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GLOBAL MERGERS & ACQUISITIONS WEBCAST SERIES

M&A issues across Europe

Feb. 24, 2022

Agenda

- European transaction activity update
- Base erosion and profit shifting (BEPS) & other EU developments
- Anti-tax avoidance directive III (ATAD3)
- How the international tax landscape changes the transaction structuring

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Intro and welcome

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EUROPEAN TRANSACTION ACTIVITY UPDATE

A spotlight on European M&A trends in 2021…

- M&A activity in Europe is quite robust → the number of transactions hit an all-time high in 2021
- Some of the drivers behind enhanced M&A activity:
  - Plentiful supply of cash for both Corporate and PE investors
  - Digital technology opportunities
- The COVID-19 pandemic has only accelerated this process
- There is a pressing need for transformation - many corporates had no choice but to begin that journey during the pandemic
- However, plenty of uncertainty and downside risk remains

Note: Information and data taken from Datasite/Mergermarket report „Deal Drivers: EMEA 2022 Outlook“.

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…and what to expect during 2022

- Activity is unlikely to slow down in 2022!
- What are the main drivers?
  - Strong economic outlook
  - Distressed acquisitions and divestments
  - TMT (technology, media and telecommunication) on every company's radar
  - The ESG (environmental, social, and governance) agenda
  - Plenty of capital is still waiting to be deployed

Note: Information and data taken from Datasite/Mergermarket report „Deal Drivers: EMEA 2022 Outlook“.

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. . . and what do we see from a tax due diligence and structuring standpoint?

- Changes in due diligence scope
  - Inquiries relating to COVID-19 benefits/aids/subsidies and its financial and tax impact
  - Focus on tax loss carry forwards and their value for the buyer
  - Inquiries around DAC 6 (EU mandatory disclosure regime)
  - The analysis of certain structures is more complex (for example, the ATAD 2 anti-hybrid regulations need to be considered)
  - Transfer pricing remains key area of focus
- Structuring
  - If holding companies are utilized, substance is extremely important
  - Debt limitations around the world need to be carefully navigated
  - The impact of some of the provisions above needs to be analyzed

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BASE EROSION AND PROFIT SHIFTING (BEPS) & OTHER EU DEVELOPMENTS

European Union Initiatives

- EU Pillar 1 directive and EU Pillar 2 directive
  - Expected to enter into force in 2023
- ATAD 3 – Abusive use of shell companies
  - Expected to enter into force in 2024
  - ATAD3 quick scan recommended to perform this year to determine impact

Other EU initiatives

- DEBRA – Debt Equity Bias Reduction Allowance (proposal expected Q1 2022) – same treatment equity and debt
- Coordinated treatment of cross-border loss relief within the EU and recommendation on the domestic treatment of losses
- BEFIT – Business in Europe: Framework for income taxation (expected to enter into force in 2023)
- Digital levy (‘independent’ and ‘co-exist’ with Pillar 1) (proposal Q3 2021)
- Transparency rules on taxes paid by large companies (‘using the methodology of Pillar 2’) (proposal 2022)
- Adjust EU Interest & Royalty Directive – subject to tax requirement

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EU plan: Pillar 1 (P1) and Pillar 2 (P2) directives

- Organization for Economic Co-operation and Development (OECD) P1 and P2 (as of Jan. 1, 2023)
  - OECD reform of the global international corporate tax framework to address the issues linked to the increasing globalization and digitalization of the economy.
  - On Oct. 8, 2021, over 135 countries (representing more than 95% of global GDP), joined a two-pillar solution to reform the international taxation rules and ensure that multinational enterprises pay a fair share of tax, wherever they operate and generate profits, in today's digitalized and globalized world economy.
  - Besides OECD P1 and P2 initiatives, the EU will also publish mandatory P1 and P2 directives for implementation in the EU.
- EU P1 – as of Jan. 1, 2023
  - Applies to multinationals with global consolidated turnover exceeding EUR 20 billion. Scope may be broadened in the future by decreasing turnover threshold to EUR 10 billion.
  - Partial re-allocation of the taxable base from a corporate income tax (CIT) perspective.
  - Until now, company only pays taxes in country if they have presence via e.g., a legal entity or a branch.
  - However, under P1, multinationals need to also pay CIT in countries where they provide services and products, even without having a physical presence in those countries (e.g., an entity, permanent establishment, branch).

