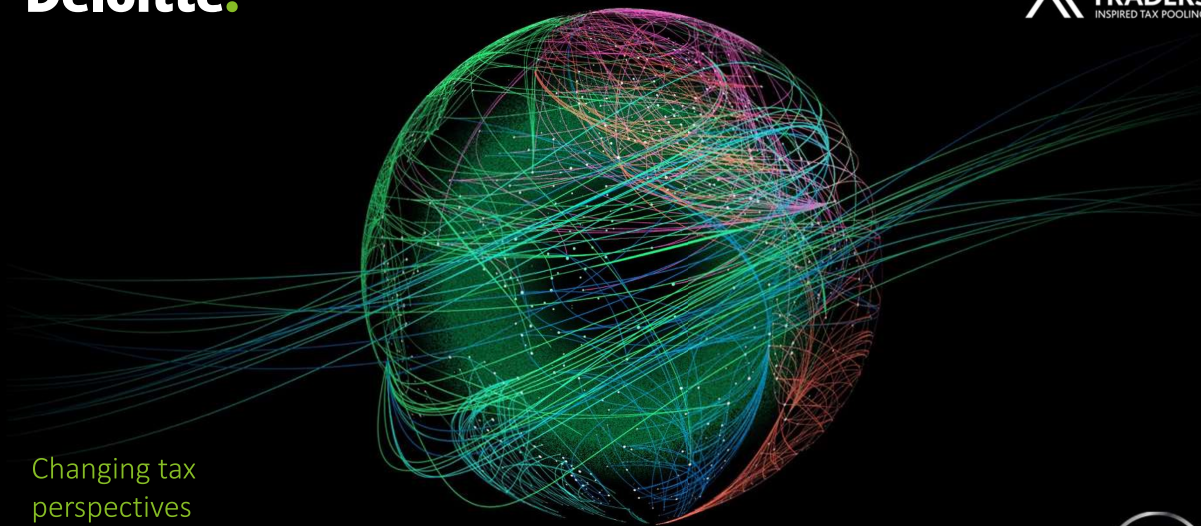

Changing tax perspectives

Mergers and acquisitions

2022 National Tax Conference

Speakers

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Tax

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Agenda

1. Introduction
2. M&A market context
3. Business continuity test
4. Purchase price allocations
5. Employee share schemes
6. Overseas Investment Office tax changes
7. ‘Dividend integrity’ rules?
8. Questions

M&A lingo bingo – Rules

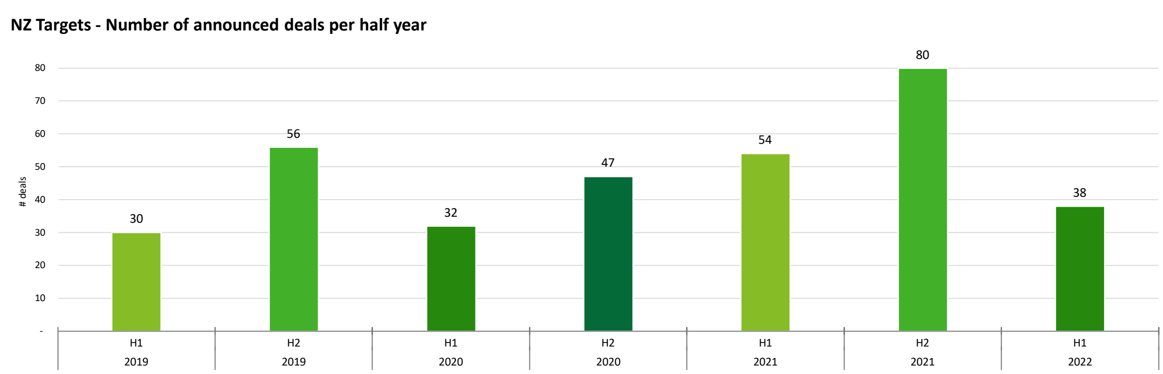
1. **Listen carefully to the presenters.**
2. **When you hear them use an acronym, cross it out on your bingo card.**
3. **“Free space” = a freebie!**
4. **You must complete a full row of 5 squares. These can be horizontal, vertical or diagonal, but must be in a straight line.**
5. **If you complete a row, jump up shouting “BINGO” at the top of your lungs, to win a fabulous prize.**

