


Inside M&A

Welcome to the Tax Transactional Survey 2017



International Tax Review's flagship tax transactional feature looks at the global M&A market during 2016, explores the tax trends in major deals that may continue into 2017, and provides a breakdown of the leading firms in transactional advice across multiple jurisdictions.

Global M&A activity throughout 2016 was a mixed bag of good and bad news. In terms of the number of transactions, last year saw the highest M&A transactions being completed since the 2008 financial crisis, but the value of those deals declined from the record levels seen in 2015.

Total global deal values reached \$3.5 trillion in 2016, according to data from the Institute for Mergers, Acquisitions & Alliances – an annual total lower only to 2015, 2014 and 2007 in recent years.

However, aside from deal values, major events in 2016 saw economic and political uncertainty reach new levels, causing the markets to be wary and vigilant when approaching cross-border deals.

For the Asia-Pacific region, the markets were slightly more cautious in 2016 particularly with big-ticket deals. Instead, the region saw more deals take place in the middle-market (valued between \$10 million and \$250 million), according to Mergermarket Group. Looking ahead, M&A activity in the region is set to pick up in 2017 with big data and analytics becoming a significant part of the deal process.

In the Americas, meanwhile, there was a split in deal activity. North America saw the biggest transaction by deal value when AT&T acquired Time Warner in the US and Canada saw record highs in cross-border deal values with Enbridge Inc's offer to buy Spectra Energy Corp being one of the biggest. South America, in comparison, experienced a significant slowdown in deal activity due to political instability in Brazil. In Mexico, meanwhile, the markets were relatively stable and partly boosted by the low peso to the dollar, but the US elections created a dip towards the end of 2016.

The EMEA region saw some uncertainty after the Brexit vote, together with shockwaves from the US election result, which

slowed deal activity but the market remained resilient. However, this did not deter some big deals, such as Telefónica's carve out deal to create Telxius. This deal points to the potential of big businesses wanting to break up certain parts of their organisation to remain nimble and successfully serve regional markets in an increasingly global infrastructure. *ITR* dissects the Telefonica-Telxius deal in an exclusive insiders' look.

With global events remaining turbulent and unpredictable throughout 2017, there is much to consider when undertaking a transaction over the coming year and tax will remain a key factor.

Across the world, tax advisers say that the OECD's BEPS project has added another aspect that must be considered to determine the tax liability of the deal and the future tax implications. Moreover, the EU's state aid investigations against big businesses have made companies re-consider the security of their advanced pricing agreements and the potential retroactive tax bills they could face. In addition, the US government's plans to introduce a tax reform and the UK's anticipated exit from the EU pose threats to how deals could materialise in the coming year.

For 2017, deal parties have been approaching M&A with wary optimism.

With business expansion and cost synergies remaining high on the agenda for boardrooms and C-suites the world over, taxpayers need to ensure they are getting the best advice available. With that in mind, *ITR* brings you its annual rankings of the world's top tax transactional firms, alongside analysis of some of the main transactional themes in Asia, Europe and the Americas. ■

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Methodology

In January and February, *International Tax Review* asked its readers, and the tax directors of the world's leading multinational companies, to vote for their top three tax transactional firms in more than 50 jurisdictions across the world. The votes were added up to produce the survey results. No votes from advisory

firms were counted and firms could not send submissions to improve their chances of being ranked. The objective was to find out if there are other firms that did not appear in our *World Tax* directory, for whatever reason, that the market regarded highly because they had a particular specialty. Or if there were firms that appeared in *World Tax* and were

known as dependable groups of tax advisers without having any star practitioners. Would they be rated for their excellence in tax transactional matters? This survey should be seen as complementary to *World Tax*, which looks at the whole profile of a firm, not just its size and its deal flow. This survey is more specific about a firm's advisory strengths.

AMERICAS

US tax uncertainty casts shadow over investment decisions

There are signs that corporate confidence grew over the past year in North America, while political instability slowed the South American markets, but there could be some dramatic changes across the whole region as US tax reforms create a “wait and see” approach to new investments. **Anjana Haines** examines the tax transactional trends across the Americas.

Liquid debt markets, evolving tax policies and currency volatility were critical influences on global M&A throughout 2016, according to Clifford Chance's report into M&A trends, and the Americas was no exception.

The firm believes that these factors, together with tax policy changes, will remain at the forefront of M&A decision-making in 2017. Furthermore, the continued implementation of the OECD's BEPS package across the world will impact the structuring and financing of cross-border M&A, particularly leveraged acquisitions.

Furthermore, practitioners say that the political direction in the US and the inevitable tax reforms will also be a big factor for global investment decisions over the coming year. In addition, tax compliance burdens when undertaking a transaction are expected to grow. Practitioners across the Americas say their clients are all paying more attention to the regulatory measures, BEPS and auditing risks as they plan for investments.

Key deals

Key deals in the US, such as the \$85.4 billion deal acquisition of Time Warner by AT&T, meant the number of M&A transactions reached 14,698 in 2016 – the highest level since 2007, when there were 16,662 deals, according to data from the Institute for Mergers, Acquisitions & Alliances. However, the collapse of the

multi-billion dollar Pfizer and Allergan deal in the wake of tough rules on corporate inversions temporarily shook investor confidence in the market, as did the UK's Brexit vote and the election of Donald Trump as US president.

“Over the last 12 months we have seen a steady level of M&A activity with a strong focus on cross-border deals,” notes Jeff Maydew, partner at Baker McKenzie. “There was a slight decrease in cross-border M&A activity in the fourth quarter of last year following the Brexit vote and the US election.”

