

WTS Mergers & Acquisitions Newsletter

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Austria



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Tax credit on royalty payments to Austrian corporations

Key issue from an Austrian tax perspective

In times of digitalisation, many Austrian target companies are fully or partially active in the field of software development and thus derive royalties from their software. In an international context, WHT is often levied in the source countries of the royalty payments. Depending on the specific circumstances, there are questions as to whether WHT can be fully credited against Austrian taxes, which is why there may also be red flags in a tax due diligence process.

New administrative practice

While the OECD-MC does not grant source states the right to levy a WHT on royalties (Art. 12), such a right is included in the UN-MC. Hence, many Austrian tax treaties provide for the right to levy such taxes at the source. For these tax treaties, it is of particular importance to analyse whether royalty payments for the provision of software fall under Art. 12 or under the general rule for business profits (Art. 7), which typically does not provide for WHT in the source state.

In June 2022, the Austrian tax authorities issued a new public statement (EAS 3436) on the tax treaty with China according to which, in many cases, software should no longer be covered by the legal term "equipment" (in German, "Ausrüstungen"). Based on this new practice, payments for software licences made after May 2022 would often no longer be subject to the royalty rules in these tax treaties.

The EAS 3436 statement only refers explicitly to the tax treaty with China. However, many tax treaties based on the UN model (e.g. with India) include a similar definition of royalty payments. There is a risk that tax credits will not apply in other countries as well. As a result, if Art. 12 is still deemed to apply to these countries and WHT is levied on royalties, Austria may not grant WHT credits.

Even though this would involve double taxation, taxation from a different application of the tax treaty can probably only be resolved by a mutual agreement procedure, which carries many uncertainties regarding timing and outcome.

EAS 3436 still leaves much room for interpretation and makes it clear that tax treatment depends on the exact nature of the software and the agreements, especially when one agreement covers several service packages. We await further development of administrative practice and case law.

WHT levy based on gross payments but credit based on net income

Typically, WHT in source countries is levied on gross payments. However, under the rules of the tax treaties, the tax credit is only granted in Austria based on the net income derived in each country (per-country limitation). This gives rise to a risk that tax authorities will ask for a further breakdown of expenses and net income related to each country and will deny the granting of tax credits to some extent.

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Belgium



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Transformation of a taxable dividend into an exempt capital gain

In a judgement dated 22 November 2022, the Court of First Instance of Liège validated the application by the tax authorities of the general anti-abuse measure ("GAAR"). This applies to transactions involving a sale by individuals (two spouses) of shares in an operating company (A) to another company (B), both fully owned by the two individuals, followed by a parent-subsiary merger (whereby B absorbs A). Under this measure, the individuals must pay dividend withholding tax on a deemed dividend received at the standard Belgian dividend withholding tax rate of 30%. In this case, the court considered that the entire process carried out by the individuals (a sale of shares followed by a merger) was aimed at allocating an amount corresponding to the distributable reserve of the absorbed company to avoid the dividend withholding tax.

The facts before the court were as follows: The two spouses were the only shareholders of two Belgian companies: A, an operational company; and B, a kind of shell entity. The spouses had a debt position on a current account with A amounting to more than EUR 600 thousand.

In 2015, the spouses sold their shareholding in company A to company B for EUR 710 thousand. The price was not immediately paid by B and a current account was instead created between B and the individuals. The sale of shares was followed by a merger in 2017, whereby B absorbed its fully owned subsidiary A. As a result of the merger, all the assets and liabilities of A were automatically transferred to B, including its current accounts receivable against the individuals. The two current account positions between the individuals and company B could thereby be compensated. In addition, the merger resulted in the disappearance of company A's distributable reserve.

The tax authorities successfully argued that the sale of shares and the merger were linked by the same unity of intent (which was clearly indicated in the sale deed).

In addition, the tax authorities demonstrated that the essential objective of these legal acts was the avoidance of the dividend withholding tax that would have been due if company A had distributed a dividend to its individual shareholders in order for them to repay their debt position in their current account. According to the court, this was clearly contrary to the objective of Belgian tax legislation, which levies withholding tax on all benefits granted by a company to its shareholders.

The tax authorities also emphasised that if a sister merger had been pursued between companies A and B (without the need for a prior sale of shares), the available reserves of company A would have been transferred to the merged company B and it would have remained in a position to distribute a dividend for the individual shareholders to repay their debt. Instead, the parent-subsiary merger following the artificial sale of shares in company A resulted in the disappearance of company A's distributable reserve.

The court also noted that company B did not have the necessary liquidity to repay its debt following the purchase of the shares in company A and that the shareholders did not have the financial means to reimburse their debt with company A. The court thus concluded that the goal of the set of operations was the clearing of a significant current account that involved remuneration of the shareholders through the set-off mechanism.

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The court did not uphold the non-tax reasons put forward by the individuals to justify the transactions (such as the rationalisation process linked to the age and health of the individuals).