M&A market context

Simon Chapman

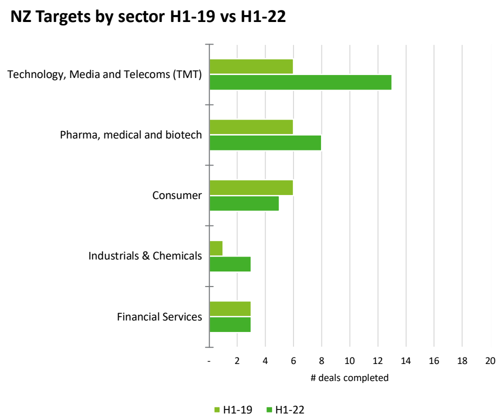
M&A market context | Recap of the last two years

Number of deals per quarter 2018 to 2022

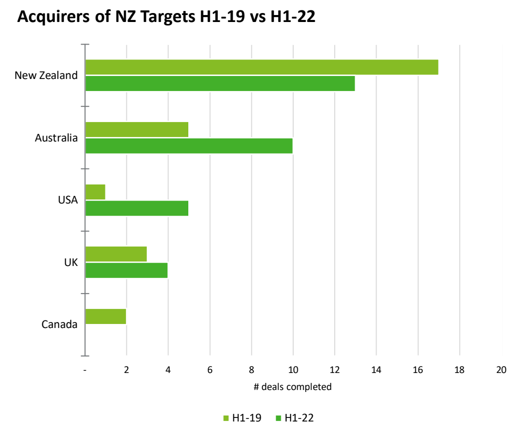


M&A market context | Countries and sectors of activity

Deals by target company sector H1 2022 vs. H1 2019



Deals by acquirer country H1 2022 vs. H1 2019



M&A market context | Current situation

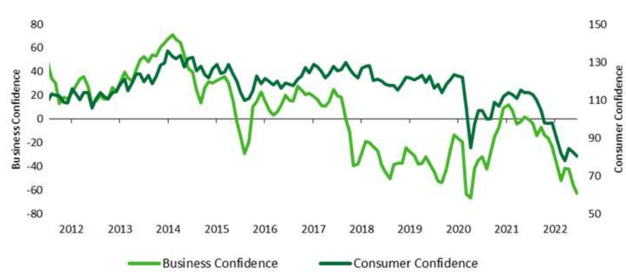
There are positive indicators that would support continued high levels of M&A activity, but some concerning signals resulting in uncertainty

Positive indicators

- **Plenty of capital available**
  - Private equity, corporates, HNW
- **Business lending growth**
  - 7% growth in 2022, faster growth than 2021
- **Consumer spending and business investment**
  - so far consumer spending and business investment intentions have held up
- **Unemployment at record low levels**
  - Both positive and negative

Signals of concern

- **Inflation**
  - 7.3% in the year to June 2022
- **Consumer and business confidence –** ANZ indices



M&A market context | M&A in uncertain times

Uncertainty may lead to a decline in activity for a period, but there are exceptions to the general trend…

General Trends

- **What drives acquirers to undertake M&A?**
  - Generate return on investment
  - Generally acquirers create value through growth in the business

If an acquirer can't be certain of growth, or worse if there is a risk of decline, most acquirers will sit and wait.

Exceptions

- **Industries underpinned by government spend**
  - Infrastructure (and related services)
  - Healthcare
  - Education
- **High growth businesses**
  - High growth businesses grow by gaining market share
  - Not constrained by the overall market growth (or decline)

M&A market context | M&A in uncertain times

Uncertainty may lead to a decline in activity for a period, but there are exceptions to the general trend…

Valuation

- **Reduction in valuation**
  - Pricing in uncertainty
  - Forming a view on normal, mid-cycle earnings

Information asymmetry regarding uncertainty and forecast driving a wedge between buyer and seller expectations.