The Obama administration's “strong actions” against inversions and inverted companies also had a “direct impact on the number of inversion transactions” in 2016 and “stalled many transactions and made some economically non-viable”, adds Mitch Thompson, partner at Squire Patton Boggs in Cleveland. Moreover, the EU's state aid investigations against big brand multinationals over the past two years has created some nervousness in the market between US companies wanting to invest in the EU, notes Linda Pfatteicher, also a partner at Squire Patton Boggs in San Francisco.

Also in North America, Canada saw record highs in cross-border deal values. In the third quarter of 2016, Enbridge Inc's offer to buy Spectra Energy Corp was one of the biggest.

“In recent years, cross-border M&A activity involving Canadian companies has soared, and 2016 gave rise to a record high in cross-

border deal value,” writes Troy Ungerman, partner at Norton Rose and Fulbright in Toronto, in a blog post. “In Q3 2016 alone, Canadian companies were involved in cross-border transactions worth over C\$77.7 billion (\$59.4 billion), easily eclipsing the C\$21.7 billion in deal value from the previous quarter and representing 41% of all Canadian announcements. In particular, out-bound deal volume continued to outpace inbound deal volume by a ratio of 1.7:1”.

Meanwhile, in South America, the markets were less active. Only 1034 deals were completed – the lowest since 2006, partly because of the political uncertainty in countries such as Brazil, complex tax laws and widespread corruption.

The political instability and economic crisis, pretty much put Brazil out of target for most multinational entities last year,” says Jose Aguilar Shea, a senior associate at Squire Patton Boggs’ tax strategy and benefits department in Madrid. However, 2017 is unlikely to be as bad. “It seems like with the new government in place and the new big infrastructure plans ahead, which were approved by the government in September 2016, it does seem like there is going to be a lot more stability in 2017,” he says. Even in the international markets, confidence is growing about the Brazilian market and the possibilities of growth in the near future, he adds.

In Mexico, meanwhile, the markets were relatively stable and partly boosted by the low peso to the dollar, but the US elections created a dip towards the end of 2016, which may continue for the year to come.

Over the past year, a few large energy-related transactions kept Jorge Correa, a partner at Creel in Mexico City, busy. For example, there was the \$1.2 billion Pemex/KKR sale and leaseback deal and the first FIBRA E transaction between Mexican transport company Promotora y Operadora de Infraestructura (Pinfra) that launched the first BRA E investment trust in an MXN 11.8 billion peso (\$577 million) offering.

Tax analysts across the US, Canada, Brazil and Mexico remain confident that the transactional market across the Americas will be stable over the coming year. However, many fear the effects of US tax reform proposals expected by US President Donald Trump’s administration, as well as the UK’s Brexit plans and key elections in France, Germany and the Netherlands that could introduce extreme far-right governments.

US tax reform to drive transactional market

In the US, there have been significant tax policy changes that influenced the transactional market in 2016, such as rules tackling corporate inversions. With bigger tax reforms anticipated in 2017, the M&A landscape could see a dramatic change that would impact trade partners.

“The relative attractiveness of US targets to non-US multinational enterprises could grow in 2017.”

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Brazil Tax Firm of the Year, 2014/2012, International Tax Review (Euromoney)

Brazil Transfer Pricing of the Year, 2013, International Tax Review (Euromoney)

The House Republican's tax reform blueprint proposes to lower the corporate tax rate from 35% to 20%, switch from a worldwide tax system to a territorial tax system, introduce a border adjustment clause, and offer a one-time preferential tax rate for the repatriation of assets. A bill is expected to be ready later this year.

"The combined effect of these changes could make US companies relatively more attractive to US buyers than foreign targets," according to Maydew.

Moreover, the proposed border adjustment clause, which intends to exempt US exports from tax, while charging a levy on imports, would have a dramatic impact on the US M&A market in terms of pricing and the selection of merger partners, Maydew says.

He believes that there could be a dramatic change in the transactional market, moving away from cross-border deals between US and foreign companies and shifting to deals between US companies only.

In addition, Thompson notes that the relative attractiveness of US targets to non-US multinational enterprises could grow in 2017 after this trend accelerated in the past couple of years. "This of course is an inversion without an inversion," Thompson clarifies. "If non-US parented groups see an attractive target in the US, you can in effect achieve something like an inversion by buying that company and capture tax advantages that aren't

available to companies that might want to invert their way out of the US."

However, the changes in the coming year depend on how the government proceeds with its plans to reform the country's tax system. These plans will determine the direction of the M&A markets – not only in the US, but across the Americas.

In 2017, the uncertainty of the US tax laws and proposed tax reform are weighing on the minds of tax planners and businesses in general.

"While a significant slowdown has not occurred just yet, every transaction is confronted with considering how the latest proposals raised in the media might impact the transaction? As the proposals begin to start coming together and greater certainty arises, I expect more transactions and planning will occur with an eye towards optimising structuring for the new tax environment," says Jason Bazar, partner and co-chair of the tax transactions and consulting practice at Mayer Brown in New York.

Susan Klein, partner at Rimon Law in Chicago, believes that one of the things tax reform is going to do is create uncertainty that will reduce the number of domestic and cross-border M&A deals undertaken. "I query whether people are going to be very enthusiastic about engaging in M&A during this period," she says. "There is uncertainty not merely because of the various proposals and their potential enactment – most particularly the

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border adjustment – but also the prospects of eliminating certain regulations, such as the debt-equity regulations and the inversion regulations, under the ‘one-in and two-out’ policy announced by Trump to significantly reduce the number of regulations.”

“Any level of uncertainty does create issues... whether that affects markets positively or negatively ... but whatever else is true, it raises questions, and questions I believe put a damper on M&A activity,” Klein says.

