Mergers and Acquisitions
A Global Tax Guide

PricewaterhouseCoopers

John Wiley & Sons, Inc.

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GENE DONNELLY
Global Managing Partner
Tax and Advisory

PricewaterhouseCoopers (*www.pwc.com*) provides industry-focused assurance, tax, and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 130,000 people in 148 countries work collaboratively using Connected Thinking to develop fresh prespectives and practical advice. The Merges and Acquisitions practice in our worldwide network is able to provide a full range of services to meet the needs of our clients and their businesses.

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INTRODUCTION

As the world economy continues to respond to increasing globalization, the problems that individual businesses have been forced to deal with have grown in number and complexity. Virtually every one of those problems shares a common element: In a truly global economy, businesses that are unable to operate effectively in a multinational environment will not achieve the economies of scale they need in order to remain competitive.

Of course, business leaders have taken a number of steps to achieve the targeted level of multinational scale, and each of those approaches carries its own unique set of challenges. However, virtually all leaders of multinational organizations realize that if their businesses are to truly achieve the level of global scale necessary to remain competitive, they will at some point in their companies' life cycles have to undertake strategic acquisitions. Ultimately, most business leaders understand that if one competitor uses merger and acquisition (M&A) transactions effectively to achieve global scale, other competitors will do the same.

When a business engages in a multinational merger or acquisition, it soon becomes apparent that dealing with a diverse set of transaction-related tax rules will be one of the major challenges to successful implementation. The fact is that a significant portion of the income earned by a posttransaction enterprise will be used to pay various types of taxes. Therefore, it would seem obvious that dealing effectively with the tax rules would be a major objective of those involved in multinational M&A transactions.

Although the world economy is globalizing at a rapid rate, the same cannot be said about the tax systems in place in the industrialized nations of the world. In fact, the opposite is true. A careful observer might conclude that many of the industrialized nations have embraced tax systems that are designed specifically to employ differences in individual tax schemes in order to attract more commercial activity to their countries.

The diverse tax environment that confronts a business that undertakes a multinational merger or acquisition demands that those who are managing the tax aspects of the proposed transaction understand global taxation on at least two levels. First, the individuals responsible for tax planning must understand the differences between the basic systems of taxation and how those systems will affect individual transactions. And they must understand the differences between direct- and indirect-transaction tax systems, global and territorial income tax systems, and entity-level and fully integrated tax systems.

Second, multinational M&A transaction planners must quickly be able to gain an understanding of how individual tax authorities apply various tax systems. It does a planner little good to know that a particular jurisdiction applies a territorial income tax to a postmerger multinational business if the planner does not understand how the jurisdiction measures the amount of income subject to tax in each individual territory.

In this book, PricewaterhouseCoopers tax professionals provide the informational foundation that tax planners need when they are involved in a multinational M&A transaction. The 31 individual country-specific chapters each offer both an overview of the general approaches to M&A transaction taxation taken by virtually all of the industrialized countries of the world and detailed information about how the tax authorities in those countries apply the rules to various aspects of a transaction. The consistency of format within each of the chapters is designed to enable a planner both to access the available data quickly and, as much as possible, to compare the rules that apply in one jurisdiction with the rules that apply in others.

In addition to the detailed individual-country discussions, the book contains several other chapters that focus on some of the broader tax issues that arise in the context of a multinational M&A transaction, including, for example, the use of hybrid entity structures to facilitate multinational acquisitions. While not focusing on the specific aspects of the laws of any particular jurisdiction, the information contained in these chapters is nevertheless extremely important in the M&A context, must be understood, and is critical to achieving a successful deal implementation program.

By adopting this approach to a discussion of global taxation, the authors have created a unique resource for planners who are involved in multinational M&A transactions. The book is focused totally on the multinational aspects of M&A transactions, it provides detailed information concerning specific issues inherent in local tax laws, it organizes the available data in a manner that is simple to use, and it accomplishes these tasks while remaining attuned to the broader tax issues that are present in almost every multinational M&A transaction.

While there is no substitute for competent local tax advisers or for detailed issue-specific research, the following chapters offer M&A tax planners a basic foundation of multinational tax knowledge.

TAXES: DEAL MAKING'S FORGOTTEN VALUE DRIVER

The CEOs of two major financial institutions are meeting to close the deal on a major acquisition of a multinational business. Discussions thus far have been heated and passionate. Exhaustive negotiations and due diligence have taken place, particularly around economic issues believed to relate to the customer base, the receivables portfolio, and other areas where potential contingent postdeal liabilities could arise. Synergies between the businesses have been identified, and redundancies have been rationalized. In short, the deal has been analyzed, scrutinized, and agreed upon; a plan has been developed to maximize the value of the combined businesses. Of course, everyone assumed that the combined enterprise would continue to pay taxes, yet no one really thought of taxes as a major issue to be addressed in the deal. As one executive put it, "Taxes are simply 40 percent of pretax earnings."