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The outcome of this case further highlights the risk of tax abuse qualification if tax optimisation schemes are put in place without sufficient non-tax motives underlying the transactions.

China



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Capital gain tax liability of an indirect transfer by a foreign individual

The China State Taxation Administration issued Announcement [2015] No.7 to guide the assessment of capital gain tax risk for the indirect transfer of shares in a Chinese company resulting from a share deal. However, this regulation pertains exclusively to corporate income tax obligations and does not apply directly to foreign individuals selling shares.

An indirect transfer of shares in a Chinese company may occur when a German individual sells shares in a German company that owns 100% of a Chinese company's shares. In this scenario, the individual will be liable to pay Chinese personal income tax (PIT) on any income derived from China. We need to assess whether the capital gain from the share deal in Germany should be considered income sourced from China, based on the following elements:

1) Income sourced from China

Article 1.7 of Announcement [2020] No.3 states that income from the transfer of equity in a non-Chinese company is sourced outside China, except where more than 50% of the fair value of the invested enterprise's assets is sourced directly or indirectly from immovables in China across 36 consecutive calendar months before the equity transfer. If the foreign company passes the immovable asset test, the capital gain from the share transfer is deemed to be income derived outside of China and is not subject to PIT in China. Otherwise, if the fair value of the company's assets sourced from immovables in China is over 50%, PIT applies to the capital gain at a rate of 20%.

2) Anti-tax avoidance clause

The Chinese tax authority may make an adjustment if an individual makes arrangements without a reasonable business purpose and obtains improper tax benefits. Therefore, even if the foreign company passes the immovable asset test, the Chinese tax authority may treat the capital gain as income derived from China if it deems the share transfer lacks commercial substance and serves only for tax minimisation purposes.

If the foreign company has commercial substance and holds no valuable real estate, the capital gain tax risk of the individual seller is low. Otherwise, if the foreign company fails the examination, the individual seller will have a PIT obligation in China for the share deal and the buyer will have withholding obligations.

In summary, when the seller in a deal (that results in an indirect share transfer of a Chinese company) is an individual, the seller's tax liability should be assessed from the Chinese PIT aspect. The following factors could be relevant for assessment:

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- › The tax residency of the individual seller.
- › Any properties/investments in China involved in the deal.
- › The commercial substance of the foreign company in other countries.

India



Key amendments to the Indian competition law

The Indian competition law (the Competition Act, 2002) has been updated to Competition (Amendment) Act 2023 (the "Amendment Act"). In the following paragraphs, we have outlined the key amendments that are relevant from M&A and transaction perspectives.

Addition of transaction value threshold to attract CCI approval

Traditionally, asset and turnover thresholds were tested for acquisitions, mergers, etc. to qualify as a combination under competition law. The Amendment Act has now introduced an additional threshold to ensure that a combination also includes the acquisition of any control, shares, voting rights, merger or amalgamation where the transaction value exceeds INR 2000 crores.

The term "transaction value" includes every valuable consideration, whether direct or indirect, or deferred for any acquisition, merger or amalgamation.

The Amendment Act provides that the transaction value threshold will only apply where the enterprise being acquired has substantial business operations in India.

It is pertinent to note that the de minimis exemption (general exemption) is applicable to any combination where the transaction value exceeds INR 2000 crores irrespective of asset size/turnover.

Increasing penalty by changing the definition of turnover

Previously, the CCI imposed penalties based on a "relevant turnover" or "Indian turnover" basis as per the judicial precedent of the Apex Court.

For penalty calculations, the Amendment Act now defines the term "turnover" as global turnover earned by a person or an enterprise from all their products and services. This amendment may have far-reaching implications, as it means that penalties can even be imposed on turnover from products and services that may not be related to the business or market under scrutiny.

Author's concluding remarks

The introduction of a transaction value threshold is a significant change, as it seeks to cover transactions such as fund raises, sales, hive-offs, mergers, etc. that exceed the prescribed transaction amounts, even if the turnover and asset thresholds are not met.

It will be essential to evaluate whether the transaction value threshold for private equity fundraising applies for each investor or to the entire fundraising round involving multiple investors.

It will be interesting to see the interplay of the exemption available under Schedule I of the Competition Act, 2002 on transactions exceeding the INR 2000 crore threshold.

The transaction value threshold is likely to cover a large number of transactions that did not need to be reported to the CCI prior to the Amendment Act. The CCI seems to be taking a cue from certain high-value transactions that took place during the pandemic where the assets/turnover exemption became available due to Covid-induced financial stress.

While we await clarity on what constitutes substantial business operations in India, it is also important to have clarity on whether the transaction value threshold in a global transaction will be computed proportionally to the value attributable to India.

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In summary, the advent of the Amendment Act means that businesses will need to carefully assess the impact and applicability of competition law provisions, especially amidst increased transaction activity in India.

