

# Carve-outs/pre-deal restructuring in M&A: Tax considerations

# Speakers



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# Pre-deal carve out & restructuring

## Why is it necessary and important?

### Historical risks in existing entities

- Not limited to tax; can be legal/regulatory/commercial

### Not aligned with business or investment objective

- E.g., Buyer may not want to acquire real assets

### Carve-outs are structurally messy by default

- Businesses are not designed to be standalone
- Tax positions reflect group thinking

### Adverse tax implications if carve-out goes wrong

- Stranded tax attributes
- Unexpected tax leakage (e.g., withholding tax, transfer taxes, duties, VAT, etc.)
- Forced post-deal restructuring may give rise to greater costs

# Purchasers and vendors may have competing interests as to how to structure a Transaction

## Sale of holding companies

- Cleaner exit for Vendor
- Purchaser now owns holding companies it may not want, in jurisdiction where it may not have substance
- Risk that acquired holding companies may no longer qualify for treaty benefits?
- Additional buy-side due diligence required—cost implications
- Additional steps required to repatriate cash

Typically preferred by Vendors

## Sale of Operating Companies

- Vendor needs to deal with holding companies post-Transaction; may delay repatriation of proceeds
- Purchaser can create new holding structure, based on their commercial preferences and reflecting where they have operational substance
- Fewer excess holding companies in new structure may facilitate cash repatriation
- Purchaser should have stepped up tax basis in top operating company; if sell at same level, this may reduce Exit taxes

Typically preferred by Purchasers

## Trade & Asset Sale

- Asset disposals likely taxable for vendor entities; share sales more likely to be tax exempt—if vendor has significant tax losses, may be more willing to contemplate an asset deal
- Risk of stamp duties, acquisition tax, VAT, etc on certain transferred assets
- Potential enhanced tax deductions for assets acquired directly, e.g., tax depreciation and amortisation
- Possibility of pushing debt down into operating companies
- May not inherit historical tax/legal risks, but could also forfeit tax attributes, e.g., losses
- Reduced requirement for due diligence
- May be legally complex, e.g., where large numbers of legal agreements need to be novated
- Maximum flexibility for Purchaser in terms of structuring the acquisition

Very Purchaser friendly

# Carve-outs may provide Purchasers with greater structuring flexibility

## Potential advantages

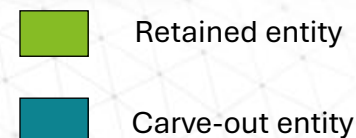
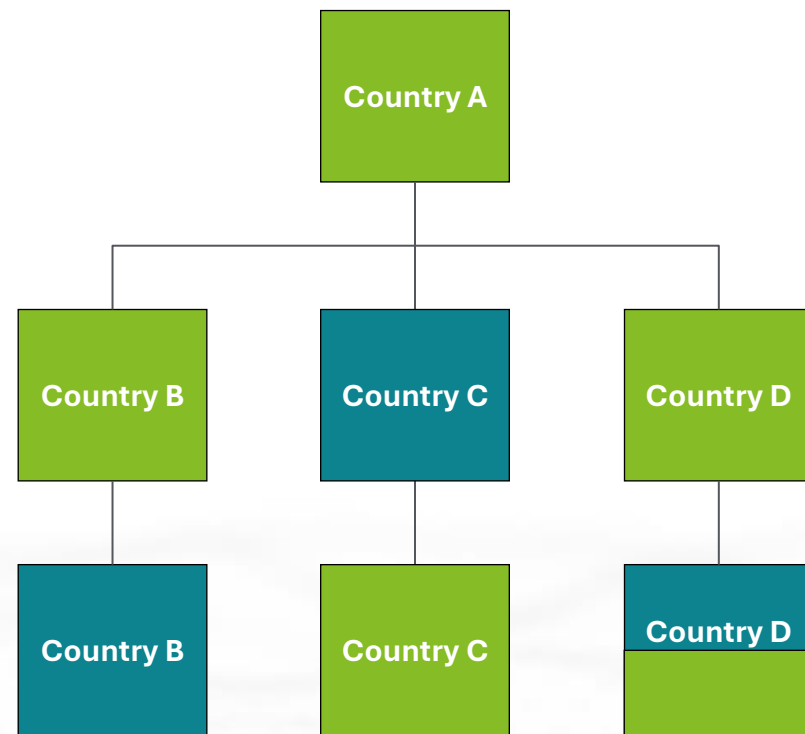
- Purchasers, especially corporates, may want to acquire different companies individually to reflect own group structure
- Purchaser now owns holding companies it may not want, in jurisdiction where it may not have substance