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EU plan: Pillar 1 and Pillar 2 directives

- EU Pillar 2 – as of Jan. 1, 2023
  - Applies to multinationals with global consolidated turnover of at least EUR 750 million; lower threshold may be applied at the discretion of implementing countries
  - Seeks to put a floor on tax competition between countries on CIT rates, through the introduction of a global minimum CIT rate of 15%
  - A top-up tax may apply if the 15% rate is not met
  - U.S. global intangible low-taxed income (GILTI) provisions may not be in accordance with the P2 guidance
- Potential impact of these directives – why they're relevant to you
  - Significant impact to national and international tax landscape
  - Increased compliance/advisory costs
  - Increased cost of capital, is expected to have impact to investment decisions
  - Multinationals may need to restructure and/or revise their transfer pricing methodology since the international tax landscape will change (including the TP methodology)

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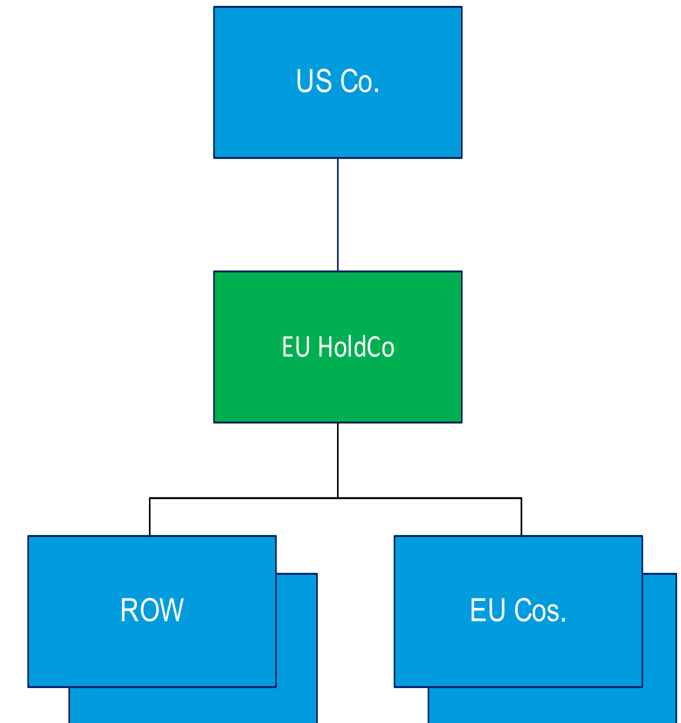
ANTI-TAX AVOIDANCE DIRECTIVE III (ATAD3)

ATAD3: Summary

- What: focus on shell companies (e.g., companies with no or minimum substance)
- Who: companies within EU, meeting gateways.
  - Specifically risk for EU holding companies & joint venture companies
- When: as of Jan. 1, 2024
  - ATAD3 quick scan recommended this year to determine impact and restructure (if required)
- Which income: Dividends, royalties, interest, lease, (im-)movable property, outsourcing
- Substance: Premises + bank account within EU + resident director / majority resident FTEs
- How: reporting obligation activities and substance status. Info will be exchanged within the EU
- Tax consequences: Deny tax (treaty) benefits, double taxation, income inclusion
- Exemptions: Yes, for example five FTE involved, no tax advantage, counterevidence, etc.



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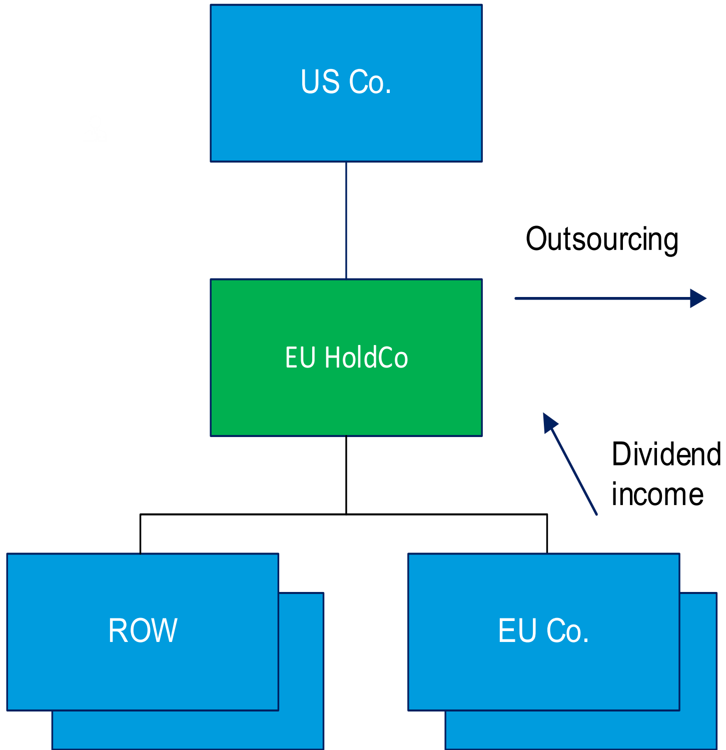
Example EU structures with potential ATAD3 risk