Nigeria



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Changes to tax laws relevant to M&A

Where government policies and legislation have a global impact on M&A transactions, this article highlights amendments to tax laws that directly impact M&A transactions in Nigeria.

Corporate Income Tax Act (CITA)

Generally, the CITA stipulates that no merger or restructuring can be carried out without the direction and clearance of the Federal Inland Revenue Service (FIRS). The Finance Act 2019 amends Section 29 (3) & (4) of the CITA to the effect that companies involved in restructuring will now be able to prepare and file tax returns in their first, second and third years of assessment based on their first, second and third sets of financial statements, i.e. according to their accounting periods. This is in a bid to amend the commencement and cessation rules, as they often resulted in double taxation of profits earned in one or more of a company's financial years. For the purpose of tax cessation, assessable company profits shall now be the profit from the beginning of the accounting period to the cessation date.

Furthermore, by an amendment of Section 29(9) of the CITA, and in a bid to reduce the tax risks associated with corporate restructuring, tax exemptions shall apply on corporate restructuring between related parties. Hence, parties must have been related for a consecutive period of at least 365 days prior to the date of the restructuring and an acquiring company cannot make a subsequent disposal of assets acquired within the succeeding 365 days after the date of the transaction. This is referred to as the minimum holding period requirement. Where this occurs, any tax concession applicable under Section 29 of the CITA shall be rescinded and the companies shall be treated as if they did not qualify for the concession ab initio.

Value Added Tax Act (VATA)

The Finance Act 2019 provides for a new Section 42 of the VAT Act, which is in line with the provisions of Section 29 (9) of the CITA as amended and Section 32 of the Capital Gains Tax Act as amended. The section covers corporate restructuring between related parties and provides that no tax shall apply under the Value Added Tax Act to such controlled transactions subject to satisfying the minimum holding period requirement as established by the proviso to Section 29(9) of the CITA discussed above.

Capital Gains Tax Act (CGTA)

Typically, in an M&A arrangement, the shareholders of the acquired/merging entities are issued with shares in the surviving entity, a cash payment or a combination of both. The Finance Act 2019 inserts a new Section 32 of the CGTA that covers corporate restructuring between related parties and provides that no tax shall apply under the CGTA to such controlled transactions subject to satisfying the minimum holding period requirement.

Notably, shareholders shall accrue capital gains tax obligations upon disposal of their shares under certain circumstances. By the provision of Section 30 of the CGTA (as amended by the Finance Act 2021), gains accruing to a person on disposal of shares worth NGN 100 million or above in any Nigerian company in any 12 consecutive months shall be liable to capital gains tax at the rate of 10%, except where the proceeds are reinvested in the shares of a Nigerian company.

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Poland



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Tax settlement of the sale of an organised part of an enterprise

WTS & SAJA provided tax advisory services for the benefit of two Polish limited liability companies belonging to the international capital group, which is one of the world's leading manufacturers of passenger cars and commercial vehicles.

The essential aim of the restructuring operation carried out by the companies was to retain their passenger car and commercial vehicle businesses and transfer their truck and bus services to separate entities. As we were informed, the business reorganisation applied to the entire capital group to which both companies belong.

We were responsible for identifying and indicating the correct, safe tax settlement methodology applicable to the restructuring revenue and costs involved with the sale of an organised part of an enterprise of each company.

Polish corporate income tax regulations do not contain precise regulations regarding the recognition of tax revenue and costs for the sale of organised parts of an enterprise. Furthermore, the Polish tax authorities have no clear-cut practices in this regard. Thus, taxpayers are faced with significant uncertainty on tax settlement methodologies for revenue and costs if selling organised parts of an enterprise, while the approach of tax authorities is often pro-fiscal and controversial. In addition, there are few court rulings on the matter, leading to a lack of answers for questions that arise while calculating the taxable income from the sale of an enterprise.

Therefore, WTS & SAJA's work consisted of:

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- › Analysing the sale purchase agreements documenting the sale of an organised part of an enterprise of each company as well as individual tax rulings obtained by the companies regarding the corporate income tax consequences of the transaction;
- › Analysing the current practice of tax authorities from the perspective of settling tax revenues and tax-deductible costs on the sale of an organised part of an enterprise;
- › Analysing the individual components, consisting of both organised parts of an enterprise (based on the balance sheets for the assets and liabilities transferred within the organised parts of an enterprise) from the perspective of tax settlement of revenue and costs on the sale of an organised part of an enterprise;
- › Based on the conducted analysis, determining what constitutes taxable revenue from the transaction, and which items and what amounts on the balance sheet constitute tax-deductible costs.

