M&A Tax in APAC

Webinar - 14 October 2021

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Contents

Introduction

04 Mazars at a glance
06 Foreword by Elaine Chow

Webinar

07 General M&A trends in the countries
08 Key tax issues to watch out for in a tax due diligence
10 Share vs asset deals and high level ways to structure them efficiently
13 Tax concerns in respect of indirect transfers of shares
14 Transfer pricing issues in M&A

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Mazars APAC at a glance

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- Hong Kong
- India
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- Japan
- Kazakhstan*
- Korea
- Kyrgyzstan
- Malaysia
- New Caledonia*
- New Zealand*
- Pakistan
- Philippines
- Singapore
- Sri Lanka*
- Taiwan
- Thailand
- Uzbekistan
- Vietnam

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Introduction
Foreword by Elaine Chow

The M&A process is highly sensitive, time consuming and involves complex decisions. It also a moment when years of tax planning can be undone.

The tax landscape in Asia-Pacific is dynamic and ever-changing. Companies must understand the various tax implications of an M&A transaction in their market of choice.

M&A activity across the region and the globe has breached new highs in 2021, building on the record-breaking dealmaking streak from the beginning of the year that has been aided by low interest rates and soaring stock prices.

The pandemic uncertainty has brought on a shift in M&A plans, with an emphasis on due diligence. In response to this, we hosted the M&A Tax in APAC Webinar on 14 October 2021 to take the pulse of tax risks and opportunities in Thailand, Singapore, Vietnam, India, and China.

In the webinar, we were joined by our local experts in tax due diligence:

- Do Thanh Tam, Director, Tax (Mazars in Vietnan)
- Peter Law, Partner, Tax (Mazars in China)
- Jonathan Stuart-Smith, Partner, Tax (Mazars in Thailand)
- Abhijit Kulkarni, Director, Tax (In a network firm of Mazars in India)

Each tax regime brings with it specific challenges to M&A deals and requires a unique approach. The report demonstrates that the overall burden of taxation arising from share and asset deals varies significantly across these five countries. We hope that you will find this report useful while preparing for an M&A transaction in APAC.

Elaine Chow
Director, Tax
Mazars in Singapore

General M&A trends in the countries

China

In China, the M&A market recorded a positive growth, with a great demand for investment from both local and international investors. The country witnessed an increase in M&A volumes in 2020 and 2021, despite the tumultuous period marked by the pandemic and other global events.

Foreign investors continue to show a strong appetite for the Chinese market. While Hong Kong remains a dominant gateway to investing in China, investors are eyeing for opportunities to access China through other countries such as Singapore.

India

In India, the M&A market reached a three-year high with deals worth $90.4 billion in the first nine months of 2021, a 35.1% increase compared to the same period last year. The market is expected to continue its upward trajectory in the coming months.

Singapore

Singapore enjoyed record levels of M&A activity in the first half of 2021, nearly doubling the values registered in the same period last year. The M&A performance is expected to remain robust throughout the year. There has been an uptick in acquisition and fundraising activities particularly in the renewable, logistics, e-commerce, and technology space.

Thailand

In Thailand, listed companies are using opportunities arising from Covid-19 to consolidate and to invest further to neighbouring countries such as Vietnam and Indonesia. Meanwhile, cash-strapped foreign owned companies are seeking new investors to raise additional capital.

Sector-wise, Thailand's hospitality industry accounts for 20% of its GDP, hence it came as a no surprise to see a rise in M&A transactions involving hotels and resorts. The education sector is also performing very well. The regulatory changes in China recently have led to further impetus for acquiring or developing schools in Thailand.

Vietnam

The M&A market in Vietnam has grown at a steady pace over the years. While 2020 registered a drop in deal value due to the pandemic, there was still an increase in the volume of deal. The months-long lockdown this year has led to a slowdown, but it is likely to pick up in the coming months. The forecast for 2021 still suggests some growth compared to the previous year.