ESG

- Increasing area of focus and due diligence
- Additional filter, but should go to value as it matures

Corporate carve outs

- **Increase in corporate reorganisations**
  - Divestment of non-core business units

Distressed M&A

- Cautious approach during pandemic
- New concerns / uncertainty leading to increased activity

Business continuity test

Vyshi Hariharan

Business continuity test

Overview of the rules

- Supplements the existing 49% shareholder continuity test.
- Will allow losses to be carried forward to future years, provided there hasn't been a "major change" in business activities.
- Primary test: Assess whether there has been a major change from the date of the breach in shareholder continuity until the earlier of:
  - all losses being used; and
  - the last day of the income year in which the fifth anniversary of the breach in continuity occurs.
- The 5-year period will not apply to companies carrying forward losses consisting of significant deductions for bad debts.
- Applies to losses arising in the 2013/14 income year onwards, and breaches in shareholder continuity from the 2020/21 income year.
- Includes anti-avoidance rules to prevent loss trading and manipulation of 'major change' test.

Relevant for share deals.

New test allows tax losses to be carried forward after a breach in shareholder continuity.

Requires no "major change" in the company's business activities.

Business continuity test

Overview of the rules

- Factors that may be taken into account in determining whether there has been a major change, include:
  - Assets used;
  - Business processes;
  - Scale of business activities;
  - Use of suppliers/other inputs;
  - Market(s) supplied to; and
  - Type of products or services supplied.
- Even if there has been a "major change", there are exceptions for "permitted changes". These are changes:
  - Made to increase the efficiency of a business activity;
  - Made to keep up to date with advances in technology;
  - Caused by an increase in the scale of a business activity; and
  - Caused by a change in the type of products or services produced or provided, where the same, or mainly the same, assets are used or the products / services are 'closely connected'.

As a whole, the test is intended to focus on the inputs a company employs and not its outputs, to allow a business to 'pivot'.

Business continuity test

M&A impact

- Diligence
  - Losses will not automatically be forfeited on a transaction event.
  - Possible 'downside' BCT analysis even where shareholder continuity seemingly maintained.
  - Review of 'compliance' with BCT for pre-transaction breach and impact of likely post-transaction changes.
  - Taking a 'snapshot' of the business on forfeiture event.
  - IR engagement to obtain further confidence.

Business continuity test

M&A impact

- Pricing of losses
  - Every $1 of tax loss in theory delivers 28 cents of tax benefit. However, to be of value:
    - Must shelter go-forward taxable income;
    - Must stay intact – how much can a business ‘pivot’ and BCT still be satisfied;
    - Must consider the impact on future distribution profile and tax payable at a shareholder level (i.e. no ‘substitution’ for tax further ‘up the chain’).

- Sale and purchase agreements
  - Amendments to standard tax indemnity and warranty provisions have begun.

- Warranty & indemnity insurer interactions

Purchase price allocation rules

Hamish Tait

Purchase price allocation rules

Overview of rules

- IR concern that taxpayers are adopting inconsistent purchase price allocations (**PPAs**).
  - Not agreeing allocations.
  - Agreeing an allocation but not following in tax return.
- Response: from 1 July 2021, new PPA tax rules to drive consistency.

- Applies to 'asset deals', in two scenarios:

Scenario 1:
PPA agreed in writing

Parties must follow PPA in their tax returns.

Scenario 2:
No written agreement as to PPA

Initially, the vendor has the right to unilaterally set an allocation.

Purchase price allocation rules

First scenario – Allocation agreed in writing

- If allocation agreed to in writing, the tax rules generally deem this to be the consideration for the transaction.
- Agreement in writing – requires:
  1. the agreement be recorded in a document;
  2. before the first tax return filed; and
  3. a specified amount for the relevant classes of property.

- IR can still adjust if it considers the allocation does not represent the "relative market value".
- IR cannot adjust for certain 'de minimis' items costing less than $10k, and less than $1m in aggregate, if the allocation is between cost and TBV.

Parties must follow an agreed allocation in their tax returns.

Purchase price allocation rules

Second scenario – No agreed allocation

- If no PPA agreed in writing, the parties can unilaterally decide the allocation based on ordering rules:
  - Vendor has first right to set, within three months.
  - If vendor does not set the allocation, the purchaser has three months to set.
- Vendor allocation is subject to a tax book value (**TBV**) floor providing some buyer protection.
- If neither the vendor or purchaser set (after 6 months), IRD can set. Practically, parties can still agree (and get back to 'scenario 1').
  - Purchaser's deductions denied / deferred until allocation is notified.