Switzerland



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Tax-free capital gains – limited by indirect partial liquidation

Introduction

Capital gains generated by the sale of shares held as private assets by Swiss individuals are generally tax-free, unless an exemption, known as an indirect partial liquidation (IPL) applies. Therefore, any Swiss individual selling shares aims to include any retained earnings in order to benefit from a tax-free capital gain, instead of distributing any taxable dividend before the sale. On the other hand, a corporate buyer could receive dividend distributions from the acquisition target without any material tax implications due to the participation exemption.

Therefore, a company could acquire a target with significant retained earnings and then distribute these retained earnings after the transaction without any material tax consequences. On the other hand, a Swiss individual as seller generates a tax-free capital gain. In consequence, this approach allows for the conversion of potentially taxable dividends into tax-free capital gains. The IPL limits such tax optimisation of a Swiss individual as the seller.

Criteria for an indirect partial liquidation

The IPL applies for share transactions if the following criteria are cumulatively fulfilled:

- › Sale of at least 20% of an equity holding in the target (joint sales are considered cumulatively) by a Swiss individual (i.e. private assets) to a company or an individual that holds the target as a business asset;
- › Within 5 years after the sale, the target distributes (i) distributable retained earnings; and (ii) the distribution reflects non-operational assets, both already available at the time of the acquisition of the target;
- › The distribution is made with the participation of the seller. A participation means that the seller knows or should have known that such a distribution will take place. Based on the Swiss tax practice, this criterion is usually fulfilled.

If the above criteria are fulfilled, the tax-free capital gain generated by the seller is (partially) requalified into taxable income at the level of the seller triggering income tax consequences. Note that the distribution criterion does not only include ordinary dividend distributions. Rather, all kinds of distributions are considered as such, e.g.

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deemed dividend distributions, a merger between the target and the buyer or the granting of loans by the target not under arm's-length terms.

Implications for an M&A transaction

Because the IPL triggers adverse tax implications at the seller level – implications that are triggered by the buyer's actions (i.e. by a distribution) – a Swiss individual as the seller usually requests a hold harmless clause from the buyer in the share purchase agreement. Alternatively, in order to avoid an IPL in most cases, all distributable retained earnings can be distributed by the seller prior to closing. However, given the adverse tax consequences of such a dividend distribution, this usually is not the preferred solution. Provided that a hold harmless clause is included in the share purchase agreement, the buyer should implement measures to avoid an IPL by not performing any harmful actions within 5 years after the acquisition.

United Arab Emirates



Impact of the UAE Corporate Tax law on M&A and restructuring

On 9 December 2022, the UAE released its Corporate Tax (CT) law through Federal Decree No. 47 of 2022. Our alert issued in January 2023 provided an overview into the key areas of the CT law relevant for businesses. This alert seeks to discuss in detail the impact of the UAE CT law on M&A transactions and restructuring.

Historically, M&A transactions involving UAE targets did not require a significant amount of due diligence or acquisition structuring due to the absence of federal corporate tax. Following the introduction of VAT in 2018 and economic substance regulations in 2019, limited-scope due diligence started to be undertaken. However, with the advent of VAT audits and the related controversies, coupled with the introduction of the UAE CT law, discussing tax planning for M&A involving UAE targets (including those with downstream non-UAE investments) has become critical. This alert aims to discuss the following key aspects of the UAE CT law, which are likely to impact deals going forward, along with the steps that companies should undertake through the different life cycles of a transaction.

Summary of issues covered in this alert

Tax due diligence	Undertake pro forma tax due diligence to assess risks on tax positions and the applicability of UAE CT law provisions going forward
Participation exemption	Review holding structures and conditions under the UAE CT law to determine tax implications on the receipt of dividends and exit tax on the sale of shares from direct and indirect subsidiaries
Debt push-down	Optimisation of certain methods of acquisition through the introduction of leveraged buy-outs whilst adhering to interest limitation provisions under UAE CT law

Restructuring and group transfers	Impact of any potential restructuring and group transfers in terms of satisfying conditions provided under the UAE CT law for tax neutrality – critical to review claw-back provisions
Other key areas under the UAE CT law	Deemed residency provisions for non-UAE companies; tax model and effective tax rate review on deals; coverage within deal documentation, coupled with representation and warranty insurance
VAT implications	Modes of effecting a transaction and its VAT implications, including documentation and compliance to be undertaken
Key takeaways	List of key takeaways for the various stakeholders in a deal – acquirers, sellers and group restructuring

A. Tax due diligence

There should be limited historical risks for acquirers looking at investing in UAE targets, as the UAE CT law is likely to apply (for most businesses) from 1 January 2024, with the first tax return filing not due until nine months from the end of the year (i.e. 30 September 2025 for a calendar year end). However, it is crucial that **the acquirer considers a pro forma review of the UAE target entities** from a UAE CT law standpoint. This is to consider the potential impact or exposure if the UAE CT law were to apply. Certain areas that can be analysed within this review include the following:

- › Free zone entities eligible for the potential 0% tax rate and satisfaction of mandatory conditions, i.e. qualifying income, substance, transfer pricing compliance;
- › Inter-company transactions and transfer pricing considerations;
- › Tax grouping and loss transfer shareholding thresholds;
- › Tax attributes such as tax losses and interest limitation;
- › Foreign tax exposures such as permanent establishment, entities deemed to be UAE residents based on control and management, withholding taxes and their creditability on payments received from non-UAE entities;
- › Impact of accounting on future taxes including unrealised gains/losses, provision for expenses and their write-back, revaluation, etc.