In any acquisition, money—in some cases huge amounts of it—can be saved by paying careful attention to management of the tax burden of the combined enterprise. Most chief financial officers and tax directors recognize that fact. However, in many instances, tax planning is considered to be a postdeal activity, and tax risks are assumed to be properly quantified and recorded in the balance sheet accounts. Far too often, deal makers do not attempt to identify tax strategies and risks that could seriously affect the price at which a transaction is undertaken. Ironically, in relation to the other complexities involved in most deals, the effort required to perform a thorough tax analysis is relatively small and can be easily integrated with other tasks—for instance, legal structuring—that need to be performed anyway.

A few quick examples can demonstrate the dramatic effect that income taxes can have on a transaction:

- Assume a strategic buyer is willing to pay $500 million, or 20 times earnings, measured on an International Accounting Standards (IAS) basis, for a multinational manufacturing company. The buyer intends to finance 50 percent of the transaction with debt, issued at the level of the buyer's public holding company. If the buyer knew that interest on the $250 million of debt would produce no global tax benefit, would therefore increase the cost of the transaction, and would reduce annual IAS earnings by $9 million per year, would the buyer not consider an adjustment to the purchase price?

- Assume a financial buyer is willing to pay $350 million—or seven times earnings before interest, taxes, depreciation, and amortization—for a multinational technology company. The buyer intends to finance 70 percent of the transaction with debt issued by the target company. If the buyer knows that the target's taxable income is generated in a jurisdiction where the interest will not be deductible, should the buyer not consider an adjustment to the purchase price?
- Assume the buyer of a distressed business is willing to pay creditors $250 million in exchange for what remains of that distressed enterprise. The buyer intends to recover the purchase price by selling off some of the assets of the enterprise and then reorganize the remaining parts into a profitable business. If the buyer finds out that the assets to be sold have no tax basis and that therefore 40 percent of the assets' sale price will be paid in taxes, should the buyer not consider a substantial adjustment to the purchase price?

Of course, most reasonable analysts would look at these situations and ask whether a change in the deal structure could be introduced to avoid the adverse tax consequences. Assuming that no such structural change is possible, reasonable analysts almost certainly would conclude that price adjustments should be made in each of these situations. Yet in many transactions, such price adjustments are not even considered, and in some instances, not even an effort is made to identify the issue and a method of adjusting the transaction structure to avoid the issue. Why this lack of attention to an area that could significantly affect the value realized from a transaction? There are several possible reasons.

In deal negotiations, it's not unusual for negotiators to make two assumptions: (1) that statutory tax rates are generally in the area of 35 to 40 percent of earnings and (2) that very little can be done to significantly change the rate applicable to postdeal income. Yet transactions exist where the taxes of the combined enterprise were as high as 60 percent or as low as 5 percent of postdeal earnings. When acquisitions involve multinational companies with various pools of earnings that are subject to multiple tax regimes, the variance between the aggregate rate of tax paid to the different taxing jurisdictions and the statutory rates imposed by those jurisdictions can be quite large.

In very large deals, negotiators often don't consider unrecorded tax risks to be significant enough to cause concern. Even though an identified and recorded tax risk might be as high as several billion dollars and might be subject to significant contingencies in the context of a multibillion-dollar deal, the potential deviation in the amount of tax that ultimately will be paid is sometimes considered unimportant relative to the long list of other economic matters that must be considered.

In large transactions involving public companies, confidentiality and speed are also important issues. Typically in such deals, very little information filters down through the organization before the deal is announced. As a result, top executives often trade the deal by using imperfect information and assumptions about the tax positions of the various entities involved.

In smaller deals, availability of resources is often the key issue that determines whether sufficient attention will be paid to taxes. Negotiators of such deals have to consider in their analysis of taxes whether they will realize a return on the investment of scarce resources. Of course, certain situations would more than justify such an investment—for example, the identification of a deal killer as a result of tax diligence, the elimination of a major transaction tax through a simple change in deal structure, and so on. Unfortunately, the existence of such opportunities cannot be identified in advance, and a buyer will never know the opportunities exist unless taxes are given appropriate attention at the inception of a transaction.

Some might ask whether different types of buyers should have different perspectives with respect to the tax issues related to a transaction. At first glance, one might assume that financial buyers and distressed-business buyers, because of their interest in cash flow as a measure of future return, would be more concerned with taxes than would strategic buyers, whose financial interest most often focuses on how a potential acquisition will affect the publicly reported income statement and balance sheet. Clearly, *all* types of buyers should be equally concerned with taxes: financial buyers because of the potential impact of taxes on annual cash flow, distressed-business buyers because of the impact of taxes on the cash that can be realized from the disposition of excess assets, and strategic buyers because of overwhelming interest in minimizing the tax expense charged to financial earnings.