Taxpayers in the US will face a fair amount of uncertainty in 2017 and possibly 2018 as Congress and the Trump administration pursue tax reform. While it is unclear how it will impact deal flow, questions remain as to how the new tax laws will work, what type of planning undertaken may be impacted. “For example, planning involving deferral of income in controlled foreign corporations, deductions for interest expense, depreciation allowances and other items of income, gain loss and deduction may all be impacted,” Bazar says. “Proposals involving border adjustment taxes could impact the entire US tax base in a manner most businesses have not yet even begun to fully appreciate. As various proposals evolve and tax law changes become more imminent, deal work and tax planning may slow to consider the impact of these changes.”

Moreover, how the tax reforms take shape will impact the transactions market in neighbouring Canada and Mexico, as well as elsewhere.



A renegotiation of NAFTA and a proposed border adjustment tax may create a slowdown in the M&A market

Compliance burden growing

Although the M&A market may experience a slight slowdown, the compliance burden is growing and is becoming a larger concern for businesses in their day-to-day work and in their wider business plans.

“Perhaps the biggest tax development affecting the tax transactional market where clients are seeking advice, globally and in the Americas region, stems from the OECD’s BEPS initiative, which has shifted our focus to how we guide corporations through the uncertainty created by the implementation of rules in various juris-

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dictions,” says Devon Bodoh, principal in charge of Latin America markets in the tax practice at KPMG in the US.

“The developments in the BEPS initiatives as well as various US regulatory initiatives (e.g. the Section 385 regulations) have focused many of our clients on making sure all of their intercompany operations are organised and documented in a manner that is efficient and consistent with these rules,” says Mayer Brown’s Bazar. “We are also seeing quite a bit of focus on information reporting and compliance. These administrative and reporting burdens are definitely a focus for large businesses.”

Canada to remain resilient during US tax reform turbulence

The cultural commonalities between the US and Canada mean that M&A deals between companies in the two jurisdictions remain commonplace.

Overall, M&A activity in Canada had a good year in 2016 and although this is expected to continue throughout 2017, the uncertainty created by the US tax reforms, Brexit, and various elections in Europe may create a slight slowdown.

“Companies will be carefully reviewing global supply chains to mitigate the negative impact of tax reforms and maximise the benefits,” says Claire Kennedy, corporate tax and transfer pricing lawyer at Bennett Jones in Toronto. “All of these factors should combine to make 2017 a busier year.”

So far, “the transactional outlook for 2017 has been more bullish than it was in 2016 motivated by improved economic growth, stock market gains and a recovery of the oil price since the oil shock”, says Kennedy. “Although the loonie [Canadian dollar] has declined relative to the US dollar it is maintaining its strength against other currencies, which may make Canadian companies attractive targets in the US or help Canadian companies grow in markets outside the US. The Canada-European trade deal (CETA) may help the latter too.”

Patrick McCay, partner and the tax practice group leader at McCarthy Tetrault in Toronto, believes the real estate sector will continue to see a boom in 2017. “In the context of Canada, both the commercial real estate and the residential real estate, in the major centres, in terms of core real estate, are trading at very high valuations,” he says. “I think in 2017, if you look at the overall real estate market it’s still very active, the prices are still very attractive from a sellers perspective and so I think people will increasingly be looking for other ways to access the product, and one way to do that is not to buy a real estate asset, but to buy, on an M&A basis, an entity that owns a big component of real estate.”

However, Canada could be adversely affected by the US tax reforms because the US is such a large market for Canadian exporters.

Separately, on compliance and audit issues, taxpayers are experiencing similar issues to the US. “Expect an increased focus on tax due diligence in cross-border M&A with the introduction of

PERU



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country-by-country reporting (CbCR)," says Kennedy. "CbCR will almost certainly increase tax disputes," she adds.

Could Mexico's M&A market dry up?

While Central America does not often see huge swathes of cross-border M&A activity, Mexico has had its fair share of deals. It will become an increasingly important jurisdiction in 2017 as tax plans in the US influence decision-making by multinationals operating in both the US and Mexico.

Furthermore, the planned renegotiation of the North American Free Trade Agreement (NAFTA), which allows free trade between the US, Canada and Mexico, has created some reservations among certain companies.

Mexico depends heavily on the US and last year's US elections was the first marker of uncertain times. Looking ahead, some fear that the Mexican M&A market could dry up if US tax reforms and the proposed border adjustment tax are enacted.

Nevertheless, Correa says there were some positive Mexican deals last year, and legislative changes are encouraging further M&A in the country.

"There are certain features of our tax legislation that are indeed promoting tax transactional work, particularly in the capital markets space. Two of them are the refinement of the FIBRA E (the Mexican equivalent to the US MLP) tax regulations and the issuance of a rule to allow FIBRAs to buy back units," says Correa.

The weak peso is complicating transactions involving Mexican companies, however. For foreign investors, they are now able to get more of a bargain than a year ago, while the weak local currency is driving up prices for acquisitions abroad.

However, Rodrigo Gómez, partner at Jones Day in Mexico City, notes that some big deals involving Mexican entities were put on hold last year because of the US elections and many remain in limbo as investors wait to see what will happen in the US with tax reforms before committing to an investment.

Alejandro Barrera, partner at Basham Abogados in Mexico City, says that transactions are becoming more difficult to carry out due

to the uncertain future of the relationship between Mexico and the US. "In my opinion, due to the Trump effect, the transactional market will face a cool down period at the beginning of 2017 and after some policy issues between Mexico and the US are cleared, such as the negotiations of NAFTA, we could face, probably until the fourth quarter of 2017 again a number of transactions, either because some operations are moving back to the US or because there is again a flow of investment into Mexico."

