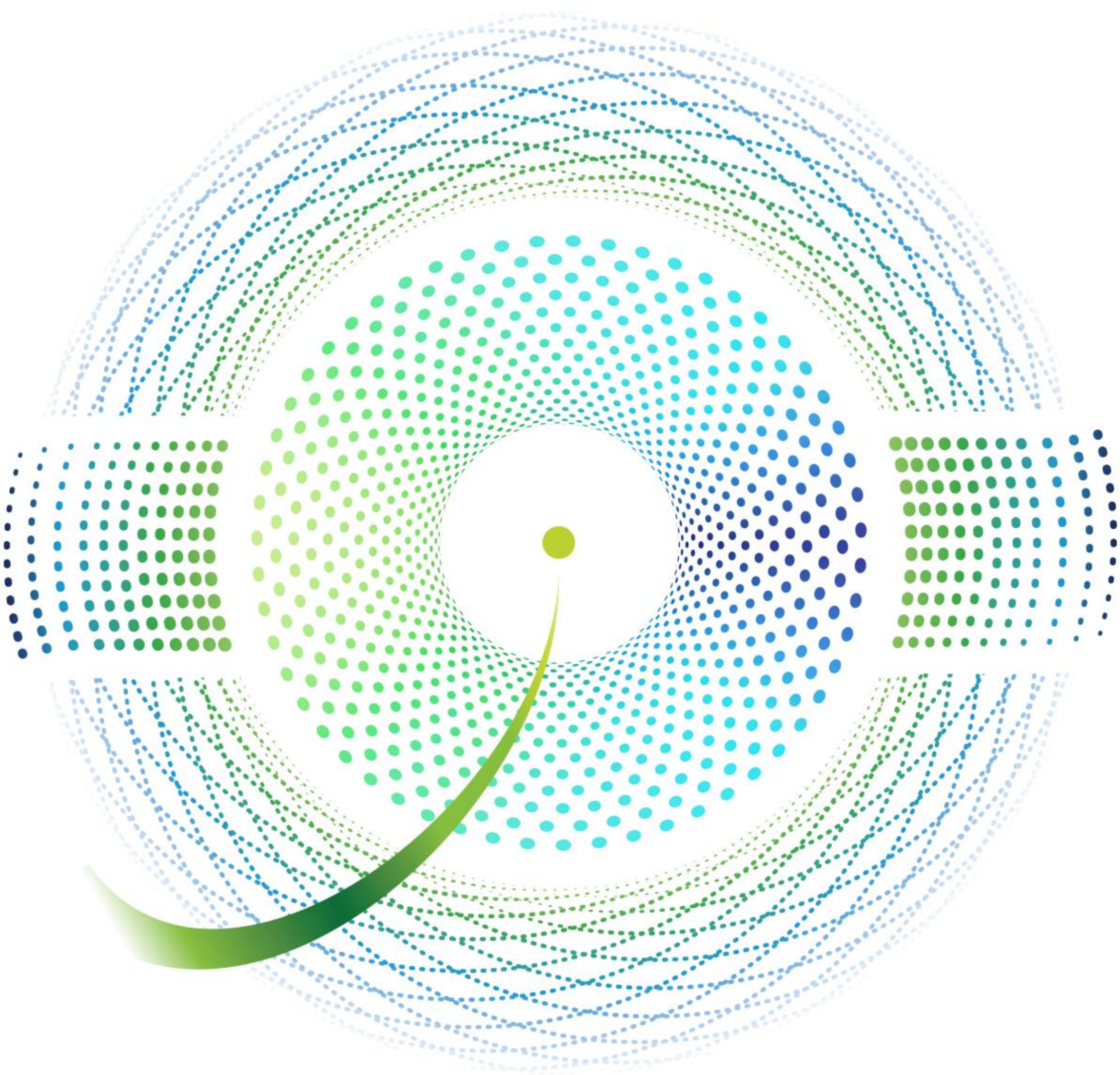
Deloitte.