"It is looking very good in India, particularly because of the government policy of disinvestment. There are many bigger public undertakings in the pipeline, involving a wide range of industries such as oil and gas and insurance."

Abhijit Kulkarni
Director, Tax
In a network firm of Mazars in India

There are specific local challenges that investors need to be aware of when doing business in APAC countries.

China

Similarly in China, the practice of having two sets of books can be found. Target companies will typically disclose the management book which display a more favourable result in their bid to maximise their valuation.

Where tax exposures may be assumed, the traditional way is requesting the target company to fulfil all their tax obligations before the deal takes place. The acquiring company may also waive their inheritance tax liability from the purchase. If this is not possible, the buyer can take steps such as including tax indemnities and warranties in the sales agreement or setting up an escrow account to ensure a fair transaction.

There is no capital gains tax in China, but capital gains are usually treated as a business-related profit. A non-PRC resident enterprise is subject to withholding tax of 10% on the gain.

India

In India, an issue will arise if the target company has significant carried forward tax losses and the situation is not assessed properly. In the event of change in shareholding of a private company, 51% of the beneficial voting power must be the same at the end of both years to be eligible to the benefit of carry forward and set off of the loss incurred.

Another key requirement in India is obtaining a tax clearance certificate for the sale of assets in case of pending or open proceedings under the Income Tax Act. The application process can be fraught with challenges such as the need to settle outstanding payments and providing indemnities. Without this certificate, the sale of assets or shares could be regarded as void.

Singapore

In Singapore, tax losses and unutilized capital allowances could be forfeited when there is a substantial change in ultimate shareholdings. If a deferred tax asset has been provided for in respect of these tax attributes, a price adjustment may be considered as the waiver is subject to approval of the tax authority.

Another key consideration in Singapore is where target entities enjoy tax incentives. It is important to assess all the conditions under the incentives to see whether they will be met post acquisition. If not, an assessment will have to be made to determine if the incentives might be clawed back by the authority which awarded the tax incentives resulting in additional tax liabilities pre-acquisition. This would impact negotiations for tax indemnities.

Thailand

Tax refunds is an area that is quite unique to Thailand. Claiming a withholding tax refund, for instance will automatically trigger a comprehensive tax audit by the revenue department. A company that applies for a VAT refund could be subject to a tax audit looking into its transfer pricing positions, potentially going back over the past five years. Therefore, if the target company has potential tax refunds which are recognised as an asset, the buyer needs to exercise caution when undertaking due diligence to identify any potential tax liabilities that could arise in a tax audit.

Another key area to look out for is transfer pricing (TP). In Thailand, the new TP documentation requirements involve a disclosure form and local files. It is critical to ensure that there are no tax exposures or if there are any, they are adequately provided for.

Similar to Singapore, Thailand also has a raft of tax incentives granted by the Board of Investment (BOI) to stimulate foreign investments such as lower or exempt rates of corporate income tax, excise duties on imports of machinery and parts. In some cases, expatriates can benefit from a lower rate (15%) of personal income tax. All of these are key considerations to decide whether you should look at an asset deal or a share deal.

M&A Tax

Key tax issues to watch out for in a tax due diligence

Vietnam

In Vietnam, many local businesses started off as a family-run business where their tax compliance and accounting practice may not be up to a good standard. These businesses generally fall under the purview of the district tax authorities. Meanwhile, for new foreign investors, the tax administration will be upgraded to the city level with higher competencies and challenges.

Another interesting observation is target companies may have more than one set of financial records: for management purposes and tax reporting. While this does not necessarily point toward a tax deficit, it surely requires additional effort in reviewing the data.

Regarding the gap between the two books, investors are strongly suggested to undertake a tax audit to look closely at the potential exposure and associated risks for they can vary significantly.

"Buyers have an obligation to withhold and pay the withholding tax. Those that do not meet this requirement may be subject to a penalty ranging from 50% to 300% of tax under-reported. Having the right advisers will help companies to avoid these risks during an M&A transaction."