Despite some positives for Mexico's transactions market, it still needs US investment. So, for 2017, the exchange rate and the political situation regarding the potential NAFTA renegotiation and the potential US tax reform will define the year ahead.

If, however, the US imposes a tougher regime on exports from Mexico, it is likely that the Central American nation may look for other countries to market their products. "Avocados are a good example of this," Gómez says. The US Department of Agriculture temporarily blocked the import of avocados after a row over potatoes. "The US did not let them in, so Mexico sent them to the EU. The avocados are a good example of the way Mexico may find new markets for its products."

On compliance issues, meanwhile, BEPS and regulatory compliance will be crucial to success. "The OECD multilateral convention could change some of the tax positions assumed by groups in the past, as well as CbCR and other transfer pricing reports," Barrera says.

"Recently, the tax authorities have developed diverse digital tools that will allow them to conduct remote audits to taxpayers," say Héctor Reyes-Freaner and Daniel Chavez-Angeles, partner and associate, respectively, at Baker McKenzie in Mexico City.

"Additionally, Mexico has diverse exchange of information agreements that have been already implemented by the Mexican tax authorities to secure information not only from the Mexican sources, but from the tax authorities of other countries," Reyes-Freaner and Chavez-Angeles say. "The foregoing aspects will imply several changes in the near future since the tax authorities will be able to conduct more audits and also such reviews may be associ-



Mexico's actions in response to the US Department of Agriculture's rejection of its avocados is a good example of how the country may look for new markets and deals

ated not only to transactions carried out four or five years ago, but they may also be able to conduct audits on transactions recently concluded. In light of this, taxpayers may be required to implement additional activities aimed at documenting all stages associated with a given transaction in view of a potential review from the tax authorities in the short term.”

Latin America and Brazil: Instability continues

In Latin America, meanwhile, the threat of US tax reforms are not the biggest concerns of taxpayers.

“In the past year, we have noticed a considerable reduction of transactions in view of the country’s political instability and economic crisis,” say Luís Rogério Farinelli and Stephanie Makin, partner and lawyer, respectively, at Machado Associados in São Paulo. “The fact that administrative courts have consistently confirmed the tax authorities’ position in certain disputes has not helped.”

Reforms in 2016 to Brazil’s administrative tax court (CARF) and political instability in the country badly affected M&A deals and there is unlikely to be much growth in transactions the coming year, but there is a silver lining.

“Potential foreign buyers are very concerned about the stability of the country and compliance matters (potential risks to inherit liabilities from the past),” adds Clarissa Machado, partner at Baker McKenzie in São Paulo. “On the other hand, several Brazilian companies (infra-structure/construction groups) have been required to sell some of their businesses in order to ‘survive’ (to pay debt or to return back money from corruption), so it is expected that very good transactional opportunities will be on the table during 2017.”

From the taxpayer’s perspective, companies are dealing with increasingly complex tax legislation, creating more uncertainty and compliance.

Compared to a year ago, it is harder to do deals because of the complex tax legislation and the adverse political and economic scenario. Moreover, future deals may be affected by progressive rates for income tax on capital gains accrued by individuals as of January 1 2017.

“Taxpayers will continue to face the issues arising from the complexity of the tax legislation and the increase in the tax burden levied on the company’s activities and on import operations, especially in what refers to indirect taxes, such as contributions,” says Rogerio and Makin of Machado Associados. “On the other hand, it is expected that a tax reform may be implemented in order to make the Brazilian tax system simpler, which may result in new market opportunities.”

“On future transactions, especially those related to investment acquisitions, group companies should be careful to not get involved in operations performed by the seller intended to decrease taxes levied on the acquisition transaction, as such measures are frequently challenged by tax authorities and may implicate the buyer,” say Farinelli and Makin.

Baker McKenzie’s Machado adds that taxpayers “should be very careful about the potential tax liabilities and capital gains on the deals”.

“Transfer pricing is also a point of concern because Brazil does not follow the OECD, and it is likely to trigger double taxation. The challenge for treaty countries will be how to deal with the

‘mutual agreement procedure’ just enacted by Brazil to solve double taxation and to motivate new M&A deals,” says Machado.

The US tax reforms plans could also affect Brazil, potentially reducing investments, but the impact may be felt much less than in Canada or Mexico. “Considering that Brazil is strongly focused in the agricultural sector and that the exports are mainly based on such activity, the political changes in other countries may not cause huge effects on the Brazilian exports,” say Farinelli and Makin.

Cautious year ahead

As the US pushes ahead with tax and wider policy reforms in 2017, and elections take place in key European countries, as well as the possible re-set of important global trading relationships, the outlook for M&A plans are uncertain.

“It’s no surprise that recent political changes in the United States and the EU are expected to bring about sweeping changes that may render a particular structure ineffective,” says Bodoh.

Nevertheless, many predict a positive outlook in deal transactions over the coming year.

“The geo-political landscape is in flux, and there is a sense that the uncertain outlook marks a significant global shift,” says Guy Norman, partner at Clifford Chance. “Overall, we expect a reasonably healthy level of M&A in 2017, as creative deal-makers continue to pursue growth opportunities and technological advancement amid ongoing disruption.” ■

VENEZUELA



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ASIA-PACIFIC

Strong deal activity in the Asia-Pacific region

Amelia Schwanke tracks transactional tax trends across the Asia-Pacific region throughout 2016, analysing the appetite for mid-market transactions despite geo-political disruption, and looks at the year ahead.

In the midst of economic uncertainty and volatility, the Asia-Pacific region has seen dealmakers taking a more cautious stance in valuations and M&As. This has led to fewer big-ticket deals in the Asia Pacific region throughout 2016, and more deals in the mid-market (valued between \$10 million and \$250 million), according to Mergermarket Group.