For all types of buyers, an awareness of both the key tax risks inherent in an acquisition and the strategies that can be used to minimize future taxes and maximize both cash flow and earnings can yield tremendous benefits. These issues should be dealt with in each of three phases of an acquisition: the diligence phase, when the tax position the buyer inherits is identified; the structuring phase, when the legal and economic shape of the deal is determined; and the postdeal integration phase, when efforts are made to minimize the cost of predeal risks that were accepted by the buyer and to maximize opportunities inherent in deal structure.

CAVEAT EMPTOR: KNOW THE RISK BEFORE YOU BUY

In the mergers and acquisitions business, horror stories abound involving the assumption of risks that had not been previously identified. A simple review of

deals undertaken in the past few years would reveal several such stories related to tax matters.

In one instance, a multibillion-dollar international acquisition involved two companies with recorded tax reserves of more than $2 billion—reserves that may or may not have become actual cash liabilities subsequent to closing the transaction.

In another instance, a $16-billion acquisition involved a target company that was in a dispute with the US Internal Revenue Service concerning previously taken deductions of more than $2 billion—that is, almost $1 billion of contingent tax liabilities and interest.

Situations like these are not uncommon. In fact, according to many analysts, large contingent tax liabilities are more often than not present in companies undertaking major merger and acquisition transactions.

The level of uncertainty that exists with regard to tax benefits and risks points out the necessity of understanding in detail the tax histories of each of the legal entities involved in a transaction. When it seems inevitable that a buyer will inherit a less-than-optimal tax position, risk management dictates that efforts be made to minimize the risk. However, for any buyer involved in a pricing process, the first steps ought to involve achievement of an understanding of the target's tax position, of the extent to which that tax position will be inherited by the buyer, and of the amount of risk involved. If planning is to be used to minimize those risks, a buyer must also understand the degree of risk inherent in the implementation of any such planning strategy.

Managing Risk: The Perils of Negotiation

While megadeals between industry giants dominate the business headlines, a substantial portion of all transactions involves the purchase of subsidiaries, pools of assets, and/or orphan businesses. In these types of deals, it is possible to manage some degree of tax risk through negotiation. However, the efficacy of negotiation is affected by the structure of the deal, the availability and willingness of a counterparty with whom to negotiate, and the actual rather than perceived effectiveness of warranties in providing satisfactory levels of tax indemnification.

Subsidiaries, Assets, and Orphans Purchasing a subsidiary often means inheriting not only the tax problems of the subsidiary but also, at least to some degree, the historical tax problems of the parent. Depending on where the entities file tax returns, the parent and subsidiary might very well be jointly and severally liable for each other's taxes. In such cases, buyers are getting more than they bargained for. Even if the parent offers some form of indemnity with respect to taxes, that indemnity must be evaluated within the context of the parent's actions. For example, how good is an indemnity offered by a parent

holding company that has as its priority the use of the proceeds of the sale of the subsidiary to pay down debt?

Asset sales offer the possibility of a slightly more positive scenario. In an asset purchase, the buyer can, in most legal jurisdictions, avoid a substantial portion of any preexisting income tax problems. However, income taxes are usually only one aspect of the transaction—a fact many buyers ignore. If the assets constitute an entire business, the buyer may still assume problems associated with taxes related to employment, turnover of produces and services, and transfer taxes.

With regard to orphans (businesses sold by their owners because they are noncore or off strategy), negotiations undertaken to mitigate tax risk are not likely to be very effective. It is highly probable that such businesses have not been heavily managed and have been off the radar screen of the owner for a significant period of time prior to the sale. These companies are likely to be offered to buyers on an as-is, take-it-or-leave-it basis, and therefore, making so-called risk-based adjustments to the proposed purchase price becomes an important aspect of the negotiations.

Warranties Can Be Deceptive In any negotiation, indemnities and warranties may seem to provide high levels of comfort with regard to tax risk management. However, such forms of risk management must be scrutinized carefully to determine exactly what is being offered.

General tax warranties usually apply only to those things that are not known by or disclosed to a potential buyer. Therefore, even if a buyer is successful in negotiating very broad warranties from a financially sound seller, the warranty will be of no use in dealing with subsequently encountered tax liabilities if the issue giving rise to the tax liability was known to the buyer. For example, a seller might disclose the fact that the target company operates in several jurisdictions but has filed tax returns in only one of those jurisdictions. In such an instance, a general warranty might be unavailable to a buyer that later incurs a failure to file penalty with respect to the acquired business. Even vague disclosures by an owner often can prevent the enforcement of a warranty.

Unfortunately, the types of disclosure that frequently mitigate the benefits of a general warranty are meaningless to buyers unless those buyers have a full understanding of the tax position of the target and of the relationship of the disclosed information to that position. For example, a disclosure of the jurisdictions in which a business files is relevant only if the buyer is aware of the jurisdictions in which the target should file. The only efficient approach to such a situation is for the buyer to make sure that items carved out by the seller as exceptions to a warranty—carve outs that are usually nonnegotiable because of the way in which the disclosure statement is structured—get subjected to a rigorous risk assessment during the diligence phase of the acquisition.

