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Lost in Transactions
BEPS' impact on Mergers & Acquisitions

A practical guide to managing M&A deals in today's tax world.

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Lost in Transactions – Impact of BEPS on Mergers & Acquisitions

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BEPS: Looking beyond the tax implications

The debate in the media over recent years about fair corporate taxation has brought pressure for greater harmonisation of international tax rules. The Base Erosion and Profit Shifting (BEPS) project[1] will drive the most significant changes to the taxation of international business since the 1980s. It is adding new complexity and uncertainty to all business operations, in particular with regards to transaction deal structuring and due diligence processes.

It's time for traditional strategies to be revisited; transparency is the new normal. Global businesses now need to reconsider how and where to invest. Multinational companies (MNCs) and financial players need to reassess how to structure their activities.

BEPS is more than just direct tax. It impacts human resources (HR) and value added tax (VAT) and even how you invoice clients in a digital economy.

During a merger or acquisition, you will now need to consider the tax sustainability of your new operating model. You will have to identify and resolve inconsistencies between the planned value chain model and how it works in practice. Due diligence, among other processes, will also need to be revisited to cover post-BEPS implications on your operations.

Why this guide?

BEPS has evolved quickly over the last few years. Whatever type of transaction you're considering – acquisition, disposal, merger, joint venture, initial public offering (IPO), public-to-private deal or refinancing – you need to carefully assess your tax obligations and cash flows in the light of BEPS.

This publication offers everything you need to know about the impact of BEPS on mergers and acquisitions (M&A). It considers every stage and all aspects of a transaction, and what BEPS means from an operational viewpoint. This publication is essential for everyone involved in M&A, whether you are dealing with operational alignment, human resources or harmonisation of financial systems. No matter what role you play in the transaction process, you need to be aware of the issues and how they impact your area of expertise.

We hope you will find this guide useful to understand these important changes. Our teams are available to guide you during this journey. You will find all their contact information in the back of this publication. You can access this guide and other relevant information on the pwc.be website.

Hugues Lamon,
Partner PwC Belgium

1 For more details on the OECD's work on BEPS, see the OECD website: http://www.oecd.org/ctp/beps.htm and http://www.oecd.org/ctp/beps-2015-final-reports.htm for a copy of the final reports.

The rise of regulation

The M&A market is a key indicator of the world's economic vitality. It is at the heart of corporate strategy and the core business of financial buyers.

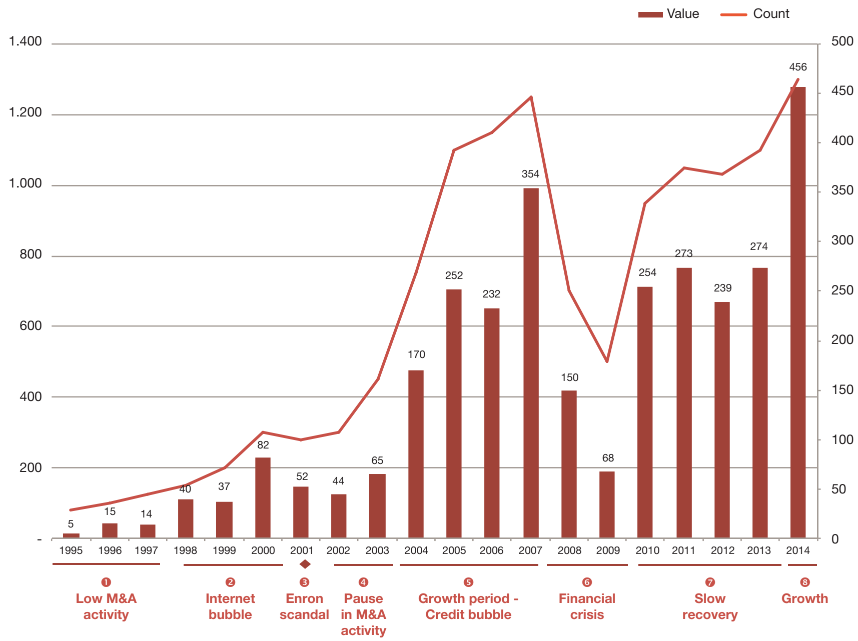
Over the last decade, the market has become increasingly globalised. This has forced players to adjust to local market standards while performing worldwide deals. It has led to very complex structuring to reconcile the interests of all stakeholders involved.

Transactions flows are cyclical and follow the trends of the global economy. Global M&A activity was severely hit by the 2008 financial crisis but has since recovered to reach an all-time high in 2014.

Policymakers have regulated capital markets, through legislation such as Dodd-Frank in the US and the EU's Alternative Investment Fund Managers Directive, to prevent another financial crisis. Such regulation, and the revision of international tax standards through BEPS, has significantly changed the way transactions are handled.

Figure 1 Global buy-outs since 1995

Value and count of buyout-backed exits



Source: Bain & Company, Inc. Global Private Equity Report 2015
Data gathered from Dealogic

I. Contents

I. M&A landscape post-BEPS

Highlights

- *Aggressive tax planning by multinational corporations (MNCs) has been widely criticised by the media.*
- *Chief executive officers (CEOs) and chief financial officers (CFOs) looking to protect their corporate image prioritise reputational risk.*
- *BEPS will make MNCs' tax affairs more transparent and change the way MNCs carry out transactions.*

A. Introduction

BEPS is the hot topic on the international tax scene. Widely discussed in board rooms and in the financial press, it is a source of concern and frustration.

The project began in 2013. The Group of 20 major economies (G20) commissioned the Organisation for Economic Cooperation and Development (OECD) to analyse the global tax environment and to issue proposals for the revision of existing tax rules.

The initiative was primarily driven by economic and political developments but also the raging public debate about whether MNCs pay their fair share of tax.

The OECD's preparatory work exposed how outdated the international legal tax framework was. It also uncovered the incompatibility of global tax legislations and the opportunism of some national tax legislators.

Global MNCs which organise their tax affairs, value chain and global operations to legally benefit from preferential tax regimes offered by national governments worldwide were the main targets of the research.

The purpose of this first section is to identify what aspects of BEPS are relevant to transactions. Subsequent sections will shed light on specific M&A topics potentially impacted by BEPS and discuss practical steps and potential opportunities.

Figure 2 Drivers for BEPS

Drivers for BEPS

Changes in trading environment

- Globalisation pressures MNCs' operational model
- Integrated vs. country-by-country standalone business models
- Rise of digital economy and impact on margins and profitability of traditional MNCs

BEPS stakeholders

- EU and other intra-governmental organizations - e.g. OECD., UN, G20
- National governments and tax authorities
- (Social) media
- NGOs and general public

Public perception and political pressure

- Austerity programs magnified awareness of low MNCs ETR
- Increased use of tax havens, aggressive tax planning and low ETR Tax rulings
- Lowered standing of MNCs in society and heightened awareness of low tax payments on welfare state

M&A transactions

- Aggressive tax structuring (e.g. debt push down, equity stripping, etc.)
- Optimisation of structure (e.g. hybrid securities, location of principal, holding location, IP company)
- Double non-taxation and tax neutral repatriation of profit

B. Why revisit tax policies now?

Several MNCs have found themselves in the spotlight for allegedly avoiding tax through legal means possible under the current system. Public opinion – notably expressed on social media – has criticised MNCs for abusing tax loopholes at a time of tight budgetary controls. Politicians, regulators and citizens are now asking not only whether a company is paying taxes, but if it is paying enough – its fair share.

Answering this seemingly straightforward question isn't easy. "Fair" and "equitable" cannot be measured in numbers or percentages, but those ideals are at the core of every MNC's corporate responsibility strategy.

While "fair" and "equitable" should never mean that MNCs can't optimise their tax position, companies must make sure that their tax strategy is transparent and aligned with their operating model and value chain. A sound tax strategy should always anticipate the evolving global tax rules and transparency standards imposed by BEPS.

Under-managing taxes could also lead to unexpected consequences in terms of costs, reputation and missed opportunities.

C. New OECD guidelines

The OECD released its 15-point BEPS Action Plan over the last few years. It covers the three key themes of coherence, substance and transparency. It has been endorsed by the G20, which paves the way for its full implementation into national and international tax legislation. As from 2016, the G20's focus will shift to the implementation and monitoring of the package.

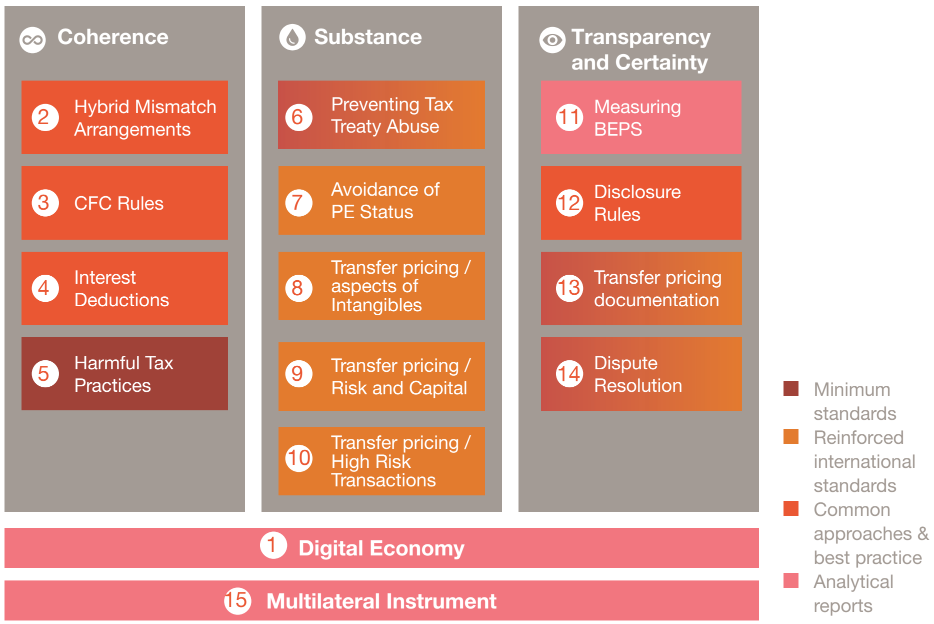
Even though there is momentum to push forward with the BEPS package, it is doubtful that implementation will be coherent across the board.

Some countries, such as France, will strongly support the full implementation of the BEPS package and may even bring stricter rules onto their law books. Others, including the UK and Ireland, may cherry-pick some of the measures but not accept the whole BEPS package. Some countries, such as the US, could try to delay the package.

During 2016, the OECD will try to reach an international compromise balancing full implementation and acceptable non-compliance with the BEPS package.

Figure 3 **BEPS Action Plan**

The 15 Actions of the BEPS Action Plan



The OECD estimates the overall tax loss due to BEPS ranging between 4% and 10% of global corporate income tax revenues, that is, at least $100 billion to $240 billion annually as at 2014.

> "Transparency is not enough."
> The Guardian, 2 December 2014

> "Google, Amazon, Starbucks: The rise of 'tax shaming'"
> BBC, 21 May 2013

> "The purpose of double taxation treaties between countries is to avoid double taxation – not to justify double non-taxation."
> Margrethe Verstager, EU Commissioner for Competition, 2015

> "Luxembourg under Junker [was] looking for a new business model, so they stole the tax base of their neighbours."
> Thomas Picketty, economist, talking about on Luxleaks, December 2014

The BEPS actions are soft law guidelines on the substance, coherence and transparency of the international tax system. Substance actions seek to align taxing rights with the relevant value-adding activity. Coherence actions aim to remove gaps and 'black holes' between jurisdictions. Transparency actions look to provide significant additional disclosure of activities.

Potential base-eroding transactions, such as intercompany debt alignments, are a major focus. At the upper-tier level, other important M&A considerations include the substance of holding companies or use of hybrid instruments.

The entire M&A process, including due diligence, will be impacted. BEPS topics, such as the digital economy, principal structures, rulings, and ownership of Intellectual Property (IP), will have to be monitored and assessed to understand their impact on pricing and operations.

The outcome of this is quite unpredictable as legislators have opted to take unilateral and immediate action to transpose parts of the Action Plan into domestic law. The EU is considering a new Anti-Tax Avoidance directive, which was inspired by BEPS[2]. Some countries, such as France, have already taken steps to increase tax transparency by extending the obligation to have supporting transfer pricing documentation and introducing 40% bad faith penalties in case of breach. Others, such as Ireland, are less enthusiastic and are keen to preserve their economy's competitiveness.

D. The BEPS Action Plan

The BEPS Action Plan is a wide-ranging set of 15 Actions which addresses the key aspects of international taxation. The different measures can be divided into four categories:

2 EU draft ATA directive proposed by the EU Commission on 28 January 2016 which lays down six fields of anti-avoidance measures: (1) uniform interest deduction denial rule in the form of an EBITDA limit, (2) rules for the avoidance mismatches of hybrid instruments, (3) uniform exit taxation, (4) switch over clause, (5) General anti-avoidance rule (GAAR), (6) CFC rules.

"The tax world will not be the same."

Pascal Saint-Amans, Director of the Center for Tax Policy and Administration at the OECD, The Guardian, 5/10/2015

"You know some people are calling these companies 'corporate deserters'"

Barack Obama, US President, July 2014

"How the offshore banking industry shelters money and hides secrets has enormous implications for societies around the globe."

ICIJ, "Swissleaks: murky cash sheltered by bank secrecy", 8 February 2015

"Financial opacity is one of the key drivers of rising global inequality."

Thomas Piketty, economist, 8 February 2015

New minimum standards

Minimum standards aim to create a level playing field where no country's action can create negative spillover effects on other countries, such as damaged competitiveness, unfair tax competition, or inadvertent double non-taxation. All the OECD and G20 countries have agreed on specific rules to prevent treaty shopping, fight harmful tax practices, implement country-by-country reporting (CbCR) and improve dispute resolution.

Revision of existing international standards

The previous OECD guidelines on transfer pricing have been updated in certain areas, as well as certain treaty aspects such as the broadening of the permanent establishment definition and refining the beneficial ownership criterion. Even though the previous guidelines were not binding for all the non-OECD countries, they are now reflected in the BEPS Action Plan that they have committed to adopt.

Common approaches

Common approaches have been adopted for, among others, rules on hybrid mismatch arrangements, interest deductions, controlled foreign company (CFC) and disclosure rules. Signatory countries want to converge on these measures over time by implementing the agreed approaches. Those new rules will be raised to minimum standards through guidance on best practice.

Analytical reports

These reports analyse the impact of the digital economy on tax systems and the feasibility of a multilateral instrument to amend bilateral tax treaties to better take the modern digital economy into account. They also provide recommendations in particular areas, including on the collection of VAT on cross-border business to consumer transactions.

E. *What will change?*

While it's still difficult to predict the outcome of BEPS, we can already identify changes which will affect MNCs' tax affairs:

Increased transparency

Tax executives and CFOs should expect all existing and future rulings, as well as preferential regimes, to be subject to spontaneous exchange by tax authorities[3]. This may result in increased audits. Corporations should evaluate whether the arrangements in place are BEPS-proof or could potentially generate a reputational risk.

More complexity and compliance

MNCs should expect increased transfer pricing documentation requirements and mandatory reporting. BEPS Action 13[4] requires the setting-up of a three-tiered standardised approach to transfer pricing documentation. That should improve transparency, while standardising documentation and filing requirements for MNCs. It will comprise a master file, a local file and country-by-country reporting.

The master file will provide tax administrations with high-level information regarding a MNC group's global value chain and transfer pricing policies. The local file will contain more detailed transfer pricing information regarding a specific taxpayer. The CbC report will only be required for multinational groups with annual consolidated revenues of at least €750m and should, in principle, be made by the parent company. It will set out a number of key indicators such as the amount of revenue generated, tax paid, staff employed, and assets owned for each jurisdiction in which the group operates, and be updated on a yearly basis. The CbCR requirements are to be implemented by countries for fiscal years beginning on or after 1 January 2016, with the parent company automatically providing the CbC report to its operating jurisdictions no later than June 2018.

More uncertainty and controversy

MNCs should expect unilateral actions by governments willing to implement BEPS action points and should stay informed about possible changes in all territories in which they operate. MNCs' entire tax strategies are now at stake. MNCs will have to balance defensive and offensive measures to guard against reputational risk and maintain a sustainable and responsible effective tax rate (ETR).

Increased scrutiny by tax authorities

The above measures will inevitably result in an increased audit risk and a focus on whether arrangements and group operations in place meet the arm's length standard and have been properly implemented.

3 As per EU directive, a mandatory automatic exchange of tax rulings will be the norm as from 1 January 2016 (the automatic exchange is already effective in Belgium as of 1 January 2015).

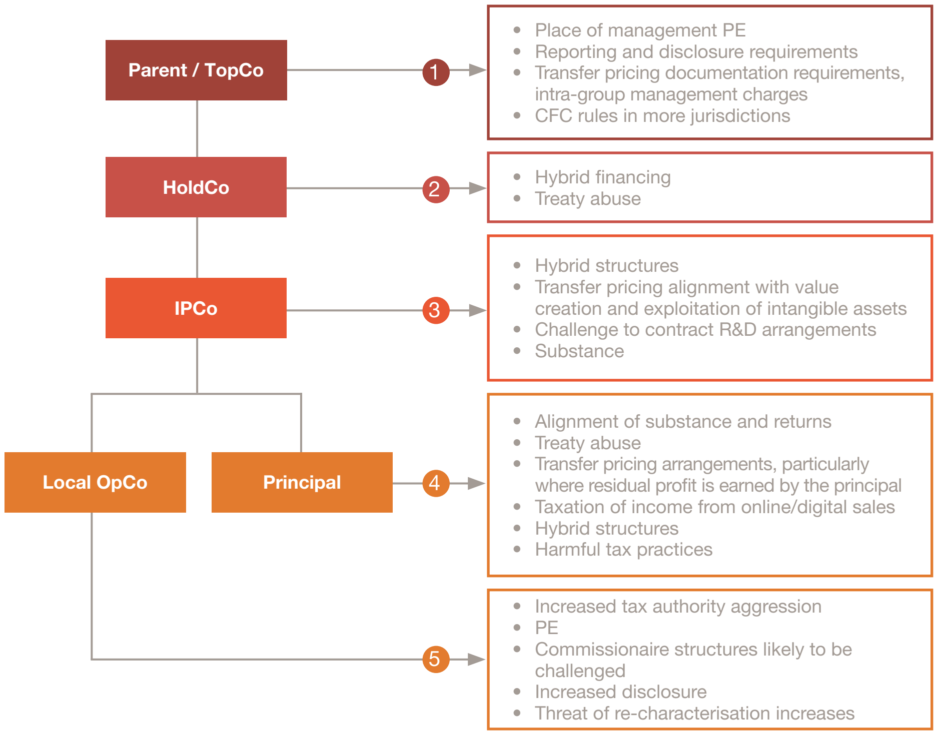
4 http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm

BEPS will influence the way multinational companies do business.

F. Impact on corporate actors

Large MNCs are aware that changes are coming and that BEPS will influence the way they do business. Their challenge is to align their value drivers and their taxation with their existing operational and legal structure in the face of negative public opinion and increased scrutiny from tax administrations. Changes in approach will impact MNCs' entire corporate structure and value chain. Some of the most relevant points for typical MNCs are shown below.

Figure 4 Impact of BEPS on typical MNCs



MNCs will have to analyse to what extent their existing tax structure and strategy is equipped to withstand the controversies and disputes expected in the post-BEPS environment.

Areas under specific scrutiny will likely be:

- Sustainability of tax rulings (and impact on ETR)
- Increased importance of transfer pricing
- Wider permanent establishment risks and challenges
- Business drivers relating to post-deal integration
- Limitation of interest relief and other financial payments.

Transactions could offer a unique opportunity to revisit existing legal structures and introduce the new BEPS principles into a revised, coherent and sustainable tax strategy, in line with new standards of corporate responsibility.

At the upper-tier level

The upper-tier level encompasses, apart from the TopCo (ultimate holding company), several HoldCos (intermediary holding companies), sub-HoldCos and one or several financing companies, usually located in countries providing favourable tax treatment of their profits.

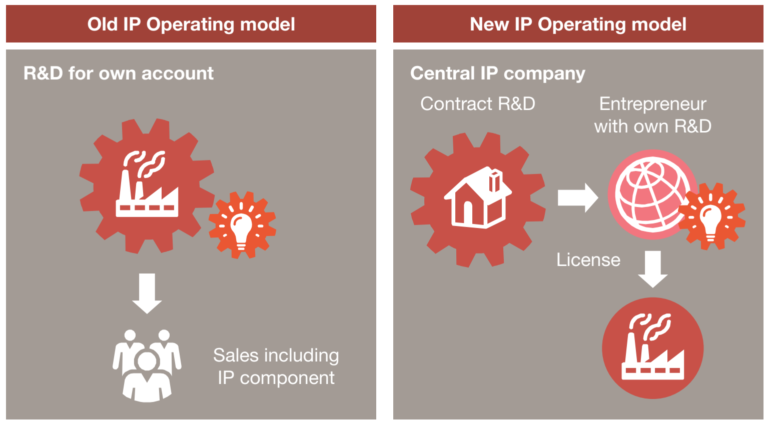
In some cases, the upper-tier level includes a complex set of financing transactions, back-to-back financing structures, hybrid securities and incoming dividend and interest flows. The availability of tax relief at the upper-tier level is often linked to having substance at the level of these entities. While substance has always been an important prerequisite, the understanding and definition of substance under BEPS might significantly affect the current upper-tier structure.

Refer to the upper-tier structure section of this publication for more information.

At the level of the IPCo

As a key component of their value chain, MNCs centralise valuable intellectual property (IP) in a given location (referred to as an IPCo), usually in countries with a beneficial IP regime (eg Ireland, Luxembourg, The Netherlands, UK). Often premium profits are attributed to the IPCo due to the availability of a beneficial tax regime. Some key value drivers are located at operational level, creating a mismatch between the profits attributed and the key value drivers.

Figure 5 Impact at the level of IPCo



BEPS focuses on "substantial activity" to determine the allocation of profits generated by intangible assets within MNCs to tackle any differences between the attributed profits and the value drivers. Two main approaches can be identified:

- the "value creation" or "transfer pricing" approach based on activities performed, territorial location of "substance" functions, legal ownership and bearing of economic risk
- the "nexus approach" based on alignment of profits with qualifying research and development (R&D) expenses.

The value creation approach requires a value chain transfer pricing analysis to ensure that the economic reality is in line with the legal structure (and vice-versa) and the actual remuneration. Legal ownership by itself does not confer any right to ultimately retain any intangible related return.

The nexus approach is aimed more at IP-Box companies. The benefit of a favourable IP tax regime will only be granted to IP income of a company in proportion to the R&D expenses the company has incurred. This puts a strong emphasis on R&D as the main value driver. Under the nexus approach, marketing-related IP assets such as trademarks are excluded from the benefit of preferential IP tax regimes.

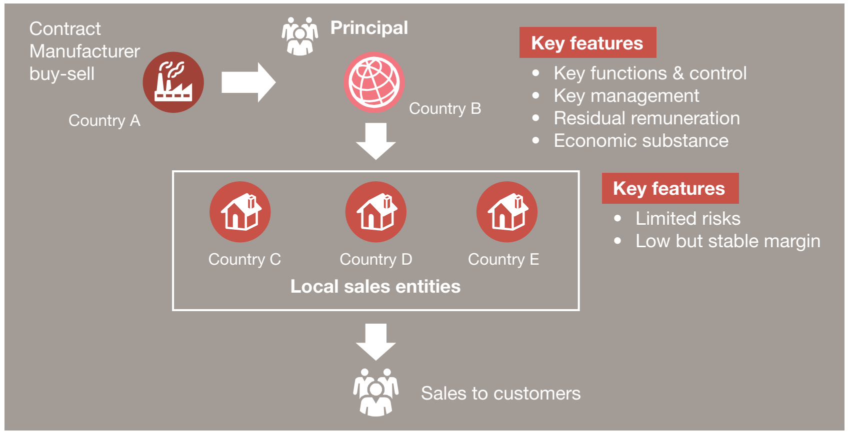
Anticipating the impact of BEPS and under pressure from EU policymakers, countries such as Ireland, Luxembourg and the UK, which have beneficial IP regimes in place, are already proactively reshaping or have reshaped their regimes to ensure the alignment of the R&D value creation and other key value drivers with the availability of the regime. Further implementation of BEPS will likely accelerate the shift towards the nexus approach.

In a M&A transaction, the transfer of IP to R&D centres of excellence and the centralisation of the R&D value creation at the level of the IPCos could help ensure the continuing availability of national and international beneficial tax regimes.

At principal(s) level

The globalisation of our economy and fast development of large enterprise resource planning (ERP) systems has had an important influence on how large MNCs organise their value chain. Over the last decade, MNCs have increasingly globalised their operations and transformed their operational model via large value chain transformation (VCT) programs. This allowed them to centralise their operations in large regional or global trading hubs located in key jurisdictions ("principal companies") and to benefit from the tax incentives and privileged tax regimes that some of these locations offer. The set-up of large VCT programs also allowed MNCs to reduce or eliminate tax across the entire supply chain through base erosion and profit shifting.

Figure 6 **Post –BEPS principal structure (Trading hub model)**



Key points

- Centralisation of group and strategic management at the level of the principal
- Strong economic substance at the level of the principal
- Functions/risks of the local entities clearly defined
- Alignment of profit level across the value chain
- Transfer pricing supporting economic substance

Economic substance at all levels, whereby risks, functions and remuneration are in line with the group's value chain

In practice this leads to the creation of regional hub structures ("principals") which attract the profits generated throughout the value chain, especially those from geographically mobile activities such as financial and other services and intangibles like IP. In those models, residual profits as well as relevant functions and risks are allocated to the principals. Local operating entities perform routine functions and assume limited risks and are remunerated as such. However, the question often arises over whether the principal performs all the relevant functions in practice. For example, key management can be scattered all over the value chain, in which case the principal's economic "substance" may be insufficient.

Due to the discrepancy between key value drivers and the allocation of functions and risks, principal structures are likely to be increasingly scrutinised under BEPS. Tax authorities will try to ensure that the principal does indeed perform the relevant functions and assumes the risks which motivate the allocation of the residual profit at its level.

Depending on the level of substance, tax authorities might opt for a more tailored approach in an attempt to successfully claim the right level of tax in their jurisdiction.

Figure 7 **Lack of substance: range of tax claims**

Worst case → Best case

Scenario	**All substance outside principal**	**Most substance outside principal**	**Some substance outside principal**	**All substance in principal**
Likely focus of tax authority challenge	Residence, Beneficial ownership	TP, Place of Mgt PE, CFC, Beneficial ownership	TP, Place of Mgt PE, Beneficial ownership	TP
Potential outcome	All profit taxed elsewhere and WHT issues	Profit reduced to cost +, CFC and/or WHT issues	PE profit taxed elsewhere, CFC and/or WHT issues	Profit taxed in principal location

Insufficient substance at the level of a principal will primarily be analysed from a tax residency perspective. As shown above, a total lack of substance could create a taxable presence in foreign jurisdictions and the taxation of part of the principal's profits in them. Unless double tax treaties are available to provide tax relief, this could even result in double taxation. The lack of substance could also result in the refusal of the withholding tax (WHT) exemption as regulators could claim that the receiving entity is not the "beneficial owner" of the income.

For MNCs, tax authorities are likely to focus on the presence of the necessary risks, functions, people and assets at headquarter and/or financing centres level to determine the appropriate audit approach. When the majority of substance resides in the principal but additional income is generated by the MNC though activities carried out abroad, foreign tax authorities might claim that part of the income should be taxed in their jurisdiction by virtue of a permanent establishment (PE), or impose taxation based on controlled foreign corporation (CFC) rules.

Principal structures are likely to be increasingly scrutinised under BEPS.

Due diligence will no longer focus on technical tax issues. A sound understanding of the value drivers and an analysis of the entire value chain will be key.

Alternatively, if a company has sufficient substance at principal level, but its profits are not taxed where its value creating activities are located or in line with the assumed risks, tax authorities could apply transfer pricing adjustments to align transactions with the arm's length model.

The relevance of the industry and the geographical location of the operations will play an important role, as each industry has specific value drivers and specific points of attention. Some industries are more affected than others by BEPS. Think of the implications of a new PE approach in the context of the modern digital economy (BEPS Action 1[5]). It may allow tax authorities to tax MNCs where the customers are located using so-called diverted profit approaches, which could result in "virtual" PEs in these countries.

From a M&A perspective, due diligence on a target company will no longer focus on technical tax issues. A sound understanding of the value drivers and an analysis of the entire value chain will be key in order to assess the potential tax liabilities linked to the structure. This could certainly influence the pricing of the target company. See the section on due diligence and BEPS for more on this.

At the level of the operational entities

At the level of the operational entities, the focus on substance is rather limited. It is taken for granted that these type of entities have sufficient substance. This assumption should also be revised, certainly in situations where the operational entities qualify as "low risk entities" carrying out routine functions with limited risks.

The BEPS approach now implies that the entire value chain should be taken into account to assess the profit attributable to operating entities with a focus on true economic substance. This changes the rules of the game. Profits should be taxed where the value creating activities are performed and where the actual risks are assumed.

In a transaction, it will be important to ensure that transfer pricing is aligned with functions performed, risks assumed and assets used. When operating entities have "excess substance" it may trigger a shift of part of the residual profits back to the operational level and out of the principal.

An important point to note is that no or low taxation should not be perceived as abusive, as long as M&A transactions and post-acquisition integration have specific attention to location, value drivers and transfer pricing principles when considering the set-up of a certain structure. Hence, BEPS does still allow MNCs to optimise their value chain, as long as the chosen structure and profit allocation is transparent and relies on economic substance.

G. *Impact on Private equity*

There are numerous commercial factors relevant to the borrowing of funds, and many tax rules concerning the treatment of financing in the borrowing entity. These vary considerably by territory. Points to consider include:

5 OECD, BEPS Action 1 report: Addressing the Tax Challenges of the Digital Economy, http://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm

BEPS will have an even more dramatic effect on financial players.

Figure 8 Impact of BEPS on financial actors

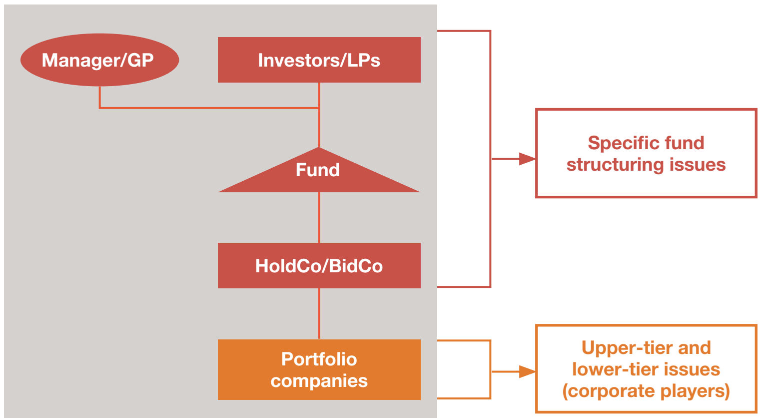
- Withholding tax on interest payments
- Debt terms e.g. maturity, repayment dates, interest periods and currency of debt
- Quantum of debt and tax cost of borrower
- Impact of inflation adjustments on tax liability

- Deductibility of interest expenses in hands of borrower
- State aid considerations
- Ability to make use of local deductions
- Substance requirements

- Impact on use of tax attributes
- Residency rules
- Financial assistance rules
- Etc.