India is rising as a hotspot for M&A activity and China remains a strong destination for companies and investors continuing to look around for deals. Over 29% of total M&A value was generated through cross-regional deals.

Despite a series of unexpected political events, such as the UK's vote to exit from the European Union and the US elections, and the exploits of authoritarian Philippines leader Rodrigo Duterte, deal making and large cross-border transactions remain a major component to global markets.

A number of driving factors have encouraged companies to pursue ambitious transactions, including debt financing's low rates, locked boxed liability structures, and greater harmonisation

between region's developed markets, particularly in disclosure standards and assessments of governance compliance.

A few 'mega deals' in the Asia-Pacific region throughout 2016 were:

- Japan's SoftBank acquisition of UK chip-designer Arm Holdings at £24.3 billion (\$30 billion), expected to become the leader in the 'internet of things';
- CGN's \$2.3 billion acquisition of the energy assets in Edra Global Energy Berhad and Jiangsu Changjian Electronics Technology Co;
- Vodafone's merger with New Zealand subsidiary and largest pay-tv operator, Sky Network;
- PLDT and Globe Telecom of the Philippines joint-acquisition of SMC's local telecommunication assets; and
- China Life's acquisition of Century Link in Shanghai Pudong at \$2.9 billion.

Following several years of rapid growth, M&A hit an all-time high in the Asia-Pacific 2015. While deal volumes and values were

AUSTRALIA

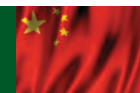
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Cyril Amarchand Mangaldas
DHC
Economic Laws Practice (ELP)
Grant Thornton
Khaitan & Co
Lakshmikumaran & Sridharan
Shardul Amarchand Mangaldas & Co

both down in 2016, the year finished above the five-year average for the region.

Australia steams ahead with BEPS

The OECD's BEPS Project continues to have a fundamental impact across jurisdictions, in particular Australia, which is forcing changes to the structuring of cross-border acquisitions and how businesses operating internationally are structured.

Rolf Drohn, executive director at EY's tax centre for excellence, believes that last year's M&A themes in Australia will continue, but that the proposed diverted profits tax (DPT) will likely dominate headlines in the first quarter.

Overall, Australia continues to be a proactive market for both domestic and international investors. "We are increasingly receiving intelligence from banks and other sources that show key focus areas for all buyers are mid-market deals, rather than transformational bulge bracket deals," Michael Sango, partner at Baker Tilly Pitcher Partners, says in a report.

China's cross-border deals dominate M&A flows

Leading the way in the transactional market is China. Throughout 2016, China experienced reasonable growth in deal activity, which is expected to continue in 2017.

For cross-border deals, Chinese buyers are leading the charge globally. Outbound investments totalled \$208.5 billion in 2016, with Chinese investment in Europe at \$88.2 billion, North America at \$65.8 billion, and Latin America at \$16.2 billion. Driven by the industrials and chemicals and technology, media and telecommunications (TMT) sectors in Europe and North America, China's largest outbound deal was between ChemChina and Syngenta at \$45.9 billion.

While the tax implications of the recently announced restrictions on capital outflows from China remain uncertain, business-

es are advised to take care during the pre-M&A transaction stage as it is often a challenge. The identification of combative tax issues is not always a simple task during a tax due diligence as Chinese tax rules and their applications by tax authorities are often inconsistent across the jurisdiction.

"For any MNE, institutional investor, private equity fund, etc. undertaking M&A transactions, thorough tax planning before making the right investment is often the key to maximising returns through steady income streams (e.g. dividends), or capital gains upon divestment," says John Gu, partner at KPMG China.

A continuing theme has been the indirect transfer rule under Bulletin 7. For Roberta An Chang, counsel at Hogan Lovells in Shanghai, the number of global equity transactions has continued to rise throughout 2016. Chang notes that a number of



For multinationals looking to invest, China remains a strong destination for deal activity in the Asia-Pacific region

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“Throughout 2016, China experienced reasonable growth in deal activity, which is expected to continue in 2017.”

these transactions have been subject to Chinese enterprise income tax, because of Bulletin 7, which states that the buyer now has a tax withholding obligation for any payable taxes in China under the indirect equity transfer. She has been advising buyers to be more active in the relevant tax filing procedures to combat these cases.

Bulletin 7 will continue to be a transactional tax issue for the next few years.

To speed up transaction processes, the Chinese tax authority has reformed formalities to encourage more efficiency from taxpayers. For example, taxpayers are able to settle the relevant taxes on a self-declaration basis, which would allow the tax authority to perform the tax review later – allowing parties to move forward with the transactions.

A major reform is expected to alter the Chinese Tax Collection and Administration Law which, if promulgated this year, may have a large impact on the transactional market. Chang anticipates it to be amended in many perspectives, including a pre-ruling procedure eligible to the taxpayers in the future.

In the long term, advisory firms do not expect there to be any meaningful curbs on M&A. The continued support by the Chinese government for its ‘going out’ policy and ‘One Belt One Road’ strategy will unlikely affect overseas acquisitions.

“Despite the introduction of restrictions on capital outflows in China, we are helping Chinese buyers explore more innovative funding structures and we remain cautiously optimistic about the longer term ability of China to sustain a strong level of outbound M&A activity,” says Terence Foo, M&A partner at Clifford Chance in Beijing.

India a bright spot for M&A

China and India have dominated deal activity in the Asia-Pacific region throughout 2016, especially in the telecommunications sector, which takes advantage of consolidation opportunities.

Several positive factors have brought India into the M&A limelight. The relaxation of foreign direct investment (FDI) restrictions in certain areas, increased investor confidence in deal execution, and tax harmonisation across the states are all good news for transactions.