## Potential issues

- Sales at multiple layers less likely to be tax exempt
- Additional tax filings required for CGT, stamp duties, etc.
- Pillar Two considerations
- Transitional services agreements

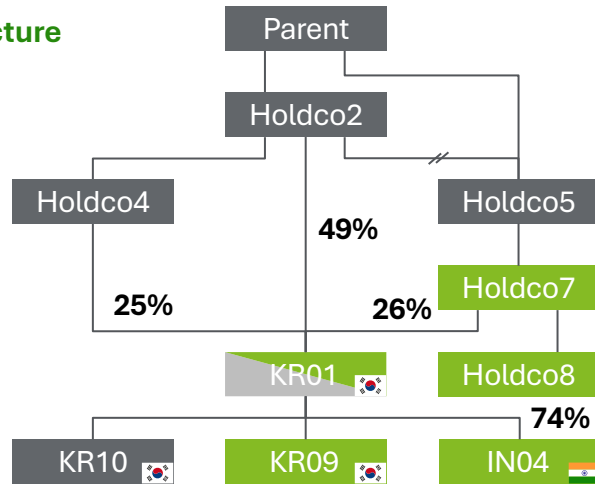
## Restructurings

- Restructurings may be required prior to carve-out
- Risk of two levels of tax—one on internal transfer, one on third party sale
- Simplifies third party sale legally, and from a closing mechanics perspective

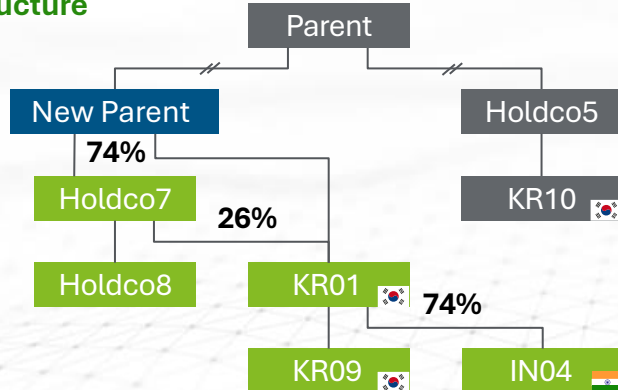


# Case Study South Korea

## Initial Structure



## Target Structure



## Key Information

### Overview of KR

- KR01: KR01 is held by...
- Real estate owned by
- Tax Losses in ...
- Intercompany payable/receivable to be settled

### Key drivers of KR Reorganisation

- Key objective is to rationalise KR Retained business and Non retained activities while mitigating cash mobilisation and Cash Tax Costs, taking into considerations certain identified non-tax constraints (e.g., invoicing, buildings, etc.).
- KR entities and IN04 have not been involved in any Pre-Reorganisation cash repatriation.