BEPS will not only affect the structure of operations for MNCs, it will have an even more dramatic impact on financial players. Financial buyers will be impacted at the level of their portfolio companies as well as their fund structure.

Figure 9 Level of BEPS impact on financial players



Several issues specific to fund structures might fall within the scope of the BEPS guidelines. This could significantly change the way financial players arrange not only their M&A deals but also their own financing structure.

Specific fund structure modalities might have to be revisited under the new BEPS rules, including:

- lack of transparency of the structure in place
- location of fund, LP or GP (instead of a low tax country), tax residency and (limitation of the use of tax transparent entities to benefit from tax advantages) substance at all levels (limitation of beneficial treaty use, PE risk)
- availability of tax incentives, which might no longer exist
- limitation of double non-taxation benefit by the use of financial instruments ("Hybrid mismatches")
- leveraging of portfolio companies to increase Return on Investment (ROI) of LP/fund and maximisation of cash and profit repatriation
- increased importance of transfer pricing.

This point is analysed in further detail in the fund structure section of this guide.

H. Post-BEPS due diligence

M&A offers a unique opportunity for a group to tackle potential BEPS issues. It provides momentum to bring existing models in line with the current tax environment and to optimise its structure by integrating the target company or via post-acquisition structuring.

While the increased scrutiny might be perceived as a burden, the post-BEPS environment also offers new opportunities. Through the nexus between transaction and transfer pricing it could open new doors to a new, compliant and sustainable tax structure and tax strategy, for example by aligning the location of the head office, R&D, and supply chain functions with the specific value drivers of the MNC.

MNCs and private equity buyers should take the opportunity of an acquisition to integrate the transfer pricing policies of the acquiring and acquired company in a robust and tax efficient manner. They should bear in mind that the use of, for instance, centralised operating models (see principal structures above) could also generate additional exposures if implemented without having a full understanding of the value chain of the combined group. One complicating factor is that the alignment of operating models of both companies could lead to a business restructuring involving IP and client base migration, potentially triggering exit tax.

MNCs should devote sufficient time and effort to risk mitigation during the entire deal. As tax authorities around the globe shift their focus towards BEPS, badly aligned transfer pricing policies can easily be exposed during a tax audit. This risk is further intensified by the additional public attention brought by M&A transactions.

Due diligence processes will become more important because they will be key for the acquiring entity to fully understand the risk and opportunities presented by the deal. Three important phases can be distinguished:

Post-BEPS environment will also offer new opportunities.

Figure 10 Post-BEPS diligence processes

Assess	Design	Implement
• More in depth review of transfer pricing (TP) pricing policies, past tax audits & APAs taking into account budget forecasts and expected post-deal tax and TP effects • Assess sustainability of rulings & IP structure post-BEPS • Analyse substance at upper-tier level and make beneficial ownership a high priority in the DD. • Acquire at operational level in case of risks in the upper-tier	• Introduce a global TP strategy for the combined group • Take into account reputational elements in the design of the new structure • Develop a plan to realign key functions and risks in the value chain so that the key activities & decision makers are at the relevant level	• Prepare TP studies & documentation to substantiate intra-group flows • Monitor functions & risks to ensure correct implementation of the structure • Develop communication plans on how to engage with the public on tax • Monitor compliance and efficiency of the structure with existing tax rules and anticipate changes to the maximum

The important things to remember for BEPS-proof structuring in transactions are:

- to make sure that the **economic substance** requirements are met by picking the appropriate location of the effective seat of management for each entity and assisting in the simplification of the upper-tier structure by centralising and integrating key decision-making functions;
- to simplify existing structures to allow more **transparent intra-group flows**, substantiated by duly prepared transfer pricing documentation supporting the arm's length nature of the several intra-group flows;
- through the **rationalisation of the upper-tier structure** (for example by relocating holding activities closer to jurisdictions), to avoid an increased impact of CFC rules;
- to assist with the **dismantling of existing aggressive tax structures** (e.g. back-to-back financing structures, hybrid securities and structures) and secure the shift towards a new BEPS-proof ETR effective upper-tier structure;
- to **revisit the cash management/repatriation strategies** and propose alternative methods (e.g. reserves generation planning).

I. The new normal?

BEPS will add a new layer of complexity and uncertainty to the traditional deal structuring and due diligence processes. Old approaches will need to be revised to effectively control and mitigate risk in a deal environment, and possibly even create value in the future.

- **Post-BEPS due diligence**

New approaches will be needed, focusing on the risk and sustainability of ETR strategies. Incompatible structures and strategies currently in place will need to be dismantled and the costs to do so will need to be considered.

- **Understanding the MNC's value chain**

Front-loaded transfer pricing modelling with a sound understanding of the entire business and operational value creation process will become standard.

- **Acquisition planning**

Traditional acquisition structures will need to be revisited and possibly reshaped in light of BEPS to rely on substance, transparency and arm's length leverage.

- **Stronger transparency requirements**

The impact on tax reporting systems of the new regulations should not be underestimated. The need for transparency will lead to increased global compliance requirements, which, if combined with inefficient processes, will increase the risk of draining already strained resources. The potential for unexpected costs can be high, both due to the resources needed and to the increased tax, interest and penalties for not complying with tax obligations. Needless to say, that also carries reputational risk.

Those responsible for tax in corporations will need to make significant efforts to cope with these changes. Not only from a people-perspective, but also from a technology perspective. However, if successful, tax directors and managers will be able to make better informed decisions, will have greater access to useful information, use analytics to model the effects of business opportunities and focus on forecasting.

J. Tax function of the future

With virtually every transaction having a potential direct or indirect tax impact, tax should be high on the CFO's agenda from both a cost and risk standpoint. As tax authorities demand more transparency and reporting, it will become necessary to rely on automated and reliable data processes.

Companies should take the opportunity of a merger or acquisition to rethink the role and responsibilities of their tax personnel within the group, improve their processes, and implement automated tax compliance tools. **Upgrading the tax department will not only reduce costs, but also contribute to a company-wide enhancement of risk strategy, tax governance, corporate branding and resource management.**

According to a 2013 PwC survey, tax executives spend more than half of their time gathering tax data, while spending less than 30% of their time on strategic tax analysis[6]. Many tax executives said that it is difficult for them to obtain tax-ready data on their own. Most tax personnel surveyed are of the opinion that better technology and integration of tax in the company's resource planning would improve their tax effectiveness.

Increased global compliance and transparency requirements, combined with inefficient processes and outsourced tax personnel, have increased tax risk and drained already strained resources in companies. It has become crucial to focus on building up sustainable tax strategies with 2.0 tax technology and special emphasis on tax branding. If oversight on the tax department is lost, non-compliance will result in high fines being imposed.

We expect that future technology will make it possible to enhance data analytics and will allow tax personnel to access "tax-ready" information without too much effort. By 2020, how an enterprise deals with tax will be viewed as a competitive advantage or disadvantage. Investors will expect robust and efficient tax strategies and have little tolerance for tax uncertainty or tax adjustments.

6 2013 joint PwC-Manufacturers Alliance for Productivity and Innovation survey on *Tax technology: Creating a strategic asset*.

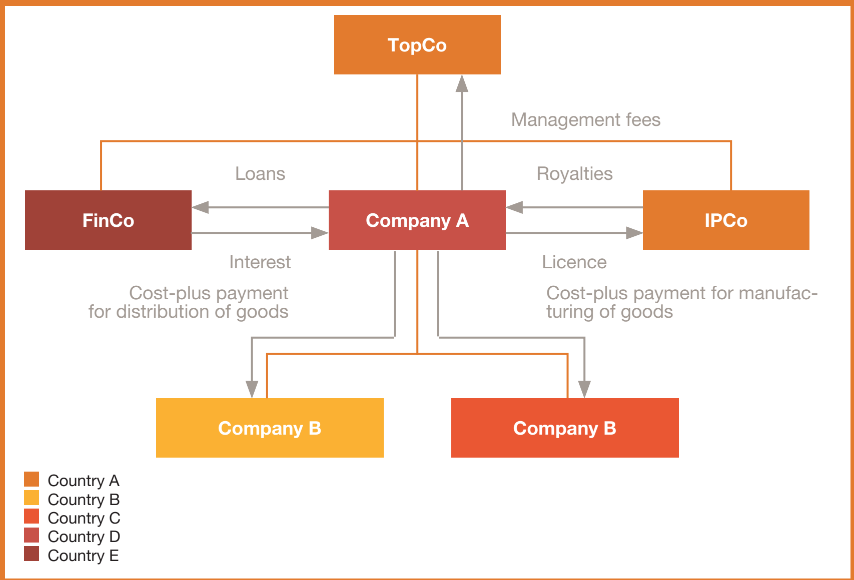
Figure 11 Strategic challenge for the tax function

All companies should take the opportunity to improve their processes by rethinking roles and responsibilities within the multinational group to automate and accelerate tax compliance, planning opportunities and trends on a global level.

K. *Case study: Post-BEPS due diligence*

We've recently been involved in the takeover of a large Country A-based MNC by a large Country Q MNC. Due diligence on the target group involved a review of the entire transfer pricing position as well as assessment of post-deal actions imposed by the lack of existing transfer pricing documents and preferential rulings which may be affected by BEPS. Below is an indicative structure of the Country A MNC:

Figure 12 **Illustration of how BEPS will change our due diligence approach**

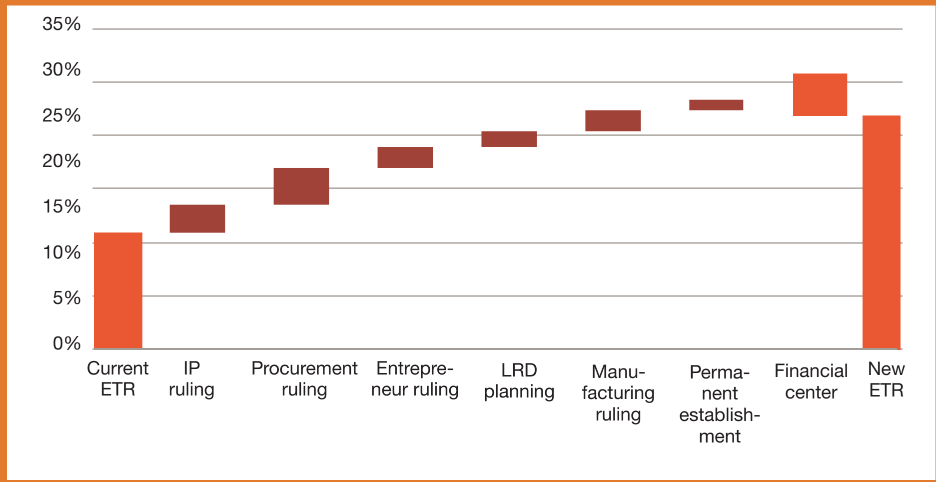


The review involved an assessment of the sustainable ETR for the target group going forward as well as a mapping of changes needed to meet BEPS requirements in terms of transfer pricing.

The exercise also included a redefinition of roles and responsibilities across the entire value chain (e.g. IP, procurement and wider value chain drivers) to bring the target group in line with the buyer's operating model. This required an assessment of the transformation needed to align both business models so as to achieve operational and financial benefits while complying with new BEPS documentation requirements and transparency regulations.

The bridge chart below provides an example of the potential impact of BEPS on existing tax planning, which will have to be reassessed to limit impact on the ETR.

Figure 13 **ETR bridge – Impact of dismantling current privileged tax regimes**



II. Financing and structuring

Highlights

- *At the outset of a deal, investors need to assess how they will finance their investment.*
- *Financing and structuring of an investment should be considered jointly.*
- *Structuring needs to align stakeholders at both higher & lower-tier levels.*
- *Transfer pricing, tax and regulatory considerations will need to be taken into account when considering the whole picture of the deal.*

A. Introduction

During an acquisition, investors do two things at the same time. They negotiate with the sellers (transactional aspects) and they secure the financing (fundraising). Implementing an appropriate acquisition and finance structure is a major factor in a transaction's success.

Fundraising negotiations impact the pricing of a deal because the ability to access financing influences how much can be paid. Any transaction therefore requires close cooperation between debt and equity providers. This applies in a corporate or a private equity context, in a private placement, a bank financed acquisition or a public issue of debt or equity.

Funding cost optimisation is vital to the success of the deal. Special purpose vehicles (SPVs) are often used to secure financing and optimise its cost. Many groups make use of a dedicated treasury centre to streamline the financing of all their subsidiaries.

As we will see, BEPS will impact M&A deal structures and financing both at upper-tier and lower-tier level. Before addressing those changes, we will focus on how BEPS will change financing and structuring.

B. Source & use of funds

Securing financing generally requires close cooperation between debt and equity providers

Transactions are generally divided into two tiers. The upper-tier is the intermediary corporate structure between the investors, such as the corporate, private equity or capital market for listed entities, and the operational entities of the target company. The lower-tier refers to the channelling of the financing and part of the transaction costs in the operational entities. Upper-tier and lower-tier transactions are described in more detail in later sections of this M&A guide.

At the outset of a deal, prospective purchasers typically need to address the following questions:

- how will the acquisition be funded?
- what will be the acquisition vehicle?
- what should be acquired: the target shares or its assets?

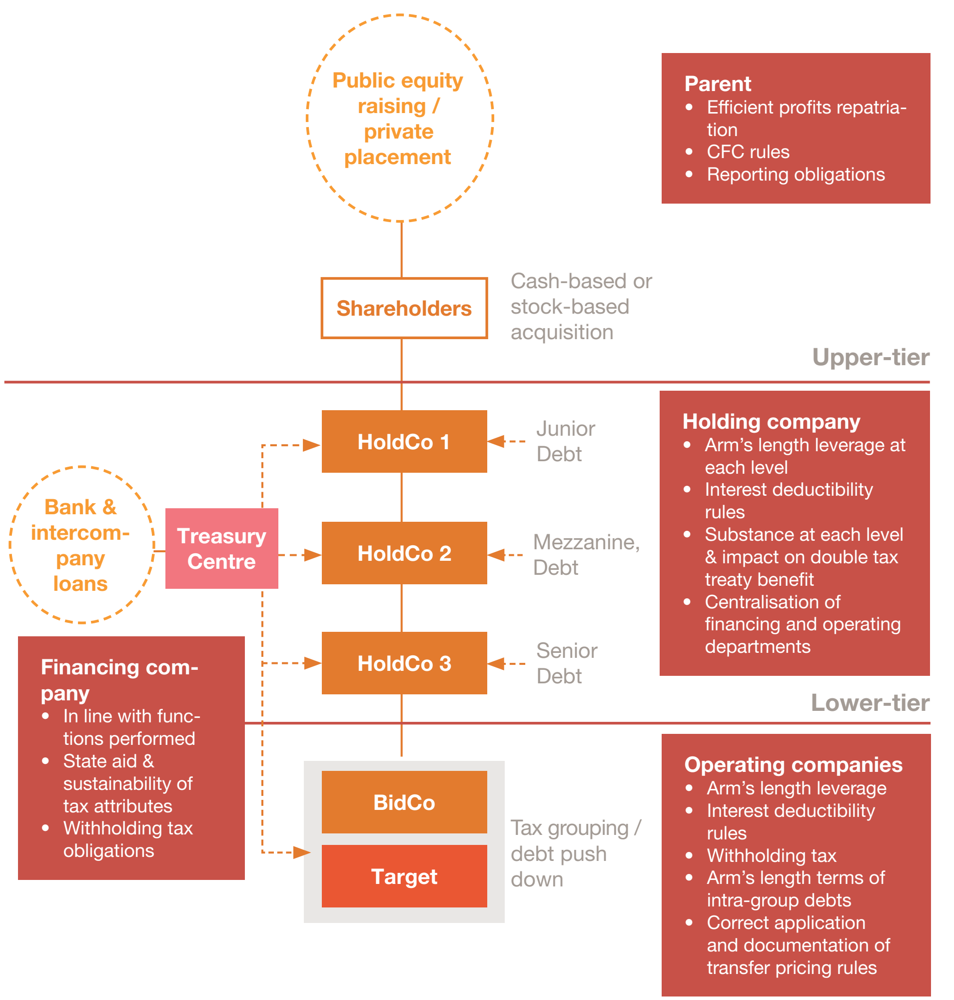
Prospective acquirers must first assess the total funds they will need to place the bid against the relevant assets and shares, and to finance the transaction costs (legal fees, banking fees, due diligence, delisting, etc.). In doing so, they will need to take into account the impact of potential post-deal disposals, asset-stripping and new investment requirements.

They also need to assess how they will finance the transaction, which is typically done through private placement, vendor loans, bank facilities, equity financing or public issue of debt instruments or listed equity. All these options require close cooperation between debt and equity providers.

The debt and equity financing of MNCs is usually done via external bank financing or resources organically available within the group. This is usually managed by the MNC's treasury department. Once the funds have been raised, they can be drawn down to where they are needed to complete the acquisition.

Private equity buyers rely on funds provided by the Limited Partners. They also negotiate external funding with banks and/or the vendors. Several layers of banks will generally be consulted, resulting in heavy investment structures, which are meant to cope with the layers of risk drawn up from the various stakeholders.

Figure 14 Fundraising at different levels

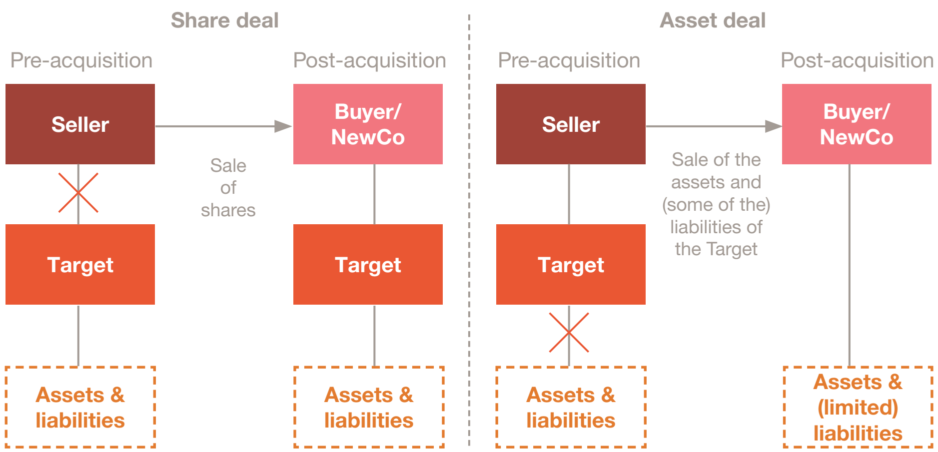


Both private equity and MNC buyers may also, in principle, call upon the capital markets to finance their acquisition. This can be done through equity, for example via a capital increase and/or public tender offer, and possibly leverage through the use of their treasury departments. However, private equity buyers may not always have access to the capital market.

Corporate buyers will also have the opportunity to finance their investment through the outright payment of cash or stock. Acquisitions through stock are usually done via mergers or share-for-share transactions. Typically, a stock-based transaction is more advantageous from a tax perspective than a cash-based transaction. A stock-based transaction can generally be realised under a tax neutral regime if certain conditions are met, while a cash-based transaction is usually taxable. Specific arbitration can also take place depending on whether a premium is needed or not.

Eventually, corporate and private equity buyers might have the opportunity to acquire either the target's shares or its assets. This will likely influence the price because it will result in a different tax treatment for the seller and the purchaser.

Figure 15 Share deal vs. asset deal



Asset deals are usually subject to ordinary taxation in most jurisdictions. This leads to a high tax cost for the seller, unless tax attributes such as carried-forward tax losses can be offset against that taxable income. Moreover, they often trigger indirect taxes and stamp duties, in particular when they involve the transfer of fixed assets. On the buyer's side, the purchase of assets may be more advantageous from a tax point of view since it generally allows for a step-up in depreciation basis for tax purposes and a limited transfer of tax liabilities. However, tax losses and imputation credits generally remain with the seller.

In contrast, **share deals are usually subject to reduced tax rates** or benefit from participation exemption, leading to a low tax cost for the seller. However, the purchase of shares does not result in an increase in the base cost of the company's underlying assets for (tax) depreciation purposes. Furthermore, the purchaser generally inherits the liabilities of the target entities, including tax and contingent liabilities.

Prospective purchasers have a choice of acquisition vehicles, which will be influenced by their goals, what is feasible, and what the risk, cost, tax, administration and other implications are. Purchasers can acquire shares or assets through, among others, a local holding company, a foreign parent company or a non-resident intermediate holding company.

For more insights on this, and the potential tax consequences, refer to the upper-tier section of this guide.

C. *Investment structure*

SPVs may be required for both upper-tier and lower-tier structures

When securing the necessary funding, corporate and private equity investors on both the buying and selling sides of a deal will typically consider the structure of the transaction when securing the necessary funding. This may involve setting up one or more special investment vehicles (SPVs) for, among others, the following reasons:

- to segregate banks' indications
- to isolate the risks linked to a specific transaction from other activities
- to offer greater flexibility in the case of a management buy-out
- to prepare for the entry of other investors in the structure
- to benefit from a certain tax treatment
- to implement a structural debt subordination with junior, senior and mezzanine creditors.

As already mentioned, the setting-up of SPVs requires specific attention to substance, which is under increased scrutiny by tax authorities.

D. Debt subordination

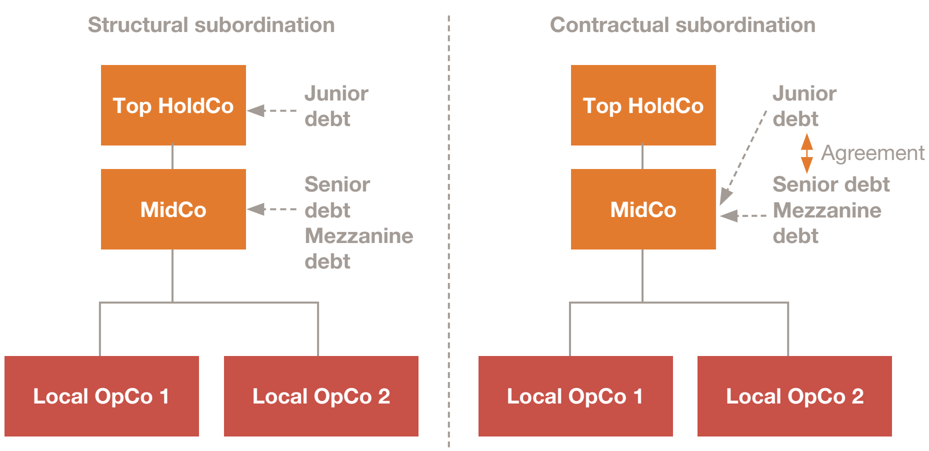
Syndication of debt is an important tool for private equity funds willing to segregate risks linked to various debt-instruments

In large M&A transactions involving various debt-providers it is quite common to come across different types of debt obligations, such as senior, mezzanine and junior debts, each at different (risk) levels of the acquisition tree. Debt syndication determines the ranking and position of the debt providers being served. It is a particularly important tool for private equity funds.

The ranking of risk obligations is usually done by subordinating the respective claims of each creditor. Subordination means in this case that a debt is not repaid before all other claims against the company have been reimbursed. As illustrated below, subordination can be organised either:

- by a contract amongst the creditors, in which the ranking of payments is agreed upon (contractual subordination)
- by inserting intermediary companies to shelter the high-risk creditors at a level above the senior lenders (structural subordination).

Figure 16 Debt subordination



In Belgium, the subordination of debt providers is typically written down in a contract, whereas structural subordination is generally required by UK and US banks in larger cross-border deals.

Credit rating agencies will usually give different ratings to the different levels of debt, based on individual credit rating assessments for each borrower. For this reason, debt subordination often comes with some inter-company credit guarantees to improve the credit position of the different entities involved.

The rules on financial assistance should be considered when giving warranties to a target or group entity in connection with this debt subordination.

As we will see in the upper-tier section, the setting up of a security package at upper-tier level is a complex exercise which requires attention to substance, treaty benefit and VAT leakage.

E. Treasury centre

Towards a better alignment with the operational model of MNCs

The globalisation of capital markets and alignment of MNCs' operational models has led to the centralisation and specialisation of finance and cash management functions in dedicated treasury locations.

Over time, treasury centres have evolved from in-house banks to integrated financing platforms, making use of technology to manage cash and being a key part of the supply chain. In doing so, treasury centres have become an important driver of the MNC operational model, in which cash and working capital management are of paramount importance, along with the overall cash management strategy.

We expect BEPS to have a major impact on the location of MNCs' treasury centres, as well as on funding strategies and relevant transfer pricing policies. When fundraising, it is important to make sure that your company's internal policies are aligned with new controls over risk transfer pricing requirements and do not fall under the definition of "cash-boxes".

Setting up a dedicated treasury centre can optimise cash management and mitigate important risks

Dedicated treasury centres can help to improve cash management and the cost of funding. Their focus is:

- to reduce liquidity risk
- to optimise cash management processes and the efficiency of back office functions
- to secure debt financing, and optimise cost of funding
- to mitigate operational, financial and reputational risk.

In large firms, treasury centres may be involved in in-house banking activities such as actual trading in bonds, currencies and financial derivatives associated with commodity risk management.

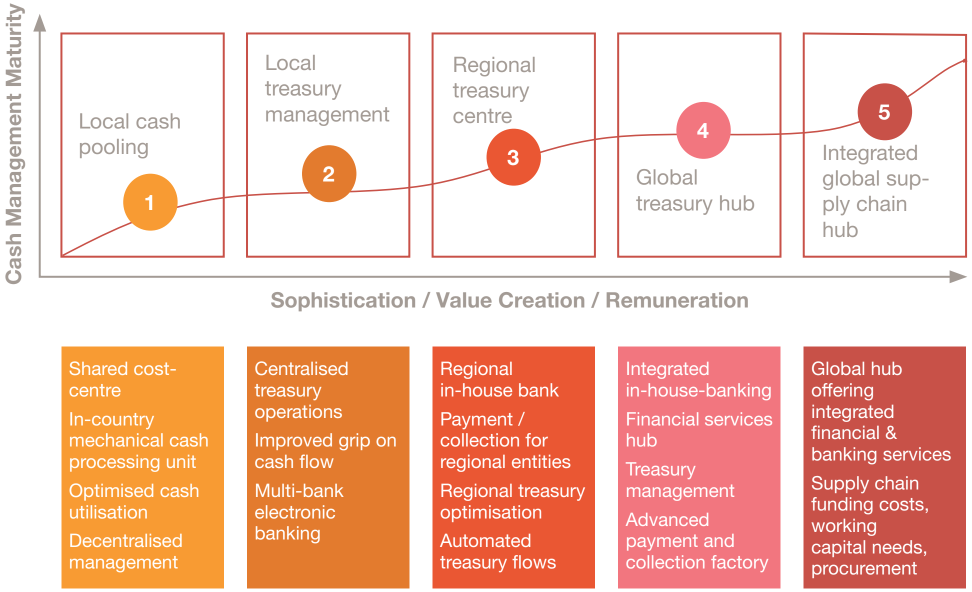
In the absence of a centralised financing structure, each entity is left virtually alone to negotiate loans with banks and external debt providers. This is not optimal from an economic standpoint since the borrowing entity will likely have to pay higher interest and administrative costs on debt raised on the capital market. Furthermore, it is less likely to benefit from advantageous conditions based on the group's credit position, unless the company has explicit parent credit guarantees.

Depending on their financing model, MNCs will make use of more mature and sophisticated types of treasury centres, active at local, regional or global levels, to bring more value to the enterprise. The classic life cycle of a treasury centre evolves along five lines and is described in the chart on the next page.

Treasury centre remuneration must be aligned with its role.

Figure 17 **Position of the treasury centre in the MNC's value chain**

A journey across the cash management spectrum



F. Treasury centre remuneration

Treasury centre remuneration must be aligned with their role, staffing and risk profile. Remuneration will vary depending on whether the treasury centre operates as a profit or a cost centre. The most important features to consider are:

- the nature of the services provided
- the level of economic substance
- the amount of risk assumed
- the capacity to have control over that risk.

When a treasury centre operates as a pure 'cost centre', providing routine or administrative services with limited added economic value, assuming no or limited risk, its remuneration should be built on a cost-based margin. It should not be allocated the profits associated with financial risk or be entitled to more than a risk-free return. If a treasury centre operates as a real in-house bank, taking strategic decisions and assuming funding risk, it adds economic value to the services it renders to the group and each incoming and outgoing transaction needs to be assessed on its own merits.

In general BEPS tends to favour a cost-based remuneration approach because of its fight against "cash box" companies. This is to prevent a treasury centre having no function beyond controlling financial risk. Nevertheless, a profit-based approach is still defensible if it can be demonstrated that the treasury centre assumes real entrepreneurial risk in intra-group financing, and performs functions that create additional value.

The mere contractual assumption of risk, if unsupported by the level of risk assumed and controlled in substance by the treasury centre, won't be enough to support entitlement to a risk-related return. To defend a profit-based remuneration approach, it is key that the treasury centre:

- Performs and controls all of the functions, including the important functions related to the treasury's activities (e.g. control over funding, credit risk, financing etc.)
- Has the necessary assets, including competent personnel
- Assumes all of the risks related to the treasury activities.

The OECD made this very clear in its final BEPS reports, which were published on 5 October 2015. "Taxation in line with value creation" and "substance over form" are the norm going forward. Economic substance will become the key international tax issue which will make or break every MNC's tax and legal strategy in the future.

"Substance over form" is the norm going forward.