Gateways



Conclusion: ATAD3 Gateways met, ATAD3 applies

Gateway 1: relevant income

More than 75% of the revenue accruing to the undertaking in the preceding two tax years is relevant income (e.g., dividends, interest)

Or

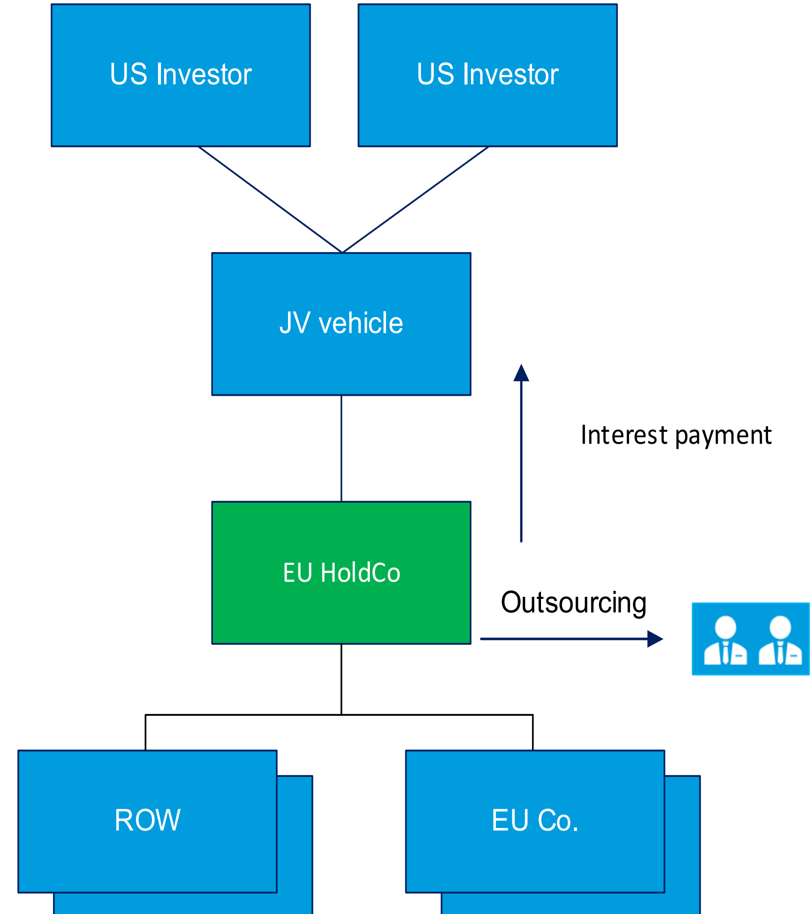
More than 75% of the total book value of the undertaking consists of shares

Gateway 2: cross border

At least 60% of the relevant income (dividend) is earned or paid out via cross-border transactions

Gateway 3: outsourcing

In the preceding two years the undertaking outsourced the administration of day-to-day operations and the decision-making on significant functions.



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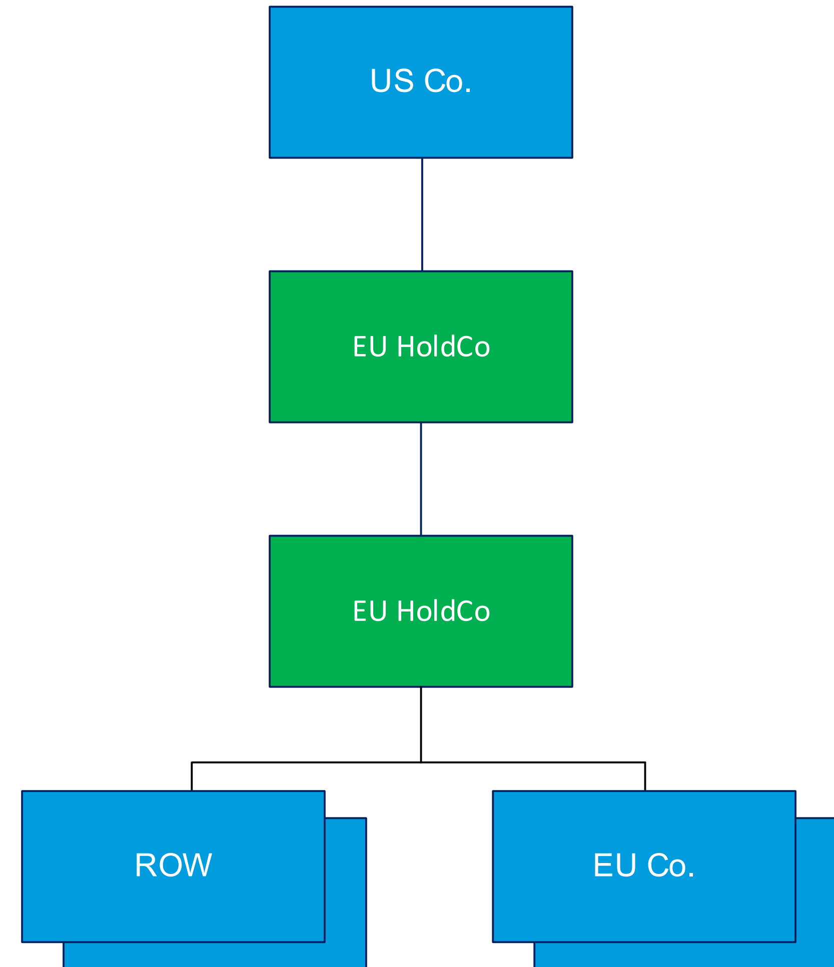
Adverse tax consequences