Understandably, recourse for exposures identified as part of tax due diligence may generally include an indemnity or a valuation adjustment depending on the level of risk and amount. Given the newness of the UAE CT law and the absence of material historical returns to review as a part of a deal (given that the first tax return may only be filed on 30 September 2025 for companies that base their financial year on the calendar year), there may not be a material recourse with respect to indemnity or valuation adjustments in the immediate future.

However, a pro forma review as discussed above may enable acquirers to identify exposures that arise immediately post-acquisition and discuss any restructuring/documentation that the sellers/target may need to put into place prior to the deal. Such areas can form a part of the mandatory conditions to close a deal and can be included as a part of the transaction documentation to provide additional protection to the acquirer.

B. Structuring considerations

An acquirer/acquirer group can consider various options to acquire a potential target, i.e. direct share acquisition from the seller (secondary transfer) in exchange for cash or shares, infusing equity/debt into the target (primary infusion) or business transfer. Each of these modes should have considerations under the UAE CT law. Unlike a due diligence exercise that is aimed at identifying historical exposures, acquisition structuring could have an immediate impact on areas such as modes of acquisition, inclusion of leverage (debt) to undertake the acquisition, acquiring entity jurisdiction and post-acquisition structure. Some areas that may merit consideration as a part of acquisition structuring include:

1. Participation exemption

Primary tests

Under Article 23 of the UAE CT law, participation exemption is provided for dividends and capital gains earned by a UAE resident from participating interests. Whilst dividends received from UAE companies are automatically exempt, for capital gains on the sale of shares (UAE and non-UAE) and dividends received from foreign entities, the participation first needs to meet the three primary tests, i.e. 5% minimum shareholding, minimum holding period of 12 months and the participation being subject to corporate tax in its home jurisdiction at a rate not less than 9%.

Relaxing the requirement for holding companies to meet a primary test

Further, Article 23(3) of the UAE CT law mentions that a participation will be deemed to have met the minimum 9% corporate tax test if a) its principle objective and activity is the acquisition and holding of shares/equity interests (that in turn meet the above-mentioned conditions); and b) the participation's income substantially consists of income from its participating interests. Further, this relaxation is also extended under Article 23(4) of the UAE CT law to participations that qualify as a qualifying free zone person or an exempt person, which ordinarily may not be subject to tax at 9% under the UAE CT law (subject to conditions). Therefore, this condition seeks to extend the participation exemption in case of intermediate holding company structures in countries such as the British Virgin Islands, the Cayman Islands, etc. and for intermediate holding companies located in a UAE free zone (subject to conditions).

Additional conditions in case of multi-tiered investments

For structures involving multiple layers of investments (i.e. indirect subsidiaries), the UAE CT law also provides an additional condition under Article 23(2)(d) for qualifying for participation exemption, i.e. not more than 50% of the direct and indirect assets of the participation should consist of ownership interests that would not have qualified for an exemption from CT if they were held directly by the taxable person. Hence, where the value of ownership interests in step-down subsidiaries held by a participation fails to meet the three primary tests and such value exceeds 50% of its total assets, the participation exemption should not be available.

To test this additional condition, the below steps may be followed:

1. At the outset, the participation (direct holding) in question should satisfy the three primary tests mentioned above, i.e. 5% minimum shareholding, minimum holding period of 12 months and the participation being subject to a CT rate of at least 9% in its home jurisdiction.

2. Once the above tests are satisfied, the total value of assets (including the investment made by the participation in each direct/indirect subsidiary) of the participation should be determined. It is currently unclear whether book value or fair value will need to be taken.
3. Next, each direct/indirect subsidiary should be tested against the aforementioned three primary tests, assuming that they were held directly by the taxable person (and not by the participation).
4. The value of all the direct/indirect subsidiaries that fail the conditions (in step one) should be added up, e.g. an indirect subsidiary in Bahrain (where no CT applies), ownership of less than 5% by the participation in a subsidiary.

If the value of the investment determined in step 4 does not exceed 50% of the value of the total assets of the participation (in all direct/indirect subsidiaries), then the additional condition in Article 23(2)(d) of the UAE CT law is satisfied and the taxable person (i.e. the recipient of dividend/capital gains) would be eligible to claim the participation exemption for dividends and gains received from the participation. Note that this evaluation is only relevant for analysing the dividend/capital gains flowing directly from the participation to the taxable person. The condition has no bearing on dividends/capital gains flowing from the indirect subsidiaries to the participation. Further, this condition holds relevance for multi-tiered structures primarily because one may have to evaluate the lowest level of indirect assets/subsidiaries held by the participation (investee company) along with their values.