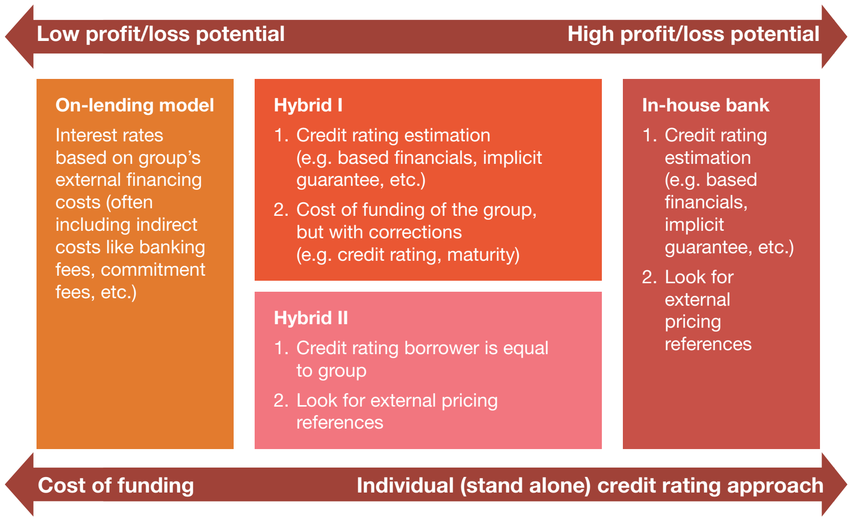
G. Loan pricing

Inter-company financial transactions, including loans, should comply with transfer pricing requirements and be priced at arm's length.

Determining those terms requires a credit risk analysis for each borrowing entity and a functional analysis of the lender. Based on the outcome of those studies, the arm's length interest rates and treasury centre margin can be assessed in a benchmarking process. These should be recorded in comprehensive transfer pricing documents.

The chart below provides an overview of the most common treasury pricing models. They vary based on the level of sophistication and role played by the treasury centre and the level of risk assumed respectively by the lenders and borrowers. As illustrated, each method will have an impact on the potential profit or loss of the treasury centre.

Figure 18 **Treasury pricing policy spectrum**



H. Credit guarantees

Inter-company credit guarantees should be remunerated in an appropriate way. MNCs have become heavily reliant on external bank debt since the 2008 financial crisis. They also face stricter agreements and increased demand for securities, such as the provision of additional inter-company credit guarantees, in order to obtain funding at lower costs, or to be able to attract funding at all.

The increase of inter-company credit guarantees has drawn this type of warranty instrument to the attention of tax authorities around the world and incorrect charging and/or pricing of a guarantee fee may result in transfer pricing adjustments.

An arm's length guarantee fee is typically required where there is a guarantee service that provides a commercial benefit to the guaranteed party. The commercial benefit can arise from more relaxed credit terms and conditions than would be obtained on a stand-alone basis, including but not limited to a lower interest rate and less strict covenants. The price of the guarantee should take into consideration the actual credit rating of the borrower. It should not be based on a fictitious lower credit rating. However, BEPS states that no guarantee fee should be paid in the case of a mere implicit parent guarantee, if the parent company does not actively provide any service.

I. Lower-tier financing

Financing at lower-tier level generally means looking at the allocation of acquisition debt to ensure the interest can be deducted against the operating income of the target company. Private equity investors and corporates will draw down raised funds at lower entity level to optimise the allocation of acquisition debt to achieve effective, possibly full, deductibility of interest. This is typically done by allocating debt, to the extent possible, to entities where operating income is generated. To this end, mechanisms such as tax grouping and debt pushdown, among others, might be considered.

For further insights on lower-tier considerations, please refer to the lower-tier section of this guide.

J. Case study: Treasury centre optimisation

We recently performed a BEPS assessment of the interest deductions limitation for a MNC group with centralised financing functions. The goal was to align the allocation of debt and financing (long term cash flows, capex, etc.) across the group and to optimise the treasury centre from a tax perspective while following the BEPS guidelines.

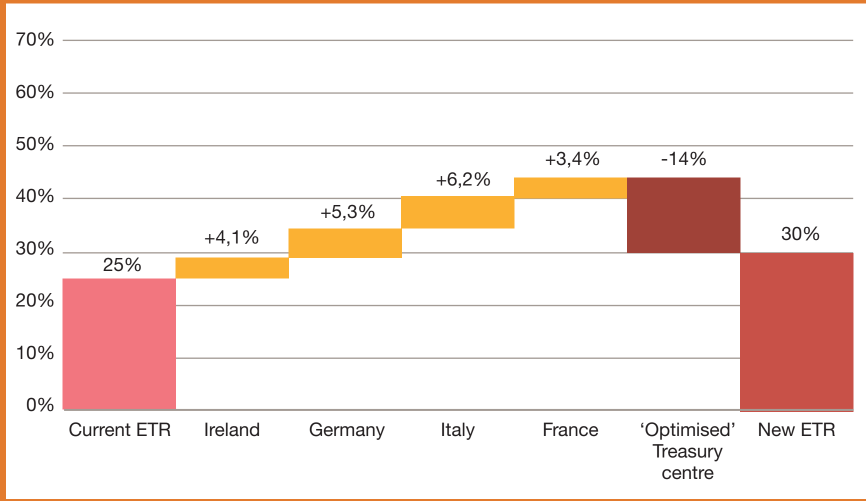
In our analysis, we ran the optimal alignment for each country based on various ratios. These included:

- a **group-wide deductibility** ratio (interest relief limited to a ratio of the group's net third party interest)
- a **fixed net interest expense / EBITDA** ratio (applied to interest paid to third parties and intragroup)
- a **combination approach** with a low fixed ratio approach as the default rule
- a **group-wide ratio approach** where the fixed ratio test leads to non-deductible interest with the more generous of both rules being applied[7].

This could be done based on the group wide profit before tax information for each fiscal unity per territory as well as EBITDA, external interest expense/income, inter-company interest expense/income, existing interest restrictions, tax charge and effective rate of tax for interest by territory. A modelling tool was developed to assess the impact of a modification of the group's debt profile by territory.

As illustrated in the figures below, we maintained the treasury centre as a profit pool for long term financing and monitored the group's effective tax rate (ETR). This was notwithstanding the downside effect of BEPS on the overall position, in terms of drastic reductions in the tax relief given for interest expense for certain territories involved.

Figure 19 Breakdown by the five territories most significantly impacted



7 For more insights on the OECD's recommendations under BEPS Action 4 ('Limit base erosion via interest deductions and other financial payments') we refer to the developments mentioned in the lower-tier section of this guide.

III. Upper-tier structure

Highlights

- *The sustainability of existing upper-tier structures should be assessed in the light of the changing tax environment.*
- *There should be enough activity and economic risk at upper-tier level to make sure that entities qualify as "beneficial owners".*
- *Transparency, accurate implementation, documentation and day-to-day monitoring are now key.*
- *Hybrid financing is now frowned upon by both the OECD and EU, while Controlled Foreign Company (CFC) rules will likely be strengthened.*

We see an increasing challenge of upper-tier structures which are not supported by sufficient economic substance.

A. Introduction

Each level of the upper-tier structure must have enough economic substance to imply the presence of the necessary risks, functions, people and assets. The presence of key functions and economic risk at upper-tier level will, among others, determine whether entities receiving dividend, interest or royalty payments qualify as "beneficial owners" of these payments.

Besides economic substance and beneficial ownership requirements, specific rules aimed at preventing treaty abuse, such as the Limitation on Benefits (LOB) clauses, along with more general anti-abuse tax rules, should also be complied with at upper-tier level.

Recent developments indicate that using hybrid financing schemes to repatriate profits will very likely be challenged by the tax authorities in the future. This will lead to unsustainable tax planning and/or an unsustainable effective tax rate (ETR) going forward.

Finally, we can expect countries to strengthen their existing CFC rules, or introduce CFC rules if they don't have them.

The combination of all these factors will play an important role in the selection of a location for a holding or BidCo by professional investors.

B. Substance

The trend towards increased scrutiny of economic substance at the upper-tier has been reinforced by BEPS

Tax authorities are increasingly challenging upper-tier structures which are not supported by sufficient economic substance. The principle of economic substance implies that a transaction or presence should be motivated by solid business reasons rather than the mere mitigation of tax burden. The relevant assets, people, risks and functions should be present at the upper-tier and perform the activities of the relevant legal entity. Sufficient substance determines whether or not a certain entity can be considered as a tax resident of a specific country. This implies that a lack of substance in that country could result in tax claims from other jurisdictions and the refusal of certain tax regimes. Treaty benefits or the application of withholding tax exemptions based on EU rules could also be refused if the recipient of a payment does not qualify as the "beneficial owner of a payment". Tax authorities generally use existing anti-abuse measures, which they interpret increasingly broadly, to assess levels of substance. In certain jurisdictions, domestic legislation includes specific substance requirements.

A successful challenge can have a significant impact on your investment return

If a legal entity in an upper-tier structure does not qualify as tax resident in the country where it is established, or if it is not "beneficial owner" of interest or dividend income, withholding tax exemptions will not apply, leading to withholding tax being due. On Belgian investments, this would mean a 27% tax leakage! The income of a certain legal entity could also become taxable in other (potentially higher taxed) jurisdictions to the extent that the level of substance is insufficient to support the activities performed by this entity. Discussions regarding substance and distribution of taxable profits across multiple jurisdictions are not only burdensome and time-consuming, but can also result in double taxation and a higher consolidated effective tax rate (ETR). Prevention is better than a cure.

Sufficient substance at the level of intermediary holding companies is key

For both MNCs and private equity investors, having sufficient economic substance at the level of the intermediary holding companies is key to make sure they qualify as local tax residents. Certain countries have already introduced specific substance related rules. Most European countries provide no or only limited specific guidance. Luxembourg and the Netherlands have a set of de *minimis* substance requirements on top of its general rule (see the table on the next page comparing Belgium with its neighbour countries).

> Five years ago, ascertaining material substance was little more than a box-ticking exercise but now economic substance is key. This is more than just questions relating to material presence and the day-to-day management. Every element will have to be assessed to demonstrate the availability of sufficient economic substance. Questions to ascertain the sustainability of the upper-tier structure from a substance perspective could be:
>
> - How many board meetings do you have a year? Are the non-resident directors flying in?
> - Who prepares board documents, e.g. information packages and board minutes, and from where?
> - Are emails and post forwarded to a non-resident director or to the HQ?
> - Are you using directors or services from a trust office?
> - Who can call a board in case of emergencies? Who is managing the company on a day-to-day basis?
> - Do you share your office with other (intra-group) companies?
> - What are the professional qualifications of the directors and employees?
> - Do you have transfer pricing documentation available?

Figure 20 Substance requirements

Belgium	No formal substance requirements, tax law refers to “registered office, principal place of business or seat of management”.
France	No relevant formal substance requirements, “registered office” and “place of effective management”.
Germany	No formal substance requirements, tax law refers to “registered seat” and “place of effective management”.
Netherlands	A company is Dutch tax resident if incorporated under Dutch corporate law or effectively controlled and managed in the Netherlands. **Minimum substance requirements**: **(I)** At least 50% of the members of the board of directors with decision making powers should be resident in the Netherlands. **(II)** The board members should be sufficiently competent and qualified to perform their tasks. **(III)** The most important board decisions should be taken in the Netherlands. **(IV)** The Dutch company should have its main bank account in the Netherlands. **(V)** The bookkeeping of the Dutch company should take place in the Netherlands. **(VI)** The Dutch company should comply with all its tax obligations. **(VII)** The Dutch company should have its registered address and office in the Netherlands and should not be treated as a tax resident of another country. **(VIII)** The Dutch company must have a level of equity which fits its functions.
Luxembourg	Luxembourg provides for substance requirements similar to the Netherlands based on a circular letter of 2011.

As the table illustrates, although substance is clearly on the radar of the authorities, the legislator provides no or only limited guidance. Even where there are specific local rules, the concept of substance within its international meaning lies in the implementation and day-to-day execution of a group structure.

For holding companies, the level of substance should be assessed at all levels of management. But how?

- **Senior management:** it is key to hold board meetings and prepare information packages in countries where the relevant HoldCos are located; well-qualified directors should take active roles in the decision-making process (no “rubber stamping”); there should be a sufficient number of directors resident in the country where the company is located;
- **Day-to-day management:** employees with relevant skills should take care of local daily activities (e.g. financing); solid and regular reporting should be in place; local bank accounts should be available;
- **Administrative management:** availability of proper offices and equipment, local email addresses and telephone numbers, books and legal documents should be prepared and reviewed locally; compliance with local GAAP and other regulations.

Thorough substance reviews, defence files and day-to-day monitoring are crucial in order to minimise any related risks. Assessing economic substance is highly fact-based.

The use of a mere conduit or flow-through entity is over.

C. *Beneficial ownership*

Besides sufficient relevant substance, entities receiving a dividend, interest or royalty payment must also qualify as the "beneficial owner" of the payment to qualify for treaty benefits or for withholding tax exemptions based on EU directives. This implies that the recipient receives the payment for its own benefit and is allowed full discretion as to what it does with the income, as opposed to being a mere conduit or flow-through entity. In the past, conduit entities were sometimes used to benefit from an exemption in cases where the ultimate beneficiary did not qualify.

To address abuse, certain countries introduced specific beneficial ownership requirements in their domestic legislation or tax practices. Others continued to rely upon their existing legal framework. Please find below a brief overview of the existing beneficial ownership requirements in Belgium and its neighbouring countries.

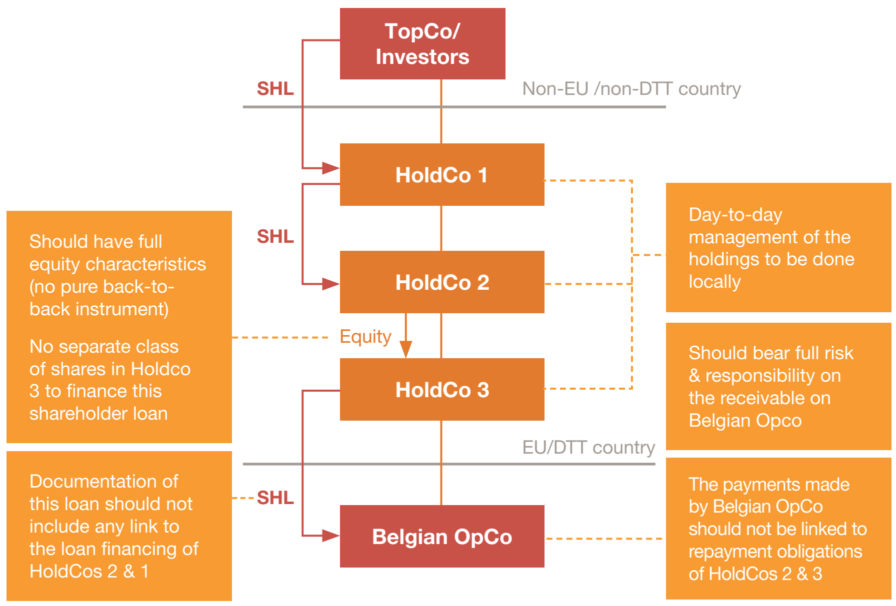
Figure 21 Beneficial ownership requirements

Belgium	No specific beneficial ownership requirements. However, most treaties require the recipient to be the beneficial owner to be entitled to withholding tax (WHT) relief and there is a tendency to interpret beneficial ownership in terms of economic substance.
France	French tax authorities can deny entitlement to WHT relief based on anti-abuse/anti-conduit provisions.
Germany	A foreign company is not entitled to WHT relief to the extent that **(I)** its shareholders would not be entitled to the same relief (in case they would receive the income directly) **(II)** its foreign gross receipts in the respective year do not stem from its own commercial activity and a) no economic/other rationale is given for its interposition and b) the foreign company does not participate by means of properly furnished business premises and equipment in the general business exchange/market.
Netherlands	No beneficial ownership definition. However **(I)** no WHT relief is granted when the receiving company is a mere conduit company (agent or intermediary) & **(II)** dividend stripping rules define when a recipient of Dutch source dividend income is not considered to be the beneficial owner.
Luxembourg	No specific domestic beneficial ownership requirements. Economic ownership prevails over legal ownership in case of discrepancy.

As the table illustrates, not all countries have specific local domestic beneficial ownership requirements in national legislation. Nevertheless, this does not prevent domestic tax authorities from denying entitlement to withholding tax relief. Indeed, tax authorities around the globe are often able to rely upon national legislation (e.g. general anti-abuse provisions (GAAR)) and/or double tax treaties (e.g. anti-conduit/abuse provisions) to tackle abusive structures. All things considered, we notice a general trend towards a more economic approach when interpreting the beneficial ownership criterion.

This means that, in multi-layer structures, the holding structure must be supported by valid business reasons, have an active function and be subject to economic risk.

Figure 22 Substance of the holding structure



D. *Treaty abuse*

The OECD aims to challenge treaty abuse with Limitation-on-Benefits (LOB) and/or Principal Purpose Test (PPT) clauses

BEPS Action 6 focuses on treaty abuse and in particular treaty shopping.

Pursuant to the Action 6 minimum standard, countries will have to include in the title and preamble of their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or tax avoidance or evasion, including through treaty shopping arrangements.

The Action 6 minimum standard sets out two different treaty-based rules to tackle this issue: (1) a specific LOB rule and/or (2) a more general PPT rule.

- LOB clauses are typically found in double tax treaties concluded by the United States and Japan. Such clauses aim to target "abusive" structures in which a non-treaty resident improperly accesses treaty benefits by filtering income through a treaty-resident intermediary. To combat these abuses, a LOB clause sets out a series of complex criteria that must be complied with. In essence, they aim to ensure the company has sufficient links with its country of residence to benefit from the treaty. These tests may require the company to demonstrate that it is "beneficially owned" by residents of the same jurisdiction. This may be difficult for private equity funds which, in many cases, may not have any jurisdiction in which such a condition is satisfied (see also our specific comments on BEPS Action 6 in the funds section). A PPT is a more general anti-abuse clause. It denies treaty benefits where one of the principal purposes of a transaction or arrangement is to secure a benefit against the purpose of a treaty. Interpreting things broadly, the Belgian general domestic anti-abuse provision as introduced in 2012 shows similarities to such PPT clauses. It aims to assess whether or not a set of transactions constitutes tax abuse by weighing a potential tax benefit against the whole of the underlying non-fiscal motives.

Several other EU countries have introduced similar purpose based rules which aim to restrict deductions for interest expense if the debt was not entered into for an appropriate purpose. It is key to understand how such rules could impact a borrower. Examples of purpose-based rules in relation to interest deductibility include:

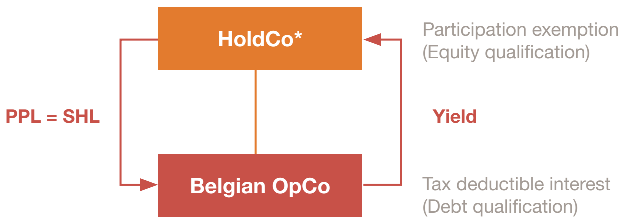
- UK "unallowable purpose" rules where interest deduction in the borrower is disallowed if the borrower does not have a commercial purpose for entering into the loan;
- Dutch rules which deny interest deductions on loans from certain transactions unless shown to have a commercial purpose; and
- the Australian GAAR which prevents taxpayers obtaining an Australian tax benefit from a scheme with a main purpose of obtaining an Australian tax benefit.

The OECD/G20 countries have agreed a flexible approach to the adoption of these new rules. This shall be included in both the multilateral instrument foreseen under BEPS Action 15 and the OECD's Model Tax Treaty & commentary. The Action 6 minimum standard will be satisfied if countries include in their bilateral tax treaties either both the LOB and PPT rules ("combined approach") or solely the PPT rule or the LOB rule.

The work on Action 6 also resulted in a number of recommendations for other specific anti-abuse rules to be included in tax treaties. Although these recommendations are not included in the Action 6 minimum standard, they will be at the heart of the discussions on the multilateral instrument that the OECD/G20 countries want to set up to implement the treaty-related BEPS measures.

E. *Hybrid financing*

Figure 23 **Example of hybrid financing: profit participating loan (PPL)**



* Typically located in the Netherlands/Luxembourg

Hybrid financing is being challenged by the OECD ...

Hybrid financing instruments feature a mix of debt and equity. This mostly leads to tax deductible interest for the debtor and tax exempt income for the shareholder/creditor. In Belgium, the profit participating loan (PPL) is the most well-known example.

In its Action 2 to neutralise the effect of hybrid mismatch arrangements, the OECD states double non-taxation or long-term tax deferral resulting from hybrid financing is unacceptable. It suggests modifications to the OECD Model Tax Convention and domestic law provisions, as well as unilateral cooperation between jurisdictions.

...and the EU ...

On 8 July 2014, the EU amended the Parent Subsidiary Directive to avoid it being used for double non-taxation. The amendment withdraws the benefit of participation exemption for the parent company where the related costs/payments are tax deductible for the subsidiary.

...and several territories

Several territories have introduced rules to prevent groups from obtaining a tax advantage via the use of hybrid entities or hybrid instruments. The operation of these rules varies by territory. For example:

- the UK anti-arbitrage rules are designed to deny interest deductions where hybrid entities or hybrid instruments are used to obtain a UK tax advantage;
- in France, interest deductions are only permitted if the corresponding interest income is taxed in the lender at a rate of at least 25% of the amount of tax that would have been payable under the French rules.

What should you take out of this in a M&A environment?

- **Consider this during due diligence:** If there is hybrid financing in a target group, it will negatively impact the ETR going forward and this should be properly reflected in financial modelling;
- **Review your existing structures:** Hybrid financing within the EU will likely become inefficient and existing structures should urgently be revised. For non EU-countries, the question should be analysed on a case-by-case basis;
- **Keep the financial potential in mind:** Hybrid instruments such as PPLs – even treated as ordinary loans for tax purposes – might still provide financial solutions for unsteady/delayed cash flows.

F. *Strengthening CFC rules*

Controlled Foreign Company (CFC) rules are an important consideration in the selection of a location for a holding or BidCo/SPV

Figure 24 **CFC legislation within the EU**

Austria		Italy	✓
Belgium		Latvia	
Bulgaria		Lithuania	✓
Croatia		Luxembourg	
Cyprus		Malta	
Czech Republic		The Netherlands	
Denmark		Poland	✓
Estonia	✓	Portugal	✓
Finland	✓	Romania	
France	✓	Slovakia	
Germany	✓	Slovenia	
Greece	✓	Spain	✓
Hungary	✓	Sweden	✓
Ireland		United Kingdom	✓

Source: IBFD database

What's in a name?

Controlled Foreign Company (CFC) rules are used in many countries to prevent base erosion when income is shifted to foreign low tax subsidiaries by preventing profit shifting or long-term deferral of taxation.

Rules differ from country to country but the bottom line is they aim to tax a parent company on the often passive income of subsidiaries it controls in other typically lower-taxed jurisdictions. Given the variety of systems, the application of CFC rules depends on local definitions (e.g. the notions of 'controlled company' and "passive income") and local rules (e.g. applicable exemptions, tax credits and reporting obligations).

In the framework of an acquisition, the presence or absence, and concrete application, of a CFC regime is an important consideration to select the location of a holding or BidCo/SPV.

Recent developments

The OECD has concluded that CFC rules as implemented in many countries do not always comprehensively counter base erosion and profit-shifting. It has published recommendations to improve them. As a result, we can expect countries to amend and strengthen their CFC rules and other countries to introduce CFC rules.

In Belgium?

Contrary to most neighbouring countries (see table below), Belgium currently does not have CFC rules and, despite some rumours, we are not aware of any formal initiative to introduce any. Even if this happens, these will have to be of a limited scope, since such CFC rules cannot prevent free trade amongst EU countries.

Figure 25 Controlled Foreign Company regulation

Belgium	Belgium does not have specific CFC legislation.
France	CFC income is taxed at the level of the direct or indirect French shareholder if: (i) the French company holds (in)directly at least 50% of the shares, interest, financial rights and/or voting rights in a non-resident (ii) the CIT due is 50% lower than the CIT liability it would have had in France. No CFC rules apply to entities located in the EU (unless artificial).
Germany	CFC income is taxed at the level of the direct or indirect German shareholder(s) if (i) these shareholder(s) hold at least 50% of the shares and/or voting rights in a non-resident (ii) the effective tax burden is lower than 25% & (iii) the income of the CFC does not qualify as active income (as defined in the German Foreign Tax Act (FTA)). Exemptions apply to entities located in the EU. More severe regulations apply with respect to passive capital income.
Netherlands	The Netherlands does not have CFC legislation. However, market-to-market valuation conditions apply if: (i) the Dutch resident together with "related-parties" hold at least 25% of the shares (ii) the participation's assets consist out of at least 90% low-taxed free portfolio investments & (iii) no profit tax is due upon the participation as a result of which a realistic levy (according to Dutch tax standards) is achieved.
Luxembourg	Luxembourg does not have specific CFC legislation.

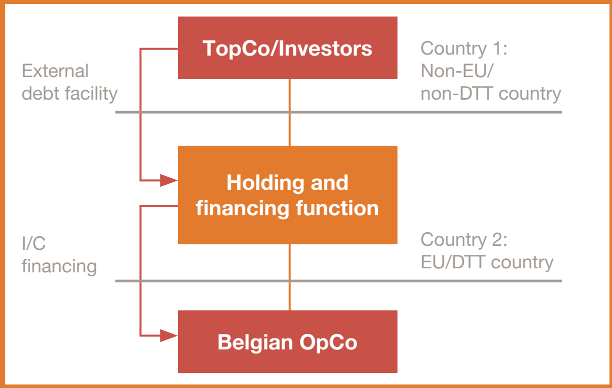
G. Case study: Upper-tier structure

In a recent transaction we were asked to review the sustainability of the holding structure of a MNC that included intermediary holding and financing structures.

Although the set-up of the structure could be explained by a variety of reasons, and was clearly not driven by tax optimisation purposes, we insisted on the importance of testing the economic rationale of the whole structure. This was important to ensure there was an adequate level of substance in each tax jurisdiction in which the MNC's group operated, be it through an intermediary holding structure or a permanent establishment.

The key takeaways from our analysis are summarised below. There are no golden rules since substance requirements may vary from one jurisdiction to another, but these are some clear guidelines based on our experience.

Figure 26 Case study – Intermediary holding and financing structure



Source: 2015 Global Equity Incentives Survey: Executive Summary, PwC

Composition of the board

- **Foreign directors?** At least 50% of the board members with decision taking powers should be resident of Country 1. A majority of these Country 1 board members should be present when board decisions are made. Naturally, all board members should be sufficiently qualified to perform their tasks.
- **Trust directors?** It is acceptable that the board contains trust directors as long they (i) form a minority within the board and (ii) are well qualified, well informed and have the ability to autonomously take decisions (and they effectively do so). These independent directors should be remunerated directly in person and not through their employer.
- **Board meetings via video conference?** All board decisions should be made during board meetings which are physically held in Country 1. If a board member cannot attend the meeting, attendance via conference call is not recommended. A better alternative is to replace him/her or to postpone the meeting. If no other option exists, participation of one or a small minority of board members via video conference could be accepted on a very exceptional basis.
- **Number of board meetings?** Board meetings should be held on a regular basis, i.e. at least bi-monthly or quarterly (or more frequently depending on the activities/specific requirements).

Please find below some guidelines regarding substance requirements, based on our experience.

Figure 27 **Management decision making: senior management, day-to-day management and administrative management**

Category	Typical requirements	Must be in TopCo	Also possible (occasionally) in a different country
Strategic decisions	Strategic decision making (management of participations, M&A activity, important asset purchases etc.)	✓	
	Occasional decision making on small transactions (small asset purchases, etc.)		✓
	Preparation of budgets and amendments to the company's business plan	✓	
	Preparation of the board package		✓
Bank and accounts	Assistance with preparation tax returns and annual accounts	✓	
	Approval and filing of tax returns and annual accounts	✓	
	Choice of accountant/tax advisor	✓	
	Physical keeping of books	✓	
Financing	Opening main bank account	✓	
	Negotiation/closing substantial loan agreements	✓	
	Negotiation/closing non-substantial loan agreements		✓
	Management of the loans/cash position + active follow-up	✓	

IV. Lower-tier

Highlights

- *Tax deductibility of interest remains an important factor in optimising a leveraged transaction.*
- *Deductibility was mainly limited by local interest deductibility ratios like thin cap or interest capping rules.*
- *These still exist but the economic rationale has grown in importance.*
- *Debt allocations must be supported by a strong operational reasoning and consider both financial and cash flow forecasts.*

There must be a robust explanation for the leverage in each entity

A. Introduction

At lower-tier level, private equity funds and corporates try to organise their financing and acquisition structure in a way that maximises their tax relief. The challenge is to achieve effective tax deductibility for interest on bank debt and for other transaction costs. This is typically realised through so-called "debt allocation" exercises which aim to allocate debt to operational entities, where taxable income is generated.

"Classic" debt allocation structures were historically based on debt-financed equity distributions, step acquisitions and tax grouping. These types of operations are still possible but they need to be reconsidered on a case-to-case basis and be handled with more caution in the light of BEPS. Indeed, the OECD considers the use of interest, and in particular related party interest, to be one of the simplest profit-shifting techniques available in international tax planning. Leverage operations are also scrutinised by tax authorities around the world.

More and more anti-abuse or transfer pricing rules may apply. In addition to the specific interest deductibility rules, **tax authorities can look at a debt push-down operation in three ways:**

1. **A business purpose test.** What is the motivation for taking out the loan? Are interest expenses incurred to maintain or acquire taxable income?
2. **Transfer pricing principles.** Is the interest rate at arm's length considering the entity's credit rating? Is the company's leverage level at arm's length compared to industry standards and considering the entity's financial position? Are the terms and conditions backed up with a strong economic rationale?
3. **General or specific anti-abuse rules.** Is the debt allocation operation itself supported by more than just tax reasons?

There is clearly a need to have a strong economic rationale for each transaction. Tax authorities will look beyond the "paper reality" of transactions to verify whether transactions are backed up by this economic rationale. Debt and cost allocation exercises should not be implemented as a straightforward, isolated exercise, but be integrated in the more global thinking of a group or target's structure and financing practices. Regional or capital alignment, where tax is only one of the benefits of the structuring, can be considered in that respect.

Parties should in any case ensure that their financing is not just supported by contracts that do not reflect the economic rationale. Each company involved in the transaction or structuring must assume an appropriate level of risk, bear its share of debt and receive proper compensation for its role and function inside the value chain of the MNC.

In this chapter, we will offer more insights on how investors can structure their financing and acquisition costs, and to what extent the allocation of these costs can be optimised from a tax perspective, taking into consideration recent developments in the light of BEPS.

B. Debt allocation

Getting an effective tax deduction for the interest due on acquisition debt can be far from straightforward.

In a classic share-deal acquisition structure, bank debt is generally at the level of the acquisition vehicle (or acquisition holding structure) while the taxable basis is in the hands of the operational target entities.