- Following tax consequences may apply:
  - Tax treaties and EU directives that provide for the elimination of double taxation may not apply anymore
  - The relevant income may be included in the taxable income of the EU shareholder
  - Member state may be obligated to impose withholding taxes on qualifying payments
  - Income from immovable property may be subject to tax as if the EU shareholder would own this directly
  - The member state has the option not to provide a certificate of residence anymore, or to provide a certificate with a warning statement
- Penalties of at least 5% of turnover for improper reporting
- Exchange of information requirements



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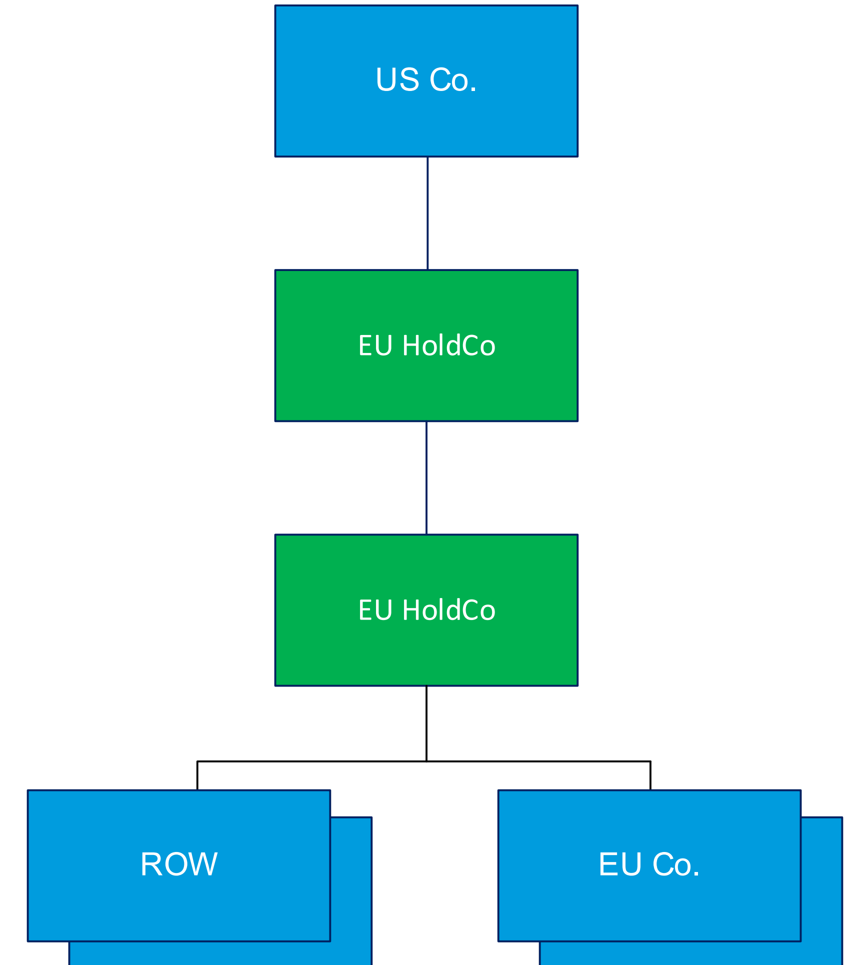
Solutions

