5.
How tax impacts deal success and values

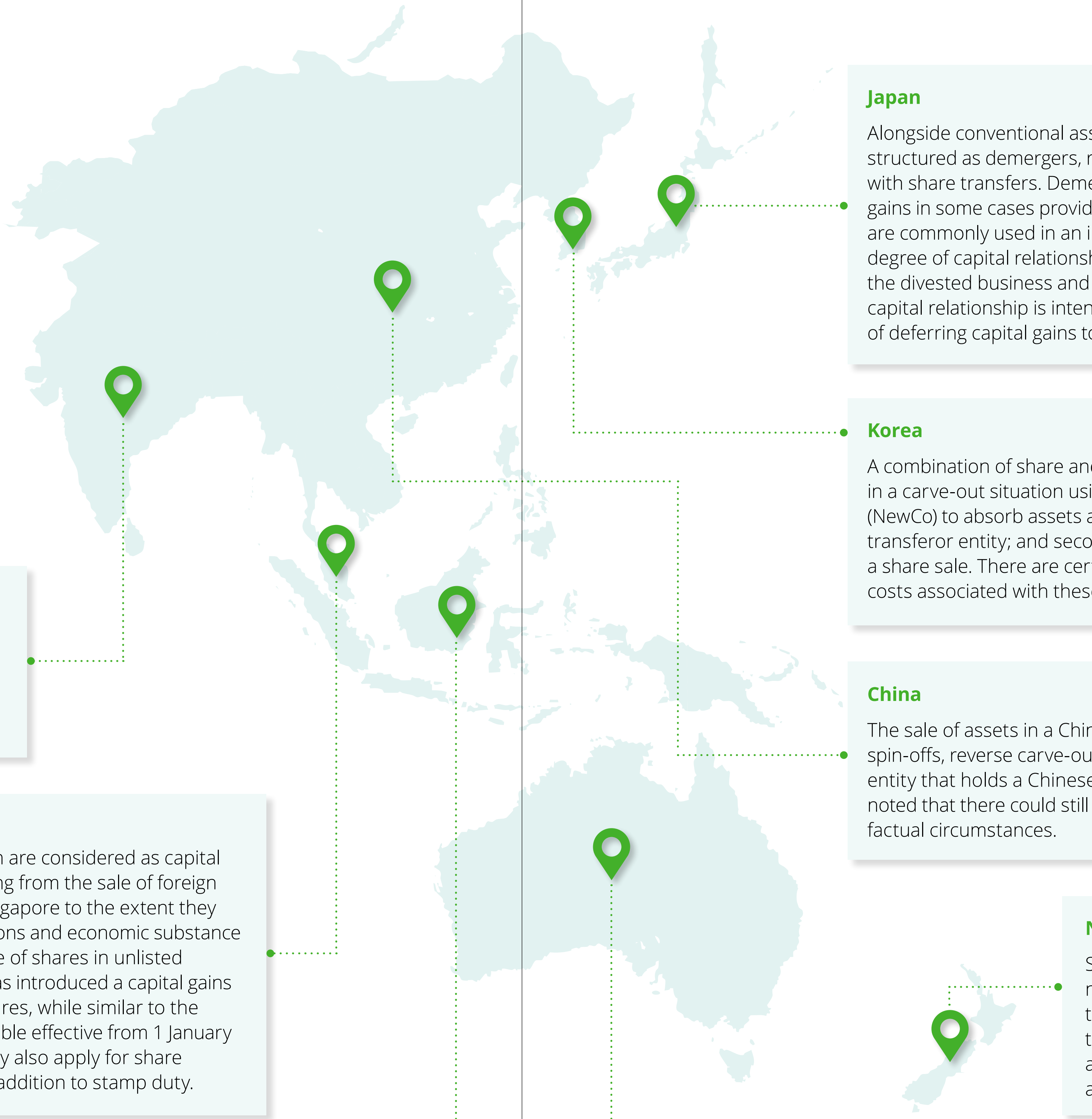
Alongside the strategic and commercial considerations of any prospective divestiture, sellers should be cognisant of their tax implications so that they realise the full value of the transaction – and that means taking a holistic view that goes beyond looking at the asset itself.