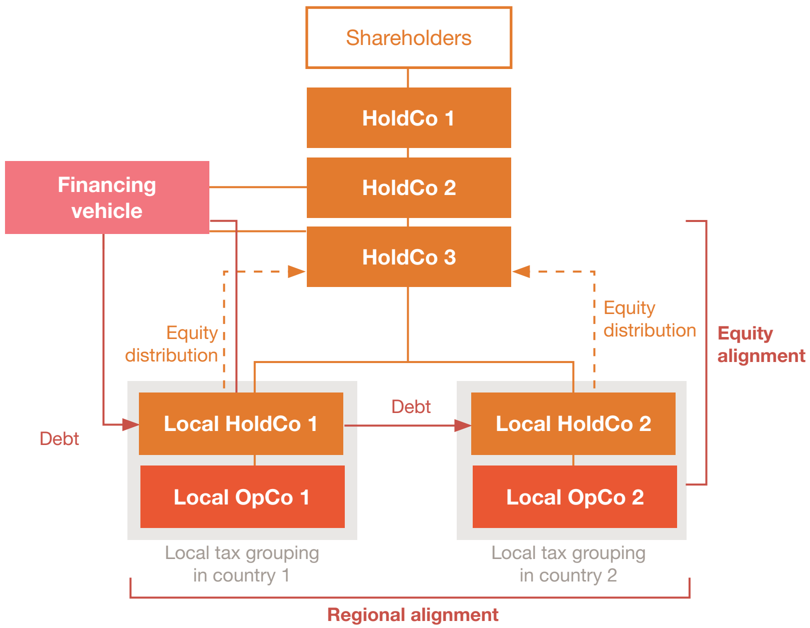
The lack of substance can lead to adverse tax consequences.

For international acquisitions, or in countries (such as Belgium) where there is no tax group regime, interest relief can only be obtained in the scope of broader (non-tax) acquisition structuring projects. These are either centred on the legal/ownership structure (regional/operational alignment exercises) or on the broader financing of the group entities (equity alignment exercises).

Regional/operational alignments

In international acquisitions, the allocation of debt among the various operating countries can be integrated in a more global **regional alignment** exercise. Local sub-holding companies acquire target entities and create a local tax group in each jurisdiction that provides for group tax relief.

Figure 28 Regional/operational alignments



For corporate players, regional alignment can also be implemented through acquisition of a target group, or some of the target entities, by an existing operational entity when it is operationally justified. This leads to direct leverage at operational level. In some cases, a similar exercise is also feasible for private equity players, where one of the target entities has an economic interest in acquiring another. More than regional alignment, similar debt-financed acquisitions of shares by operational entities can also be considered in the framework of the alignment of a group legal structure with its divisional structure, for example.

For such structures to be sustainable going forward, the acquiring entity must play its active role as shareholder. The lack of substance of the holding structure can lead to adverse tax consequences, as we describe in the chapter on the upper-tier structure.

Equity alignment

Another approach is to realise a global analysis of the equity position of the target group in which the equity of overcapitalised entities could be up-streamed, via dividend distributions, share buy-backs or reductions of share capital of the target entities concerned to the acquisition vehicles.

These distributions can be (partially) debt-financed where no cash is available. Such an exercise is feasible when a company is over-capitalised compared to industry or group standards. The resulting capitalisation level should be supported by a benchmark study.

Local interest deductibility rules

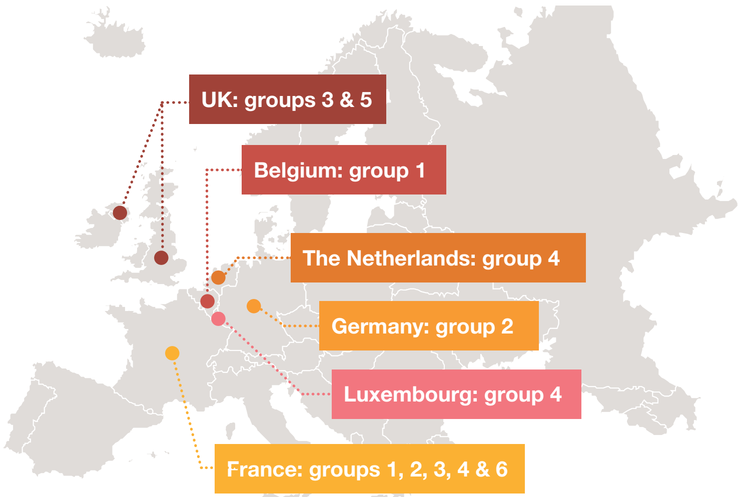
Most countries have specific rules limiting interest deductibility

These rules are meant to limit the tax relief for interest expenses. In some countries, the rules aim to cover all types of debts, in others they are limited to intra-group financing. In general, the rules currently applied by most jurisdictions fall under the following broad groups:

1. limits to the level of interest expense with reference to **a balance sheet fixed ratio** (e.g. debt to equity);
2. limits to the quantum of debt with reference to a **P&L fixed ratio** (so-called “earnings stripping rules”);
3. **group-wide rules** under which the allowable interest deductions for a particular entity are limited to reflect the group’s consolidated finance costs;
4. targeted rules that disallow interest expense on **specific transactions**, such as recapitalisations, dividend distributions or investments in certain types of assets such as shares;
5. **arm’s length tests**; comparing the level of interest or debt with the position that would have existed if the entity had been dealing entirely with third parties;
6. rules that disallow a **percentage of the interest** expense, irrespective of the nature of the payment or to whom it’s made.

Figure 29 Groups of rules applicable in some EU countries

The map below indicates which countries apply which broad groups of rules



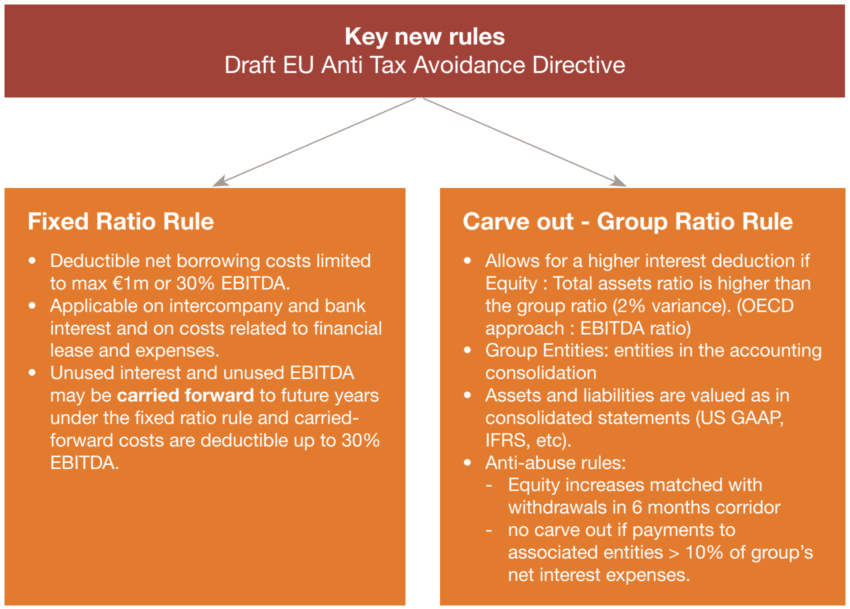
The OECD’s BEPS Action 4 recommends that countries use a combined approach to deal with base erosion attempts linked to interest deductions and other financial payments. This approach includes general rules, which limit interest deductions based on ratios, and targeted rules meant to address specific BEPS risks.

As regards the fixed ratio rule, the OECD recommends implementing a fixed **net interest/EBITDA cap between 10% and 30%** applied to interest paid to third parties and intragroup as best practice. It gives member states the possibility of implementing **group-wide interest limitation rules** as an **optional** carve-out. This rule allows for a higher interest deduction than the limit under the fixed ratio rule under certain circumstances. Countries can also provide for a carry-forward of unused interest expenses. Industry specific features for the banking and insurance sectors, for example, still need to be further developed.

The OECD rules apply to all forms of interest and payments economically equivalent to interest to prevent attempts to characterise loans as a different type of legal instrument.

Although the final report was released only very recently, countries are already starting to tighten their existing interest deductibility rules. The European Commission also issued a draft anti-tax avoidance directive[8] (ATAD) with rules similar to the OECD’s proposed approach. The evolution of local implementation should be closely followed. As a taxpayer, you will need to proactively revisit your intercompany financing arrangements taking into account these developments.

Figure 30 Key elements of the draft EU Directive on reducing the impact of interest limitation rules in its BEPS Action 4



8 European Commission, 28 January 2016, Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

Debt capacity

An economic approach is essential

For a debt push-down exercise to be implemented successfully, it is important to look at the operations - regional and/or capital alignment - and their economic impact and motivation apart from their financing.

Each operation should be financed on an arm's length basis, via a mix of equity, available cash and debt, to meet those standards. This implies that an economic analysis is needed to determine the debt servicing capacity of the leveraged entity as well as its appropriate leverage and capitalisation levels.

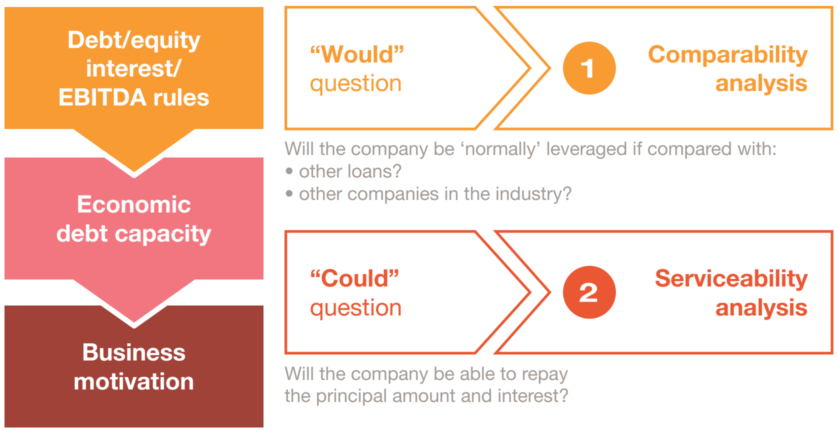
The **debt-servicing capacity** of an entity is the arm's length level of debt and interest that it can bear from an economic perspective. This implies that the company:

1. is able, **cash-wise**, to bear at least the interest cost. Ideally, the entity should also be able to repay the principal over a reasonable timeframe. Under certain circumstances, it can however be argued that comparable independent entities would work with bullet loans and refinance their debts at maturity and therefore that capacity to repay the principal may not be required;
2. can still maintain a reasonable level of **profitability** compared to industry standards and is not in a tax or accounting loss position further to bearing the interest expenses.
3. The appropriate **leverage** and **capitalisation levels** should be assessed based on group and industry standards and ideally be supported by a benchmark study.

This requires that the forecasted cash flows available for the borrower to service the loans are taken into account and the financial performance of comparable companies over a representative scope is analysed and aligned.

In addition, the **arm's length interest rate** and other terms of financing, should be assessed using peer group comparables or established credit rating agencies. It is important in that respect that the analysis is realised **at entity, and not solely group, level.** The duration of the financing granted should be assessed taking into account the effective financing and investment outlook of the company.

Figure 31 Transfer pricing principles: Is it at arm's length?



C. *Transaction costs*

Transaction costs should be allocated with caution

Besides interest paid on acquisition debt, lots of other transaction costs related to a merger or an acquisition need to be taken care of throughout a deal. Such costs may include due diligence, legal and consultancy fees, investment banking fees, transaction financing charges, and regulatory and filing fees. These expenses may range from 3% to 5% of the total deal value.

For book and tax purposes, transaction costs may be either capitalised or taken as an expense. Most countries, such as France, the UK, and USA, apply the capitalisation method, instead of the expensing method. In Belgium, there is no formal obligation to use one reporting method rather than the other, but the allocation of costs should always comply with the arm's length principle. Hence, **costs should be borne by the company benefitting from them, whether they are capitalised or taken as an expense.**

One should also keep in mind local rules against aggressive tax planning, tax avoidance, and tax abuse. There are also limitation rules on the tax deductibility of certain types of costs (to be appreciated on a cost-by-cost basis), financial assistance and substance requirement.

In practice, this generally means that a large part of the costs will be borne by the entities bearing the financing and by the acquisition vehicles. The practical tax consequences of this allocation will differ greatly. This depends on whether the entities at stake have a basis for tax deduction. If they don't a great deal of the costs may in practice not be deductible, which is often the case in private equity deals. Tax consequences also depends if entities have a right to VAT deduction. Pure holdings and financing entities generally do not have that right, so VAT on those costs will be a final cash cost.

Why does it matter?

Since a BidCo often lacks sufficient income to deduct its transaction costs, investors will typically try to allocate them to operating entities of the target.

The choice for one or the other approach is relevant. Buyers generally want to optimise their deal structure in a way that allows current deductibility of transaction costs. They will most likely prefer the expensing method. But accountants may prefer a long-term capitalisation of expenses, which has less negative impact to the earnings per share charge.

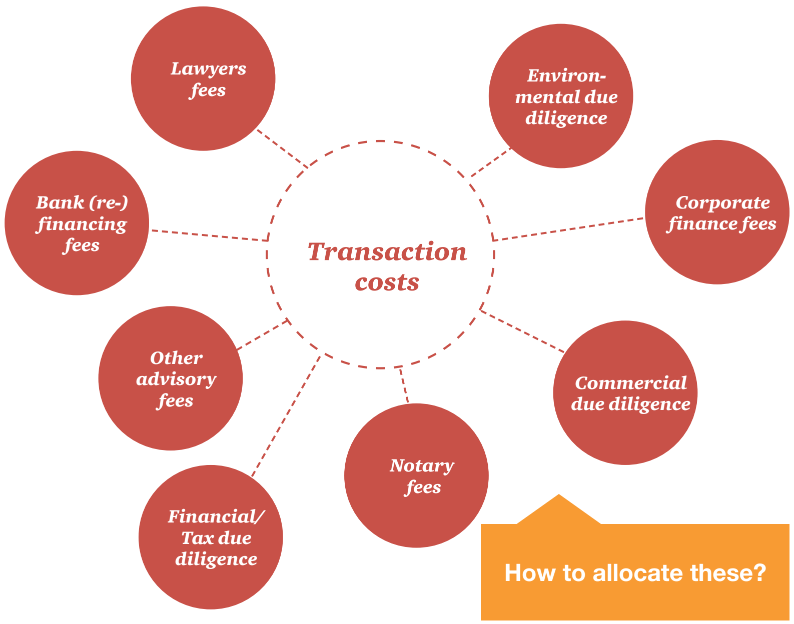
Current deductibility of transaction costs can easily be achieved in some countries by making use of tax grouping. As this option is not available in Belgium, acquisition costs attributable to the acquisition vehicle may not be fully deductible in the absence of tax capacity. As a result, transaction costs should be allocated, to the extent possible, to operational subsidiaries of the target, instead of the acquisition vehicle. Cash flow should be created in the target, in the form of management fees, royalties or another type of income, allowing for the offsetting of costs and reducing the group's consolidated effective tax rate.

Make use of various allocation keys

If several companies are involved in a merger or an acquisition, one should determine which entity has benefitted from what cost, especially when comprehensive lump-sum cost arrangements have been made with service providers. Such comprehensive costs should be individualised to the extent possible and a prorated amount be allocated to every entity benefitting from the services.

Transaction costs may range from 3% to 5% of the total deal value.

Figure 32 Illustration of various transaction costs



In practice, the most sustainable approach to allocate the various transaction costs may be to use various allocation keys depending on the type of cost and the entity benefiting from the cost, e.g.:

- when **banking fees** or **advisory fees** are a consideration to be paid for receiving the bank debt, the loan granted to finance these could be allocated to each of the companies receiving part of the bank debt;
- costs relating to **real estate valuation** on the occasion of a real estate swap could be allocated to the different companies involved in the swap;
- **legal fees** incurred in the preparation of legal documentation relevant for one or more group companies (i.e. other than for the share purchase agreement) could be allocated to the companies which have concluded these agreements;
- **advisory fees** relating to the acquisition and structuring should be borne by the companies that have acquired target companies on the occasion of the structuring. To the extent that the recharging of certain costs to the subsidiaries can be justified on the basis of an economic interest for the group companies of the costs concerned, these costs may be deducted in the hands of the companies bearing the costs.

For corporate buyers, when the funds are being raised by a dedicated treasury centre it could either be allocated to the entities where the funds are being drawn down in a back to back position or taken as an expense by the treasury centre and passed into the financing margin.

Alternative scenarios

If a transaction costs push-down is not possible, there are other options

Costs that cannot be allocated to operational subsidiaries will typically give rise to tax losses in the hands of the holding company, unless they can be offset against taxable income. Therefore, it could be possible to:

- organise management services in the holding company, increasing the level of taxable income; or,
- merge the operating entity into the acquisition vehicle in order to have the transaction costs at operating level. However, this solution presents its own issues from tax and company law perspectives.

D. *Case study: Align your financing structure*

PwC helped a large MNC with the review of its financing and treasury structure, as well as the general allocation of debt, in the various countries in which it operates.

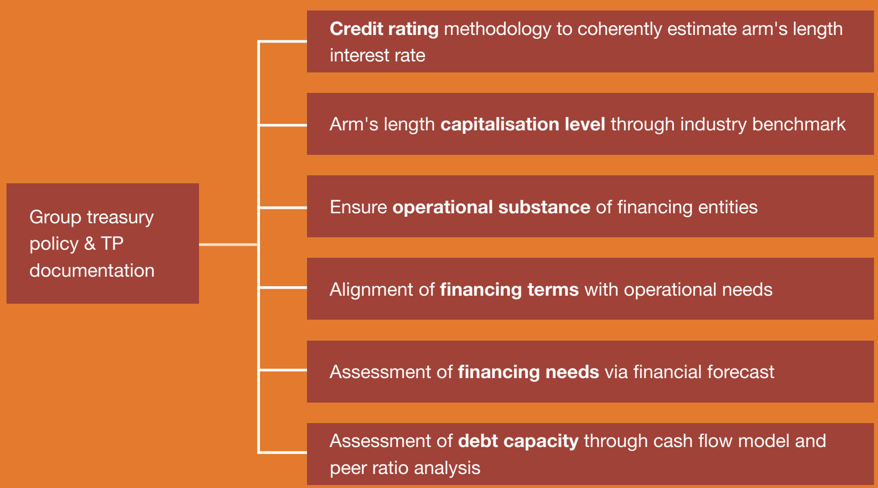
The review involved assessing the strength of the financing structure and mapping the debt and interest deductions at risk, as well as the implementation of a best practice methodology going forward.

The exercise essentially consisted of:

- understanding the effective **financing needs of the key operational entities** including those relating to stable working capital requirements and investment, to align financing levels with operations;
- recommending an arm's length **allocation of financing between debt and equity** based on a benchmark study across the industry;
- analysing the economic **debt capacity** of key entities through a cash flow model and aligning loan terms to their repayment capacity;
- implementing a credit rating methodology enabling an assessment of the **arm's length interest rates** for each entity on a coherent basis going forward;
- making recommendations on the **governance of financing entities** located outside the group's HQ country.

Our assistance resulted in state-of-the-art transfer pricing documentation and a group-wide treasury policy. This helped the group prepare for upcoming tax audits and optimise the efficiency of its funding through effective tax rate improvement and cash efficiency.

Figure 33 **Key aspects of a BEPS compliant treasury policy**



V. *Human resources*

Highlights

- *In-depth due diligence on human resources (HR) related matters is key to identify deal breakers.*
- *A first day focused on continuity is a good start, as is having a playbook outlining future plans.*
- *A new and competitive reward programme post deal is important to retain talent.*
- *The taxation of capital gains depends on the structure of the management incentive.*
- *BEPS may lead to additional costs on reward.*

A. Introduction

An aspect of M&A that is often overlooked is corporate culture. From an HR perspective, merging two corporate cultures might be much harder than first expected. The success of the merger hinges on the employees from both organisations making a smooth transition to the chosen way of working. Disregarding this may lead to serious problems in the integration process. Based on our experience, the absence of "cultural fit" often explains the partial, if not complete, failure of some business combinations.

Successful transactions consider all aspects of a corporation, not just the business, or the potential synergies, but also the often overlooked human factor.

The human factor cannot be handled in a silo. It should be considered through the entire deal process. In this section, we will look at human resources matters through a transaction – from the first discussions until the deal is closed.

We look at differences in reward approaches between corporates and financial buyers, and highlight BEPS' impact over reward practices.

B. HR due diligence

A deal process can be divided in four major stages:

Figure 34 Different HR due diligence stages in a deal process

Pre deal	Pre sign	Pre close	Post deal
• Conduct high level analysis of people, organisation and culture fit • Plan for HR due diligence	• HR DD: identify people related deal risk, costs & savings • Analyse and benchmark key employees' roles, rewards • Review recruitment and turnover issues • Assess employees effective costs • Identify immediate actions post deal	• Secure key talent to retain • Create HR integration plans (e.g. culture, organisation, people, HR processes, HR systems and policies)	• Design and implement new reward programs aligned with the business strategy of the future • Provide support regarding post-deal people issues in terms of motivation, integration, job security/career concerns

Pre-deal analysis

Gaining an understanding of the target company's culture – the way its employees think, act and perform their daily tasks – is a first critical step which should be performed before the deal. The culture or company philosophy goes much further than purely remuneration. It's also about day-to-day interaction and can be difficult to change. If the culture is too deeply ingrained, it might be better to look for a new deal.

Understanding a target's culture is also important for financial buyers. They have less impact on operations but still want strong, dedicated and motivated management teams, supporting their investment strategy, at their portfolio companies.

Pre-sign: HR under the microscope

Once the go-ahead is given to start the deal process, the buyer will usually request a due diligence process. Human resources is a critical part of this process and usually focuses on the following four areas.

Employee demographics and key terms of employment

Both public and private investors need to have a clear view on how many employees there are, where they are located, and whether there are collective bargaining agreements in place.

When putting forward the timeline of a deal, it is important to take into account factors such as the strong union presence in Belgium and the collective bargaining agreements that grant certain rights during mergers and takeovers. Certain material risks regarding key terms of employment (e.g. sham self-employed individuals) should also be identified and discussed early on.

Material compensation and benefit programmes

The compensation packages and benefit programmes for employees, and especially management and executives, must be reviewed as part of HR due diligence.

Are there any liabilities regarding social security, corporate income or wage withholding tax? As the statutes of limitation differ, each risk needs to be evaluated separately so that appropriate indemnification provision can be planned.

It also gives the buyer a chance to get to know the culture of the target a bit better. Are they comfortable with current reward practices? Can the management keep employees motivated?

Management talent assessment

At this time, key individuals within the company should be identified. What is the future of these employees in the new organisation? How motivated are they? Do you believe there is a risk that they might leave after the transaction? Are there any retention or severance agreements in place?

It is also time to look at cost saving opportunities. Can the number of staff be reduced? Is management overpopulated? These are important questions because cost saving opportunities can positively influence the value of the target.

Human resource transaction challenges

Taking the three steps detailed above should facilitate work on a plan to align the processes, systems and policies of the target and acquirer. While detailed plans are generally only tackled after signing or even closing, it is best to identify at due diligence stage the key challenges that you may face.

The challenges will be very different depending on the type of transaction and context.

Figure 35 HR transaction challenges[9]

Standalone

Acquiring a freestanding, standalone company is normally the easiest. The starting point may be that not much will change.

Some key challenges are:

- Get management and employees comfortable with the new ownership through clear communication and change management;
- Set clear goals and objectives post deal for everyone involved;
- Exert financial and operational control post deal.

As value creation can only be achieved by optimising the company's processes, it is key to review the full HR effectiveness and identify opportunities for improvement.

Add-on

Add-on acquisitions are in general the most challenging as the acquirer needs to have a clear picture of how he plans to proceed through integration. This may include:

- Align both organisations;
- Identify and eliminate overlapping management positions after the transition period;
- Implement a common HR platform;
- Align compensation & benefits policies of both organisations.

It is key to find synergies and optimisations to create added value of the add-on acquisition. It is also essential to analyse whether/where the acquired entity may be more efficient from an HR perspective & build on its better practices.

Carve-out

As the carved-out business should be able to operate independently, a freestanding HR structure will need to be implemented.

The challenge may be to set up:

- An in-house operational structure;
- New dedicated HR individuals;
- Relationship with payroll agencies and other external service providers;
- A dedicated compensation and benefit plan.

The allocation of human resources and its organigram should be optimised to reflect the economic reality while limiting the costs as much as possible given that the costs will be taken into consideration when determining the financial value of the entity to be sold.

Pre-close: put it into practice!

HR plays a prominent role in a merger or acquisition process and should be a key element of the signing-to-closing period. The goal is to achieve a smooth closing day, with continuity for the business and the people that work there. In order to reach this goal, HR "day one" tasks need to be identified and addressed prior to closing.

Employees will most likely have questions. They should be provided with adequate information from the start, but not overloaded with it. It is important to carefully consider what should be communicated immediately and what comes later. An analysis of the impact of the changes may help to plan and spread communication over the different stages of the change.

HR professionals are key in M&A integration. While most companies design a playbook, in practice hiccups occur. It will be important to remain calm and composed during the first days and weeks after the deal. Careful planning and clear communication towards all parties involved goes a long way.

9 S. Rimmer and A. SanAndres, *Human Resource due diligence*. The article is available at https://www.pwc.com/us/en/hr-management/assets/pwc-human-resource-due-diligence.pdf

Post-deal: merging two worlds

Reward in transactions is often more complicated than stakeholders believe at first. The reality is that certain benefits granted in the past should be restructured or even cancelled.

Next to job security, one of the key concerns for employees is the impact on their existing equity incentive plans. Following a merger, the company may no longer be listed or the buyer might not want to have trailing equity incentive plans to worry about. Either way, the impact of the transaction on existing equity incentives and the tax treatment of any changes needs to be clarified as soon as possible. A deal stands or falls depending on the motivation of the employees. Making sure their reward package remains attractive is vital.

The next section will guide you further through different reward approaches. Those often greatly differ between public and privately held companies. Public groups tend to use traditional incentives such as stock options or restricted stock units. In private groups, management is often offered "sweet equity", tax optimised incentives.

C. *Make reward in Belgium work for you!*

A fair reward for people's efforts is at the heart of all vibrant organisations. Getting the right balance between employee expectations and costs is a challenge, especially in a rapidly changing tax and legal environment.

Tax efficiency emerges as a key area where businesses could improve, particularly in Belgium, with its high tax and labour costs. Our Belgian reward barometer study[10] indicates that only 15% of employees were highly satisfied with their employer's efforts to optimise the tax efficiency of remuneration.

Is your reward programme effective?

The results of our study are not a surprise. The usual net to cost ratio of a cash bonus is around 30%. This is due to the 50% income tax rate already applying from €38,000 yearly gross pay and to employee and employer social security contributions, which are uncapped and amount to respectively 13.07% and ±30% of gross pay.

The Belgian government took action in the "tax shift" agreement to lower employer social security contributions. Even with the decrease of employer contributions to 25%, the improvement of the net to cost ratio of a cash bonus is expected to be limited to some 2% - leading to only a 32% net to cost ratio.

Figure 36 General contributions in Belgium[11]

Entry into force	General contributions		
	Basic contribution	Special contribution	Total
Current	24.92%	7.48%	32.40%
01/04/2016	22.65%	7.35%	30.00%
01/01/2018	19.88%	5.12%	25.00%

10 2014 Belgian Reward Barometer, the Reward Barometer is an annual study on how financial and non-financial rewards influence employee motivation, an executive summary is available at http://www.pwc.be/en/services/people-organisation/reward/reward-barometer.html

11 It is possible that on top of the total basic contributions, additional contributions are due (contributions to the fund of subsidence, etc.).

In practice, employers struggle to select the right instruments to optimise reward packages from a tax, social security and labour law perspective and to keep the package consistent with the remuneration philosophy and challenges. Our reward barometer study shows that half of all respondents believe that their pay package does not adequately reflect their efforts.

Employers can increase return on reward by evaluating the role of different components in the total reward programme. Certain tax friendly remuneration elements determine the taxable benefit on a lump sum basis, lower than the actual financial value.

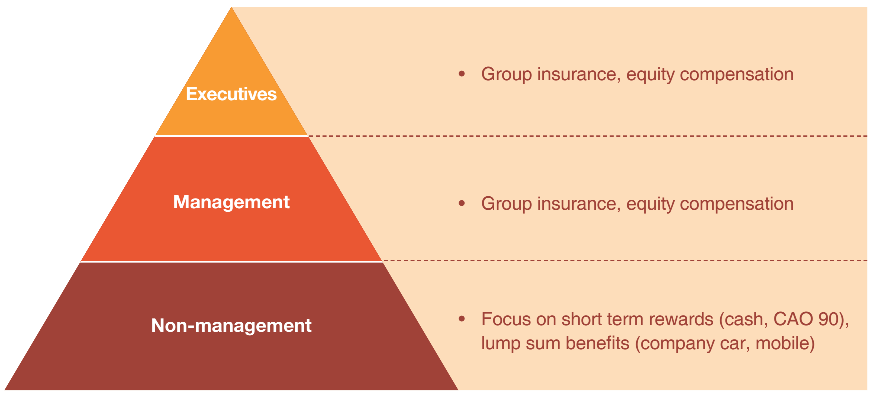
Another option to increase return on reward is to look beyond direct reward to a wider employee value proposition by rebalancing financial and non-financial rewards. Workforce motivation is linked to both financial and non-financial rewards. Both should take your business specificities into account.

In the next sections we will illustrate how business specificities may be different in terms of reward approach for corporations compared to private equity backed companies.

Reward in corporations

Reward can take several forms depending on the level of the individual, but equity incentives in general remain extremely popular for the first and second tiers.

Figure 37 **Reward approach**

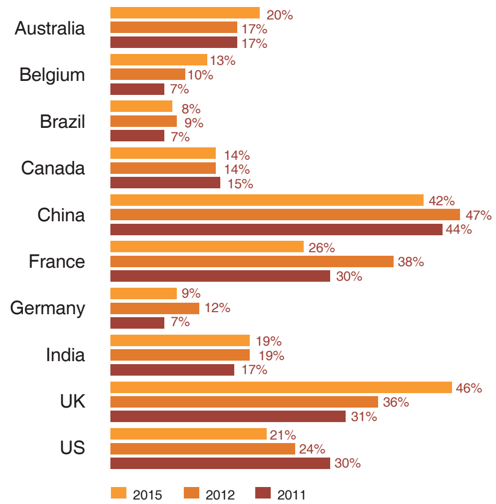


The 2015 Global Equity Incentives Survey[12] indicates that 45% of the non-US grants of equity incentives were meant to align compensation with business strategy. However, since 2012, there is a decline in broad based grants (with the exception of employee stock purchase plans which are usually offered to all employees). While this might be surprising at first, we noticed that the prevalence of performance awards has increased since 2012. It is clear that equity compensation is increasingly used to reward executives and management for their performance instead of being a part of the compensation package for all employees.

12 *2015 Global Equity Incentives Survey,* the Global Equity Incentives Survey is one of the most comprehensive studies on the design and administration of equity incentives compensation plans for multinational companies. An executive summary is available at http://www.pwc.com/us/en/hr-management/publications/2015-global-equity-incentives-survey.html

Comparative analysis may be useful to support discussions on executive remuneation.