- Not meeting gateways > not in ATAD3 scope
  - Relevant income + cross border + outsourcing
- Meet substance requirements > no adverse tax consequences
  - Premises + bank account within EU + resident director/majority resident FTEs
- If gateways are passed, several exceptions (i.e., no reporting obligation)
  - Beneficial owner exception
  - Shareholder exception
  - FTE exception: at least five own full-time employees or members of staff, exclusively carrying out activities generating relevant income
- Advantage Exemption > no reporting obligation
  - If interposition has no actual advantage on the overall tax position of the undertaking's group, or of the beneficial owner(s)
  - Comparison tax due between situation (1) with interposition, and (2) without interposition

Takeaway
Perform ATAD3 assessment ASAP to verify tax impact on your structure



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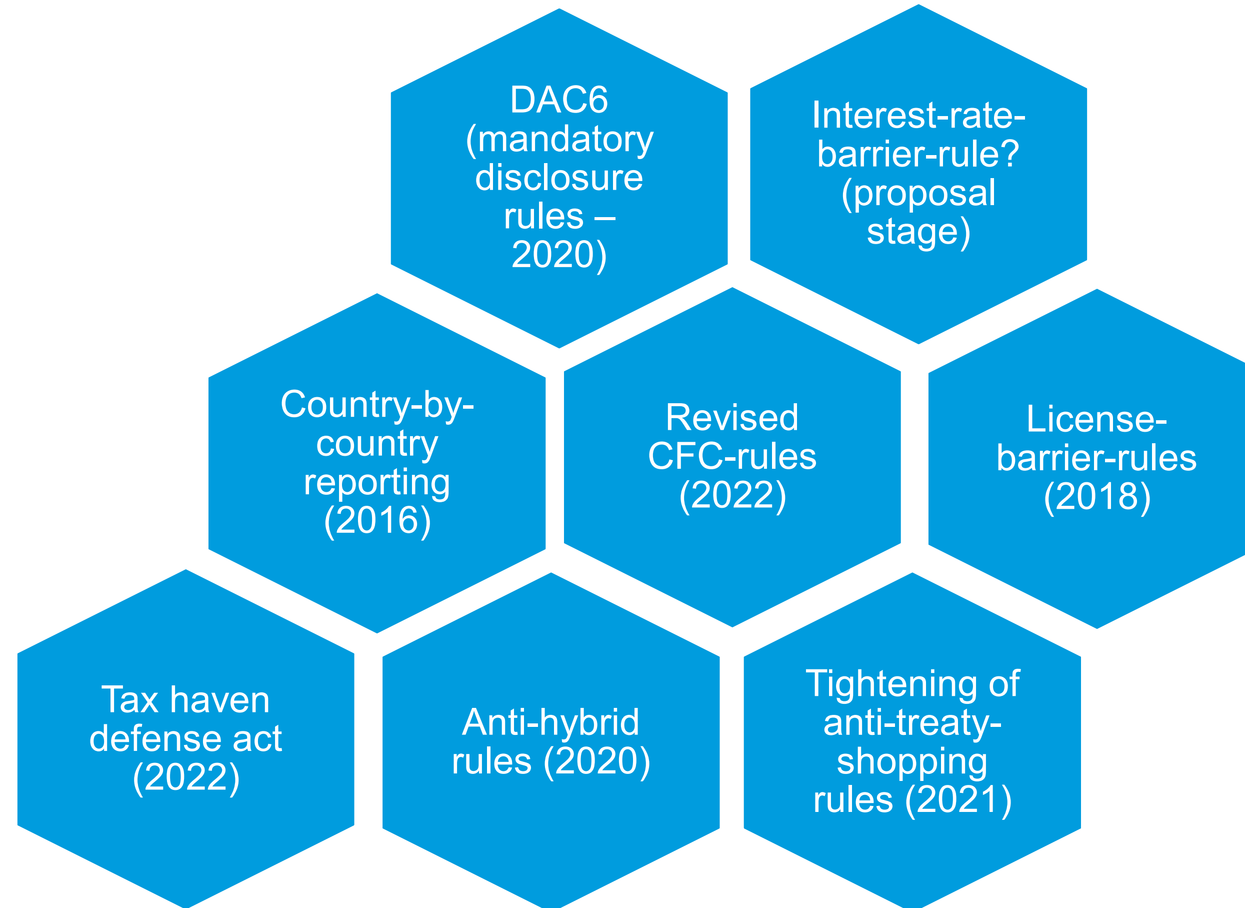
HOW THE INTERNATIONAL TAX LANDSCAPE CHANGES THE TRANSACTION STRUCTURING