Peter Law
Partner, Tax
Mazars in China

Share vs asset deals and high level ways to structure them efficiently

An M&A transaction may take the form of a share deal or an asset deal, and it is crucial to understand the differences between them. There are a number of reasons that drive one acquisition or the other, and some of the tax considerations are very unique to each market in APAC.

China

The main difference between the two is that a share deal, in general, is not subject to VAT. However, an asset deal in China will incur VAT and several other taxes and transaction costs. A company may apply for an exemption on the grounds that the transfer of business asset is out of the VAT scope in China, but they must meet several conditions.

An asset deal is not very favorable as it would traditionally incur higher tax. In China, unless the legal risks or the tax risks are very high, a share deal will be more desirable to both the buyer and seller. While there are tax deferrals which involves a lengthy procedure with uncertain outcomes, they do not apply to cash transactions.

India

In India, a concept called slump sale refers to the transfer of one or more undertaking as a going concern for a lump sum consideration without values being assigned to the individual assets and commonly used structure to transfer the assets.

Under a slump sale agreement, GST is not applicable if the assets are transferred for a lump sum consideration on a going concern basis. Slump sale is subject to stamp duty and the rate varies from state to state. The cost can be reduced through an appropriate transfer mechanism.

In case of transfer of shares, a long term capital gain tax of around 20% is applicable. GST is not applicable on transfer of shares. The stamp duty rate on transfer of shares is lower as compared with rates applicable for asset deals.

In the past, India regarded goodwill as an intangible asset that is eligible for depreciation. However, a recent amendment to the Finance Bill 2021 indicates that goodwill will no longer be considered as a depreciable asset.

Singapore

In Singapore, a transfer of shares would typically incur stamp duty which may be remitted provided a number of conditions are met.

Legacy tax exposures of the target would be inherited by the buyer whereas this is usually not the case in an asset deal. It is likely for the acquirer in a share deal to inherit the existing incentives of the target company which are often essential to the business, however the conditions will need to be reviewed to ensure incentive continuity. Tax incentives generally do not transfer in an asset or business deal.

Meanwhile, an asset deal that involves the transfer of shares, properties, and mortgages could incur stamp duty unless certain conditions are met. Under certain circumstances with a transfer of business, there is an avenue to apply for relief from GST under the Transfer of a Going Concern (TOGC) regime.

Thailand

While considering an acquisition structure in Thailand, it is important to note that some industries are required to have more than 50% Thai ownership according to the Foreign Business Act.

In an asset deal, goodwill is tax deductible in a third-party situation over 10 years. However, it is not deductible in a share deal, due to no mechanism in place to step up the basis of the inside assets.

Share vs asset deals and high level ways to structure them efficiently

"Interestingly, Thailand has no restrictions in place on interest deductibility, no thin capitalization rules, nor earnings stripping limitations. The only limitation is the interest rate which follows the arm's length principle. All of which makes an asset deal attractive. Through an asset acquisition, a company can offset the interest deductions against the future operating profits of the business."

Jonathan Stuart-Smith
Partner, Tax
Mazars in Thailand

Another issue to consider is tax losses. In an asset deal, tax losses are not transferable. But in a share deal, assets, including tax losses will carry over for the normal five years. There is no change of ownership restrictions on the ability to carry over losses. This poses as an advantage for share deals because the losses can be utilized post-acquisition.

A disadvantage of a share deal is that Thailand does not have tax consolidation or group relief making it difficult to offset interest in this transaction.

Vietnam

For share deals in Vietnam, the tax losses and the incentives go with the company. The income tax on the transaction is generally 20% on the gain in both share deals and asset deals, if we talk about resident sellers and non-public target companies. The tax base is different and tends to be more complicated. It depends on the value of each asset that they sell.