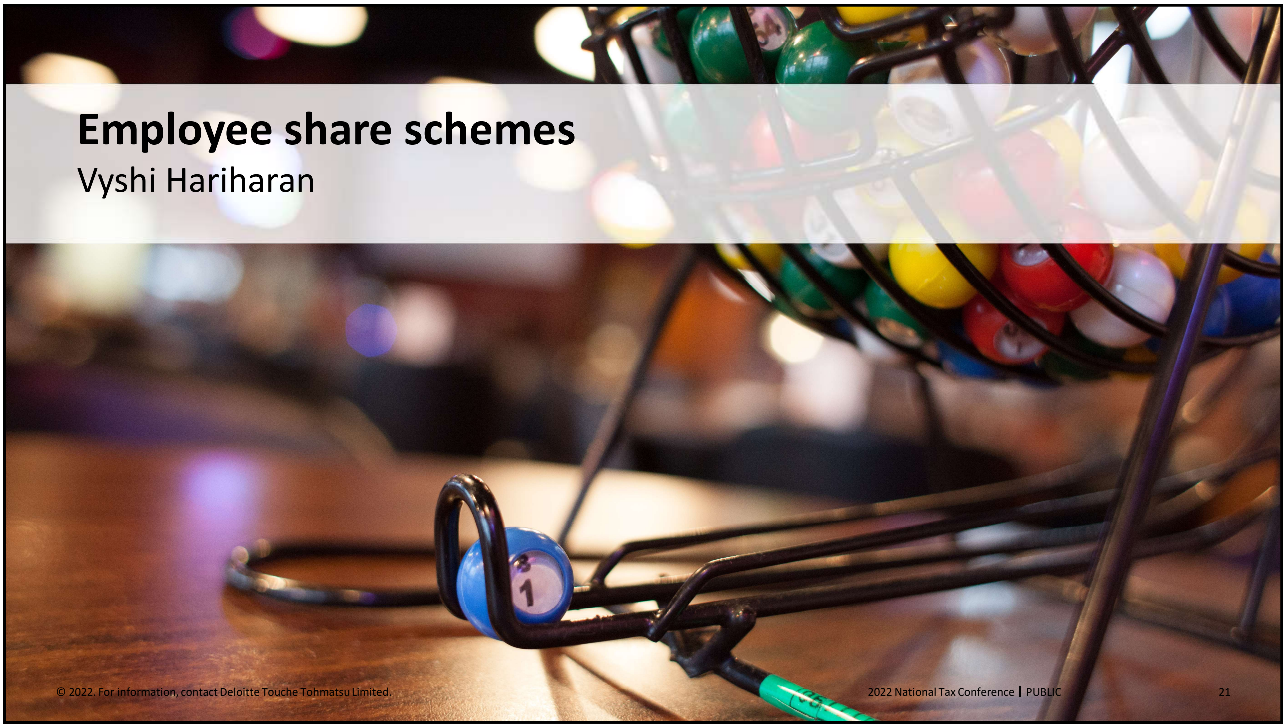
If no agreement as to allocation, the vendor has the first right to unilaterally set.

Purchase price allocation rules

How are parties dealing with the new rules?

- Common to 'agree to agree' an allocation
  - Vendor (and purchaser) 'contracting out' of right to unilaterally set allocation, and setting out a process to agree the allocation
  - Standard drafting being regularly used – including standard ADLS / REINZ clauses – deals with adjustments to purchase price.
- Impact on deal dynamics?
- Valuations?

Seeing an increase in 'agreeing to agree', if allocations are not agreed upfront.



Employee share schemes

Vyshi Hariharan

Employee share schemes

Overview of the rules

- The current rules have applied since 2018.
- The objective of the rules is, to the extent possible, for the tax position of both the employer and the employee to be the same whether remuneration for labour is paid in cash or shares.
- A benefit received under an employee share scheme is assessable income for the employee.
- Prescribed rules regarding
  - The timing of when assessable income is derived; and
  - The amount of the benefit.
- An employer is allowed a deduction for an amount equal to the employee's income.
- Company needs to meet the general permission and not be subject to the capital limitation.

