing planning

A « business restructuring » or « conversion » refers to the cross-border redeployment by a multinational enterprise of entrepreneurial functions and risks. A business restructuring may involve cross-border transfers of key intangibles.

- Dissolution of existing principal structures in which losses are trapped in low tax countries
- Full-fledged distributors → conversions into commissionaires or limited-risk distributors operating for the Principal
- Full-fledged manufacturers → conversions into contract or toll manufacturers operating for the Principal
- Rationalization or centralization of operations
- Transfers of IP to a Principal
- Renegotiation of contracts

# Determination of optimal restructuring scenario

## Legal restructuring planning

- Remove “obsolete” legal entities from structure
  - via liquidation
  - via merger
- Align business model with legal structure
- Reduce effective tax rate by reallocating the debt

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# Any Questions?

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