The role of tax in the mergers and acquisitions lifecycle

Understanding tax considerations in M&A in the Middle East

December 2024

MAKING AN IMPACT THAT MATTERS since 1845

I – Introduction

In 2023, Mergers and Acquisitions (M&A) activity in the Middle East and North Africa (MENA) region increased by 4% to USD 86 billion. The Gulf Cooperation Council (GCC) region led this growth, contributing USD 83.2 billion, with the United Arab Emirates (UAE) being the preferred M&A destination, due to its business-friendly environment and efficient legal framework. The UAE and Saudi Arabia (KSA) together accounted for USD 24.8 billion of M&A deals. [1]In 2024, key MENA projects such as NEOM in KSA and Palm Jebel Ali and Tower at Creek Harbour in the UAE are set to bring in foreign direct investments and attract investments from the United Kingdom to the Middle East.[2]

Companies typically engage in M&A transactions to achieve strategic objectives, such as market expansion, economies of scale, synergies, business diversification, shareholder value creation, and competitiveness enhancement. M&A deals can be structured in multiple ways, including mergers, demergers, share purchases, asset purchases, and leveraged buyouts, influenced by business strategies, legal and regulatory factors, and market dynamics.

The M&A landscape in the Middle East is changing fast, with tax considerations becoming more crucial. The introduction of Base Erosion and Profit Shifting (BEPS) and Pillar 2 has made tax planning a key factor in M&A. As governments in the region work to attract foreign investment, tax regulations are proving to be powerful tools. This is especially true in M&A deals, where tax planning can significantly affect transaction value, post-deal synergies, and long-term profitability. From transfer pricing rules to corporate income tax, understanding the complex tax implications of M&A deals is now crucial for businesses in the Middle East.

The M&A life cycle covers various stages that companies navigate through when engaging in an M&A transaction. The M&A life cycle starts with strategy development, a crucial stage where companies define their strategy and seek to identify potential targets for M&A. This is followed by a target screening, which involves evaluating the potential targets based on strategic fit, financial criteria, and other factors, after which the actual negotiations begin.

As negotiations progress, due diligence is initiated to analyze the target's financials, legal and tax matters, and other aspects, in detail. The valuation and deal structuring phases involve determining the accurate value of the target and structuring the deal accordingly. Once due diligence is completed and the valuation is finalized, the actual signing takes place, where the terms and conditions of the deal are formalized, and the relevant legal agreements are signed. Post signing, the closing phase involves the completion of the transaction and the transfer of actual ownership. The integration phase follows, combining the operations and cultures of the two companies. Finally, post-merger evaluation assesses the success of the merger and determines any necessary adjustments to ensure the combined entity operates smoothly.

[1]M&A activity in MENA region jumps 4% to $86bn in 2023 (gulfbusiness.com)
[2]What does 2024 herald for MENA M&A and private credit? (gulfbusiness.com)

II – Overview of the tax considerations at different stages of the M&A life cycle

A. Due diligence and valuation

The valuation phase involves a comprehensive assessment of the target's worth. Concurrently, the buyer typically undertakes due diligence on the target company. A tax due diligence is particularly crucial, as it may impact the valuation of the target, help mitigate risks, and identify potential future tax planning opportunities. The extent of due diligence will depend on the construct of the transaction i.e., whether it's a share deal or an asset deal. In a share deal, the historical tax risks and liabilities of the acquired business would typically remain with the acquired target company (as opposed to an asset deal) and will therefore pass over to the buyer.

From a tax perspective, the primary objective for the buyers during the tax due diligence is to identify any past tax liabilities that could affect the target company's valuation and could potentially become the buyer's liability, post-acquisition (in case of a share deal). This involves an examination of the target's historical tax compliance, including corporate income tax, VAT, withholding tax, customs duties, and other relevant tax obligations. The buyers also need to assess whether the target company has any ongoing tax audits or disputes with tax authorities. Another critical aspect for buyers is understanding the target company's tax attributes, such as tax losses and tax credits, which can be a valuable post-acquisition asset or liability. On the seller's side, the main objective is to identify and resolve or mitigate any discovered risks and liabilities before final negotiations, to enhance the target's value. To the extent any material tax issues are identified during the sell-side tax due diligence process, sellers would have the opportunity to take steps to remediate those exposures before the formal sale process. This approach can help mitigate the risk of last-minute surprises and strengthen the seller's negotiating position.

B. Deal structuring

The structure of the deal can vary significantly depending on the strategic objectives of both parties, the financial health of the target, and the local regulatory environment.

Proper tax consulting is essential in the M&A life cycle, as it helps efficiently manage tax obligations associated with the transaction. This can be achieved through finding the right balance in the acquisition's debt-equity mix or choosing favorable jurisdictions for a holding company structure. Tax advantages, such as loss carryforwards and tax credits, can also substantially enhance the financial returns from the transaction. Furthermore, effective tax consulting can be critical for cash flow management, enabling the more effective repatriation of income. Additionally, it is important to consider the impact of the transaction on the combined entity's future tax position, i.e., evaluating the ability to offset taxable income with the target's tax liabilities, and planning for post-transaction integration.