Another complication of an asset deal involves the VAT. Vietnam has a concept of project transfer which is not subject to VAT declaration and payment. But its definition is unclear and is capable of varying interpretations.

As this continues to be a controversial issue, there are recent proposals to remove the tax free status for project transfers. This comes with a huge VAT burden on the buyer, as a seller may try to impose 10% VAT on the deal value, but it remains unclear whether this is refundable by tax authorities.

In general, an asset deal is not preferred in Vietnam. A more common approach would be the buyer requiring the target to set up a new entity themselves, and then take over the business under a share deal between the investor and the new entity.

Tax concerns in respect of indirect transfers of shares

While an acquisition of target is in a tax benign jurisdiction, if it owns shares in other jurisdictions, the implications of an indirect transfer of those shares would need to be considered.

China

In China, the tax rules in relation to offshore indirect transfer were revamped in 2015 with Announcement 7 to replace Circular 698. While the previous circular only targeted offshore indirect transfer of Chinese TREs, Announcement 7 expands the scope to include all taxable properties.

It is up to the buyer or seller to report the offshore transactions to the tax authorities. However, Announcement 7 requires the foreign buyer to act as the withholding agent and apply 10 percent tax to the gain. Failure to do so may expose the buyer to a severe penalty of 50% to 300% of the outstanding tax. Therefore, both parties must come to an agreement before the transfer, to avoid jeopardising their business relationship.

India

In India, the regulations are more developed for indirect transfers. Capital gains arising from the transfer of assets through a foreign company are taxable in India if such shares, directly or indirectly, derive value from the assets located in India. This applies if the sale value is at least INR100 million and assets in India represents at least 50 percent of the total asset value owned by such foreign company.

A transaction between two non-residents for sale of shares will be liable to a withholding tax. There is an increasing tax compliance in India that comes with practical challenges. Only national Indian banks and a few private Indian banks can accept tax payments, which push foreign companies to seek assistance from a consultant with local expertise.

The Indian company is under obligation to report the indirect transfer of shares to the tax authorities within the prescribed time. The penalties for non-compliance are significant.

Vietnam

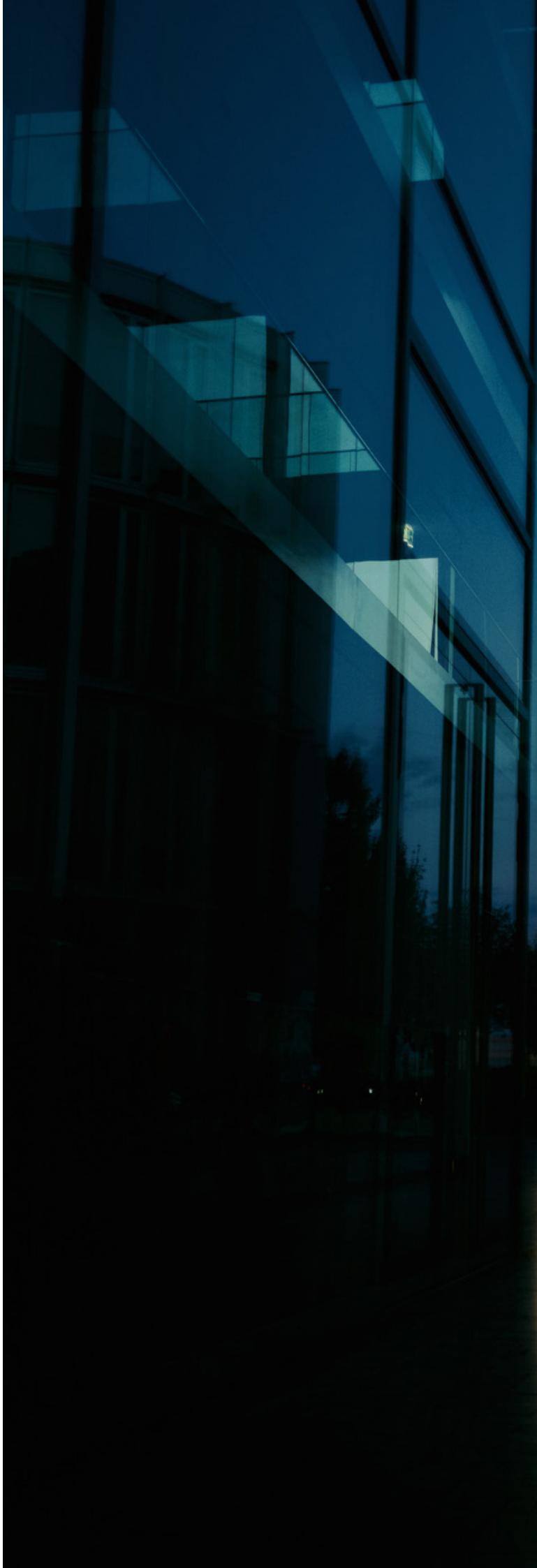
Indirect transfers are a growing concern for the tax authorities here in Vietnam. Officially from Decree No. 12/2015/ND-CP, effective from 2015, an income deriving from a capital transfer of foreign investors in Vietnam would be regarded as a taxable income regardless of where the transaction takes place, although there were attempts where the tax authority tried to collect tax from such indirect gain before the effective date of this Decree as well.