Example: Snapshot on German tax law changes impacting international structuring



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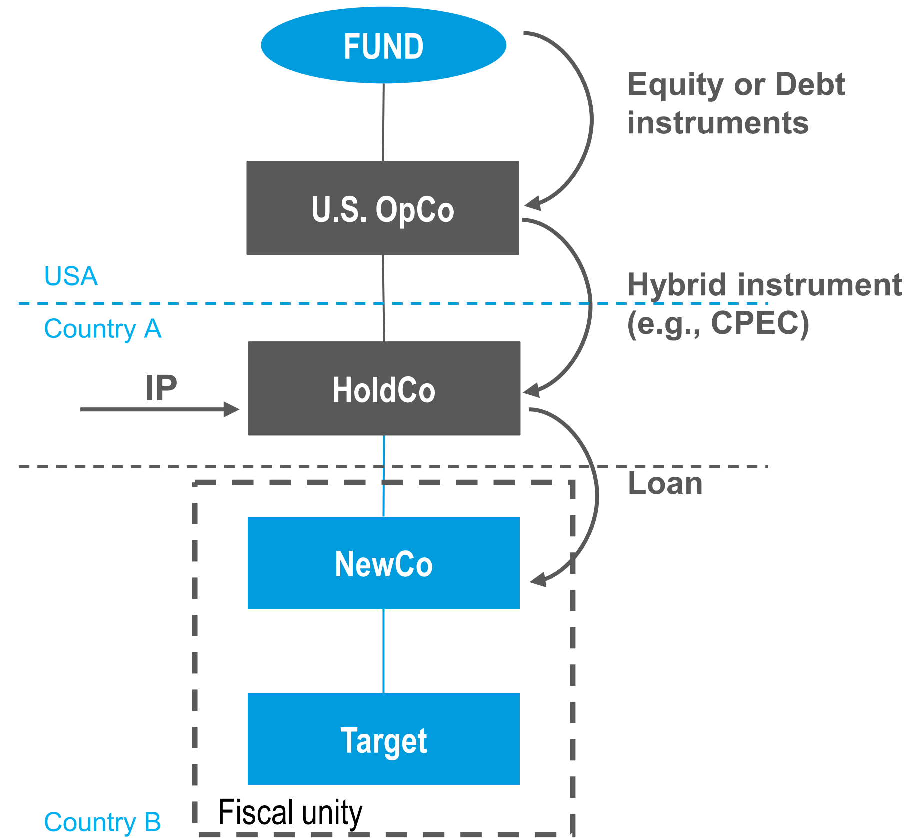
Which structures worked in the past?



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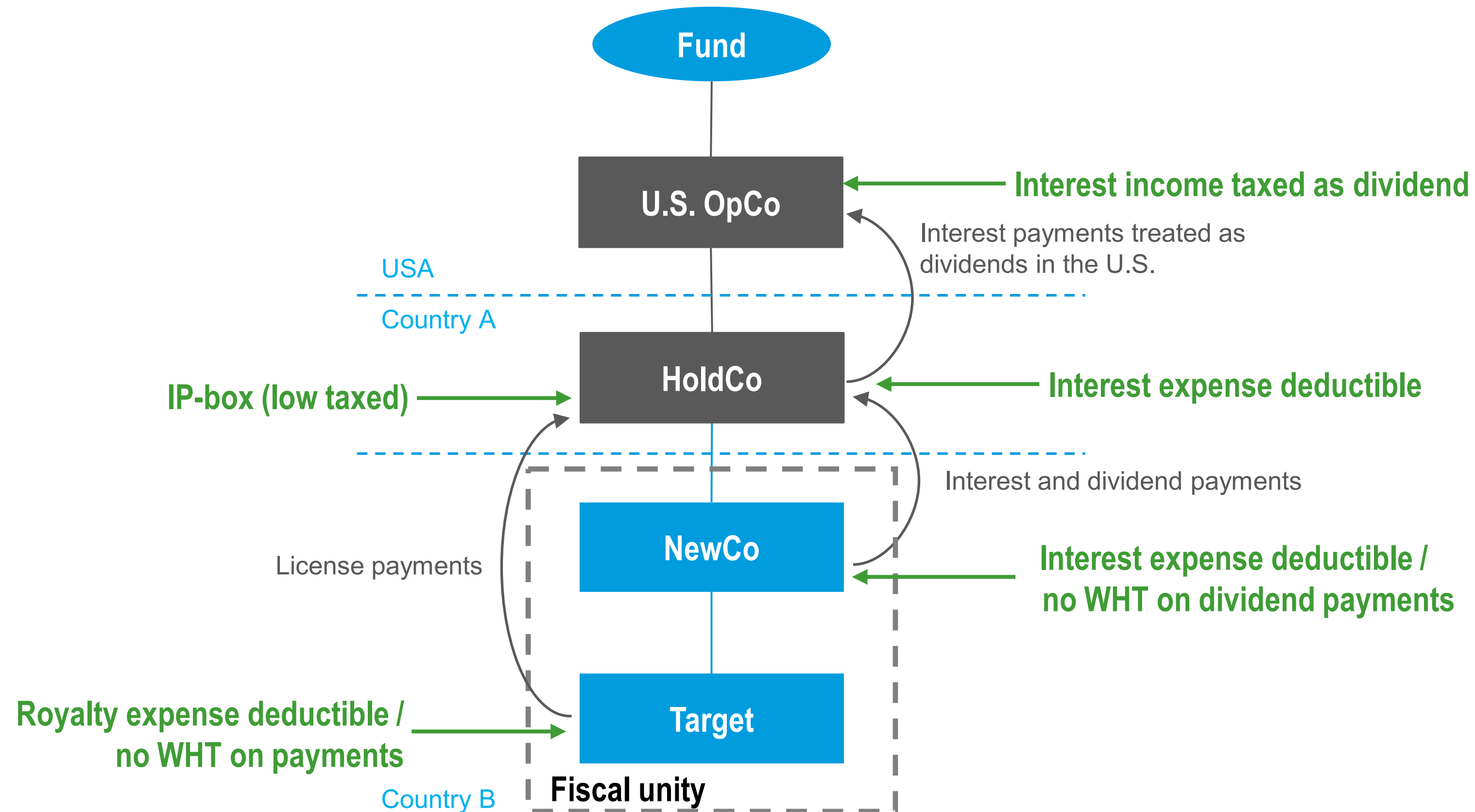
What was the benefit?