Figure 38 **Countries with the most challenging tax compliance**



Source: 2015 Global Equity Incentives Survey: Executive Summary, PwC

The preferred equity instruments will vary depending on the remuneration strategy but local specifics should also be taken into account. As a distinct tax regime may often apply to equity instruments, it is important to seek external advice in the territory of residence of the various beneficiaries. This is not only to understand what tax treatment will apply to the instruments, but also to ensure that the plans are implemented in compliance with local legislation – which our clients find more and more challenging in many European countries, including Belgium[13].

In Belgium, the most frequent equity incentives are stock options, restricted/performance stock units and share purchase plans. While in several countries stock options are taxed at exercise, Belgian law provides for a lump sum taxation at grant under certain conditions. This provides for tax optimisation opportunities, but implies a pre-financing of the tax which remains due in all cases, even where the options are under the water at exercise date. It is important to informing your employees of that risk.

Besides informing the beneficiaries, **managing perception from the public** and corporate stakeholders **is also of a growing importance.** When the economy is sluggish, large bonuses are often criticised. In these times of increased scrutiny, non-executive directors and remuneration committees must act decisively in the field of corporate governance.

Market surveys, analyses based on strategy and performance, and comparative analyses may be useful to support discussions on executive remuneration. They will allow your remuneration committee to have a view as to whether the current or envisaged remuneration policy is appropriate in view of the relative performance of the company as compared to that of its peers. Scenario analyses may also help further fine-tune the policy to calibrate possible pay-outs to different levels of company performance.

13 ibid

Reward in private equity companies

Exit considerations: Capital gains

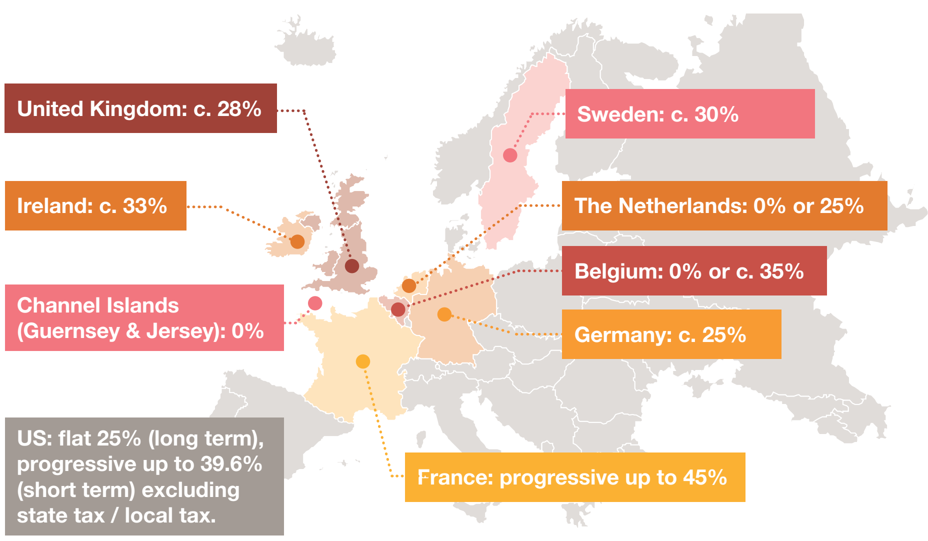
Aligning the financial interests of portfolio company executives and fund managers with those of investors is the most effective way of motivating the executives. Portfolio company executives and fund managers are asked to commit private funds to the transaction equity package. In return, they can expect to receive gains when performance objectives are met.

The challenge in designing or resetting incentive arrangements lies in designing them to support a successful behaviour from portfolio company executives and fund managers at a cost that is acceptable to the other private equity stakeholders. As a result, incentive arrangements need to be tax effective and their financial implications should, from the outset, be understood and agreed by all stakeholders.

In some countries, the compensation of private equity executives and portfolio managers generates a continual debate on whether such incentives should qualify for favourable tax treatment as capital gains/investment income, or be subject to a higher tax charge as earned income. There is clearly a trend to limit the favourable tax treatment with restrictive conditions.

In Belgium, however, there are no specific laws or guidelines addressing the tax treatment of income and capital gains arising from incentive arrangements for fund managers and portfolio company executives. The taxation of these incentive arrangements will essentially depend on the way they are legally designed.

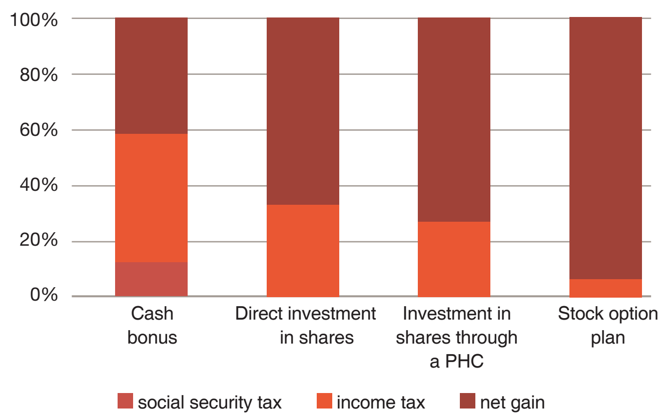
Figure 39 Overview of capital gain tax rates in Europe



Belgian tax charge on an identical return under four different incentive arrangements

The chart below illustrates the Belgian tax treatment of the financial return from four different incentive arrangements (from ineffective to very effective). As you will note, the Belgian tax system allows for sweet equity, tax-optimised incentives for portfolio company managers, which is a competitive advantage for the private equity industry.

Figure 40 Belgian tax charge on an identical return under four different incentive arrangements



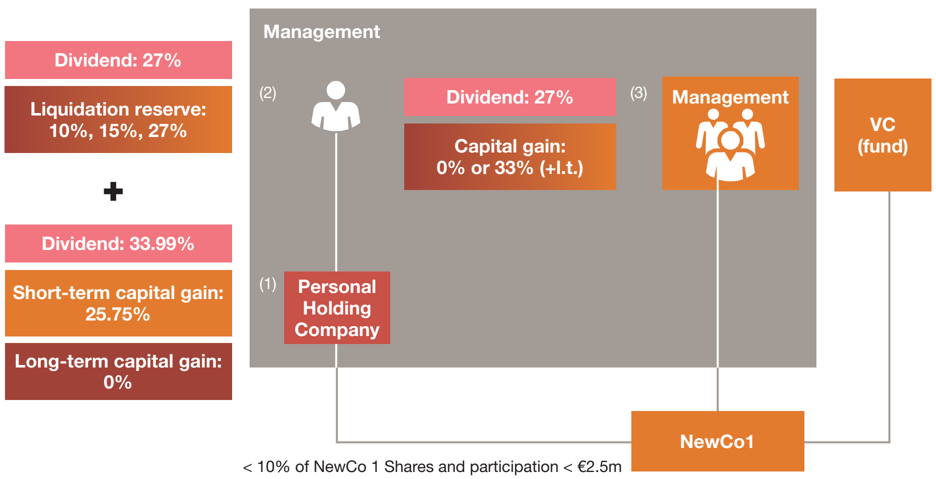
As the chart shows, the structure of an investment arrangement can make a difference from a tax perspective.

Managers may consider two alternatives. They can invest directly or through a Personal Holding Company (PHC).

In normal circumstances, investing through a PHC may allow for a tax free capital gain at exit provided the shares have been held for at least one year. However, when the exit proceeds are expected to be distributed in the form of dividends, these will most probably suffer corporate tax at 34% as the investment threshold is set quite high (10% or €2.5m), which is not really favourable.

The proceeds may not suffer further taxation if the managers decide to keep them in their PHC. Upon distribution as dividend or liquidation proceeds, a 27% withholding tax will apply. If the PHC qualifies as a small company, this rate may be reduced to 15% if the distribution is deferred by five years or to 10% in case of liquidation.

Figure 41 **Taxation at exit**



(1) If the exit proceeds are distributed as a dividend (i.e. the sale occurs below NewCo 1), the dividend is taxed at 33.99% in the PHC (no DBI-deduction available).

If the personal holding company sells its shares of NewCo 1 the capital gain realised will be taxed at either 25.75% in case it concerns a short-term capital gain or 0% in case it is a long-term capital gain.

(2) In case the PHC distributes the proceeds as a mere dividend, the individual will be taxed at 27%.

It could be opted for to create a liquidation reserve (immediate taxation at 10%) and possibly a second taxation upon a future distribution at rate of 5% or 17% depending on the circumstances.

3) If the exit proceeds are distributed as a mere dividend (i.e. the sale occurs below NewCo 1), the dividend is taxed at 27%.

If the manager sells its shares of NewCo 1 the capital gain realised will either not be taxable or be taxed at 33% (+local taxes).

Capital gains on shares realised beyond the scope of the individual's professional activity are taxable (at 33% plus local taxes) as miscellaneous income, unless the investment in shares falls within the scope of the normal management of the individual's private estate. As such, the statement that capital gains from private investment in shares are not taxable in Belgium is, at a first glance, a myth. But this myth becomes reality when the share investment may be regarded as "normal".

There is no specific definition of what is meant by "normal management of a private estate", which allows a wide range of interpretation. The Ruling Commission was asked on several occasions to confirm the tax treatment of capital gains realised from private investments in shares. It has issued guidelines which may help taxpayers identify the need to apply for a ruling decision. In this ruling, the investment could be considered as "normal management of the individual's private estate" when:

- it is common practice in the private equity industry to invite managers and executives to invest in the company so this investment wasn't really an initiative of the managers;
- the amount invested was low compared to the managers' and executives' total estate, so the risk was considered to be limited;
- the holding period of the investment was between three to seven years.

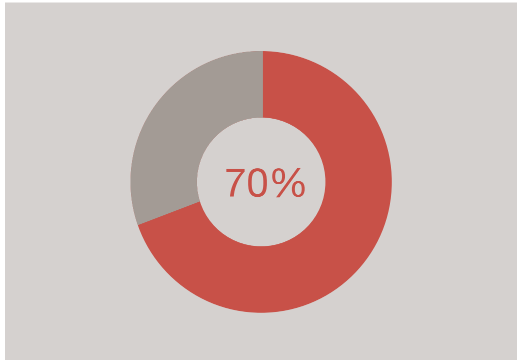
In another ruling, the Commission confirmed that exit profits weren't taxable as miscellaneous income if the investment was held for several years, and there was no external funding needed at the time the managers originally invested.

Structuring an investment via options: Belgium's favourable regime

While share investment is common practice, resorting to stock options may be considered a solid alternative to help incentivise managers. Our "Driving portfolio company performance in a changing private equity environment" survey found that over 70% of incentive plans in US private equity-backed companies are options or profit interests.

Figure 42 **US private equity awards in 2013**

70% of all US private equity awards were in the form of stock options.



Source: "Driving portfolio company performance in a changing private equity environment", 2013, PwC

There's specific legislation in Belgium to tax stock options, at grant, on a lump sum basis, provided the stock options are accepted in writing within 60 days of the offer. The 60th day is when taxes can be levied.

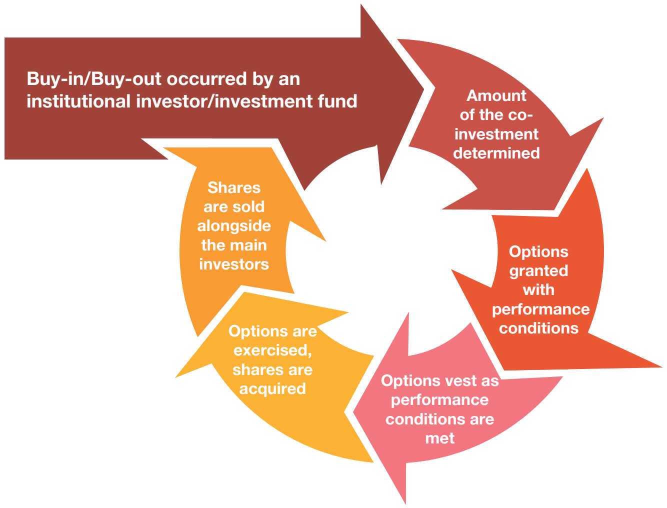
The lump sum valuation is calculated as follows:

- **taxable time value:** 18% of the stock's fair market value at the time of the offer for options that have a maximum life of five years. For options that have a life of more than five years, the value will be increased by 1% for each year or part thereof in addition to the five years. Provided certain conditions are met, the 18% and 1% figures may be reduced by half to 9% and 0.5%;
- **taxable intrinsic value:** the positive difference between the fair market value of the stock at offer date and the exercise price (the discount).

Upon exercise of the option, in principle, no further income tax is due. Upon sale of the shares, no capital gains tax is due if the sale is made within the normal management of the individual's private assets.

Structuring an investment via options may provide additional flexibility as options can include performance conditions and vesting conditions without altering their tax treatment. Moreover, no upfront investment except the tax is required by managers. However, if the options aren't exercised, the income taxes paid at grant cannot be recuperated.

Figure 43 Stock option mechanism



Executive remuneration

Depending on the industry, self-employed directors can be more common

PwC's remuneration surveys for executive and non-executive directors in Belgium provide an extensive overview of the salary packages paid to directors, including base and variable salary, long-term incentive plans, company car, pensions and others.

It is not uncommon in certain industries to organise the professional collaboration of executive management on a self-employed basis. This can reduce the high company social security cost.

Differences in cost and coverage

In practice, this can be organised through the board of directors delegating all its decision making authorities to an executive committee (ExCom). ExCom members can be self-employed.

The company does not have to pay employer social security, which is usually about 30%, for the activities of the self-employed ExCom-member. These are the personal liability of the ExCom-member. In addition, personal social security contributions for the self-employed are capped (income year 2015):

- 22% on net taxable income up to €55k;
- 14.16% on net taxable income between up to €55k and €82k.

As a result, the maximum annual social security contribution amounts to about €16k (plus administrative charges of e.g. 3.05%).

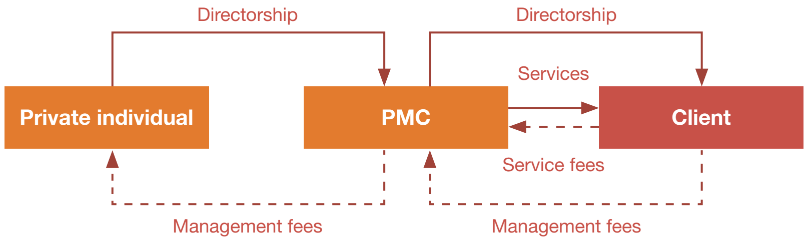
A switch of social security status has an impact on the social security coverage for the individual. However, most differences can be addressed through private supplementary insurance policies or with a slight adjustment of the gross remuneration.

As an alternative to a company mandate, self-employed collaborations can also be exercised by means of a service contract where the service provider renders services to the company.

Why work with a Personal Management Company (PMC)?

A self-employed collaboration can be exercised in person or by means of a personal management company. The term "personal management company" (PMC) not only covers service companies providing management support to third parties but also cases where the management company holds a company mandate. A combination of the two structures is also possible.

Figure 44 Director's fees



In order for a management company to function properly, it is essential that the management company itself and its managing director respect all the legal and operational consequences of the structure that was chosen to operate in. Compliance with all formal (reporting) obligations imposed by Belgian corporate, accounting and tax law is therefore crucial.

As illustrated in the figure below, working by means of a PMC has certain advantages/ benefits.

Figure 45 PMC pros and cons

Pros	Cons
• Lower corporate income tax rate (34%) vs. high progressive personal income tax rates (c. 50% to be further increased with communal taxes) • Greater flexibility in the distribution of the profits • Greater deductibility of professional expenses	• No 'automatic' pension plan • Participation in some foreign incentive plans might be harder • Additional administrative costs (start-up costs, accountant fees, etc.)

Based upon our experience, it is generally possible to optimise an individual's overall net disposable income by means of a PMC.

Figure 46 Why work with a PMC?

In this table we compare the benefit of working as an employee (salaried), a self-employed or through a ManCo in terms of net revenues for an individual married to a spouse who has her own professional income, living with their two dependent children (aged more than 3 years old). We have assumed communal tax of 7.5% and a total cost for the employer of €250,000.

	Employee	Self-employed	PMC
Total cost for the employer	**250,000**	**250,000**	**250,000**
Min: Employer's social security contributions (c. 30%)	55,000	-	-
Gross remuneration	**195,000**	**250,000**	**100,000**
Min: Personal contribution soc. sec. employee/self-employed	-25,000	-17,000	-16,000
Min: Belgian income taxes	-81,000	-116,000	-36,000
Min: Special social security contribution	-1,000	-	-
Net Remuneration	**88,000**	**117,000**	**48,000**
Invoiced revenue of the PMC			250,000
Min: Operational expenses			-3,000
Min: Remuneration paid to company director			-100,000
Taxable basis corporate tax			147,000
Min: Belgian corporate income tax (34%)			-50,000
Available for dividend distribution			97,000
Min: WHT on dividend (27%)			-26,000
Net dividend			**71,000**
Total net 'in the hands' of the employee	88,000	117,000	119,000

Equity incentive plans

Transactions have a significant and often unwanted influence on longer term equity incentive plans.

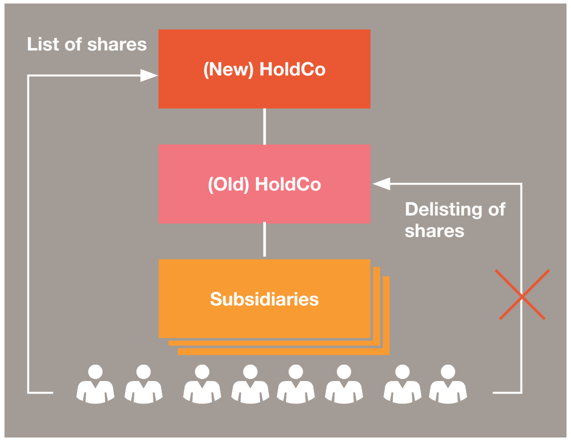
When taxation arises upon receipt of the benefit, changes to the equity incentive plan often do not have a significant impact. However, Belgium provides for a special legislation under which stock options can be taxed at grant, where modifications are, in principle, considered to be a new grant. These modifications are quite often mandatory (e.g. the underlying share is no longer listed) in the context of the transaction, or out of the control of the beneficiary (e.g. cash cancellation in a change of control provision). To avoid negative tax consequences, companies can seek a ruling to confirm that the modifications do not constitute a new offer of options.

Illustration:

Options are granted to Belgian employees. The share underlying the options is the listed share of Old HoldCo. Following a corporate restructuring, New HoldCo is placed on top of the current Old HoldCo. New HoldCo becomes listed. Following a buy-out and squeeze out process Old HoldCo shares are delisted.

In order to avoid the beneficiaries to be stuck with options on non-liquid Old HoldCo shares, the underlying shares are modified to listed New HoldCo shares. The Belgian Ruling Commission confirmed that this change did not constitute a new grant. It is important to note however that a ruling is only binding between the requesting party and the tax authorities and under specific facts. As such, it is common practice to request a ruling in this kind of scenario.

Figure 47 Process of (de)listing of shares



D. HR matters and BEPS

A number of the BEPS Actions will impact on how organisations manage and report on their globally mobile workforce, and more generally on their operations abroad.

Let's explore what the BEPS Actions mean for the global mobility of the workforce.

Figure 48 Global mobility - BEPS impact

Permanent establishment	• Mobile workforce may increase the risk of taxable presence. • Potential increase of compliance requirements to be fulfilled by the assignees and PE.
TP for international assignments	• Intercompany service fees need to reflect the arm's length value of services performed by mobile employees. • Costs of mobile employees should be allocated to the appropriate entities. • Transfer of assembled workforce should also be remunerated at arm's length and can generate and exit tax.
Intellectual property	• Transfer of employees with specific skills of knowledge may lead to transfer of IP.
Transparency and disclosure	• The exact number of employees will have to be disclosed in the CbCR, which will require new tools to trace mobile emplyees.

Failure to manage the PE risk associated with globally mobile employees may result in significant penalties for non-compliance.

Permanent establishment

Employee related permanent establishment (PE) issues have existed prior to BEPS and are, as such, not a new matter. As a result of the BEPS Action Plan, however, we expect that tax authorities worldwide will increase their efforts in identifying PEs in order to be able to better allocate profit to them.

Failure to appropriately manage the PE risk associated with globally mobile employees may result in additional reporting requirements, withholding requirements, corporate tax filing, individual income tax filing, etc. As penalties for non-compliance are significant, it is key for companies to get a detailed view on mobile employees to address potential risks.

Conducting a business has changed substantially over the years. BEPS proposes a new interpretation for having a PE, which includes both a widening of the dependant agent test and a narrowing of the independent agent exemption. The approach is now such that:

- the scope of the dependant agent PE would apply to persons regardless who employs them who habitually (i) accepts an offer made by a third party on behalf of an overseas enterprise, or (ii) negotiate all the elements and details of a contracts event if the contract is signed outside that territory, or (iii) solicits and receives orders which are concluded by an overseas company;
- the independent agent exemption would not be applicable where the persons acts exclusively or almost exclusively for one or more enterprises that are closely related.

This could mean that an activity that did not give rise to a PE may be now considered as an element of the core business and lead to the existence of a PE for tax purposes, and subsequent attribution of profits to that PE.

Expansions into a new territory may lead to the existence of a PE much faster than before. The authorities' focus will move from looking at contractual arrangements to understanding what people are doing in practice. For example, in a sales process, this means that it will be important to consider, not only where a contract is signed, but also where and by whom the client was convinced to enter into it. The impact on the fund management industry is in this respect dramatic because this can impact the work carried out by advisory teams conducting due diligence and acquisitions locally (see also funds section).

This will introduce a significant amount of subjectivity, increasing the possibility of disputes with and between tax authorities. In order to manage their PE exposure, multinationals with a globally mobile workforce should set up and implement systematic controls and processes to track and analyse where their workforce is, what it is doing, and over what time period. The data collected through such processes could prove useful for country-by-country reporting.

A transfer of an assembled workforce may lead to an exit tax.

What actions should you take to limit PE risks?

- Review the **role played by global and regional employees** as well as senior executives in the conclusion of contracts and determine for whom they are concluding contracts and which country is bearing the risk and reward for it.
- Establish a mechanism to **track business travellers**, including changes to travel patterns and activities, to flag when and where individuals may be creating a PE risk.
- Consider building a **pre-travel assessment** to identify risks for sales workforce activities and presence in overseas territories.
- Review existing **corporate structures** (e.g. global/regional employment companies) to ensure that they are still compliant under BEPS.
- Review **inter-company agreements** in relation to the various types of mobile employees to determine in particular whether they reflect accurately the relationship between the **movements of intellectual property**. These agreements may include subcontracts as well as secondment agreements.
- Consider whether **current employment structures** for mobile employees, such as secondments in particular jurisdictions, may create a PE risk or be considered a transfer of assembled workforce and should still be used.

Transfer pricing for international assignments

Transfer pricing arrangements need frequent review especially if they systematically involve all mobile employees. Some of these pricing arrangements might no longer be appropriate under BEPS. Economic reality should be reflected in the pricing arrangements and the actual transaction should be properly delineated.

Inter-company service fees need to reflect the arm's length value of the services which are provided by mobile employees. With respect to services, a distinction should be made between the high value-added services of mobile employees and low value-added services[14]. For high value services, the fees should take into account the value drivers of rendering the service and an arm's length profit element, including possibly the contributions of the mobile employees. The group may opt for a simplified approach for low value services. In such cases, the costs in relation to the mobile employees, among other costs, need to be considered in the cost pools and shared out to the service recipients with a mark-up of 5% and based on an appropriate allocation key.

Assembled workforce

A uniquely qualified or experienced (group of) employee(s) may constitute a so-called "assembled workforce" and imply a transfer of intellectual property/value when transferred abroad. This should not be ignored in the framework of secondments or internal transfers. In some restructurings or transactions, an assembled workforce can add value when assets of the business or an ongoing concern are transferred, resulting in an exit tax cost.

Contractual engagements with the workforce can prove to be valuable and should be considered alongside other assets. It could be appropriate to reflect the time and expense savings obtained by the buyer/transferee/beneficiary and the time loss or additional costs incurred by the seller/transferor/granter (e.g. in terms of training the new staff). Under the BEPS Action Plan, the transfer of the assembled workforce is a key element to analyse in a corporate restructuring.

14 As defined under the revised Chapter VII of the OECD Transfer Pricing Guidelines on intra-group services.

Intellectual Property (IP)

The Belgian industry often has a high number of skilled employees with specific knowledge and expertise. **When such employees are moved between corporate entities**, it may be that part of the expertise and **knowledge they gained in one entity is transferred to the other entity.** In other words, there is a transfer of IP, such as know-how or other intangibles such as customer or client goodwill.

One example is where an employee – for example a high-level researcher - is seconded or transferred from one corporate entity to another. It is logical that the employee will also apply his or her specific knowledge and expertise during his or her secondment. The following questions, among others, may arise. Should there be a separate re-charge agreement for the secondment or transfer of the employee? Does the service fee cover the secondment in which case no separate fee for the secondment may be charged? Has the IP been transferred and if so has it been appropriately remunerated? Another question may be linked to the value of the contractual arrangements with the seconded or transferred employee and whether it should be remunerated separately.

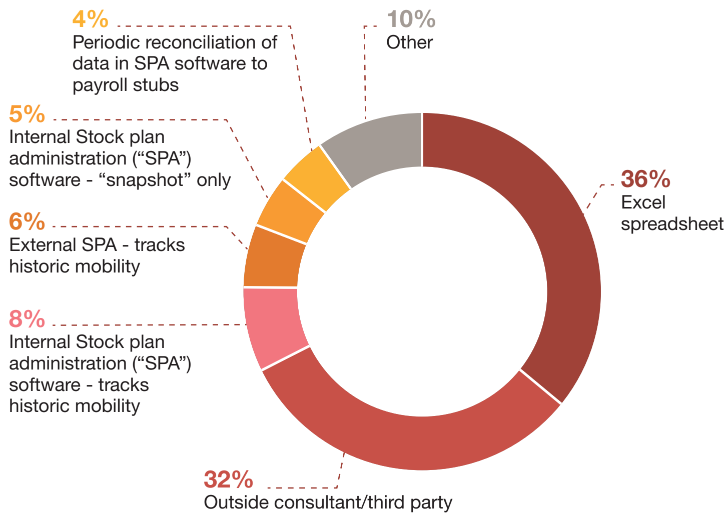
Transparency and disclosure

Large companies (with consolidated revenues exceeding €750m) will have to report in their country-by-country reporting the exact number of employees working in their different business units (including permanent establishments) across the world. The BEPS report on Action 13 does not provide any specific guidance on seconded employees, but it can be reasonably assumed that seconded personnel should be reported in the tax jurisdiction of their employer.

The increased reporting requirements will make it easier to **map all the mobile employees** across the world. However, corporates will need new tools to facilitate compliance work. It is expected that this new reporting will require a severe overhaul of HR IT. Some surveys reveal that 36% of the surveyed companies keep track of mobile employees who received equity in Excel spreadsheets.

Corporates will need new tools to facilitate compliance work.

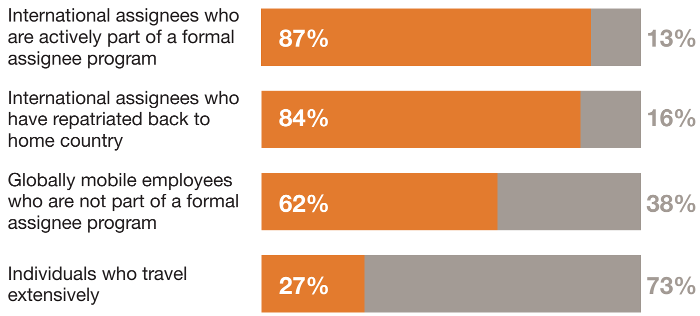
Figure 49 **Tracking methods of expatriates/cross-border employees movements from grant through settlement date of awards**



Source: 2015 Global Equity Incentives Survey: Executive Summary, PwC

Recent surveys show that most companies do not properly keep track, or only selectively, of their mobile employees. Of the surveyed companies in the 2015 PwC Global Equity Incentives Survey, 87% stated that they actively track employees who are part of a formal assignee program. But this statistic drops down to a worrying 62% once the scope also includes mobile employees who are not part of a formal assignee program, and only 27% when it concerns individuals who travel extensively.

Figure 50 **Companies tracking the movement of internationally mobile employees**



Source: 2015 Global Equity Incentives Survey: Executive Summary, PwC

Companies will have to map their employees worldwide.

As a result of the increased reporting requirements, companies will be able to better map their employees worldwide and be more compliant for transfer pricing purposes. They will be able to better allocate their costs across their global value chain, including costs relating to reward policies.

Increased transparency also means that the companies with a globally active workforce and operations abroad will be confronted with a higher risk of permanent establishment exposure. Tax authorities in foreign jurisdictions will have access to the information included in the country-by-country reporting files.

Reward policies

To be BEPS compliant, all the **costs relating to a bonus should be allocated to the entity employing the individual** receiving the bonus. This could have an impact on the structure of certain reward policies.

For example, in Belgium, the contributions are not capped and the applicable social security tax rates are high. Under certain conditions, benefits can be granted without a social security contribution being due. Since the rule in Belgium is that no social security is due where the pay-out is not borne by the Belgian employing entity, the costs relating to bonuses are not always allocated to the Belgian employing entity, but to foreign entities. This is not in line with the BEPS approach.

Taking this into account, the reward policies implemented by some companies may be at risk. This should be considered when measuring the effectiveness of a reward policy and the cost of it at the moment of a transaction.

E. Case Study: Management Investment Plan

We recently assisted a management team involved in a secondary buy-out. The transaction was carried out through a very competitive auction process, involving several potential corporate and financial buyers.

As the management team was involved in the first buy-out they were part of the negotiations as equity owners in the secondary buy-out. Their investment significantly increased in value and the buyers involved were looking for a roll-over of their investment into the new transaction.

Our client asked us to assist them in designing a competitive Management Investment Plan (MIP).

1. Upper-tier structuring terms

The total amount of funds needed to acquire the group amounted to €556.3m.

Figure 51 Simplified US table

Uses	in €m	Sources	in €m
Purchase of Equity	500,0	Total shareholder investment	156,3
o.w.: *Enterprise value*	*552,5*	o.w.: *Investor*	*150,9*
Net debt (or debt-likes)	*- 100,0*	*Management - existing*	*5,0*
Net cash (or cash-likes)	*49,9*	*Management - new*	*0,4*
Misc. leakages	*- 2,4*		
Refinancing existing NFD	50,1	Net finanial debt	400,0
Transaction costs	6,2	o.w.: *Senior debt*	*200,0*
		Junior debt	*100,0*
		Mezzanine debt	*100,0*
Total uses	556,3	Total sources	556,3

The total purchase price of the target group amounted to €500m. The initial MIP set-up at the time of the first buy-out (in 2011) amounted to €1m and represented a total amount of €10m at exit (Money Multiple of 10).