Treatment of hybrid instruments

According to Article 23(6)(a) of the UAE CT law, the participation exemption is not available where the participation claims a tax deduction for the distributions/dividends on its home country tax return, even if all the conditions mentioned above are met (e.g. in case of hybrid instruments). Therefore, this results in an additional area to be looked at in the M&A context, in addition to the prescribed conditions.

Evaluation of the fulfilment of participation exemption conditions to a proposed acquisition is not only important from a target's standpoint, but also following integration of the target into the acquirer's structure. The acquirer should evaluate the fulfilment of conditions and the potential tax leakages on dividend/profit distributions through the structure. This review may also provide an insight on exit taxes on future sale or any interim sale of a portion of the business/certain geographies.

2. Debt push-down

Article 30 of the UAE CT law, in line with the OECD's BEPS Action Plan 4, has introduced interest limitation rules wherein interest expenses are limited to 30% of the taxable person's EBITDA at book value or a specific amount (yet to be prescribed), whichever is highest. Any excess interest (above the allowance) is disallowed in the respective tax period but can be carried over for 10 years to be used as a deduction from a future year's taxable income (subject to conditions).

The relevance of the interest limitation rules for M&A is twofold. Firstly, as discussed above, its impact on taxable income for the UAE target entity/group in terms of tax-deductible expenses should be evaluated. Secondly, a critical area for consideration is expected to be in cases involving leveraged acquisitions. Article 31 of the UAE CT law additionally clarifies that interest obtained from related parties (as defined under

transfer pricing provisions) will be disallowed if i) the loan is used for a prohibited end-use, such as dividend payments, redemption/repurchase of shares of a related party, capital contributions to a related party or acquisition of an ownership where the investee company becomes a related party following the transaction; and ii) the purpose of the loan is not to obtain a CT advantage, which is deemed not to arise if the lender is taxed at least 9% on the interest. Interestingly, the additional restrictions on related-party loans raise many interesting issues, such as:

- › The deductibility of interest used to acquire minority stake;
- › The jurisdiction of the lender given the deeming fiction for the condition relating to obtaining a tax advantage – such as loans from the British Virgin Islands, the Cayman Islands or European entities that follow hybrid structures for certain types of convertible debt;
- › The applicability of the prohibited end-uses to asset acquisitions or business transfers.

Given the above, the debt push-down provisions may limit deductions for borrowing costs, depending on the structure adopted. Thus, in a jurisdiction like the UAE where debt push-downs are not relevant from a tax standpoint, stakeholders participating in M&A should review the impact of leveraged buy-outs for potential tax breaks and future impact on effective tax rates.

C. Restructuring and group transfers

The UAE CT law provides explicit exemptions for certain qualifying group transfers and business restructuring transactions. While the latter may be another mode of acquiring a target business, the former enables existing groups to restructure in a tax-efficient manner, either in a non-M&A context or potentially in preparation for a sale (either fully or hiving off a separate vertical).

The business restructuring relief under Article 27 of the UAE CT law provides an exemption for transfer of business between taxable persons under the UAE CT law if the transfer is undertaken in exchange for ownership interest for the transferor, i.e. shares in the transferee entity. In such a case, the assets and liabilities are deemed to have been transferred at book value and the transferor/transferee has a lock-in period of 2 years to avoid claw-back of the exempted business transfer. Thus, where the shares are sold to a person that is not a member of the qualifying group to which the taxable persons belong, or the business in question is transferred/disposed of within two years of the acquisition, the exemption will be revoked. The business transfer will then be deemed to have been carried out at market value on the date of transfer and will be taxed accordingly. Interestingly, the business restructuring relief provisions are also linked to participation exemption provisions. These provisions require that the ownership of the transferor post-transaction (exempted under Article 27 of the UAE CT law) must be held for at least two years for participation exemption to apply to such ownership. A similar requirement also exists for certain specified share-swap transactions.

Similar to the relief on business transfers, Article 26 of the UAE CT law also provides an exemption on transfer of assets between members of a qualifying group, subject to conditions. Among others, the main condition of a qualifying group is that the transferor and transferee should have common ownership of 75% or more, or own 75% or more of either (transferor in transferee or transferee in transferor). Further, neither the transferor

nor the transferee can be an exempt person (e.g. government entity, government-controlled entity, qualifying public benefit entity, qualifying investment fund, etc.) or be claiming benefits under the 0% tax rate for free zone entities. If the conditions are satisfied, the assets transferred between such entities are considered to take place at book value, thus not triggering a gain under UAE CT law. Conditions relating to claw-back period and implications on claw-back are similar to that of business restructuring.