Tax structuring and close attention to changing tax laws can help to manage tax costs associated with divestments, mitigate any adverse tax risks and exposure, and deliver tax efficiencies for the seller or buyer both during and post-divestment. In our survey, 68% of respondents said that tax law changes have had at least a moderate impact on their divestiture strategies, with 10% saying the impact has been high. We have surveyed some of the major jurisdictions across Asia Pacific to identify the key tax issues and considerations for companies reviewing potential divestitures.

Structures and modes of divestment

Divestments are typically undertaken through share sales, asset sales or a combination of the two. In share sales, it is usually the selling shareholders who receive payment, while in asset sales, the consideration will be received by the selling entity. So, where a divestment is undertaken through an asset sale, but the shareholders want to receive funds from the transaction, it will be necessary to devise a way of upstreaming the sale proceeds and this may then entail additional tax costs and planning.

Individual Asia Pacific markets display widely differing characteristics when it comes to the typical forms of portfolio rebalancings, including:



India

Alongside conventional asset and share sales, slump sales (i.e. the sale of a business for a lump sum consideration without attribution of specific values to assets and liabilities) of itemised assets, and tax-neutral demergers are common types of asset sales often used in an India divestiture transaction.

Singapore and Malaysia

In Singapore, any gains from the sale of shares or assets, which are considered as capital in nature, are generally not subject to tax. However, gains arising from the sale of foreign assets (as defined) may be deemed taxable upon receipt in Singapore to the extent they take place on or after 1 January 2024, subject to certain exclusions and economic substance requirements. In addition, stamp duty generally applies to sale of shares in unlisted Singapore companies. Effective from 1 March 2024, Malaysia has introduced a capital gains tax (CGT) regime which taxes disposal of Malaysia unlisted shares, while similar to the Singapore regime gains from disposal of foreign assets are taxable effective from 1 January 2024 subject to certain exclusions. Real property gains tax may also apply for share transfers of companies which are real property companies, in addition to stamp duty.

Indonesia, Philippines and Vietnam

Indonesia, Philippines and Vietnam generally impose capital gains taxes on the sale of unlisted shares in these markets. In the Philippines, donor's taxes can also be imposed on the excess of fair market value over the selling price of unlisted shares in certain instances. Vietnam, however, also imposes capital gains tax on indirect share transfers, and that is something that sellers should be aware of as returns may be impacted.

Japan

Alongside conventional asset and share sales, divestments in Japan are typically structured as demergers, reverse-demergers, or business transfers in combination with share transfers. Demergers can be used to defer the recognition of capital gains in some cases provided that certain requirements are met. These techniques are commonly used in an internal group reorganisation scenario, where some degree of capital relationship is expected to continue between the entity housing the divested business and its original contributor/shareholders. Maintaining such capital relationship is intended to generally restrict the preferential tax treatment of deferring capital gains to internal group reorganisations.

Korea

A combination of share and asset sale transactions would typically be undertaken in a carve-out situation using a two-step process: first, by establishing a company (NewCo) to absorb assets and businesses through an in-kind contribution from the transferor entity; and second, through the subsequent spin-off of such NewCo via a share sale. There are certain tax concessions in Korea that can minimise the tax costs associated with these steps, subject to certain conditions being satisfied.

China

The sale of assets in a Chinese company, can be achieved through sale of shares, spin-offs, reverse carve-outs and indirect share transfers (e.g., via selling an offshore entity that holds a Chinese company). For indirect share transfers, it should be noted that there could still be a reporting and capital gain exposure, subject to the factual circumstances.

New Zealand

Since there is no comprehensive capital tax gains regime, nor stamp duties or other transfer taxes, share sales are the most common mode of divestment. Asset sales are typically undertaken for carve-outs, where the seller has available tax shelter to mitigate any adverse tax costs associated with such asset sales.

Australia

Share sales are the most common mode of divestment since share sales, unless the relevant target is land-rich are typically not subject to stamp duty. However, in a carve-out where a share sale is not possible for commercial reasons and depending on the specific tax profile of the seller and the assets being carved out, either of these scenarios are possible: the seller transfers the relevant assets to a newly incorporated entity (NewCo) and then disposes of them, or the seller disposes of the relevant assets directly by way of an asset sale.