STRUCTURING THE DEAL: FOCUS ON TAX

Deal structuring can be simple, or it can be complex. A plain-vanilla structure might be the optimal choice for a transaction involving a plain-vanilla company. However, most companies are not plain vanilla, and under most circumstances, educated transaction structuring can have a dramatic impact on the tax position of the postacquisition enterprise.

The value realized with respect to transactions involving multinational companies can be substantially enhanced by incorporating educated tax planning into the deal structure. There is a broad spectrum of tax planning that can be incorporated into the acquisition of a multinational company. In the recent past, several of the often-used approaches to multinational acquisition planning have come under a great deal of public scrutiny. Offshore tax-haven strategies that create so-called inverted companies—that is, companies legally resident in a jurisdiction other than the one in which the most significant operations are conducted—in an effort to shift the tax burden to alternative jurisdictions with lower tax rates, have been the subjects of a number of bills in the US Congress,[1] and have caused statutory and regulatory changes in a number of European jurisdictions.

Not all, however, agree with moves designed to limit the benefits of corporate inversion strategies. The US Chamber of Commerce, for example, "urged the US Congress to reject legislation that would penalize American businesses locating their headquarters offshore in an effort to compete with foreign companies that have an unfair tax advantage over US companies" and suggested that Congress "revisit the U.S. tax system that drives businesses offshore in the first place."[2]

The use of tax havens and inverted companies is the basis of a politically charged debate that is expected to continue for a number of years. In fact, it will probably take years for the major industrial countries to agree on definitions for the terms *tax haven* and *inverted company,* yet those who negotiate transactions need to understand that tax havens and inversions represent only two points on the spectrum of tax-planning structuring that is needed when major acquisitions are undertaken.

Negotiators must recognize that there is no global system of business taxation. In fact, the disparities that exist between the taxing systems of major industrialized nations guarantee that a multinational corporation will be subjected to a

1. For summaries of a number of these bills, see *http://www.citizenworks.org/enron/offshoretaxbills.php*.
2. "U.S. Chamber Urges Congress to Reject Penalties on Offshore American Businesses," October 16, 2002, *http://www.uschamber.com/press/releases/2002/october/02-172.htm*.

multitude of local tax rules that produce something substantially different from a global tax liability. Examples include:

- The tax systems of some countries are applied differently depending on the legal form—such as corporation, limited company, or partnership, and so on—adopted by the business that is paying the tax. Other countries tax all business organizations in the same manner regardless of the legal form taken by the organization.
- Some countries tax a corporate entity on the basis of the entity's country of legal incorporation. Other countries establish the taxing jurisdiction to which a corporation is subject by identifying the jurisdiction from which the corporation is managed.
- Some countries tax a business organization on the organization's income regardless of the jurisdiction in which the income is earned—that is, worldwide taxation. Other countries tax a business organization only on the income that is generated within their borders—that is, territorial taxation.
- Some countries exempt from local-country taxation dividends received from controlled foreign businesses—that is, participation systems. Other countries allow as a credit against local tax any foreign taxes paid on the earnings that are subsequently repatriated from controlled foreign businesses—that is, credit systems.

Given all of these potential differences, it would be foolish to ignore the impact of tax structuring in the consideration of a multinational transaction. Even if the combined business is unwilling to consider aggressive tax planning as a means of achieving an effective tax rate that is below the existing statutory rate, international tax planning is needed to ensure that the combined business enterprise does not subject itself to an effective rate that is substantially above the aggregate of the existing statutory rates.

AFTER THE DEAL: CAPTURING POSTDEAL SYNERGIES

Of the three phases of tax planning applicable to a transaction, postdeal integration is the one on which corporate tax teams focus most. The additional focus could be the result of any number of factors—for example, the availability of more time and more information after the deal is closed, or the additional urgency created by a you-break-it, you-own-it approach to the acquired company, or the pressure that evolves from the need to show that the deal achieved its objectives, and so forth. However, even with the additional emphasis that is placed on realizing the tax benefits and managing the tax risks associated with

a deal, tax synergies still somehow manage to fall between the cracks and value is lost.

The major roadblock encountered in postdeal integration of tax matters consists of the natural tension that often exists between running the business efficiently and running the business efficiently while minimizing taxes. Immediately after an acquisition, those responsible for managing the combined business enterprise focus almost entirely on integrating business operations and achieving operational efficiency. In many instances, effective tax planning does not automatically result from the achievement of operational efficiency.