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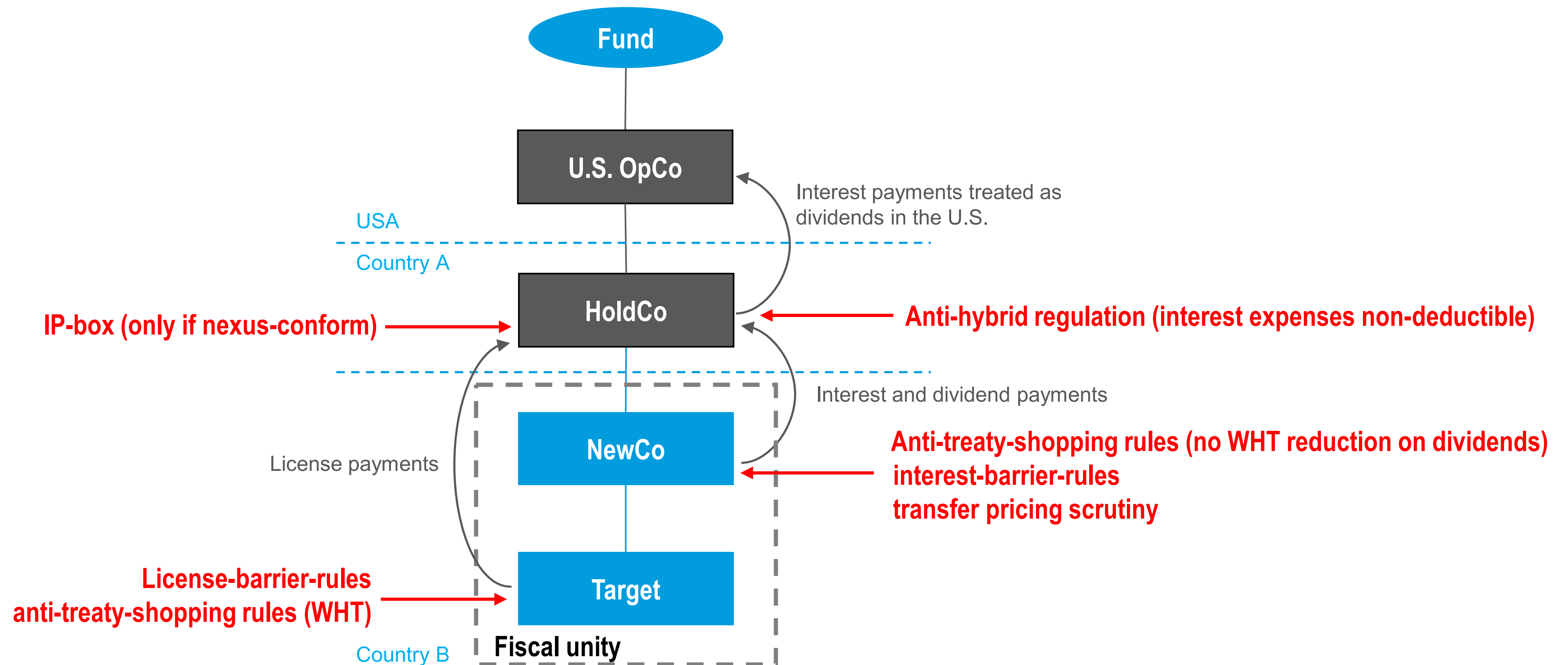
What are the issues now?