As one of the most attractive investment destinations for foreign investors, second only to China, India has closed a number of favoured investment routes throughout 2016. The amendments of double taxation agreements (DTA) have ensured that its tax base is not eroded.

Looking ahead, an FDI Report 2016 by the Financial Times predicts that M&As will likely be the favoured route for FDI flows into India in 2017, because of market consolidation in major sectors like e-commerce and telecommunications.

Vodafone-Idea Cellular merger

In a landmark deal, Vodafone’s Indian subsidiary and Indian mobile network operator Idea Cellular announced on January 30 2017 that they were conducting a proposed merger with equal rights in an all-share deal. Vodafone and Idea Cellular are India’s second- and third-ranked telecommunications companies respectively, with the proposed merger expected to create the country’s largest mobile phone company.

A major focus for the due diligence, which is being carried out by EY and Deloitte, is likely to be on whether the merger will create any tax liabilities.

Another notable tax issue surrounding the merger is Vodafone and the Indian government’s tax dispute on the 2007 acquisition of Hutchinson Essar. Now, investor concerns are based on the tax demands stemming from retrospective changes in the law. The long-standing dispute is yet to be resolved as it is in international arbitration.

Tax amnesty in Indonesia

Indonesia’s tax amnesty, launched in July 2016, has brought back just under one-third of fund repatriation commitments up to October 2016.

For M&A, tax amnesty related issues have increasingly featured in deal structuring conversations, according to Herbert Smith Freehills.

This trend is expected to continue in 2017.

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New Zealand deals remain robust despite geo-political headwinds

David Snell, executive director of tax at EY, says “with markets fully priced, there has been a dip in appetite and enthusiasm”. However, in the face of economic, political and regulatory changes, M&A activity as a whole has remained resilient for New Zealand.

Snell observes that private equity in New Zealand has remained robust for both domestic and international inbound private equity houses, but that the IPO market has slowed over the past 12 months, coming off the back of some strong years. He also notes that large takeover activity has returned, highlighting the Allnex/Advent’s acquisition of Nuplex.

In addition, infrastructure continues to be a significant sector, with transport, roads, rail, corrections, housing and other projects all having considerable activity.

Notable changes that MNEs should be aware of include the non-resident withholding tax and interest deductibility rules, expected to be enacted this year, which have been key considerations in structuring acquisitions and financing.

Snell also advises businesses to be aware of the government’s international tax package, which is likely to include thin capitalisation rules, transfer pricing rules, and the multilateral instrument, and a tougher tax treatment of employee share plans that could hit the transactional market.

Singapore: The global asset management hub

For 2017, Herbert Smith Freehills predicts a rise in domiciled funds with tax treaties favouring Singapore as fund and asset managers are increasingly migrating to the city.

“Global private equity funds are already showing interest in regional IT plays, infrastructure funds and pan-Asian funds have already established in Singapore,” the firm says. It suspects the funds management industry will be competing heavily for assets in the region.

Optimistic outlook for M&A activity in the Asia-Pacific region for 2017

M&A activity in the Asia-Pacific region is set to pick up in 2017.

According to EY’s 15th Global Capital Confidence Barometer, nearly half of Asia-Pacific executives are said to pursue deals in the next 12 months. The majority of companies in the region have five or more deals in the pipeline, with 10% planning deal sizes of \$1 billion or more.

For MNEs looking to invest, China remains the top destination, followed by Japan, Australia and India.

As an overriding theme, companies are using big data and analytics as part of their deal process, with 91% of companies recognising the value of analytics in their diligence process to better assess targets. The knock-on effect for tax is a greater use of cross-border information from transparency initiatives like the common reporting standard and the exchange of tax information. ■

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EUROPE, MIDDLE EAST AND AFRICA

Telefónica and Telxius: The anatomy of a major European deal

One of the most complex transactions in the telecommunications industry in the past year was the carve-out deal in which Telefónica created Telxius, a new company made up of much of its infrastructure assets. Joe Stanley-Smith peers behind the surgical curtain to see how and why the operation was completed.

A multinational group is a lot like a human body. It has large and small parts working together to move forward. Sometimes, for the good of the group, a certain part of an underperforming company – much like an appendix on the verge of bursting – has to be removed. But in a carve-out deal, the idea isn’t to dispose of a non-essential, self-contained or unwanted business, but to create a new one of value from the existing parts, without damaging the host.

The science of Dr Frankenstein, however, this is not. During late 2015 and 2016, Spanish multinational broadband and telecommunications provider Telefónica created a new company, Telxius, made up of much of the multinational’s infrastructure assets. “The thing about a carve-out deal is that, by definition, the assets that you want to sell aren’t in the company that you want them to be in”, says Brian Leonard, a tax partner at Deloitte Spain, which carried out tax, legal and consulting work on the transaction. “A carve-out deal, generally, as the name suggests, involves



Tax transactions have to be executed with the precision of surgical procedures

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you cutting out pieces of a company and putting them somewhere else, and that needs to be done with sufficient precision to allow you to create something new and marketable, but that's not going to damage your business."

"Essentially what you're saying is: 'we want to create value in a group by carving things out and putting them into something else, putting them together into something that makes sense and which actually creates value in the business', which Telefónica was looking to do here."

Telefónica is Spain's largest multinational by market capitalisation and one of the largest telecom companies in the world. It has huge amounts of infrastructure across four continents, with assets valued at \$135.4 billion as of September 2016 and a customer base of more than 321 million.

"Very often, in large multinational groups, there can be a perception that they're just so big that they're not agile enough to respond to market changes," says Leonard. "That, for telecoms companies, is very important. They need to show that yes, they're huge and yes, they have worldwide coverage, but they're nimble, fast-moving and they're ahead of the changes."