For example, in most multinational transactions, the combined organization's intercompany transaction systems and transfer-pricing mechanisms must be redesigned to ensure both global tax efficiency and territorial tax compliance. However, from an operational point of view, intercompany transaction systems and transfer-pricing mechanisms are often viewed as obstacles to organizational efficiency. In some instances, operations management believes that such systems push the organization away from global cooperation and efficiency, and therefore operations management fights to avoid implementation of such systems.

Yet if the combined enterprise is to be successful, an effort must be made to integrate tax matters and operational matters. Success cannot be achieved if the income of the combined enterprise doubles while the global effective tax rate increases from 35 percent to 75 percent. Sometime early in the post-deal integration phase of the transaction, there must be an effort to ensure that the increased efficiencies achieved by the business combination are retained for the benefit of the shareholders rather than simply turned over to various taxing jurisdictions.

Fortunately, if the tax diligence and tax-structuring phases of the acquisition have been undertaken properly, there will already exist a platform on which two major elements of the postdeal integration process can be built. First, the diligence phase of the process will have identified risks that need to be managed in the postdeal period. Every effort should be made to ensure effective implementation of the steps necessary to control and reduce the economic risks assumed.

Second, the structuring phase of the process will have outlined an operational structure that can be used to maximize the tax benefits realized by the combined business enterprise. Unfortunately, during the structuring phase, an organizational outline will have been only mapped out; during the postdeal integration phase, it will be necessary to implement the detailed procedures that are necessary to ensure that the structures work as planned.

Once the risks identified in diligence have been controlled and the opportunities inherent in the planned structure have been captured, there are still aspects of postdeal integration to be pursued. Examples include:

- It will be necessary to develop a system of tax administration that ensures that the combined enterprise complies with all applicable laws and therefore avoids incurring any risks that are not already present.
- As the business enterprises get integrated, it will become apparent that there are other, more-isolated aspects of combined tax planning that can be implemented to achieve an economic advantage.
- Once the immediate tax integration is complete, an effort should be made to develop a long-term strategic plan designed to manage global taxes in the most efficient manner.
- As the integration process gets completed, an effort should be made to ensure that the resulting plans allow for an element of flexibility that will almost certainly be needed to deal with changes in both the nature of the business and the laws of the jurisdictions in which the business operates.

In today's mergers and acquisitions environment—an environment characterized by multinational transactions involving billions in consideration—taxes are often viewed as a minor aspect of the transaction. In most cases, a great deal more emphasis is placed on global labor agreements, customer relations, intangible property rights, and tangible fixed assets. However, most multinational businesses pay more than 35 percent of their net income to various taxing jurisdictions. Most multinational businesses incur wage-based taxes in excess of 10 percent of the cost of their workforce. And most multinational businesses collect and remit taxes on goods and services transfers of 10 percent or more of the amount of their turnover. The fact is that most taxing jurisdictions collect from their citizens more than 30 percent of gross domestic product.

Taxes represent a material component of virtually any value equation. Within the world of mergers and acquisitions, a bit more focus on tax matters could result in a substantial increase in the returns realized with respect to any particular transaction.

FINANCING AND HYBRIDS: MAXIMIZING YOUR TAX AND LEGAL STRUCTURES

Hybrids. Transparent entities. Flow-through enterprises. The words themselves conjure up the image of a mad scientist cooking up a new life form in the basement of a Gothic castle. While these are the words of deals, not of pseudoscience, the analogy is not entirely without merit. When a new entity is born out of a merger or acquisition, its creators must understand its ultimate treatment, particularly from legal and tax perspectives.

A new entity must adopt a legal structure that is recognized by the various jurisdictions in which that entity intends to operate. For example, an entity may be structured under local law as a corporation or a partnership. Based on the legal structure chosen, the local jurisdiction will subject the entity to a particular tax regime.

Because global tax rules are both flexible and rigid with regard to how entities are taxed, the legal structure selected does not subject the entity to the tax regime that was sought by those that created the entity. It may be that accomplishing certain business objectives requires that the entity be established in a particular legal jurisdiction where the desired tax regime is not available. It may be that a particular tax regime is denied to a particular entity because of the type of business conducted by that entity—regardless of the legal structure adopted for the business.

The one absolute fact is that there can be considerable latitude with regard to how a particular business enterprise is taxed. In some cases, businesses obtain access to that degree of tax latitude by selecting a particular legal form through which to conduct the enterprise. In other instances, local law provides certain types of entities with a tax election that allows the entities to choose the tax regime to which they are subject—regardless of the legal form selected by that entity. In other words, in some instances, local laws allow for certain entities to be treated as hybrids—that is, entities with one status for legal purposes and another for tax purposes.

Entity structure selection is a key component of deal planning, in that it offers the opportunity to balance the application of various tax regimes to a single multinational enterprise. Understanding the opportunities inherent within the legal and tax parameters afforded by the rules governing entity structure selection and

hybrid utilization is critical to achieving the optimal tax position, particularly with respect to multinational entities.