C. Negotiation and agreements

During these phases, both parties engage in detailed discussions to set out the terms and conditions of the deal. This includes negotiating the purchase price and the payment mechanism, amongst other aspects. The negotiation of the purchase price will involve a detailed analysis of the target company's financials, tax position, and future growth. Because both parties must agree on a fair valuation that reflects the true worth of the target, purchase price adjustments are often included in the agreement to account for any changes in the target's financial condition between the signing of the agreement and the closing of the deal. The findings during the due diligence phase would also impact the value of the target.

From a tax perspective, the negotiation and agreements phases are critical for ensuring that the transaction is structured in a tax-efficient manner. Tax considerations can significantly impact the overall cost and benefits of the deal, influencing the final structure and terms. During these phases, both parties must carefully evaluate the tax implications of different transaction structures, such as an asset deal versus share deal. Each structure has distinct tax consequences that can affect the buyer's and seller's tax liabilities.

Given the changes in the GCC's tax landscape, the importance of appropriate tax provisions in the legal documentation has increased significantly. Robust representations and warranties, as well as indemnities, are typically added to the legal agreements to ensure the interests of both parties are protected.

D. Closing / post-closing

The closing and post-closing phases of the M&A life cycle mark the final stage of the transaction. The closing phase involves the formal transfer of ownership from the seller to the buyer, which is typically executed through the signing of the share purchase agreement (SPA) or asset purchase agreement, the settlement of any outstanding purchase price adjustments, and the fulfillment of any closing conditions such as regulatory approvals or third-party consents. During the closing phase, various legal documents are exchanged between the parties, such as legal opinions, resolutions, share certificates, and other documents required to effect the transfer of ownership. Once the transaction is closed, the post-closing phase begins, focusing on the integration of the acquired entity into the buyer's operations.

After the transaction is finalized, the focus shifts to integrating the operational practices of the merged entities. From a tax perspective, it is crucial to ensure a smooth integration of the tax technology environment as well as the tax operating model. Integrating the tax technology environment requires consolidating various tax systems, processes, and tools used by the merged entities. Each entity might have different Enterprise Resources Planning (ERP) (incl. adjacent) systems, tax reporting platforms and data management tools, which can create complexity, especially as there may now be consolidated reporting requirements. A thorough assessment of the existing tax technology landscape is essential to identify overlapping functionalities, outdated systems, and areas for potential automation. Migrating to a centralized tax technology platform helps streamline data collection, improve accuracy, and enable real-time tax reporting across the newly combined organization. Additionally, it is crucial to align the tax operating model and the tax governance framework, to ensure consistent tax risk management, reporting standards and accountability across the newly merged organization. This includes setting up clear roles and responsibilities within the Tax Function & harmonized processes and procedures, ensuring proper oversight. The organization will need to implement a governance framework that reflects the strategic objectives of the new organization and has the right reporting and escalation lines in place. Integrating tax governance and technology in an effective manner not only ensures compliance with regulatory requirements but also enhances the organization's capability to manage tax risks, optimize tax outcomes, and maintain control in the constantly evolving tax landscape.

III – Conclusion

The M&A life cycle, from initial strategy development through target screening, negotiations, due diligence, valuation, structuring, and finally closing and post-closing integration, involves complex and crucial steps to ensure the transaction's success. Tax considerations play an increasingly critical role throughout this process, given the changing tax landscape in the GCC region and internationally.

Deloitte Middle East is able to assist clients with advice on valuations, due diligence, deal structuring and consulting, as well as integrating tax governance and technology, so that clients can navigate and ensure maximum value from any M&A transaction.

What is coming next:

- Tax due diligence: Key areas of focus in light of the UAE corporate income tax
- Acquisition structuring (from a tax perspective)
- SPA: Tax warranties and indemnities

Contacts

For more information, please contact our M&A Tax Team at Deloitte Middle East:

Alex Law
alexlaw@deloitte.com

Oxana Zhupina
oxzhupina@deloitte.com

Ashish Gandhi
asgandhi@deloitte.com

Elizabeth Livke
ellivke@deloitte.com

Marie Germain
mgermain@deloitte.com