As part of the secondary buy-out, the management team was asked to reinvest (roll-over) at least between 35% and 55% (total roll-over of 50 %) of their MIP proceeds into the new MIP, i.e. about €5m.

The CEO of the group (€2.2m), the CFO (€1.93m) and the IT (€0.35m), HR (€0.35m) and legal manager (€0.18m) would all re-invest in the new MIP. Along with the existing management, the MIP also foresaw the possibility for other managers to sign-up. Two new managers would invest at closing for an amount of €50,000 each, and a reserve for additional managers of €300,000 was also provided.

The investment structure of the secondary buy-out was structured through the incorporation of a newly set-up investment vehicle (SPV) in which both the investor and management would participate. About 10% of the total shareholders' investment was done via ordinary shares (equity). 15% of the shares were reserved for the sweet, the additional ordinary shares allocated to management in addition to their pari passu investment. This investment, the so-called "strip", was made with the investor in ordinary shares, preference shares and shareholder loan.

Figure 52 Capitalisation table

Investment structure	Investors	Management			Total	%Mgt	%Investors
	Instit strip	Sweet equity	Instit strip	Total			
Ordinary shares (excl. sweet)	€13,277m	€0,264m		€,264m	€13,277m	1,99%	100,00%
Ordinary shares (sweet)			€2,296m	€2,296m	€2,296m	100,00%	0,00%
Ratchet shares			€0,047m	€0,047m	€0,047m	100,00%	0,00%
Preference shares	€61,239m	€1,241m	-	€1,241m	€62,480m	1,99%	98,01%
Shareholder loan	€76,548m	€1,552m	-	€1,552m	€78,100m	1,99%	98,01%
Total	**€151,064m**	**€3,057m**	**€2,343m**	**€5,400m**	**€156,200m**	**3,46%**	**96,71%**
Total Ordinary Shares	€13,277m	€0,264m	€2,296m	€2,560m	€15,837m	16,16%	83,84%

Based on the above investment structure, the SPV was capitalised by contributions in cash in exchange for ordinary shares (€15.62m) and/or senior preference shares (€62.48m) and a shareholder loan (€78.1m) granted by the investor. The terms of the strip coupon were 8.5% for the preference shares and 11% for the shareholder loan.

Ratchets, structured as junior preferred shares or performance warrants, were considered as part of the MIP. The ratchet is a type of performance share with access to 10% of the return realised by the investor exceeding a MoM of x2.

Figure 53 Detailed overview of shareholders' investment

Shareholder		OS	Pref / strip	Sweet	Ratchet	Total equity	Total Invest.	Envy
Investor	Investor	€13,01m	€137,79	-	-	€13,01m	€150,80m	x1,0
CEO	Mgt - Individual	€0,11m	€1,14m	€0,94m	€19,09k	€1,06m	€2,20m	x5,5
CFO	Mgt - Individual	€0,09m	€1,00m	€0,82m	€16,70k	€0,93m	€1,93m	x5,5
Manager IT	Mgt - Individual	€0,02m	€0,18m	€0,15m	€3,04k	€0,17m	€0,35m	x5,5
Manager HR	Mgt - Individual	€0,02m	€0,18m	€0,15m	€3,04k	€0,17m	€0,35m	x5,5
Manager Legal	Mgt - Individual	€0,01m	€0,09m	€0,07m	€1,52k	€0,08m	€0,18m	x5,5
Manager - New I	Mgt - Individual	€0,002m	€0,03m	€0,02m	€0,43k	€0,02m	€0,05m	x5,5
Manager - New II	Mgt - Individual	€0,002m	€0,03m	€0,02m	€0,43k	€0,02m	€0,05m	x5,5
Unallocated MIP	Mgt - Individual	€0,01m	€0,16m	€0,13m	€2,60k	€0,14m	€0,30m	x5,5
Total Shareholders		**€13,28m**	**€140,58m**	**€2,30m**	**€46,86k**	**€15,62m**	**€156,20m**	
Total Management Shareholders		**€0,26m**	**€2,79m**	**€2,30m**	**€46,86k**	**€2,61m**	**€5,40m**	**x5,5**

The MIP terms were designed taking into account the following market parameters in a medium-sized transaction:

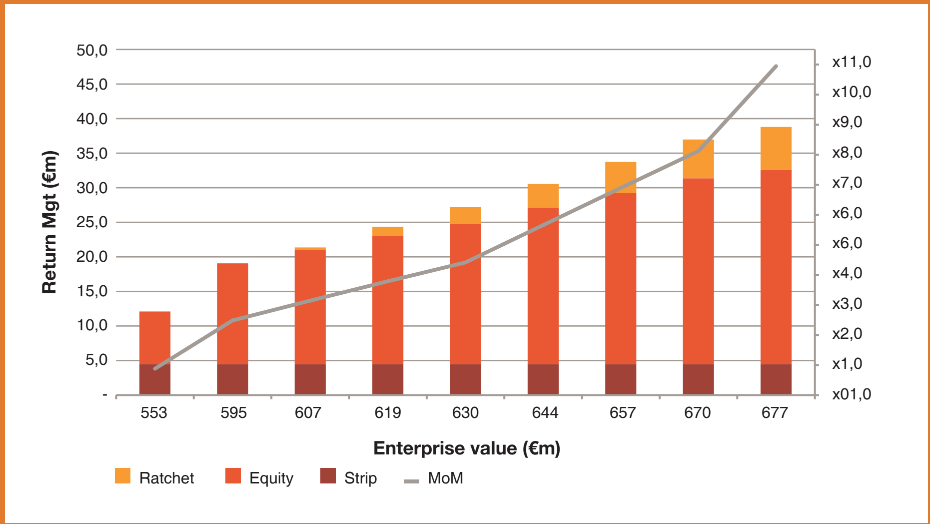
- a **roll-over between 25% and 50%** is normally required for managers-shareholders in mid-sized secondary buy-outs;
- **ordinary shares** usually represent about **10% of the total funds** contributed by the financial sponsor and management;
- **managers** are usually eligible for **10% up to 20% of ordinary shares** (ordinary shares pari passu with the investor and additional ordinary shares), while the **total investment** of managers usually represents **between 1% and 2% of the entire strip**. The exact allocation will usually depend on the chosen envy ratio in a particular case (see case study in appendix for further information). The envy ratio usually ranges between three and ten, but could be as high as 25;
- in smaller transactions, management usually does not participate in the strip. However, a participation to the strip pari passu with the investor (especially in larger transactions) is normally required;
- **preference shares** are favoured over shareholder loans in the hands of management as they **could qualify for the capital gain tax exemption upon exit**;
- the **coupon of preference shares or shareholder loans should be set at market rates**. Usually, the coupon ranges between 8%-10%, sometimes reaching up to 15%. In order to present a competitive MIP, one could consider lowering the fixed coupon yield. However, if the coupon yield is too low, this would lead to a value leakage into the ordinary shares in which management holds a stake, potentially leading to a negative tax impact (e.g. taxation of difference as professional income in the hands of management). It is crucial to ensure that the yield is at arm's length and to ensure that the subscription price of the ordinary shares represent its fair market value. A valuation report in this respect is key;
- several non-financial terms were also discussed, such as good and bad leaver provisions, vesting, warranties attached to the budget plan, funding of the new management participation, management aggregation vehicle set-up, restrictions to transfer and drag/tag along clauses, fees and investor funded expenses of the MIP set-up.

2. Exit waterfall

In order to estimate the potential return on investment, an exit waterfall was prepared in line with the business plan of the target. This was to test the financial position of the management at exit, based on the existing (conservative) business plan and taking into account the upper-tier financing structuring, obtaining a better understanding of the potential Money Multiple at exit. The graph on the next page illustrates the value creation of the MIP, as the residual value, after repayment of the external debt and strip, is allocated to the ordinary shares and sweet equity.

Figure 54 **Exit waterfall**

Example - Exit after 5 years - Mgt return



Our assistance allowed the client to remain very competitive in the bidding process, finally convincing the shareholders and current managers to accept their offer.

VI. Fund structuring

Highlights

- *While it initially targeted the practices of multinational companies, BEPS will severally impact private equity fund structures.*
- *Offshore structures are being scrutinised on substance, and there is a trend towards increasing onshore presence.*
- *The permanent establishment risk attached to local advisory activities is on the rise.*
- *States increasingly tend to consider carried interest to be employment income.*
- *Fund managers are facing more stringent local tax and regulatory requirements, while they operate in a globalised and changing environment.*

A. Introduction

The investment fund industry plays a central role in the modern investment landscape and has recovered quickly from the 2008 financial crisis.

One of the most important decision-making factors that an asset manager (General Partner - GP) considers in the setting up of a fund is to ensure that the investment structure is tax neutral for its investor (Limited Partners - LPs) and provides the most reliable regulatory framework. The complexity of setting-up international investment vehicles - pooling several classes of assets and investors - led to the setting up of offshore funds. Those funds were typically not subject to tax but of course portfolio companies and investors were subject to tax in their home jurisdiction.

The BEPS Action Plan and increased regulation on the finance industry will fundamentally change the way asset managers operate. While BEPS was initially aimed at imposing wider transparency over the tax affairs of MNCs, it will have an even more dramatic impact on the financial services and fund industry. Think about the new approach regarding substance, not only for the funds and managers but also the portfolio entities. Think about the new rules impacting double tax treaty benefit, hybrid financing, permanent establishment and country-by-country reporting.

Those changes will deeply impact the way in which governments and most institutional LPs will deal with GPs and their asset managers when negotiating future fundraising. In this section we look at how the fund industry, and in particular the private equity industry, operates and the key challenges the industry will face in the coming years.

B. The fund industry

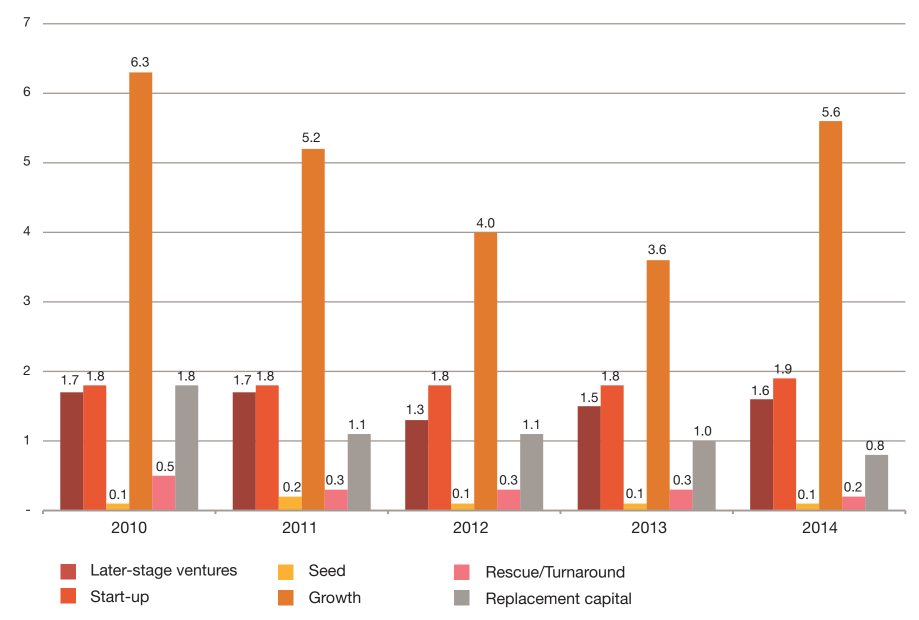
Fund investments are increasingly globalised. As a result, managers have to adapt to numerous local regulatory and tax environments.

The fund industry is an important way to pool finance from the different investors on the market, which do not typically back privately held companies because they lack the expertise or resources to structure and manage the investment. The investors could be institutions, pension funds, high net worth individuals (HNWI), or sovereign wealth funds (SWFs). Some institutional investors are big enough to create their own diversified private equity investment portfolios. Others will invest in funds of funds to get more diversity in their portfolio. Investment funds therefore contribute to the vitality of the financial markets as a whole.

Investment funds differentiate from one another based on the asset classes (such as credit, bonds, asset backed securities, private equity, etc.), the development stage (seed, venture, growth, buy-outs) or are dedicated to certain types of investors, such as regional funds, SWFs or HNWIs.

The figure on the next page illustrates the different development stages of investments which correspond in turn to different types of funds.

Figure 55 **Maturity stages of investments**



Invest Europe, 2014 European private equity activity: Statistics on fundraising, investments & divestments, 2015, available at http://www.investeurope.eu/media/385581/2014-european-private-equity-activity-final-v2.pdf, p. 32.

The fund industry has also become highly specialised with players focusing on specific geographic markets, market segments and development stages.

C. Evolution of the industry

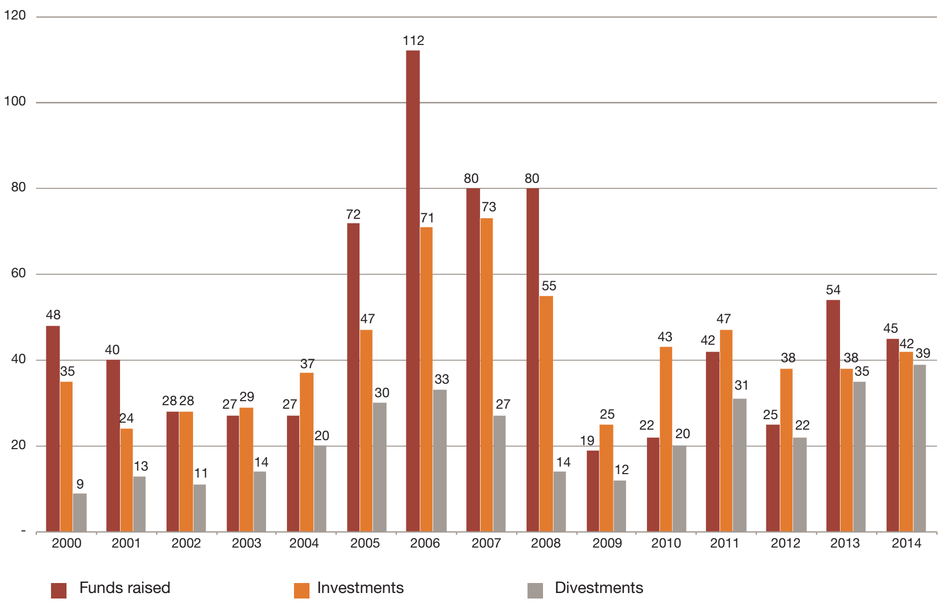
The private equity industry's performance is typically measured over the number and size of buy-out acquisitions.

Post-crisis financial activity was fuelled by substantial refinancing because acquisitions before 2008 were highly leveraged. De-gearing has now reached a sustainable level and **acquisitions are now carried out with a much more conservative loan-to-value ratio.** Refinancing risk, once referred to as the wall of debt, has been mostly resolved.

Since 2010, private equity has noticeably picked up and fundraising has significantly increased. €44.6bn was raised in Europe last year, which constitutes the second highest level in the last five years.

Investments in European companies increased by 14% to reach €41.5bn and divestments reached an all-time high at €37.8bn.

Figure 56 **Industry statistics 2000 - 2014**



Invest Europe, 2014 European private equity activity: Statistics on fundraising, investments & divestments, 2015, available at http://www.investeurope.eu/media/385581/2014-european-private-equity-activity-final-v2.pdf, p. 4.

At global level, the value of buy-out backed exits has reached an all-time high since 1995. Dry powder has also reached global record levels. In terms of investment, the current situation is affected by the scarcity of good investments and pricing concerns.

D. Investment structure

CIV vs. Non CIVs

From a tax perspective, the funds can be classified as either Collective Investment Vehicles (CIVs) or non-CIVs.

CIVs are regulated and widely held funds such as pension funds, for which specific measures have been foreseen to facilitate double tax treaty (DTT) access. Non-CIVs are mostly closely held and unregulated funds, such as private equity, hedge funds or trusts, for which no specific measure has been foreseen with regards to DTT access. Non-CIVs therefore often set up master HoldCos which can benefit from DTTs in order to benefit from withholding tax exemptions locally.

GP-LP structure

A private equity fund is based on a co-investment between a GP (the private equity house that manages the fund) and LPs, which are typically institutional investors (pension funds, SWF or HNWI). The LPs provide capital to the GP, for a limited number of years (typically eight to 12 years maximum) depending on the type of market being invested in. They mostly play a passive role.

Current trends

Private equity funds enter into an investment to create value and optimise the entries and exits of companies. Being highly specialised (according to geographic market, market segments, development stages, etc.) helps maximise the value creation process. They also realise more and more built-on deals, where a new deal arises from an existing deal, and joint venture deals with other private equity funds. Exits are realised either by trade sales or IPOs.

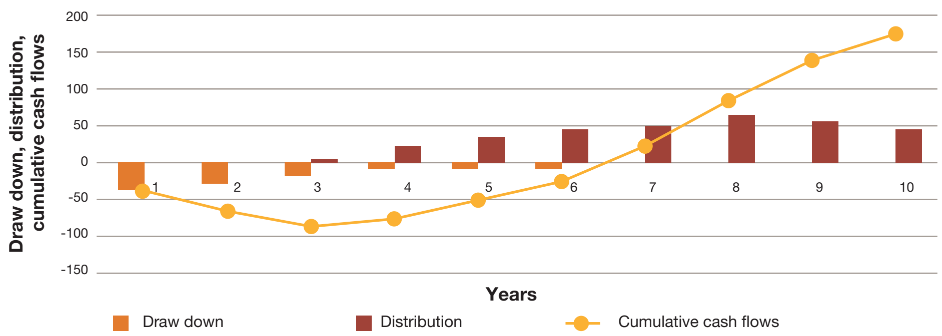
The previously passive role of LPs as co-investors has recently shifted towards more active involvement on the deal market. This is noticeable by the increasing trend of LPs to directly invest alongside GPs in private equity (co-investments), and their more active role in monitoring GPs' performance.

Typical investment structures

Investors normally support fundraising from the outset, but capital commitment is only drawn down when needed to make investments. This minimises the time during which a fund holds non-invested cash, which penalises its internal rate of return (IRR).

The draw-down mechanism, cost of maintaining funds, management fees and running expenses mean that, in the first few years, a fund may have a negative return, as illustrated in the figure below.

Figure 57 **Typical fund's annual cash flow**



Once a fund harvests its investments, it can start distributing proceeds to its investors. Proceeds should usually be immediately distributed to the LPs as the capital may only be invested once during the life of a fund (reinvestment provisions are only allowed in early exits). Draw-downs and distributions are evaluated following a "J" curve, as illustrated above.

Draw-downs are organised by way of LP loan commitments, where the LPs and GPs contribute to a fund's capital. Own investment by GPs can help reassure LPs that both parties' interests are in line with what is perceived as a risky asset class.

GPs have an interest in investing as their limited contribution entitles them to share in the large profits available after repayment of hurdle interest on investors' loans (see carried interest below).

The figure below shows how the fund manager and investor can partake in a fund.

Figure 58 IRR structure

Source	Capital	Capital	Capital
Fund ratios	10.00%	90.00%	100.00%
Investor Loans & Equity	€8m (80%)	€90m	€98m
Carried Interestholders (equity)	€2m (20%)	0	€2m
	€10m	€90m	€100m

Note: holders of carried interest become entitled to 20% of the fund after repayment of the investors' loans and achievement of the preference return. The investors' and fund manager's capital contributions are made on a pro rata basis.

Fund management

Fund management can be organised either internally by employing a fund manager or by a separate management entity that provides services to the fund. The management company is remunerated through management fees, which usually amount to 2.5% of investors' initial commitment.

Carried interest

In addition to management fees, the management company or individual managers and the sponsor are usually entitled to carried interest; an interest in the fund's profits, typically up to 20%. Carried interest often only takes effect once all investors have been repaid their investment coupled with, in many cases, a hurdle corresponding to a basic return on their investment.

Fund structuring: Partnership structure vs. holding structure

Private equity investment structures are often highly complex. In Anglo-American practice, most funds are managed under a partnership agreement concluded between venture capital or private equity houses (GPs) and large institutional investors (LPs). The typical continental European model of fund structuring involves either an onshore collective investment vehicle, such as a Luxembourg Specialised Investment Fund or a Dutch Cooperative, or more exceptionally a holding company which is funded by the private equity house and institutional investors.

Basically, a fund can be created as a collective investment vehicle (such as a partnership), which can be either tax-transparent or benefit from a favourable tax treatment on income derived from securities, or as a holding company subject to standard corporate income tax with participation exemption. Many fund structures also involve the creation of a partnership-type vehicle which in turns incorporates master holding companies that hold the investments.

Holding structure

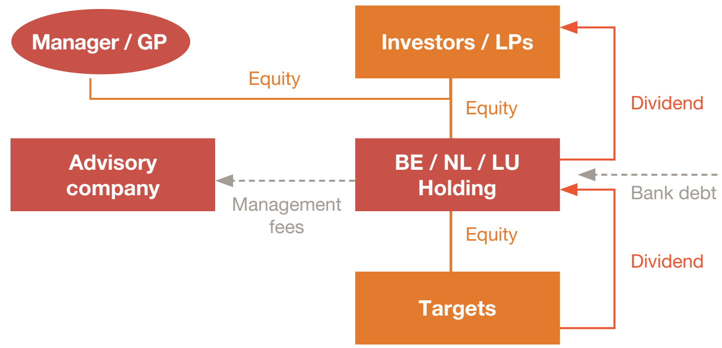
A holding structure is typically used in situations where the investment base and investors are limited and the fund is not open for retail.

The holding vehicle is subject to the standard corporate income tax regime, but usually benefits from a participation exemption on the dividend income received from targets, subject to holding and taxation conditions. In Belgium, the participation exemption regime provides a 95% exemption of dividends received, whereas the Netherlands and Luxembourg provide for a 100% exemption of dividends received.

Dividends distributed by the holding vehicle benefit from withholding tax (WHT) exemptions/reductions under the Parent-Subsidiary Directive or double tax treaties, subject to holding conditions.

Owing to the favourable Belgian participation exemption regime and reduced regulatory constraints, most private investors use companies incorporated in Belgium as a vehicle for their private equity investment (usually incorporated as a partnership limited by shares).

Figure 59 Holding structure



The table below summarises the most important features of the holding regimes in Belgium, the Netherlands, Luxembourg and the UK.

Figure 60 Holding regimes in Belgium, Luxembourg, the Netherlands and the UK

Holding	BELGIUM	LUXEMBOURG	NETHERLANDS	UK
GENERAL				
Tax rate	33.99% (33% plus 3% crisis tax)	29.22%	25.5% (Financing income: 5%)	20% (standard rate)
Capital duty	Nil	Nil	Nil	0.5% stamp duty on the consideration paid upon share transfer Exemption for intra-group transfers of shares
OUTBOUND INCOME				
Statutory dividend withholding tax rate	27%	15% (no withholding tax on liquidation proceeds or share redemptions (under certain conditions))	15%	No WHT on dividends is levied in the UK
Withholding tax on dividend paid to foreign individuals	27%	15%	15%	No WHT on dividends is levied in the UK
Withholding tax on dividend paid to Investors – companies	Exemption if: • Holding of min 10% ≥ 1 year; • Parent company is tax resident in a DTT country with qualifying exchange of information clause; Reductions/exemptions available based on DTTs.	Possible reduction/ exemption of statutory rate based on double tax treaties and PSD	Possible reduction/ exemption of statutory rate based on double tax treaties and PSD	No WHT on dividends is levied in the UK
INBOUND INCOME				
Dividend income	95% exempt if: • Min. 10% or €2.5m holding; • Uninterrupted period of min 1 year; • Taxation condition met.	100% exempt if: • Min 10% or €1.2m holding; • For at least 1 year; • Subsidiary is EU collective entity or non-EU fully taxable joint stock company.	100% exempt if • Min 5% holding • Taxation condition met (if not: tax credit applies) does not apply to portfolio companies (tax credit)	Exemption if dividend qualifies as one of the following: • Distributions from controlled entity; • Distributions in respect of non-redeemable ordinary shares; • Distributions arising from portfolio holdings (<10%) • Dividends derived from transactions not designed to reduce UK tax; and • Dividends in respect of certain shares accounted for as liabilities
Capital gain on shares	• Long-term (≥ 1 year): 0,412% taxation of net capital gains (subject to taxation condition) • Short-term (≤1 year): 25,75% of net capital gains (subject to taxation condition)	100% exempt if : • Min 10% or €6m holding; • For min. 1 year; • Subsidiary is EU collective entity or non-EU fully taxable joint stock company.	100% exempt if holding of at least 5% (unless the subsidiary qualifies as an investment subsidiary, which is subject to an effective taxation of less than 10%)	In principle taxable at Standard rate Substantial Shareholding Exemption under the following conditions: • Disposal of shares by a company; • Participation of at least 10% for at least 12 months; • Company making the disposal must a.o. be a member of a trading group for 12 months before and immediately after disposal • Company being disposed must a.o. qualify as a trading company or holding company for 12 months before and immediately after disposal;
Capital loss on shares	Not deductible	Deductible Write-downs are also deductible but may be subject to recapture (claw-back)	Not deductible (unless qualifying for liquidation loss)	Tax deductible – can be carried forward for offset against future capital gains

E. *Fund structure*

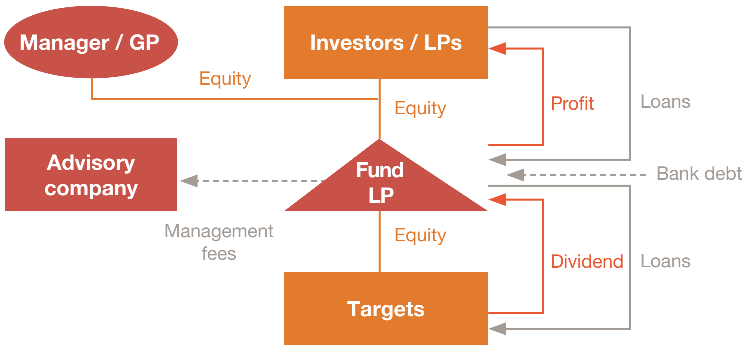
Tax transparency

A fund structured through a collective investment vehicle or partnership is usually transparent for tax purposes, especially when the investment vehicle is an unincorporated entity.

A fund without legal personality (unincorporated) is normally transparent for tax purposes. Consequently, revenues arising in its hands are deemed to be derived directly by shareholders/investors and taxed in their hands under the specific regime applicable to each type of revenue.

Foreign private equity investors mostly rely on partnership structures, such as UK or US limited liability partnerships (LLPs), due to their flexibility and transparent nature. However, a Belgian entity or individual investing in these types of structures has to appreciate the tax consequences of investing in a foreign partnership.

Figure 61 **Fund holding structure**



Below is an overview of fund vehicles and their characteristics.

Figure 62 **Overview of most common fund vehicles in Belgium, France, UK and Luxembourg**

	French FCPR	UK LLP	JERSEY LP	Luxembourg SICAR or SIF	Belgian SICAV (inst.) or SIC
Legal form	• No legal personality • Co-ownership of securities	• Legal personality • Limited liability	• No legal personality • Limited liability	• Legal personality • Limited liability	• Legal personality • Limited liability
Tax treatment	• Transparent for tax purposes	• Transparent for tax purposes	• Transparent for tax purposes	• Transparent for tax purposes	• Subject to specific tax regime • Flow trough for DRD
Open/ close-end	• Open-end	• Open-end	• Open-end	• Open-end	• Open-end
Regulated	• Yes	• No	• No	• Yes	• Yes

Open-end versus closed-end

In an open-end structure, a fund can buy back shares from its investors. This is done by providing for a specific form of company with shares, whose capital varies without amendment to its articles upon the issuance of new shares or repurchase of existing shares.

Due to the nature of their investments, most private equity funds are closed-end funds. In a closed-end fund, units or shares may be sold to other investors, but generally cannot be redeemed by the fund until winding-up or dissolution. Proceeds are also usually fully distributed without being reinvested, making the private equity fund self-liquidating.

Regulated versus unregulated

Regulated funds, also called rubber-stamp funds, benefit from a specific tax and legal regime, which prevents additional tax charge and risk at fund level, and bears a quality label, which increases investor trust.

These funds are less flexible due to investment restrictions and marketing requirements. Funds may be either public or private. A private equity investment can be made both in public and private rubber-stamp funds.

Previously, most private buy-out funds were established in offshore locations that provide fund-friendly regulation, such as Jersey, Guernsey or the Cayman Islands. The purpose was to benefit from confidentiality and fewer public filing requirements, rather than to invest in a tax haven location.

However, **the current trend points towards the establishment of onshore funds**, mostly for reputational reasons. Indeed, as recently demonstrated by the "Panama Papers", offshore investment structures are more and more controversial.

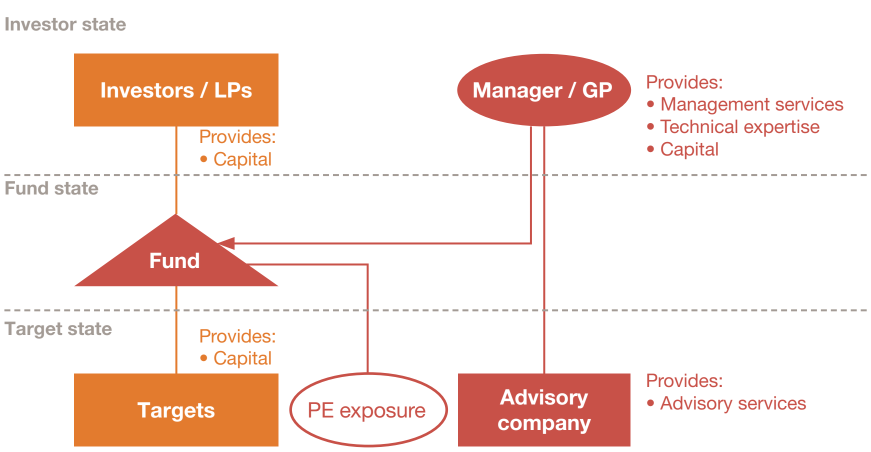
Since offshore locations are excluded from tax treaty provisions and tax authorities worldwide are increasingly applying a look-through approach in order to identify the beneficial owner of the income, the use of offshore structures has become rather constraining.

Offshore investment structures are more and more controversial.

Furthermore, investments by Belgian investors in low-tax jurisdictions may fall under the anti-evasion provision, whereby the transfer of cash or other assets may not be enforced vis-à-vis the Belgian tax authorities unless justified by legitimate economic needs or where similar income is earned as if the assets had still been held in Belgium.