As a separate note, Article 38 of the UAE CT law also contains provisions to transfer tax losses between members of a qualifying group as long as the tax loss offset related conditions are met. Some areas of consideration under these provisions include:

- › The limitation on the overall tax loss that can be offset (75% of the taxable income of the entity);
- › The interplay of tax losses available with a group company prior to transfer. Such losses can be transferred for offset only after the transferee's tax losses have been offset, subject to the 75% limitation;
- › The requirement to be members of the qualifying group from the period in which the loss is incurred by the transferor to the period in which it is offset by the transferee;
- › The requirement for the loss-making entity to carry on the same or a similar business following a change in ownership of more than 50%.

The above not only amplifies the need to meet prescribed conditions at the time of effecting a business/asset transfer, but also highlights the importance of keeping track of the claw-back conditions. Considerations that apply may include taxability of future exits and the corresponding impact on books, along with the related depreciation/amortisation. In terms of a proposed acquisition, while transactions carried out prior to the target's first year of UAE CT law applicability are expected to be grandfathered, the review of such transactions following implementation of the UAE CT law will be highly relevant.

D. Other

Other areas also merit consideration as the UAE CT law enters into force within the next 12 months and M&A deals are being actively pursued in the region.

Deemed residency

As per Article 11(3)(b) of the UAE CT law, non-UAE entities that are effectively controlled and managed from the UAE are deemed to be UAE tax residents for the purposes of UAE CT law. The location of effective management and control may depend on where the key managerial personnel or board of directors are located, and where the key decisions are taken by such individuals/bodies. In the M&A context, these provisions may need careful analysis for targets with non-UAE operations being acquired by a UAE group/fund. Where the seller is also a UAE-headquartered group and the effective management and control of its non-UAE entities are from the UAE, the acquirer should review these provisions appropriately or have the seller put in place certain procedures through closing conditions in transaction documents. This is critical, as it may increase the potential applicability of the UAE CT to entities, resulting in added compliance and potentially complex tax filings (to consider foreign tax credits, where applicable).

Tax models and effective tax rates

This is an equally important area for concluded deals, and ongoing and prospective transactions. Acquirers may have factored in an internal rate of return (IRR) from a prior M&A deal based on the non-applicability of the UAE CT law. However, this may need to be revisited for transactions not yet concluded, as the potential UAE CT may have an impact on the free cash flows available for distribution due to tax payments in the UAE. Therefore, all M&A transactions require a detailed review of financial models for tax purposes and verification of the effective tax rate, along with the availability of tax attributes (such as losses, credits, interest allowances). There may be structuring avenues available under the UAE CT law to optimise the effective tax rate and especially to bridge any gaps between the factored/proposed IRR and any potential reduction due to the UAE CT law.

Documentation and insurance

Increasingly, a tax review of share purchase/asset purchase agreements will place more importance on analysing deal documentation. Areas such as tax indemnities, period of coverage (given statute of limitations under the UAE CT law), de minimis and tax indemnity caps may need more detailed consideration than was required previously on deals involving UAE targets. Also, the insurance coverage on deals may now need to consider tax as part of discussions with representations and warranty insurers. This makes tax due diligence and pro forma reviews highly relevant. It is also imperative to review deals that are in the transitory phase of signing and closing where the transaction documentation has been concluded but the deal has not closed (due to completion of conditions or for regulatory reasons). If aspects discussed in this alert need additional evaluation pre-closing given the advent of the UAE CT, the impact of the tax on deal documentation should be reviewed.

VAT considerations on M&A transactions

The VAT implications for transactions involving mergers and acquisitions depend upon the specifics of each transaction, including the nature of the transfer, the type of assets/liabilities being transferred and whether the parties involved are registered under the UAE VAT law.

Transactions are considered to involve either share purchases or asset purchases (further split into business transfers or individual asset transfers) for VAT purposes.

The UAE VAT law provides that the transfer of a business via a share purchase should be exempt from VAT. However, the transfer of business as a going concern should be considered as outside the scope of the UAE VAT law only if the following conditions are met:

- › All or part of the business is transferred;
- › The business is transferred to a taxable person; and
- › The acquirer intends to continue the business being transferred, in part or otherwise.

On the other hand, the transfer of assets on a piecemeal basis should attract VAT at the rate of 5%.

It is pertinent to note that transactions involving mergers and acquisitions could be multifaceted, and sale and purchase agreements must be carefully examined to arrive at the appropriate treatment under the UAE VAT law.

Furthermore, companies involved in the transaction must obtain, cancel and/or amend their VAT registrations and conform to the procedural and compliance requirements within the prescribed time limit to avoid potential penalties. The most important challenge here is to ensure business continuity and the issuance of tax invoices, tax credit notes, etc. while the entities being acquired are de-registered by the transferor and registered by the transferee. Such registration procedures may be either on a standalone basis or involve adding the business to existing VAT groups, as the transferee's tax registration number needs to be stated on tax invoices after the effective date. Hence, the cancellation, amendment, etc. of VAT registrations need to be planned in a way that causes minimum or no disruption to the ongoing operations.