TAX-TRANSPARENT ENTITIES

For tax purposes, some entity structures result in tax-transparent entities. Such entities, in the various jurisdictions in which they exist, are recognized as legal entities and enjoy all of the privileges that their particular legal status affords. However, from a tax perspective, the entities are ignored, and the tax authorities treat them as flow-through enterprises. A US example of a tax-transparent entity would be a general partnership. Under US tax rules, general partnerships do not exist as taxable entities, though they are required to perform some information reporting. A non-US example of a similar type of entity is a Netherlands-based *Commanditaire Vennootschap* (CV). In either case, such entities can be viewed as separate entities for purposes of the application of nontax law and at the same time, as transparent entities for tax purposes. As tax-transparent entities, a US general partnership and a Dutch CV are not subject to tax in the jurisdictions in which they are formed.

The reason? Tax authorities consider the owners of such entities to be responsible for the tax consequences of the business activities undertaken by the enterprises. So, for example, it is the owners of US-based partnerships, rather than the entities themselves, who are, for tax purposes, considered to have undertaken the activities of the partnership that they own. To the extent that the owner would have been subject to US taxes if that owner had undertaken the activities directly, the owner will become subject to US taxation. Owners of a Netherlands-based CV are assessed independently by the government with respect to the activities the CV undertakes. In many cases, those owners are not subject to Dutch tax.

Both a US partnership and a Dutch CV could represent ways of undertaking economic activity in the US and the Netherlands and never being subject to local-country taxes with respect to such activity. However, the more common case is that the US partnership and the Dutch CV are examples of tax-transparent activities that can provide a means of consolidating, for tax purposes, the activities of a separate business enterprise and its owners.

Tax transparency is a major part of tax planning and deal structuring. It is a method by which an operational or strategic objective that involves locating an entity in a certain country can be achieved while, at the same time, shifting the taxation of the business activities of that entity to another jurisdiction. In an acquisition, this strategy can provide a great deal of flexibility with respect to planning the global tax position of the acquired entity.

The importance of tax transparency becomes obvious in almost every major multinational asset acquisition. If a US corporation purchases the assets of a business that operates in a non-US jurisdiction, it is almost always important for the US corporation to make sure that the assets are acquired by a subsidiary that is properly qualified to do business in the foreign jurisdiction in which the assets are located. In most cases, this objective is best accomplished by establishing a local-country entity.

However, when the acquisition is financed with local-country debt, it is highly likely that the acquired business will generate tax losses in the early years of its operations. If the local-country entity that operates the business is treated as a separate entity for both US and local-country tax purposes, the entity will pay little or no local-country income tax in the early years of operations. However, the losses generated by the local-country operations could be of no use even though the acquiring corporation is paying substantial US income taxes.

If the local-country entity is treated as tax transparent for local-country purposes, the impact on local-country taxes will be little or nothing. However, if the local-country entity is treated as tax transparent for US purposes, the early-years losses generated by the foreign business will be considered to be part of the income of the US corporate parent and will potentially result in a significant reduction of current US income taxes.

Not an Intangible Holding Company

While in some respects tax-transparent entities resemble intangible holding companies—for example, both involve movement over jurisdictional lines—there are important differences. The purpose of an intangible holding company is to transfer income-generating intangible assets, such as trademarks, and the taxable income attributable to those intangibles from entities located in high-tax jurisdictions to entities residing in jurisdictions that impose low or no income taxes.

Tax-transparent entities, however, are far more comprehensive in what they attempt to accomplish. Rather than simply moving taxable income from one jurisdiction to another by charging a royalty or a fee for the use of a transferred intangible asset, tax-transparent entities move all of the business activities of one entity to another and combine the activities of the two. From a tax perspective, the transparent entity exists only as a local-country extension of its owners. Because there are so many aspects of tax law that are affected when the operations of two entities become blended together, tax-transparent entities often offer powerful tax advantages over even the most favorable tax position that can be achieved by two stand-alone entities.

A simple extension of the foregoing example can demonstrate the difference between the two approaches to multinational tax planning. In the case of a US corporate acquisition of a pool of foreign business assets, an attempt could be made to segregate intangible assets and to move them to a low-tax jurisdiction. However, if both the intangible holding company and the local-country operating company are treated as separate entities, no real tax advantage will be incurred in the early years of operations. If the acquired asset pool is going to generate tax losses in the early years of operations, the payment of a fee to an intangible holding company will only increase the amount of that loss. Assuming that all entities are treated as separate for tax purposes, the increase in the loss of the operating company will produce no tax benefit, and the transfer of the income stream to the intangible holding company can sometimes result in an increase in taxes—the taxes levied in the low-tax home of the intangible holding company—and almost certainly will result in an increase in the operational complexity of the overall organization structure.