F. Fund operation

Figure 63 Fund operation



A fund is usually structured and operated as follows:

- a GP manages the fund directly or through a separate management entity which invoices management fees to the fund. The GP is responsible for making the key decisions with regards to investments and divestments of the fund;
- the advisory company provides (non-binding) advisory services to the GP with regard to the acquisition process, etc;
- for the services carried out, the advisory company is usually remunerated with a mark-up on costs incurred.

G. Barriers to fund structuring

It is commonly agreed that the 2008 financial crisis was rooted in excessively risky behaviour by the financial sector. Regulators enacted new controls over the financial industry as a result.

Tax authorities, like regulators, are increasingly focusing on transparency, the contractual allocation of assets and risks among group entities, and the underlying economic substance of these entities. There is nonetheless a fundamental difference in the use which they make of such information. Tax authorities focus on how and where risks and functions are allocated throughout the fund structure. Regulators are more focused on ensuring that potential risks are effectively managed by the appropriate entities within the fund structure.

Figure 64 Fund structuring hurdles

Regulatory constraints	• Any TP analysis for an AIFM should take into consideration the evolution of the BEPS agenda.
PE exposure	• Research, advisory and managerial services, which are carried out by the fund manager and the advisory company, could trigger a PE in the portfolio state.
Transfer pricing	• TP model of funds is likely to be subject to increased scrutiny in the wake of BEPS. • Cost-Based remuneration is no longer appropriate for services considered as being high value-added.
Transparency activities	• Reporting requirements such as CbCR, FATCA and CRS will significantly increase and have a material impact on the work-load, staffing and expertise of fund managers, increasing the compliance burden of an international presence.
VAT impact	• Recovery of input VAT should be analysed carefully to avoid cascades of non-deductible input VAT.
Substance	• Appropriate substance throughout the structure will be key to qualify for the beneficial ownership of the income.

The fund industry was subjected to stringent regulatory reporting rules, which have fundamentally modified the functional profile of the entities involved in the fund structure. At EU level, this took the form of the Alternative Investment Fund Managers Directive (AIFMD). Its objective is to provide greater investor protection, better and clearer investor information, as well as more transparency for the regulators on alternative investment funds and their managers.

Parallel to the AIFMD, tax transparency initiatives have been taken up at international level in terms of disclosure requirements. The US and its Foreign Account Tax Compliance Act (FATCA) were pioneers in this respect and was soon imitated by the OECD, which launched its own Common Reporting Standard (CRS). Both initiatives aim at creating a framework where entities qualifying as financial institutions have to disclose the identity of their beneficial owners.

For a typical fund structure, this would imply disclosure of the beneficial owners behind the LPs, which may be problematic from a confidentiality perspective.

Aside from such initiatives, it goes without saying that BEPS will have a tremendous impact on fund managers, such as the hybrid mismatch report (BEPS Action 2) or the agent permanent establishment report (BEPS Action 7). Particular focus should however be on the following BEPS points for fund managers:

- proposed adjustments "beyond the arm's length principle" in transactions involving intangible assets and risks where there would be discrepancy between the economic substance and the contractual agreements;
- the introduction of a country-by-country reporting obligation, involving several disclosure requirements on a group's global operating activities;
- increased scrutiny on permanent establishments (PEs) which includes lowering the thresholds for the existence of a PE.

The forthcoming BEPS changes will impact the typical M&A and fund structures at three different levels. The level of the holding company / limited partnership / general partnership, the level of the investment vehicle(s), and the level of the portfolio companies.

As illustrated in the below chart, which is for indicative purpose only, BEPS changes will bring different degrees of risk depending on the level of the fund structure that is impacted.

We provide below a detailed overview of the current and upcoming most challenging hurdles in fund structuring and fund management.

Figure 65 **Risk matrix of the potential impact of BEPS-related risks on the typical M&A and fund structure**

Nature of risk	Holding / LP / GP	Funds / SPVs		Portfolio companies	
		PE fund	Credit fund	<50%	>50%
Substance	High risk	Medium risk	Medium risk	Medium risk	Low risk
Hybrids - Artificial arrangements	High risk	High risk	High risk	High risk	Medium risk
Use of tax deductions / incentives	High risk	High risk	High risk	High risk	Case specific
PE risk	Medium risk	High risk	High risk	Medium risk	Case specific
Tax ruling	High risk	Case specific	Case specific	Case specific	Case specific
Treaty abuse	High risk	Case specific	Case specific	Medium risk	Case specific
Operational risks / BEPS	Case specific	High risk	Low risk	High risk	High risk
Transfer pricing	High risk	High risk	Low risk	High risk	Medium risk
Interest deductibility	High risk	High risk	Medium risk	High risk	Medium risk
FATCA, reporting obligations	High risk	Medium risk	High risk	Low risk	Case specific
CFX rules	Medium risk	Medium risk	Case specific	Low risk	Medium risk
Treasury financing	High risk	High risk	Medium risk	Medium risk	Medium risk
Tranparency / Exchange of information	High risk	Case specific	High risk	Medium risk	Case specific
Country-by-country reporting	Case specific	Case specific	Case specific	High risk	Case specific

High risk Medium risk Low risk Case specific

BEPS will impact M&A and fund structures at three levels: the holding company, the investment vehicle, the portfolio company.

PE exposure

Carrying out prospective investment requires research, advisory and managerial services, which are usually carried out by the fund manager, assisted by the advisory company. Many of these services are carried out by the fund manager's employees or by the advisory company in the state where the target entities are established. The tax authorities of that state may argue that the exercise of these activities constitutes a permanent establishment (PE) of the fund or its investors either by considering that, as dependant agent they are effectively engaged in signing or negotiating of contracts on behalf of the fund or the GP, or as independent agent they are closely related with the fund or GP.

Dependent agent

Historically, many funds have relied on the first exemption, under which no PE was triggered unless the dependent agent was concluding contracts in the foreign jurisdiction.

However, under the new definition of a dependent agent PE, contract signature will no longer be decisive. People who habitually conclude contracts or play the principal role leading to the conclusion of contracts signed without major modifications will be liable to constitute a PE. The exemption for preparatory and auxiliary activities will become limited to purely administrative activities.

This new definition goes far beyond the previous definition of an agent PE which focused on the place where the contract was effectively signed. It is likely to tackle the typical activities performed by senior executives and funds' investment teams when acting locally.

Independent agent

The independent agent exemption is also being narrowed. Currently, independence is mainly assessed based on the legal and economic dependence of an agent. The OECD recommends also excluding from its definition persons or entities who act exclusively or almost exclusively for one enterprise or closely related enterprises.

This new rule is likely to have a significant impact on advisory companies which usually perform services for one fund or for a group of related funds.

Impact for funds

If these recommendations are adopted, funds will need to make changes to how they employ agents outside the jurisdiction of their home office.

If local tax authorities conclude the existence of a PE of the GP, there's a high risk of double taxation (at the level of both the PE and investors). While this could be resolved under mutual agreement procedures, most GPs do not benefit from a treaty protection as they are still mostly located off-shore.

Some EU tax authorities have adopted a particularly aggressive approach in recent court cases, when the entire acquisition process was handled locally by the advisory company, but the acquisition was ultimately concluded by a non-resident vehicle. Authorities have been able to tax the deal locally and attract the taxation of management fees to their jurisdiction.

Certain states have already reacted to these more stringent rules by announcing that specific safe harbour rules would be foreseen for the financial sector. Besides, even where such PEs would not generate taxable income, these new rules are likely to bring about a significant administrative burden for the funds.

If local tax authorities conclude the existence of a PE of the GP, there is a high risk of double taxation.

Particular care will be needed around how contracts are negotiated and entered into and how related decision making protocols are established and executed on an operational basis. Careful drafting of the services contract, a mapping of the activities actually performed by the fund manager and advisers will be crucial to mitigate PE exposure in the new context where actual conduct prevails over contractual arrangements.

Transfer pricing

In the wake of BEPS, the transfer pricing model of funds is likely to be scrutinised more closely by tax authorities worldwide. Parallel to the PE exposure, tax authorities are also increasingly challenging the remuneration model of advisory companies, which was mostly based on a method based upon costs (cost plus method or Transactional Net Margin Method (TNMM)). On this basis, tax authorities can argue that the cost based methods (cost plus or TNMM) are no longer an appropriate remuneration and a profit split remuneration model would better reflect the high-value added services performed by the advisory companies, which play an important role in the decision making process of the GP. Similarly, remuneration of high value-added services performed by flying-in teams of fund managers on the basis of a remuneration split is likely to be increasingly challenged by tax authorities.

The remuneration of the different entities involved in the operation of the funds have to be determined in accordance with the risks assumed and functions performed, bearing in mind regulatory constraints on the exercise of certain functions. A fund manager qualified as an AIFM may, for example, delegate certain functions to other entities. However, it will still have to retain sufficient resources to oversee and monitor the delegated functions. Certain functions such as portfolio management and risk management may however not be delegated by the AIFM, so that he will always remain responsible for these functions. Any transfer pricing analysis for an AIFM in the current environment should therefore take into consideration the evolution of the BEPS agenda, as well as the broader tax, regulatory and business factors impacting the fund industry. In particular, in view of the increasing trend towards transparency and disclosure, **it will be crucial for AIFMs to coordinate and manage the information the information disclosed** via websites, regulatory reporting, transfer pricing documentation, and the marketing information provided to investors.

All those evolving regulatory constraints will ultimately affect the remuneration models applied by fund managers. They will, over time, have to change the way they price inter-company transactions and attribute the profits between the advisers and the GP.

Anti-treaty shopping measures (BEPS Action 6)

Since non-CIV funds are often not granted double tax treaty (DTT) access, a common practice consists of interposing a vehicle master HoldCo, which in principle would qualify for DTT access, to secure optimised cash repatriation.

Over the last few years, states have increasingly implemented stringent anti-treaty shopping rules whereby such intermediary holding entities are being disregarded for DTT purposes.

The remuneration of the different entities involved in the operation of the funds have to be determined in accordance with the risks assumed and functions performed.

There is a high risk that the holding companies incorporated by funds will not be able to qualify for DTT access.

Under BEPS Action 6, countries have agreed to include new anti-treaty abuse provisions in their tax treaties. As a minimum standard they may choose between a specific anti-abuse Limitation on Benefits (LOB) provision and a more general principal purpose test (PPT) provision that would also include situations not covered by the LOB provision.

In practice, there is a high risk that the holding companies incorporated by funds, and in particular private equity funds, will not be able to qualify for DTT access for the following reasons:

- the funds are often not listed on a stock exchange (stock exchange test);
- the fund and the holding companies will not be considered to carry out a trade or business; and
- the derivative business test as proposed will most likely not apply as it is rather uncommon that 50% or more of a fund's investors would be resident in the same jurisdiction as the fund or the holding company. Even in the event that the fund would be in the position to identify its ultimate beneficiaries, it would be extremely burdensome for the fund to ascertain their treaty status.

Next to the LOB provision, the PPT would also be problematic for funds due to its subjective character which could result in different outcomes in different jurisdictions. The inclusion of an LOB provision and/or a principal purpose test in DTTs will therefore generate more uncertainty as well as an increased administrative burden for funds.

The work on Action 6 also resulted in a number of recommendations for other specific anti-abuse rules to be included in tax treaties. Although these recommendations are not included in the Action 6 minimum standard, they will be at the heart of the discussions on the multilateral instrument that the OECD/G20 countries want to set up to implement the treaty-related BEPS measures[15].

It will therefore be essential to ensure that all entities claiming treaty benefits can be considered as the beneficial owners of the income received to avoid undesirable WHT consequences, among others.

Hybrid mismatch (BEPS Action 2)

Action 2 of the OECD's BEPS report focuses on the development of a coherent approach for the neutralisation of hybrid mismatches. Refer to the section on upper-tier structuring for more detail on the BEPS Action 2 report.

The fund industry is a significant user of hybrid instruments and hybrid entities, which are directly targeted by the BEPS Action 2 report. As a result of the proposed changes in the report, the fund managers will have to assess current hybrid structures and what the impact of the contemplated changes could be for their respective investors. Aside from the BEPS Action 2 report, it is also important to note that individual legislative initiatives have been taken both at EU and at national levels to combat hybrid mismatches, which is liable to eventually result in incoherent approaches. The development and implementation of these rules should be carefully monitored.

15 For more insights on BEPS Action 6 we refer to our comments in the section on the upper-tier of this M&A Guide.

Reporting requirements: BEPS Action 13, FATCA & CRS

Reporting requirements such as country-by-country reporting, FATCA and common reporting standards will significantly increase the workload, staff and expertise of fund managers.

The reporting requirements in BEPS Action 13 aim for increased transparency on the transfer pricing position of multinationals in order to assess the need for further audits. While the concrete precise timing and scope of country-by-country reporting are not yet clear, these proposed changes will result in additional reporting obligations for funds.

This may also be used for risk assessment outside of transfer pricing, increasing the compliance burden of an international entity. Furthermore, it is not clear at this stage at which level of the structure the obligation to file the country-by-country reporting will apply, either at fund level or at any lower level (or a combination of both).

Therefore, investment funds should be as prepared as possible by ensuring that the arm's length nature of the following flows is duly documented:

- management fees to management companies located in low-tax jurisdictions;
- inter-company financing;
- global value chain reporting of fund entities and portfolio entities.

The EU has recently picked up on the BEPS initiative and is currently working[16] on an impact assessment on whether and how to expose enterprises to more intense scrutiny on the part of authorities or by different stakeholders, through further corporate tax transparency.

In any event, how the EU's and OECD's legislation evolves, as well as the overall trend in international taxation and transparency, should be monitored closely in the future.

VAT impact

In addition to the direct tax impact on services provided by the advisory company, it is also important to consider the impact of the VAT on the services carried out by the advisory company and GP. When non-deductible VAT is levied on the services received, this will not only impact the funds but also the GP's/advisory company's operational expenses by approximately 20%. In certain cases, specific VAT exemptions exist for the management of special investment funds. It is however up to EU member states to fill in the framework under which conditions the exemption can be applied. Given the complexity of the matter, it is crucial that the different costs incurred by the fund, GP and advisory company are mapped and qualified as VAT taxable/exempt. Should it be a taxable advisory service, it should be further determined in what country the services will need to be taxed.

In principle, GP management services are exempt from VAT if the fund falls within the scope of the VAT exemption for the management of special investment funds. The recovery of input VAT would thus be problematic for the management fees sourced by and paid for by the GP. Throughout the chain of supplies of services this can create a cascade of non-deductible VAT, whereby the fund will be hit with the final cost.

Reporting standards will significantly increase the workload, staff and expertise of fund managers.

16 A Proposal for Directive was issued on 28 January 2016 by the Commission in that respect.

Substance

Within the framework of ongoing discussions at international level on BEPS and on beneficial ownership more generally, it has become crucial to implement and secure a comfortable level of substance throughout an investment structure.

Lack of sufficient substance at entity level can trigger disqualification for DTT benefits on the grounds that the entity is not the beneficial owner of the income received. Particular attention should be paid to existing structures with offshore GPs where only limited substance is in place.

The tax strategy of the fund should be aligned with its investment and business strategy and be coupled with sufficient economic substance. To facilitate this, funds may need to revisit their typical investment structures by using a limited number of holding companies in a single jurisdiction rather than separate holding chains for each acquisition and/or by on-shoring their existing Bermuda or Jersey funds to substance-friendlier locations such as The Netherlands or Luxembourg.

The choice of this single jurisdiction should take practical criteria into account and consider the possibility to attract relevant employees and resident managers/directors, in order to ensure sufficient substance and business purpose to support structuring through that location.

Lack of substance at entity level can trigger disqualification of DTT benefits.

Cayman tax

The Belgian legislator introduced a legal bill where Belgian individuals, and Belgian entities subject to legal entities income tax, have to declare the legal constructions (foreign trusts, foundations, undertakings for collective investments or pension funds when not publicly offered, etc.) to which they are in any way linked (as founders, effective beneficiaries, potential beneficiaries, etc.). An informative, but not exhaustive, list of legal constructions targeted by this provision will be published.

Legal fictions of tax transparency apply to most of these legal constructions (unless they're already subject to tax at an effective tax rate of 15% at least, to be assessed according to Belgian income tax rules) so that the real estate income, movable income (interest, dividends, royalties) and miscellaneous income (defined according to Belgian income tax law) collected by the legal constructions will be subject to an immediate effective tax charge in Belgium.

When the legal construction is considered to be not tax transparent (when subject to an effective tax rate of at least 10%), the full proceeds upon termination of the legal construction (e.g. liquidation) will be taxed at 25%.

Rules avoiding potential double taxation will also be implemented.

Various anti-abuse provisions will also be implemented to avoid that legal constructions are modified before the law is enacted.

Carried interest income

The tax treatment of carried interest on acquisition and on receipt has been subject to much uncertainty over the years. In most EU countries, there's no specific legislation dealing with the taxation of interest.

If the carry is acquired at fair market value (FMV), no employment income tax for executives should arise upon acquisition. Any undervalue is likely to be taxed as a benefit in kind or employment income.

No consensus has been reached in Europe on the tax treatment of the receipt of carried interest. In some countries it may be treated as income, in others as capital. Tax treatment often depends on the terms of the carried interest, the nature of the underlying income and whether the conditions for any favourable tax system have been met.

Figure 66 Trends in the taxation of carried interest income

The table below gives an overview of the trends in this respect in some EU countries

Country	Tax on acquisition if FMV not paid?	Potential tax on receipts where structured tax efficiently	Preferred carry vehicle
Belgium	Yes (55% plus SST)	Dividend and interest: 27%	Corporate
France	Yes (40% plus SST)	30.1% capital gain	Corporate
Germany	Yes (45% plus SST)	Up to 45% PIT - but 40% of certain income may be exempt	LP
The Netherlands	Yes (52% plus SST)	25% (or 52% if falling under lucrative investment rules)	Corporate or LP
UK	Yes (40% plus SST)	18% capital gain	LP

H. Case study: Fund on-shoring

We recently advised our clients to reconsider locating their fund structure onshore due to increased scrutiny by the tax authorities for lack of substance in offshore locations. In some cases, such scrutiny has led to huge transfer pricing adjustments.

When giving our advice we carefully considered the operational and tax implications of an onshore relocation, and the transfer pricing flows between the different parties involved in the funds' management and operations.Our assistance required a sound understanding of the value chain of the entire fund, based on interviews in the field and a review of workflows. This led to fundamental changes in the way the fund operates and delegates its authority for specific tasks.

A post-implementation review was done to ensure the sustainability of the new business model.

VII. VAT and transactions

Highlights

- *Non-deductibility of VAT on deal fees can increase your costs by an average of 20%*
- *For acquisitions, the VAT recovery position of the corporate structure can be positively influenced by increased “management” involvement and appropriate VAT deduction allocation methods*
- *For share disposals, optimised VAT deduction methods and strong roles and responsibilities within the structure can work in your defence*
- *A successful VAT integration of the acquired business will require taking a close look at the impact of VAT compliance/obligations on your supply chain…*
- *… and at the underlying ERP business processes and tax function organisation*

Tax planning includes a strategy to maximise input VAT recovery on transaction fees

A. Introduction

When dealing with transactions, your strategy should include the potential impact of VAT as proper measures can limit the negative cash impact of VAT on the transaction. The key takeaways for M&A stakeholders before and after the deal include:

Figure 67 **Assess, design, implement VAT strategies to mitigate the potential negative cash impact of VAT on the transaction**

Assess
- Analyse **the VAT status** of the companies that will incur deal fees (directly/via re-charge) up front.
- Analyse the **nature of costs** (VAT exempt/VAT taxable) to assess the impact if part of those are allocated/re-charged to operational entities.

Design
- Look at **roles and responsibilities** of the companies concerned from the outset.
- Consider your VAT deduction methodology to maximise VAT deduction in holdings companies, especially if they perform both management and VAT-exempt (financing/real estate) activities.

Implement
- Consider the ECJ case on active holdings that were denied recovery of input VAT on deal fees & determine whether post-deal VAT recovery is still possible.
- Integrate the business operation in a VAT efficient and compliant manner. A well designed ERP can reduce costs of compliance and improve risk management and tax governance.

B. Can I deduct VAT on deal fees?

The basic European VAT principle means that VAT should be neutral throughout a chain of transactions and only become a burden in the final stage of consumption. This basic principle does not always apply in a transactions context due to various factors, such as the VAT status of some companies involved and the existence of exempt transactions.

Assessing whether you will be able to deduct the VAT incurred on deal fees is therefore not straightforward, especially as there are different practices and interpretations among EU member states.

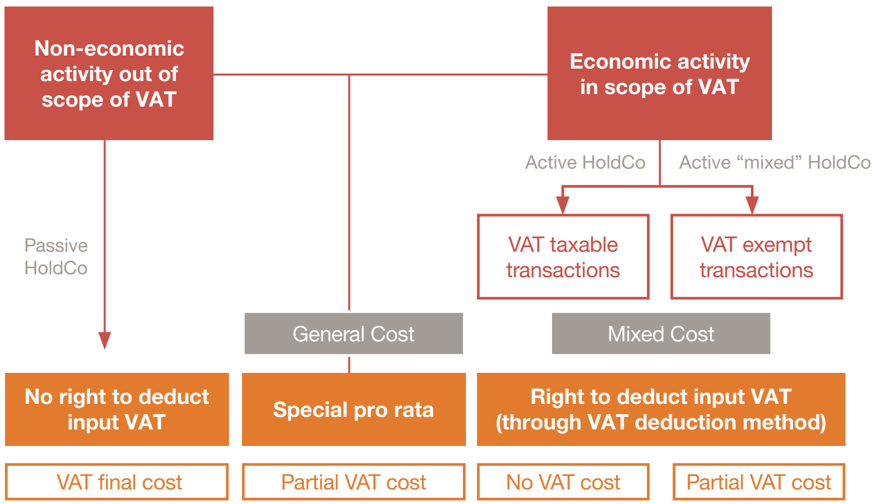
VAT status

If a transaction involves a corporate structure comprising operational and holding companies, it’s crucial to analyse upfront what the VAT status of the various (holding) companies will be, which (holding) company will incur which expenses, and whether VAT on these expenses can be deducted or not.

The European Court of Justice (ECJ) recently confirmed[17] that "active" holdings involved in the management of their subsidiaries should have the right to deduct VAT on the costs made for the acquisition of their shareholdings. To what extent VAT will effectively be deductible depends on the overall business carried out by the holding company and in particular whether there are VAT-exempt supplies. This decision confirms that VAT deduction is allowed for active controlling parent companies that exercise management activities in all their subsidiaries and is in principle directly applicable to entities in similar circumstances. It should however be monitored how member states will adapt their local regulations further to this case.

For a (passive) holding company (the sole purpose of which is to acquire, hold and sell shares without further involvement beyond exercising its rights as a shareholder) VAT on deal fees will remain a final cost.

Figure 68 Active and passive holdings



Nature of costs

Transaction costs typically include banking, financing, lawyer, notary and advisory fees. Unlike registration duties and some other legal costs (on which no VAT can apply), these costs are either subject to VAT or exempt.

If the cost is subject to VAT (not exempt), and the service provider and the recipient are located in the same country, the invoice will contain VAT.

If the cost is subject to VAT (not exempt) and the service provider is located in another country than the recipient, the VAT payer recipient will need to self-account for the VAT. This has the positive effect that the VAT to be paid can immediately be offset with the amount of deductible VAT (no pre-financing).

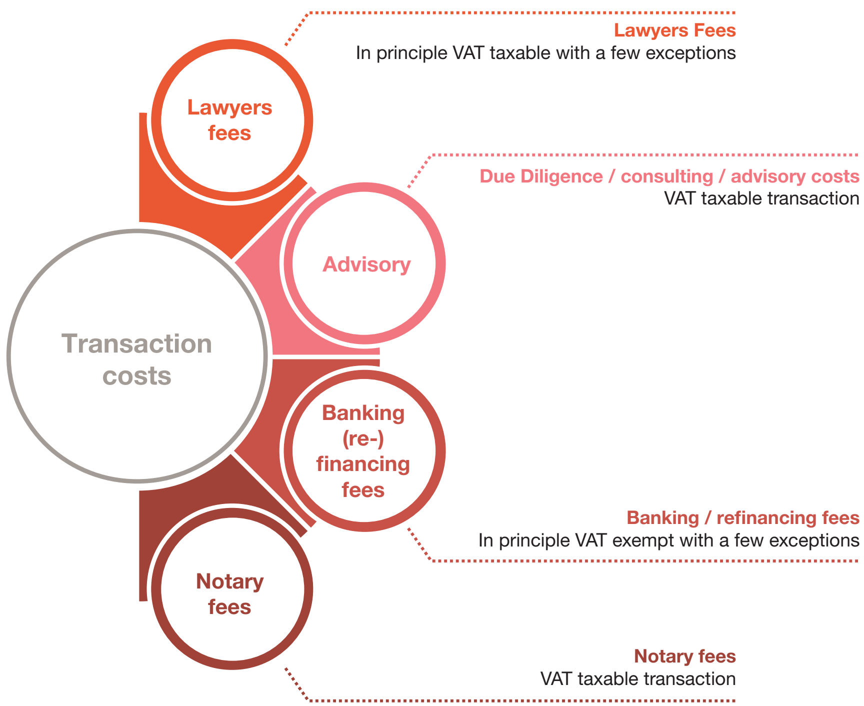
In case of a passive holding company (not a VAT payer), and a service provider located in a non-EU country, no EU VAT will apply. However, if the service provider is located in an EU country and the cost is subject to VAT, local VAT will be charged and not be deductible. Analysing the nature of the costs and their VAT treatment is therefore doubly important for passive holding companies as any VAT leakage will be a full cost for them.

A VAT exemption applies for banking, financing, share dealings and financial intermediary services in general. However, certain advisory and consulting services performed by the banks and insurance companies are subject to VAT.

A VAT strategy should include a "what, where, when" analysis on the transaction costs incurred to mitigate VAT leakage on deal fees.

This is also important from an outbound perspective in case part of the costs will be re-charged within the group. In that case, the costs will follow their proper VAT treatment depending on their nature unless they are part of the costs for a wider service. For instance, re-recharging VAT-exempt transactions can negatively impact the VAT recovery position of the on-charging entities unless measures are taken (e.g. applying for a direct allocation VAT deduction method).

Figure 69 Nature of costs



17 In joined cases Larentia + Minerva (C-108/14) and Marenave Schiffahrts (C-109/14)

Roles and responsibilities

The roles and responsibilities of group entities can positively influence the right to deduct VAT.

- **Why does 'involvement' matter?**

M&A stakeholders should verify whether transaction costs can be directly and immediately linked to taxable output transactions. If so, input VAT on deal fees linked to the acquisition of shares can be deducted.

If there is no direct link to taxable output transactions, the treatment will depend on whether the costs are part of the general costs incurred for the business activity of the company. If so, VAT deduction will apply based on the company's overall right to deduct input VAT.

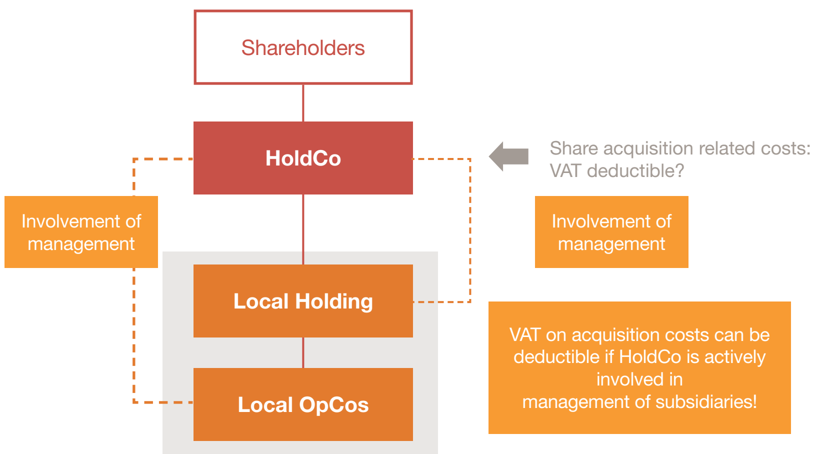
If a holding company is involved in the management of all its direct subsidiaries, deal fees (e.g. costs related to share transactions, increase in capital or issue of shares for funding the acquisition) will be considered as general costs that have a link with the (taxable) business as a whole. They are therefore considered fully VAT deductible if no other non-VAT taxable or VAT exempt transactions are performed.

Under different circumstances (e.g. in case of limited involvement or in case of other involvement besides "pure" management activity, such as financial/real estate activities), reviewed specific analysis will be needed to assess to which extent VAT can become deductible.

There is however no clear guidance on whether shareholders' involvement must be towards all indirect (grand-daughter) subsidiaries or on how to prove involvement in the management of subsidiaries. Tax authorities can also tend to consider the impact of the non-economic holding activity on the right to deduct input VAT and therefore still claim that part of the input VAT to be non-deductible.

Nevertheless, ECJ case law must be regarded as binding. If a taxpayer falls under the same circumstances and meets the same conditions as the case, he can directly apply the interpretation given by the court and deduct the input VAT.

Figure 70 Involvement in management?



- **Why does 'linking' matter?**

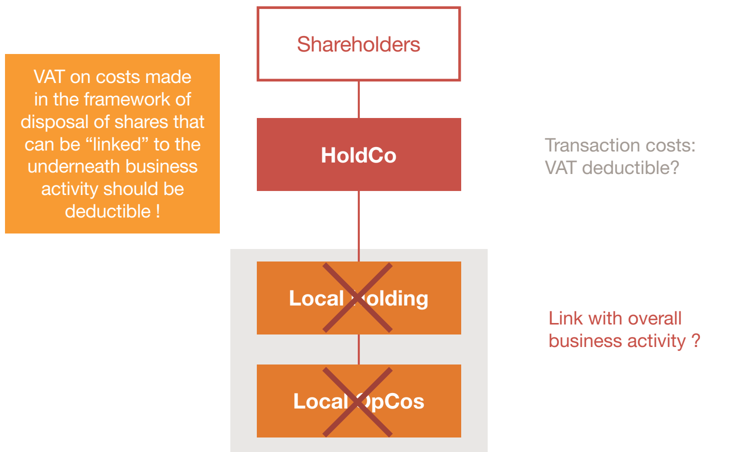
A disposal of shares is, in principle, a VAT-exempt transaction or a transaction realised out of the scope of VAT. Costs made directly in the framework of a disposal of shares will therefore not be deductible.

If, besides the disposal of shares, the entity carries out other taxable activities, one could argue that the costs of share disposal are general overhead costs (operational expenses) which are made in the framework of the overall business activity or in the framework of future taxable transactions.

A few years ago, the ECJ granted the (partial) right to deduct VAT on transaction fees to active controlling, managing and holding companies disposing of subsidiaries' shares, if they could demonstrate that the disposal costs were included in the price of their VAT-able activities and not in the sales price for the shares.