Key takeaways

As it may be appreciated, the deal environment surrounding taxes in the UAE is set to undergo a paradigm shift. It is important to begin considering tax implications early in the deal (possibly as early as when preparing initial models for reviewing a target and adequately scoping work for tax due diligence). While it may still be more than two years before the first tax return needs to be filed – meaning that historical reviews can realistically start only after that period – the key is for acquirers to be ahead of the curve in terms of identifying key issues that may have an impact after the deal.

Companies looking to sell their businesses or potentially IPO a specific hived-off vertical will also need to factor in restructuring- and asset-transfer-related provisions along with other considerations. All in all, the changes will broaden the team involved in M&A and restructuring transactions, with tax now having a material impact on the deal (even before the law comes into effect) in the following ways:

Acquirers

- › Pro forma tax diligence;
- › Review own structure and integration of target structure, including the impact of the target joining the acquirer's tax group, if any;
- › Tax impact on the financial model and related IRR considerations;
- › Taxes on exit and repatriation through the holding structure;
- › Protection for any risks in transaction documentation.

Sellers

- › Evaluate potential taxes on the transfer;
- › Hive off considerations pre-sale, including group restructuring relief;
- › Health check of the target's tax affairs for impending deals;
- › Ability to provide indemnities: period and amount;
- › Existing transfer pricing considerations and compliance relating to any inter-company transactions.

Group Restructuring

- › Adherence to conditions for group transfer relief;
 - › Impact of existing inter-company transactions and operating model post-restructuring;
 - › Accounting considerations of restructuring and related tax impact;
 - › Optimisation of tax losses and their transfer within the group;
 - › Monitoring claw-back conditions and related tax implications on business restructuring and qualifying group transfers.
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United Kingdom The Qualifying Asset Holding Company ("QAHC") regime



Introduction

The QAHC regime was introduced to increase the UK's attractiveness as an asset-holding jurisdiction. As many European funds have deal and management functions in the UK, the regime allows them to align their holding structures with their existing operational substance. This is of particular importance considering the increased focus on economic substance as a result of BEPS Action 6, the Danish cases on beneficial ownership and ATAD III.

Although the UK is no longer within the EU, such that certain directives are not available, it currently has the largest treaty network.

Key benefits

- › Broad exemption from corporate tax ("CT") on gains on disposal of overseas property and qualifying shares (no conditions, unlike most participation exemptions);
- › CT exemption on overseas property business profits (including loan relationships), provided that such income is subject to tax elsewhere;
- › Disapplication of the late-paid interest provisions, such that a tax deduction arises on an accrual basis rather than a paid basis;
- › Interest on PPLs is tax-deductible and the anti-hybrid rules are disappplied;
- › Separate corporate interest restriction groups for certain subsidiaries (subject to conditions);
- › Disapplication of loss restriction rules;
- › WHT exemption on interest (note that there is no UK WHT on dividends);
- › Capital treatment for the redemption/repurchase of shares (subject to exceptions) along with an exemption from UK stamp duty;
- › For non-UK domiciled individuals who (i) are taxed on a remittance basis; (ii) provide investment management services in connection with arrangements to which the QAHC applies; and (iii) receive income and gains from the QAHC's non-UK assets, these will not be subject to UK tax unless remitted to the UK.

Eligibility

The following conditions must be met to qualify for the regime:

Ownership condition

At least 70% of the company's relevant interests (profits, assets or voting power) must be held by "Category A" investors (e.g. qualifying funds, QAHCs, UK REITs (or overseas equivalent), UK public authorities, pension schemes, charities or sovereign immune entities).

There are provisions that allow a company a grace period of up to two years (can be extended via HMRC agreement) to meet this condition.

Activity condition

The main activity of the company is the carrying on of an investment business and any other activity is ancillary to that business.

Investment strategy condition

The company's investment strategy should not involve the acquisition of listed equity securities or interests deriving value from such securities, although such securities can be acquired with a view to completing a delisting.

The company must also be UK tax resident, cannot be either a UK REIT or a securitisation company and must opt into the regime.

If a QAHC unintentionally breaches either the activity or ownership condition, it can remain in the regime if it remedies the breach.

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Multiple companies in an ownership structure can elect to be QAHCs, thereby permitting stacks of QAHCs.

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Administration

Upon entry into (and exit from) the QAHC regime, there is a deemed disposal and reacquisition of ring-fenced assets at market value. For qualifying shares (any shares except UK property-rich companies), there should not be an entry/exit charge (assuming the UK's participation exemption applies on entry).

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Annual returns must be submitted (in addition to CT returns) containing certain details of the QAHC's business.

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