### General point of attention:

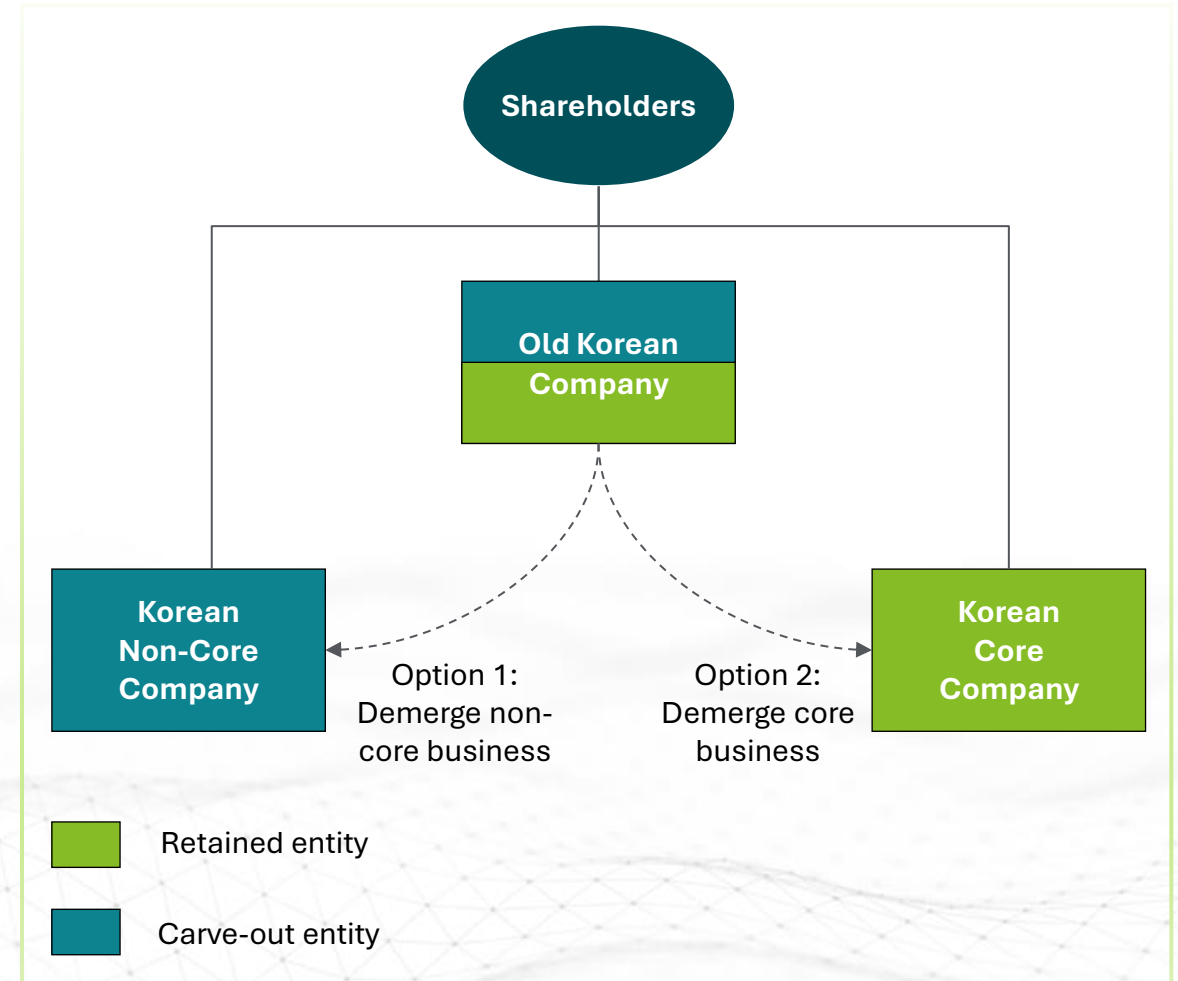
- Local tax valuation has been undertaken to confirm most sustainable tax structuring options for KR—considering larger tax implications at Group level. Preliminary figures should be refined in Phase 2 Implementation to confirm certain assumptions of local appraiser wrt. KR01 Non retained valuation.
- KR Section must be read together with overall restructuring Section.

# Spin-offs where individual entities have multiple core and non-core activities

## Demergers in Korea

### Two main options:

1. demerge non-core business to new company, which is then sold; or
  2. demerge core business to new company, then sell old company
- Various conditions for tax-free spin-off, including around the number of employees retained in the new company
  - Tax-free treatment may be withdrawn if certain events occur, including a sale of more than half of the shares held by the new company's largest single shareholder (plus related parties) within two years from the end of the year in which the demerger occurs
  - May therefore prefer to demerge the business that the current shareholders wish to retain





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