Of course, some acquirers have elected to combine the two strategies—tax-transparent organizations and intangible holding companies—in an effort to pursue an efficient tax strategy. If in our example, the local-country operating company is tax transparent for US tax purposes and the local-country intangible holding company is honored as a separate entity, it might be possible to achieve the best of all worlds. The increased loss of the tax-transparent operating company would flow through to the US parent corporation and reduce the current US tax liability, while the fee paid to the intangible holding company would continue to be subject to the local-country low-tax regime. Of course, US and foreign country rules intended to limit jurisdiction shopping would almost certainly make it difficult for tax planners to implement such a structure.

USING HYBRIDS EFFECTIVELY

Although the ability to use tax-transparent entities has been available for many years, the introduction of hybrid entities has substantially reduced the levels of complexity and risk inherent in implementing tax strategies based on transparent entities. A tax hybrid is an entity that is allowed to make a simple tax election to choose its tax status: transparent or separate-company treatment. In the United States, entities other than corporations are generally considered hybrids because they are provided elections through which they can select the tax regime to which they will be subject.

Prior to the creation of hybrids by US tax authorities, deal makers were always subject to the risks inherent in selecting an entity form. If the creators of an entity selected the wrong entity form or operated a properly selected entity form in an incorrect manner, they were subject to the risk that the tax

authorities would treat their entity in a manner that was different from the manner intended. It was not uncommon for tax authorities to argue that a limited partnership that had been created properly under local-country law should be subject to a corporate tax regime because of the way in which the business was operated. Briefly stated, the creation of hybrids provided for a higher level of certainty with respect to various aspects of the tax-transparency issue.

Despite different regulations that govern the use of hybrids in different areas of the world, the benefits, from a tax perspective, are generally significant. One area in which opportunities exist is in the use of the US foreign tax credit. While intended to provide tax relief on a worldwide basis, use of the foreign tax credit has been fraught with problems.

When a US corporation acquires a foreign business entity that can avail itself of the US hybrid rules, an interesting opportunity is presented with respect to foreign-tax-credit planning. Assuming that the acquired foreign entity is going to pay local-country income taxes, any dividend paid from that entity to the US corporate acquirer will carry with it a foreign tax credit. That credit may be used to offset the US tax paid by the corporate acquirer and therefore reduce the possibility of triple taxation of the income ultimately earned by shareholders of US corporations.

Unfortunately, the US foreign-tax-credit rules place significant restrictions on the ability of the US corporation to ultimately realize a credit for the taxes paid by the foreign subsidiary. These restrictions take into account many factors, including the foreign-sourced gross income of the US corporation, the amount of certain expenses incurred by the US corporation, and the relative amounts of US and foreign assets held directly and indirectly by the US corporation. In many cases, US foreign-tax-credit restrictions can virtually eliminate the ability of a US acquirer to use the foreign tax credits attributable to its acquired foreign businesses.

With the use of hybrid treatment under the check-the-box regulations, the US corporation is provided with a second approach to foreign-tax-credit planning. If an election is made to treat the acquired foreign company as a tax transparent enterprise for US tax purposes, the US foreign-tax-credit computation will be undertaken as if the two legal entities constitute a single US taxpayer. Such a consolidated calculation can produce results that are substantially different from those that would result from a separate-company calculation. Thus, the existence of the hybrid rules provides deal makers with an opportunity to achieve the best overall tax result without having to make changes in either the legal or operational structure of the acquired business.

An added advantage of the US hybrid regulations is that they are generally effective across jurisdictions for US purposes but usually not effective in non-US jurisdictions. So, for example, a UK limited company might be treated as a

real and taxable entity—a corporation—in the UK and as a transparent and, therefore, nontaxable entity in the United States.

US check-the-box regulations can be most effectively exploited when they are used for taking full advantage of the play that exists between US and foreign jurisdiction tax laws. For example, a US corporation acquires a foreign holding company with 35 foreign country subsidiaries. To consolidate the operations of these entities, the US corporation establishes a Dutch or Luxembourgian holding company. For US tax purposes, the acquirer checks the box with respect to the 35 companies, electing to treat each as a transparent entity. The result is that from a US tax perspective, the US corporation owns one foreign entity—the holding company—thereby avoiding all of the potentially costly issues raised by US tax law with regard to crossing jurisdictional lines. The true benefit is that this US tax result has been accomplished without changing the structure of local operating companies and while maintaining the most favorable foreign-holding-company structure.

Other jurisdictions around the world offer other types of hybrids resulting in other options and benefits. In Europe, for example, an entity's location for tax purposes is often based on a concept referred to as mind and management. Basically, the concept asserts that for tax purposes, the legal jurisdiction in which an entity is deemed to be based is determined by the location at which the directors and officers control and manage the company and at which the day-to-day operations of the company take place. So, for example, a Delaware corporation whose mind and management reside in the United Kingdom would be treated as a UK corporation for UK purposes and receive the benefits and detriments of that designation. In the United States, the same entity would be treated as a US corporation. Since the entity is subject to dual incorporation, it has many of the basic tax attributes of a hybrid.