Employee share schemes

Recent Australian case

- *Clough v Commissioner of Taxation*
  - Recent Australian case regarding deductibility of option and other equity right cancelation payments
  - The payment failed to meet the "positive limbs" of the general permission
    - Even if the payment had satisfied the positive limbs of the general permission, it would not have been allowed as a deduction as it was also of a capital nature.
  - Yet to see the impact of the decision in NZ (if any)

Payment to cancel employee options in anticipation of a transaction non-deductible.

Employee share schemes

- The design of schemes are still nuanced. Trend toward:
  - Option schemes
  - Phantom schemes
  - Flexibility for cash settlement built into scheme terms
- Upfront consideration of tax implications and tax review of documentation.
- IR engagement to obtain comfort / clarification in relation to a number of aspects of the rules.
- Pricing of deduction for company, noting
  - Timing of the deduction
  - Application of BCT

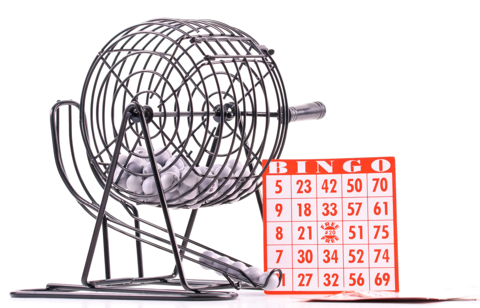
Overseas Investment Office tax changes

Hamish Tait

Overseas Investment Office tax changes

Investor test

- New tax limbs to "investor test"
  - Relevant for all deals subject to OIO approval
- Covers issues with overseas tax compliance history, where the "investors":
  - *have been liable in the last 10 years for penalties for an "abusive tax position" or "evasion or a similar act" in NZ or overseas; or*
  - *currently have outstanding "unpaid tax" of NZ$5m or more "due and payable" in NZ or overseas.*

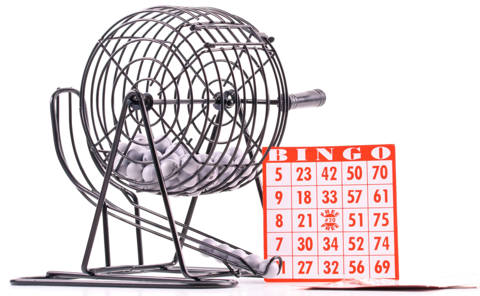


Overseas Investment Office tax changes

Tax information disclosure

- New IRD tax information disclosure form
  - Relevant for OIO applications to acquire "significant business assets"

- Must provide details of:
  - business 'plan' for assets over next three years;
  - tax residence of key entities, and relevant tax treaties;
  - split of debt and equity funding, and whether hybrid entities/instruments are likely to be used;
  - cross-border related-party transactions; and
  - detail of any proposed tax ruling or 'advance pricing agreement' application.

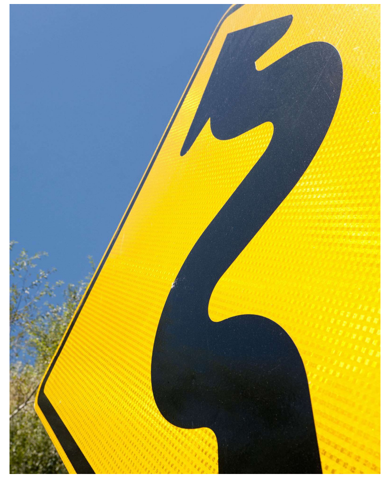


'Dividend integrity' rules?

Hamish Tait

‘Dividend integrity’ rules?

- Government has concerns about avoidance of the 39% tax rate, including not paying a dividend prior to a transaction event.
- **Proposed solution:** Tax a company’s retained earnings on sale
  - Effectively a tax on capital gains
- Strong criticism; initial proposals scrapped
- Watch this space!
  - New proposals being developed
  - Inland Revenue investigation activity



Questions