Jerónimo Payan, tax director at Telefónica, says that the telecom giant wanted to make "a company for putting together and tidying up part of our infrastructure: submarine cable and towers, in a way that it could be up, nice and ready for an IPO or a partial disposal".

What is Telxius?

The deal allowed Telefónica to demonstrate its agility and ability to raise equity by opening up some of its key assets to the market.

The telecommunications industry is investment-heavy, with companies needing thousands of telecommunication towers and other infrastructure to meet ever-increasing competition and consumer demand for high-speed internet and mobile phone signals.

At the centre of the Telxius carve-out was the Telefónica Group's 65,000km network of submarine fibre-optic cables, including the SAM-1 (South America-1) submarine communications cable, which connects the US with Central and South America, as well as around 15,000 telecommunication towers in Spain and other countries.

The SAM-1 cable presents particular tax issues due to its design: it runs in a ring from Miami, Florida around the Caribbean, with docking stations in several countries in several island nations in addition to South and Central America.

After explaining in detail how the cable and its docking systems work, Leonard elaborates on how important this knowledge is to advisers working on such transactions. "It's absolutely key because if you don't [take the time to understand the submarine cable system] then you can't analyse the tax implications; it's just impossible because if you don't know how something works you can't adequately analyse the tax implications," he says.

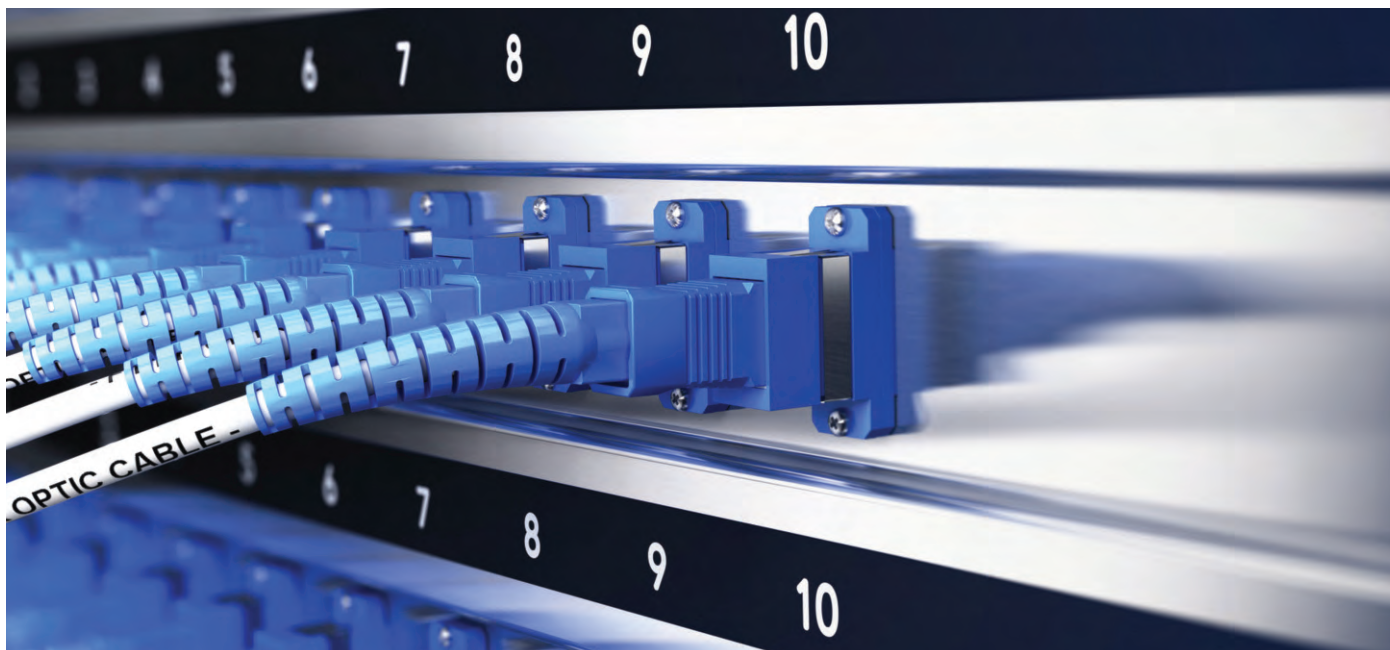
"For example, if you don't know the different elements that make up that chain of transmission, you're never going to be able to advise on things like permanent establishment and transfer pricing because you just don't know what the value drivers are because you don't understand the transaction."

What assets were carved in to Telxius?

Together with its subsidiaries, Telxius Telecom, formerly known as Telefónica América, makes up the Spanish Telxius group.

The management of the Telefónica Group decided to create Telxius Telecom at the end of 2015. On March 31 2016, assets from many of Telefónica's companies were transferred to Telxius.

A key entity that moved under the Telxius umbrella was Telefónica International Wholesale Services América, under which Telefónica transferred 73.14% of its shares to Telxius on March 31 through a nonmonetary contribution. The remaining 26.86% of its shares, previously owned by Telefónica International Wholesale Services (a Spanish company) were also sold to Telxius.



Major submarine fibre-optic cables in the Gulf of Mexico now form a large part of Telxius

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Also on the same date:

- Telxius entered into sale and purchase agreements to acquire all the shares of Telxius Torres España from Telefónica and all the shares of Towerco Latam Perú from Telefónica del Perú; and
- Telxius Torres Brasil (formerly Towerco Latam Brasil) signed an infrastructure sale and purchase agreement with Telefónica Brasil.