Regardless of type, tax relief results from careful understanding and selection of hybrids and jurisdictions, with an eye toward reaping the benefits of certain consolidations. For example, the Delaware corporation headquartered in the United Kingdom that was mentioned previously, can consolidate with both its UK and US affiliates. However, it is also possible to achieve the same result with a hybrid, even though the entity does not have US legal residence.

It should be noted that in certain jurisdictions—Canada and the United Kingdom, for example—there are legal liability issues associated with the use of hybrids because from a legal perspective the entities eligible for hybrid status (transparent entities) are slightly different from the normally designated corporation. However, these issues are often not substantive and with the application of some focus to ensure that proper steps have been taken to mitigate the issues, are very easily managed.

Elective Classifications: Making All of It Work

While the options available with respect to transparency and hybrids are generally elective, they are not totally so, particularly in a multinational context. For example, the rules governing hybrids particularly and, to a certain extent, those governing transparency apply only to certain legal entities. And of these, some might automatically be transparent in certain jurisdictions, while others might need to be run in particular ways in order to achieve transparent status. Therefore, focus is important in the decision about the right combination of legal form, management, and tax status while goals with regard to this strategy are being set.

Let's consider a hypothetical case. A US business entity is involved in an acquisition and wishes to structure the deal in a way that results in a dual-status entity. For strategic or legal reasons, the acquired entity is legally organized in the Cayman Islands and is structured so that mind and management is located in Dublin. The actual directors and operational managers of the acquired company are resident in many countries, including the United States, the Cayman Islands, Ireland, and the United Kingdom.

As events unfold, nonresident directors and managers are reluctant to travel to Dublin for board meetings, preferring instead to conduct meetings telephonically. This approach to operations raises an issue for tax purposes. If, for example, several of the managers and directors are resident in the United Kingdom, the mind-and-management argument underlying and justifying the entity's dual status will come under intense scrutiny by tax authorities in the United Kingdom and possibly be in serious jeopardy for UK tax purposes. In this case, management has fallen prey to a common mistake: They have made an election but failed to act in a manner that supports its consequences. Believing that the election itself is all that matters, they have ignored the other two components necessary to make all of it work: legal necessity and management activity.

Money is another factor necessary to make all of it work. As one might imagine, the complex planning and analysis required, particularly on a multinational basis, to decide, for example, where to use a hybrid, where to use a transparent entity, or where to dual incorporate on a division-by-division and country-by-country basis is expensive, particularly because the rules concerning types of organizations, tax rates, and tax regimes change constantly around the world. Depending on the size and scope of the entity, the analysis phase alone could cost several million dollars.

Do the benefits justify the cost? Many multinationals believe they do. For example, the US Congress recently reduced by as much as three percentage points—almost 10 percent—the tax rate imposed on the US income of US manufacturers. Given that change in law, nearly every multinational manufacturer will be going through the process of determining whether, through the

use of hybrids and transparency, more income can be moved into the lower-tax jurisdiction that might apply to US entities. Why? As the US rate moves below the global average, the US could effectively become a tax haven for manufacturers. In short, however expensive hybrid planning might be, that planning and analysis, if properly executed, could—and frequently will—result in payoffs that far exceed costs.

ARGENTINA

INTRODUCTION

This chapter details the principal tax issues that are relevant to purchasers and sellers engaged in the transfer of ownership of an Argentine trade or business. Unless otherwise stated, it is generally assumed that all sellers and purchasers are Argentine companies with limited liability.

The transfer of ownership of an Argentine trade or company takes the form of a disposal of shares or assets. While there are significant differences in the tax implications of an asset sale or share sale, nontax issues must also be considered.

The relevant taxes to be considered are:

- **Income tax.** This is a 35 percent tax on net profits earned by a company. Argentine companies are taxed on a stand-alone basis even if they are members of a tax group. Provisions exist, however, that allow members of a tax group to perform tax-free reorganizations—such as mergers, spin-offs, or transfers of assets—among themselves.
- **Value-added tax (VAT).** This is a sales tax whereby 21 percent is added to the sales price charged for goods or services—except for certain categories of sale that are exempt from or outside the scope of VAT. A purchaser or recipient of goods or services can generally recover VAT paid if the purchase was incurred in the course of a commercial activity. However, the level of recoverability varies from case to case.
- **Stamp duty.** This is a transfer tax levied on the value of the consideration paid for certain items such as assets, shares, and real estate. The rates vary among the provinces—for example, 1 percent and 4 percent for assets and real estate, respectively, in the province of Buenos Aires. Buyers and sellers customarily share these costs per purchase-and-sale contract.

1. ACQUISITIONS

1.1 Asset Acquisitions

As a general rule, the purchaser is severally liable with the seller for taxes due at the transfer date that are attributable to the business sold in an asset acquisition.