However, there has been no specific regulations on the taxing mechanism, leading to broad interpretation. The local tax authority would have varied interpretations, leaving investors with uncertainty on how the tax is being determined, or what method is used by the tax authorities when they audit the offshore capital acquisitions.

"At present, there is a significant lack of clarity in the regulations related to indirect capital transfer of foreign investors. Investors are encouraged to seek out a local adviser to know how the local tax authority in a specific province looks at this issue. We hope for a clearer guidance in the future."

Do Thanh Tam
Director, Tax
Mazars in Vietnam

Transfer pricing issues in M&A



Vietnam

In Vietnam, there is a general stipulation in the Tax Administration Law that requires fair market value in any transaction. If the tax authority has reasonable suspicions that the M&A price falls outside the market value range, it has the right to make an adjustment for tax collection purpose. As such, even in the case of M&A between unrelated parties, a solid ground on how the transaction value is being determined should be readily in place to prepare for any potential challenge from the tax authorities.

India

All international transactions including transfer of shares are subject to transfer pricing (TP) regulations. The definition of international transactions specifically includes transactions related to business reorganization or restructuring. There are anti-avoidance measures by the tax department in India to ensure that even the transactions of sale of shares or assets between unrelated parties are tested for fair value.

Thailand

Thailand does have provisions that relate to fair market value being applied for transactions between completely unrelated parties. Meanwhile for transactions between related parties, Thailand's TP rules apply to both domestic and international transactions.

The first risk to look out for is when the target company's operating margin is below the lower quartile of Thai comparable companies. This result will likely to be to be challenged with a proposed adjustment.

Secondly, any TP adjustments made during the year would raise a flag especially if it was a one-time adjustment linked to the profit of the company. Thailand has a specific provision under corporate tax whereby an expense linked to the profits of the company for the year would be non-deductible.

China

Both related party transactions and third-party sales would be subject to the fair value regime. While a valuation report is not compulsory by the law, providing this document would help to substantiate that the transaction price is of fair value. This is especially if the transaction price is below the net worth value of the target company. Under the Chinese TP rules, the tax authorities have the right to make tax adjustments within 10 years of the transaction and recover any underpaid taxes.

Contact

Elaine Chow
Director, Tax
elaine.chow@mazars.com.sg

Jonathan Stuart-Smith
Partner, Tax
jonathan.stuart-smith@mazars.co.th

Peter Law
Partner, Tax
peter.law@mazars.cn

Do Thanh Tam
Director, Tax
tam.do@mazars.vn

Abhijit Kulkarni
Director, Tax
abhijit.kulkarni@kmllp.in

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