Managing portfolio rebalancing tax costs

Divestments will often carry capital gains and transfer-tax implications which may impact transaction pricing. However, there are ways to manage these tax costs. Some jurisdictions provide a relevant tax framework that allows business restructurings to be treated as tax-free or tax-deferred, provided certain conditions are satisfied. However, these tax-deferral schemes typically only apply in an intra-group transactions. Hence, to help mitigate taxes, early planning and restructuring of the target assets to be disposed of, such as moving target assets into a separate holding vehicle and selling shares in that holding vehicle some time later, could be considered to avail to such schemes. Alternatively, a reverse-carve out where the seller carves out the assets to be retained could also be considered.

Warranty and indemnity (W&I) insurance is increasingly used to better manage tax risks and exposure in the target group, where they exist in jurisdictions across Asia Pacific. For example, this can be done in private equity and privately (family) held exits by transferring to an insurer, material legacy tax risks in the target group which might otherwise be a deal breaker.

Tax efficiencies and deal pricing

While portfolio rebalancing is largely driven by commercial considerations there can be associated tax considerations too. Sellers seeking to attract investors into their profit-making businesses may want to segregate or dispose of loss-making business segments. However, these loss-making businesses may also have accumulated tax losses over the years, which can represent value if they can be applied to reduce future taxable profits and therefore future taxes payable. In certain cases, these entities may recognise deferred tax assets on these losses.

In our survey, 31% of respondents said that the availability of tax attributes and/or other tax-related benefits were among the most significant reasons for them achieving a higher-than-expected value on their most recent divestiture.

However, while sellers may want to price in certain tax attributes to derive maximum value out of a portfolio rebalancing, they should be aware that the practices of different jurisdictions in Asia Pacific vary significantly. In the case of India and New Zealand, tax costs are typically not explicitly priced into the deal. Specifically, in Korea, the tax value does not directly affect the deal price unless the tax value is very likely to be realised. In China, the buyer and seller can reach an agreement on how tax attributes may be priced into the sale consideration, so long as the deal price is commercially justifiable by the parties.

In other cases, tax attributes may be disregarded and not priced into the purchase consideration, particularly when the availability of the tax attributes post-divestment is uncertain. It is also possible to implicitly price certain tax attributes or costs into the overall transaction, though these may not be expressly presented in sale transaction documents. These tax items can include Net Operating Losses (NOLs) and the tax cost of asset sales, as well as additional costs of cash upstreaming, where the portfolio rebalancing was achieved through an asset sale and shareholders are keen to access the divestment proceeds. More importantly, in an asset sale, typically there is a step up of asset value to transaction price. This benefits the buyer, who would otherwise be buying shares and inheriting the underlying assets at book cost. However, asset sales are often more difficult or take longer to execute owing to the need to transfer contracts and licenses.

Rebalancing your portfolio to fuel growth

Sellers may also want to look at the impact of the divestitures on their effective tax rates (ETR), specifically on the adjusted Global Base Erosion (GloBE) ETR per jurisdiction. The impact on GloBE ETR would be especially relevant where the seller wants to manage the ETRs in the group for the purposes of minimising any top-up taxes, which may need to be paid by the relevant group in accordance with global tax regime changes brought about by OECD's Base Erosion Profits Shifting (BEPS) Project 2.0, Pillar Two.[36] For example, a multinational group that is in-scope for Pillar Two may want to consider the impact on the GloBE ETR of an asset sale as compared to a share sale. While a non-portfolio share sale may not have an immediate impact on a company's GloBE ETR, an asset sale could significantly alter the company's adjusted tax expenses and income, and consequently its GloBE ETR. This would especially be the case if the company sells high-value assets. Strategic planning and knowledge of the BEPS rules are therefore essential in either scenario to effectively manage the multinational group's global tax liabilities.

As ever, the tax component of a prospective divestiture is both complex and nuanced. But it also cannot be ignored. While the specific tax rules that apply differ widely across the Asia Pacific region, the cost of not fully understanding the tax implications of a divestiture transaction is potentially the same regardless of the specific jurisdiction: that is potentially a failure to realise the full value of the deal.