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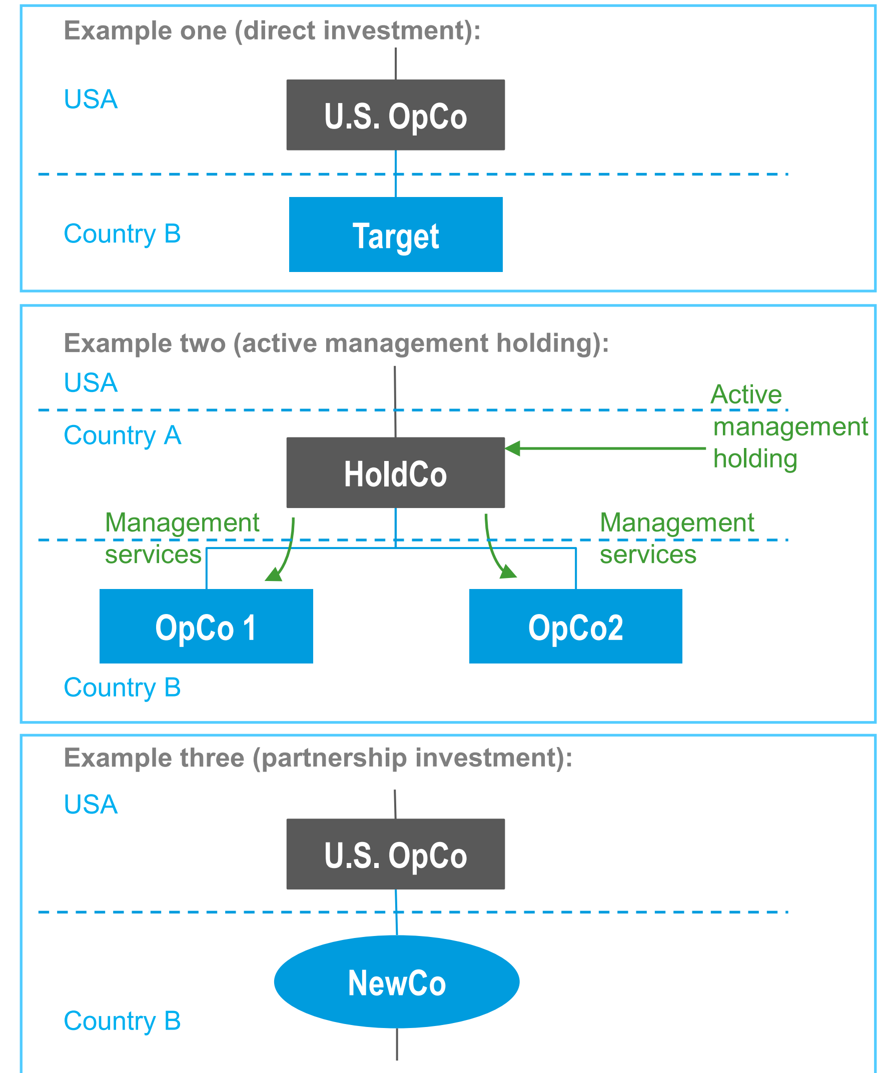
What can we do now?

- Avoid artificial structures that lack substance
- Align income stream with functions and risks and appropriate documentation (transfer pricing)
- Think of direct investment rather than using (low-substance) holding companies (example one)
- If the holding company isn't conducting the trade, the HoldCo needs to conduct active management activities (example two)
- Think of alternatives to corporate structures (e.g., using partnerships to avoid WHT issues on dividends – example three)
- Avoid financial instruments with hybrid character
- If using IP-Box jurisdictions equip entity with personnel to carry out R&D activities or oversight functions
- Document that a tax advantage is not the main purpose for interposing entities into the structure
- Remember: Every investment is unique and requires adaption to the actual facts and circumstances



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