Later, on April 21, Telxius acquired all of the shares in Telxius Towers Germany (formerly Telefónica Germany Vermögensverwaltungsgesellschaft) and, on May 1, acquired all of Towerco Latam Chile Holding.

“The most difficult part was that on the one hand there is the existing submarine cable [around America] but on the other all of these towers in Spain, Germany and some countries in Latin America,” says Payan. “It was particularly difficult to comply with all of the tax regulations in Brazil and the rest of the Lat-Am jurisdictions.”

“Telxius operates in so many different markets, it has to play by many different sets of rules and obtain a variety of different permits and licenses in many different jurisdictions,” he adds.

Leonard was able to use the consultancy arm of Deloitte Spain to become proficient in the technical side of SAM-1 and other aspects of the deal, including local regulations, before meeting with Telefónica. “It’s very, very helpful for them to be able to do that – they explain the different elements in the value chain. If you go to a client and the client’s got to sit down with a piece of paper and explain how it works then it’s a waste of time. The one thing you don’t have in these transactions, which move very quickly and change very quickly, is time.”

The knowledge is particularly important due to BEPS considerations. While the docking stations are large pieces of infrastructure, they are not heavily staffed, which incurs a controlled foreign corporation risk. While these kinds of issues are always looked at in the due diligence process of a standard sale/acquisition, they come to the forefront in a carve-out deal.

“In a carve-out, because you’re creating something that wasn’t there essentially – creating a company with pre-existing assets and

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Taj – Deloitte

pre-existing people – you’ve got to understand what people you need, who’s coming with this and what the final picture is going to look like,” says Leonard.

BEPS analysis

Key figures in the transaction, aside from Leonard and Payan, were Telefónica’s head of tax, Angel Martin, Alfonso Ricón, head of taxes at Telxius, and Alex Sanchez, a Deloitte transfer pricing expert who specialises in the telecom industry. Another key figure was Deloitte partner Francisco Martín Barros, who completed the BEPS analysis for the transaction.

Multinationals carrying out transactions of any size would be well-advised to undertake BEPS analyses to safeguard against the potential implications of the wide-ranging OECD tax project.

“Any investor coming in, their first question’s gonna be: what tax risks are in the structure?” says Leonard. “The second question is: how’s my tax rate going to look in the next few years given all the stuff going on surrounding BEPS? So you’ve got to be prepared for both of those.”

“Obviously, for BEPS, the first thing you’ve got to look at is the context of Action 1 on the digital economy, because Telefónica is a digital business, essentially,” says Leonard.

When looking at Action 1, it is important to be careful not to appear to be using digital structures to lower tax by placing profits in low-tax jurisdictions. Post-BEPS, these structures will not survive.

Action 6 (preventing treaty abuse), is particularly relevant for infrastructure companies because they often have a huge asset substance but not a lot of people substance.

Action 2 on hybrid mismatches, however, is not much of a concern in a transaction like this, Leonard notes. This is because financing is not often included such transactions and Telefónica is not a hybrid-using group.



Brian Leonard has worked at Deloitte since 1998

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Nevertheless, Action 3 on controlled foreign companies can be important in carve transactions because when assets are carved out, liabilities are also included. So, this leads onto consideration on Action 4 of BEPS on interest deductions and other financial payments.

It is important to understand what effect the carving out of assets and effectively of carving out EBITDA (earnings before interest, tax, deductions and amortisation) have on the interest deductions carved out via loans and put into the new entity, and the effect this has on the existing structure and the existing interest deductibility, Leonard says.

Traditional Telefónica

Telefónica generally takes a “loyal” approach to tax risk, says Payan, and this transaction was no different. While some groups would – perfectly legally – view such a transaction as an opportunity to create tax savings through financing vehicles or other methods, this was never on Telefónica’s agenda.

“In a company like Telefónica, they’re very traditional, if you like,” says Leonard. “This isn’t a group that’s going to be saying ‘ok, if we do this transaction can we drive down the tax’ – they don’t work like that. They want a reasonable tax rate but not to create any risks. They’re risk-focused rather than opportunity-focused, if you like.”

“In these kind of things... we look at the options to come to these deals in a decent manner, always respecting a fair approach to taxpaying,” says Payan. “We don’t use funny structures to disguise commercial transactions. When we need to pay taxes, we pay taxes.”

Operation a success

The deal holds significance not just for Telefónica, but also for the telecommunications industry as a whole. One of the issues facing the industry is that while there is a great deal of infrastructure, most of it belongs to one company. By carving out infrastructure assets and then putting them on sale to private equity or other investors, companies can ensure the most efficient use of infrastructure, their continued access to it, and a return on the capital they invested when building it.

“With a group like Telefónica, its investment in infrastructure is ginormous, and it’s constant,” says Leonard. “Everyone always wants more megabytes, more minutes, better coverage, they want to go on holiday to the Outer Hebrides [a mountain range in Leonard’s native Scotland] and have 4G and top-speed Wifi, so these things cost an awful lot of money.”

“You’ve always got to have one eye on the cash, if you like, and where the investment’s coming from, to be able to say at any given point that we’ve got all these things we can source finance from doing this kind of thing,” he concludes. “I think it’s good for Telefónica and their image. It’s innovative in the sense that it’s putting a lot of different assets together and creating something that makes a lot of sense, and not harming the business in doing so, but actually creating value.”

While Frankenstein was horrified by the sight of his monster, this is certainly not the case for Telefónica. The company successfully sold a 40% stake in Telxius to private equity group KKR on February 21 in a deal that values the carved-out company at €3.2 billion – a successful surgery by any counts, and one that casts those involved as midwives rather than mad scientists. ■

GULF COOPERATION COUNCIL



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