In practice, it comes down to demonstrating that the costs are not exclusively made for the disposal of shares in itself. In that case they would be considered as VAT exempt/out of scope of VAT and no right to deduction would be allowed. This can sometimes be difficult, but is perfectly possible. Taking this into account, it will be more and more important to duly review share disposal cases upfront to ensure that proper documentation is available to defend VAT deduction.

Figure 71 Disposal of shares: linking matters!



Maximising input VAT deduction at group level

Besides input VAT recovery on transaction costs, a tax strategy should also include the maximisation of input VAT recovery on recurring costs at group level in a post-deal context.

The acquisition or disposal of shares will most likely impact intra-group transactions that are performed post-deal. Roles and responsibilities of entities can change, which can lead to increased and decreased management involvement in subsidiaries, impact other business flows or intra-group cross-charges being made.

The various flows of services and goods occurring in a post-deal context should be mapped to determine where, when and to whom they should be allocated, what the applicable VAT treatment is, and how that will impact the overall right of the group to deduct input VAT.

The group's cash flow could be positively influenced by analysing the possibility and impact of setting up a VAT group or putting in place appropriate VAT deduction methods for mixed VAT payers.

If VAT aspects weren't looked at in detail in the past, this can still be done later on but the number of options might be reduced. Depending on the general statute of limitations, VAT can even be recovered retroactively.

Figure 72 VAT strategy

Assessment of VAT input deduction at company & group level	*VAT Status*	• Roles and responsibilities may change upon the acquisition or disposal of shares.
	Determination of costs	• Determination of VAT treatment of costs will highly depend on how they are allocated.
	Linking costs with output	• Linking of (transaction) costs with taxable output in order to achieve VAT deductibility on these costs.
Possible optimisations for maximisation	*VAT alternatives*	• Setting up a VAT group or putting up "real use" method for mixed VAT players.
	Management involvement	• Management involvement impacts business flows & intragroup cross-charges being made and increases level of taxable output.

C. *VAT and BEPS*

Although the BEPS project mainly concerns direct taxation, it also addresses some VAT issues, in particular with regard to the digital economy. Beside the direct implications with regard to VAT, care should be exercised because other actions under BEPS may have spill-over effects on VAT.

Figure 73 VAT and BEPS

Digital economy	• The BEPS action point on Digital Sales will gradually move the VAT taxation towards a destination principle in order to facilitate the collection of VAT locally.
PE	• The new guidelines on PE will have a spill over effect for VAT.
CbC reporting	• The information listed in the country-by-country report will impact indirect tax.
Value creation	• VAT will have to be aligned with new TP models, o.a. for TP adjustments.

The digital economy

In the BEPS Action 1 on the digital economy, several approaches are recommended to facilitate the collection of VAT in the country of where the consumer is situated both in B2C & B2B transactions. The approaches are aligned with the international VAT guidelines dealing with the application of VAT to cross-border supplies of services and intangibles.

Value creation

In line with international guidance, international trade intangibles should be liable for VAT or GST in the country where the intangibles are consumed (B2C) or where the "business customer" is located (B2B). Along the same lines and based upon the same international guidance, services should be liable to VAT in the country where the intangibles are consumed (B2C) or where the "business customer" is located (B2B).

For transfer pricing purposes the transactions need to be accurately delineated and priced in accordance with the revision of the relevant chapters of the OECD Transfer Pricing Guidelines (cfr. BEPS Actions 8-10). When reviewing the business model for BEPS purposes, considerations with regard to VAT may need to be aligned with the positions with regard to transfer pricing in order not to have conflicting positions.

Permanent establishment

It should be noted that in a B2B context, when there are multiple establishments in different countries, the right to tax is allocated where the establishment is situated. Based on the BEPS Action 7, the permanent establishment (PE) threshold is lowered.

Although the criteria for the existence of a fixed establishment (FE) and a PE are not identical, some countries will assume a FE exists when a PE is established. Because of the lowering of the PE threshold, this may give rise in certain countries to an increase in the number of FE. When re-evaluating the business model, this element may need to be taken into account, also for VAT purposes.

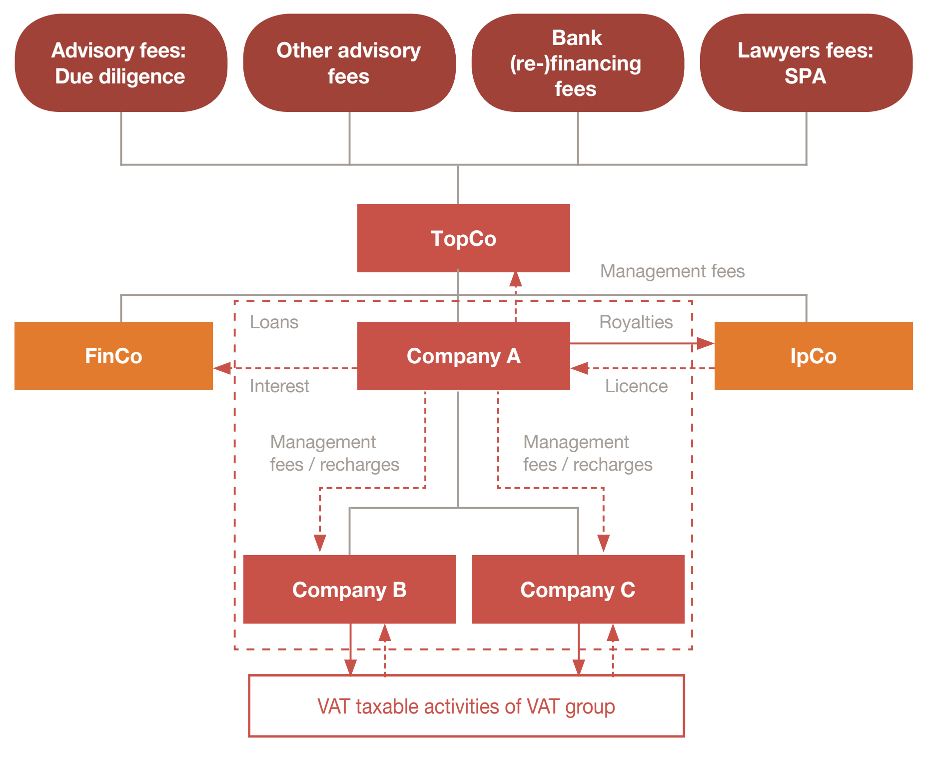
Country-by-country reporting

Despite country-by-country reporting (BEPS Action 13) being targeted towards identifying direct taxation issues in general and transfer pricing issues in particular, the information listed in the country-by-country report may be useful for indirect tax purposes as well.

D. Case study: VAT and transactions costs

We advised a MNC throughout its acquisition of a third group. Our client had incurred many transaction costs on which VAT was due, such as due diligence costs and lawyer fees. The client wanted to know to what extent VAT could be recovered on the transaction costs incurred at the level of his acquiring holding company. We illustrate the transaction below and how VAT could be recovered.

Figure 74 VAT and transactions costs



The entities acquired could comprise a HoldCo (Company A) including its subsidiaries, i.e. two operational companies (Company B and C).

The TopCo will incur advisory fees, bank (re-)financing fees and lawyer fees, with respect to the acquisition of shareholding in target group.

Depending on its VAT status and level of involvement, TopCo could argue for a VAT deduction on the transaction costs if it renders management services for Company A. In such a case, the TopCo could be entitled to a full input VAT deduction on transaction costs if its outgoing transactions are limited to management services.

Further down-charging of transaction costs, such as recharging financing costs, could create VAT leakage in the hands of Company A. An alternative to treating intra-group services as outside the scope of VAT would be to set up a VAT group. A full input VAT deduction can be claimed in this set-up, which only allows VAT taxable outgoing supplies.

VIII. Corporate simplification

Highlights

- *Growth is good, unnecessary complexity is not*
- *Globalisation resulted in the duplication of legal entities in large MNCs, but is this complex web of legal entities still necessary?*
- *A complex corporate structure with overlapping management structures and functions is strong evidence a business model is inefficient*
- *A cost-efficient, substance-based and sustainable corporate structure is essential*
- *Corporate simplification should integrate the management structure, operational model and legal entities structure*

A. Introduction

Simplifying your business is about reducing costs, complexity and tax risks

Experience shows[18] that synergies from an acquisition are only realised when businesses are integrated.

Groups tend to grow through acquisitions but post-deal integration is not a priority.

That's why corporations are often left with a huge number of legal entities around the globe, an unaligned business model and overlapping management structures.

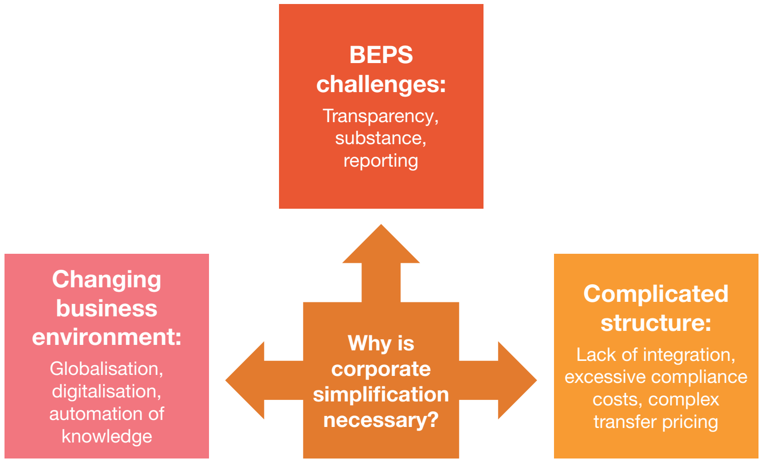
Meanwhile, increased transparency, substance, and reporting requirements force groups to rethink their structures and ways of doing business.

A simplified, substance-based and cost-efficient structure becomes more and more appealing, even inevitable, in the present changing business environment.

B. Setting the scene

Why is corporate simplification necessary?

Figure 75 Why is corporate simplification necessary?



Complicated group structures

More and more entities have joined MNCs after years of M&A transactions. However, due to a lack of dedicated resources many are not fully integrated into their group. This lack of integration leads to a duplication of back office functions and lots of "little kingdoms", even though convergence and a "one face to the client" approach are increasingly important.

Such complex structures generate compliance costs, complexity and non-harmonised transfer pricing. It is inefficient and a source of risk.

All of the above impacts investors' confidence and should make groups consider going "back to basics".

18 PwC US, "*Talking about the people side of M&A*", https://www.pwc.com/us/en/people-management/assets/talking-about-the-people-side-of-ma.pdf.

Changing business environment

Evolving sales channels and emerging markets in a world of booming digitalisation and globalisation confront groups with changing businesses and challenges in attracting and retaining talent.

The Internet of Things, cloud technology, 3D printing, near autonomous vehicles, renewable energy, energy storage are examples of changes brought by digitalisation that will bring significant changes to the business environment.

Competition from operators in cheaper countries and the consolidation of both customers and suppliers has increased the demand for a simple group structure and efficient business model.

BEPS

One of the key objectives of the BEPS initiative is to reach "economically sustainable tax planning that is aligned with the place where functions and activities take place".

MNCs will have to analyse to what extent their existing tax structure and strategy is equipped to withstand and deal with the changing tax environment. Corporate simplification also has a role to play here. Only a simplified, substance-based and cost-efficient structure will be sustainable going forward. Most **traditional international tax planning models should be revisited** as they rely predominantly on structures based on legal agreements rather than substance.

Implementing a tax-efficient and substance-based structure in a stable business with a well-established value chain can be difficult. Structural changes can lead to exit taxes being levied, which can impact the operation. M&A processes are an opportunity to streamline the business structure, make it compliant with BEPS principles and minimise adverse tax consequences. The integration of operations should be considered alongside a BEPS-proof transfer pricing and new tax risk profile, in each M&A context.

For a more detailed overview of the BEPS guidelines and impact on M&A transactions, we refer to the first chapter on the M&A landscape post-BEPS.

C. Why now?

The changing business and tax environment makes it necessary to move to a cost-efficient and sustainable simplified structure

Numerous companies operate globally through various legal entities with different functions in their value chain. These legal entities are generally located in multiple jurisdictions, making structures international and complex. The increasing use of technology in today's world and the proposed changes in international taxation following the BEPS project, requires multinational groups to reconsider where to invest and how to structure their global business operations.

The following five focus areas need to be considered when rethinking the group's legal structure and way of doing business.

Only simplified substance-based and cost efficient structures will be sustainable going forward.

Figure 76 **Changing tax landscape impacts 5 key areas**

Key focus areas:	Why now ?
Substance	BEPS-triggered national and international measures will increase focus on substance in coming months and years. Corporate structures where the tax planning is not consistent with the place where activities happen risk substance related adverse tax consequences.
Risk	BEPS Action Plan and the European Commission's Anti-Tax Avoidance Package make it necessary to assess if existing complex group structures are exposed to new tax risks.
Cost	A complex group structure with a vast number of legal entities leads to excessive costs, e.g. compliance costs, duplication of functions, ICT costs, inefficient transfer pricing structure, etc.
Transparency	The signing of the Multilateral Competent Authority Agreement by 31 countries (providing for the automatic exchange of country-by-country reports) is just one example of the new arsenal of tax related transparency regulations.
Reputation	Given the general public's interest in MNCs paying a "fair" amount of taxes, corporate simplification can safeguard a company's reputation.

There is a strong likelihood that the rapidly changing tax landscape will change the optimal way of doing business. Think of:

- new reporting requirements that will increase the compliance burden;
- the increased focus on sufficient substance;
- the many existing beneficial tax regimes in different countries, including manufacturing incentives, beneficial holding regimes, R&D and IP incentives, that may disappear partly or in full;
- the BEPS Action 7 report on preventing artificial avoidance of Permanent Establishment (PE) status that will lead to a material lowering of the PE threshold.

This creates additional complexity and an increased risk of double taxation. As discussed above, MNCs cannot wait any longer to revise their business models and legal and tax structures.

Drivers & benefits

The main driver in all corporate simplification is value creation. This drives everything else including:

- complex intra-group transactions and transfer pricing structures;
- compliance cost resulting from non-integrated post-acquisition structures;
- monitoring of the effective tax rate due to the possible disappearance of beneficial tax regimes and international tax measures;
- non-trading and dormant entities induced opacity;
- implementing a "one face to the client" approach as a result of the globalised digital world for clients and suppliers; and
- lowering the PE threshold.

Corporate simplification provides a number of specific benefits:

- it results in streamlined organisations with leaner back office structures and fewer statutory filings, which means cost savings;
- clear reporting channels and consistent information that reduce risk and make compliance simpler, cheaper, more efficient and in line with BEPS;
- perhaps most important are the intangible benefits of a simple, clear corporate structure. Simplification makes a group more flexible and agile and helps it be more successful.

Figure 77 Some benefits of a simplified structure

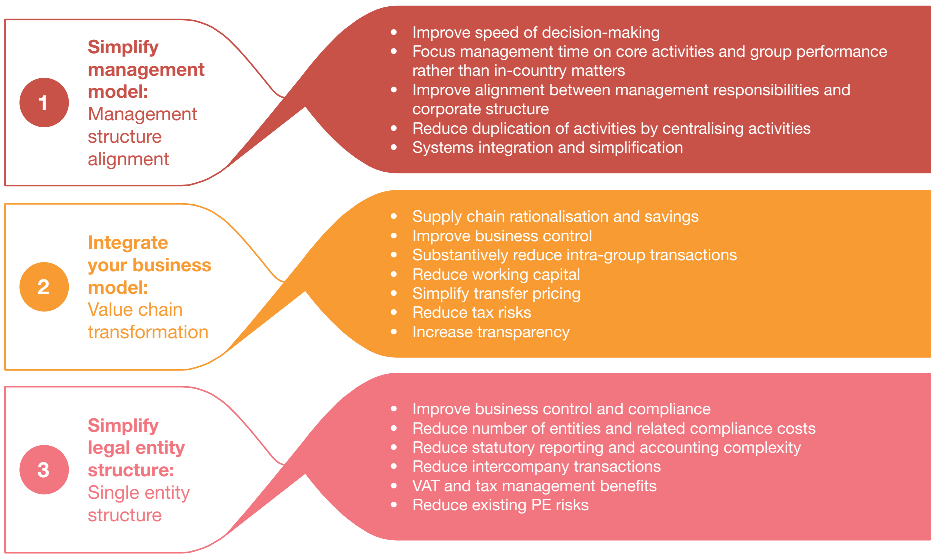
D. *Business model simplification*

How are companies simplifying their business model?

Strategic corporate simplification can bring operational, financial and tax benefits that may help groups deal with the complex challenges of global business. However, corporate simplification is much more than entity reduction. There are generally three different levels, management, operations, and legal, when transforming an organisation. Each level of transformation has clear and substantial benefits.

Each level of corporate simplification is discussed below in more detail.

Figure 78 How are companies simplifying their business



Only simplified substance-based and cost efficient structures will be sustainable going forward.

Management level

Simplification of the management model mainly focuses on the aligning of the management structure with the business model, including talent management and governance. This level of corporate simplification includes advice on which decisions should be taken centrally rather than locally, and where activities should be carried out.

When properly implemented, corporate simplification at the level of management structures should lead to:

- an improvement of the decision making process;
- less duplication of activities through centralisation; and
- an optimisation of reporting through system integration.

These operational benefits will also automatically result in a decrease of future tax risks because a simplified and centralised management model will be more aligned with the fundamentals of BEPS.

- **Transparency**. Referring to the clearer alignment of management responsibilities with the corporate structure, centralisation and optimised reporting systems;
- **Coherence**: Centralisation of departments and decision making processes will allow the application of a coherent set of taxation rules; and
- **Substance**: The centralisation of decision making will clearly indicate where substance is located and will allow the allocation and taxation of profits in those locations.

Substance-based approach

In view of the focus of the BEPS Action Plan on substance and where taxation is meant to follow activity simplification of the management model becomes even more important.

The OECD's work on transfer pricing documentation and the country-by-country reporting obligation means tax authorities will have meaningful information about where the "real" economic activity of a MNC takes place, where important decisions are taken, and where management is based.

Simplifying the management model and centralising decision-making will reduce risk and allow profit allocation and taxation in the location where economic substance can be found.

The more straightforward the management structure of a company, the smaller the risk a company will face in today's changing business and tax environment.

Operational level

Simplification of the operational model is another form of corporate simplification. It is all about centralising the strategic decision process and standardisation.

When well-structured and aligned with the corporate strategy, simplification of the operational model should lead to supply chain rationalisation, improved business control and a substantial reduction in intra-group transactions.

Besides Value Chain Transformation (VCT), the different business models in the framework of globalisation and transfer pricing are also important.

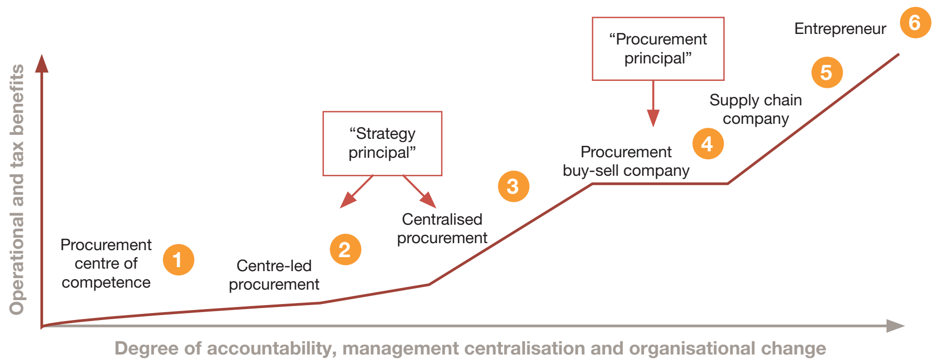
VCT

Simplification of the operational model is a proven way to reduce operational costs and increase profits. In order to increase efficiency, the operating model should cover the entire value chain from planning over procurement and manufacturing to logistics and distribution. It should be aligned with the company's organisational structure, different teams and existing technologies.

The VCT model can be applied to various essential operational activities. The same rationale can be applied to the simplification of the IP Model (see IP Model evolution in the sub-chapter on the impact of BEPS on corporate actors) and to the company's treasury centre (see the sub-chapter on dedicated treasury centres).

Figure 79 Operational & tax benefits resulting from integration

Given that organisations have different maturity levels, a phased approach can be foreseen. The below figure gives an idea of the possible different levels of integration of a company's procurement activities.



Information sharing limited global planning

Strategy set at the centre for key items, some aggregated negotiation, local contracts and orders

Strategy set at the centre, aggregated and negotiation and contracts, local call-off

Strategy development, aggregated negotiation, contracts, inventory management, risk management and orders conducted at the centre

From a decentralised to a centralised procurement, the value chain drivers typically range from the following:

1. procurement activities are decentralised, i.e. every local procurement unit (i.e. at this stage the local OpCos) works with its own local supplier. No collaboration between procurement units. Limited oversight and visibility.
2. small centre to set procurement strategy and policies but supplier relationship stays on local level.
3. a procurement core team is physically co-located in one centre. The procurement strategy, policy and key spend strategies are set at the centre. Framework agreements are negotiated centrally, with a local call-off option.
4. in addition to centre led responsibilities, centre takes title of goods and services and sells onto the local OpCos. The "Buy-sell procurement company" has responsibility for contracting,
5. inventory management, price, demand, supply, control, and it bears a higher economical risk than the local OpCos.
6. additional supply chain responsibilities (logistics, SC planning, tolling/contract manufacturing) with extended risk management and aligned financing strategy.

A business model which is not based on a robust transfer pricing policy will likely lead to the business facing controversy, double taxation and penalties.

Centralising aspects of the operating model is an opportunity to create and sustain value throughout the value chain.

Some typical examples of operating simplification can involve streamlining a wide range of equipment into a centrally managed infrastructure hub to increase utilisation and lower conversion costs. It can also include the creation of shared services support functions in order to optimise resources instead of having multiple production locations each with their own fixed costs.

Simplification of the supply chain consists in, for example, combining the inventory level management over different warehouses in order to decrease the overall inventory.

Simplification of sales can include the creation of an "umbrella brand" in a group that has a lot of different brands in order to come to a clear and uniform marketing communication strategy. It can also involve the drafting of a uniform price list and methodology instead of a complex pricing policy. An important point to monitor in this respect is to ensure that simplification does not change the "face to the customer".

BEPS

Simplification of the operations should lead to a substantial reduction in intra-group transactions and in some cases optimisation of the effective tax rate. A correct transfer pricing model and documentation is key in operational simplification.

A new business model which is not based on a robust transfer pricing policy will likely lead to the business facing controversy, double taxation and penalties. BEPS is extremely relevant in this context.

In the past we have seen models mainly based on legal agreements. Now the actual activities, where decisions are made and substance will rule the game. The tax approach is now focused on "value creation" rather than on contractual and legal risks. The traditional transactional model may no longer suffice.

We are now moving to operational models where value and remuneration do not solely rely on legal ownership. From now on, the key questions will be:

- Where do the operations take place?
- Who takes the decisions?
- Who has the supervisory power?
- Which entity effectively bears the risk and who has the power to manage the risk?

In order to set up a tax-efficient structure, there may be an increased need to move people. Exit tax charges triggered from such moves will also become more important, for example in the transfer of a valuable assembled workforce or IP (see also our comments in the HR section).

An integrated, substance-based approach where the after-tax benefits of the structure are considered will drive successful operational models.

Implementing those new transfer pricing methods may not be straightforward as decision-making is often scattered through an international group over a number of legal entities. Ideally the decision-making power should reside in a single legal entity.

Entity structure level

There are different options when reducing the number of legal entities during corporate simplification; from eliminating dormant companies to centralisation and transformation into a single entity structure.

Reshaping the conventional business model into a flexible international branch structure may provide the following benefits:

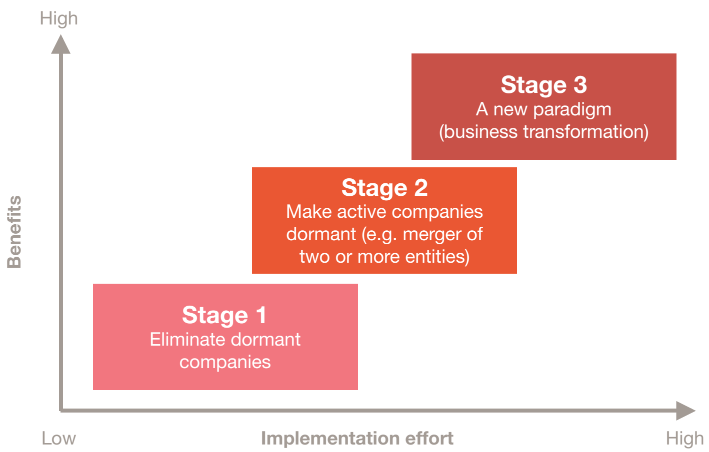
- improvement of control of the business e.g. reduced corporate governance requirements;
- simplification of intra-group arrangements e.g. less accounting complexity, more efficient cash management;
- efficient up-streaming of cash and reserves leading to less legal requirements and no cash traps;
- internal and external cost efficiencies e.g. reduction of internal functionalities (accounts, administration), less audit mandates required;
- VAT and tax management benefits;
- elimination of PE risks and related double taxation risks.

Reducing the number of legal entities or moving to a single entity structure may help manage some of the additional risks brought by BEPS.

Working in stages

There are three stages by which a company can simplify its entity structure. They require different levels of effort and bring different benefits.

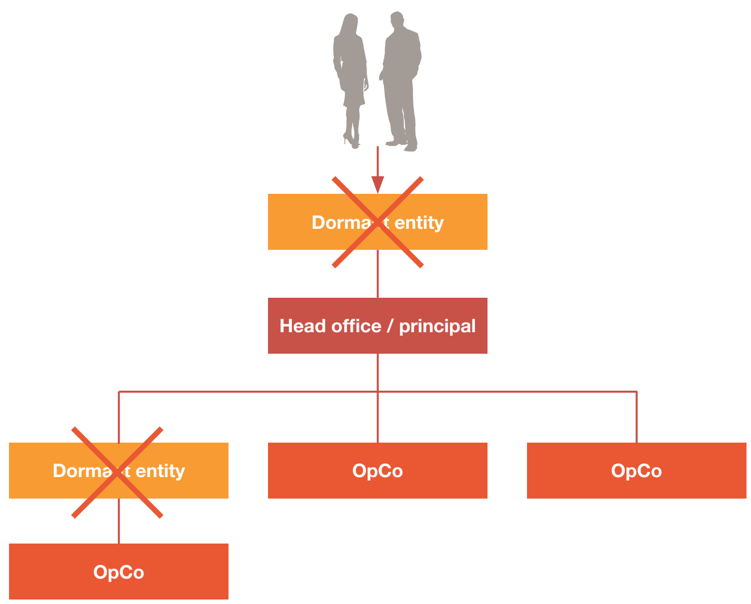
Figure 80 Increasing the implementation effort will likely generate higher benefits



Eliminate dormant entities

The first stage is to eliminate dormant entities. This is the low hanging fruit in any corporate simplification project and removes the companies which add the least value to the group. The elimination of such companies is often the starting point of each legal entity simplification project.

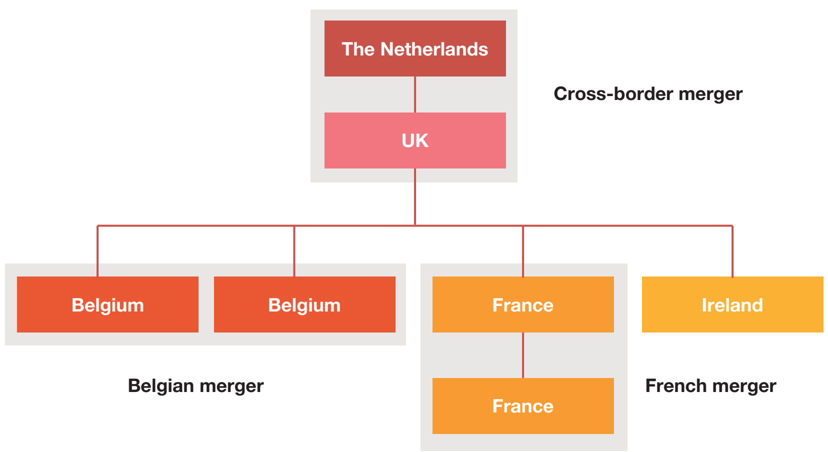
Figure 81 Elimination of dormant entities



(Cross-border) group restructurings

The second stage is more extensive. It streamlines the group structure by making some active companies dormant, for example by a merger of two or more group entities.

Figure 82 Group restructurings



The single entity model implies a structure of one entity operating via branches in foreign countries.

The objective might be to reduce the group structure to one legal entity per country or division. Such cross-border group restructurings brings great value to the group through greater flexibility, minimising cross-border losses and inter-company dealings, and the reducing timing issues and tax leakages when up-streaming dividends.

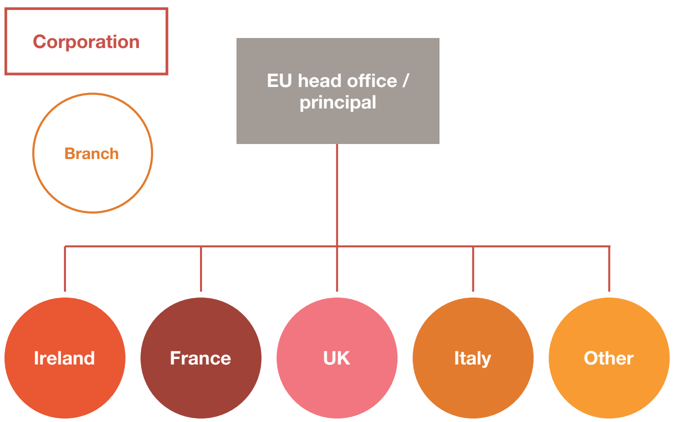
This will change the operating model so one should carefully consider the management, operational and systems implications before implementation.

A legal and tax framework has been created to facilitate EU cross-border mergers, as a result of which cross-border mergers are now possible between all 28 EU member states. This makes it very attractive for companies to simplify their legal structure within the EU, because all legal and tax (corporate income tax and VAT) aspects are facilitated across the bloc.

Single entity model

The third stage is to completely transform the legal entity structure. As this results in an entire group transformation, a strong case for change is necessary.

Figure 83 Single European Entity Model



The single entity model implies a transformation from a structure with in-country legal entities to a structure of one single entity with branches ('branch structure'). The single entity can be a national company or take the form of the European company, also known by its Latin name *Societas Europaea* (SE). This European company is a type of public limited liability company regulated under EU law. The benefits this EU company statute offers are:

- a simpler way to run your business if you are active in more than one EU country;
- greater mobility in the integrated EU market (e.g. the possibility of transferring the registered office to another EU country without having to dissolve the company);
- a framework for how to involve staff employed in more than one country in the running of your business; and
- a uniform and neutral European image.

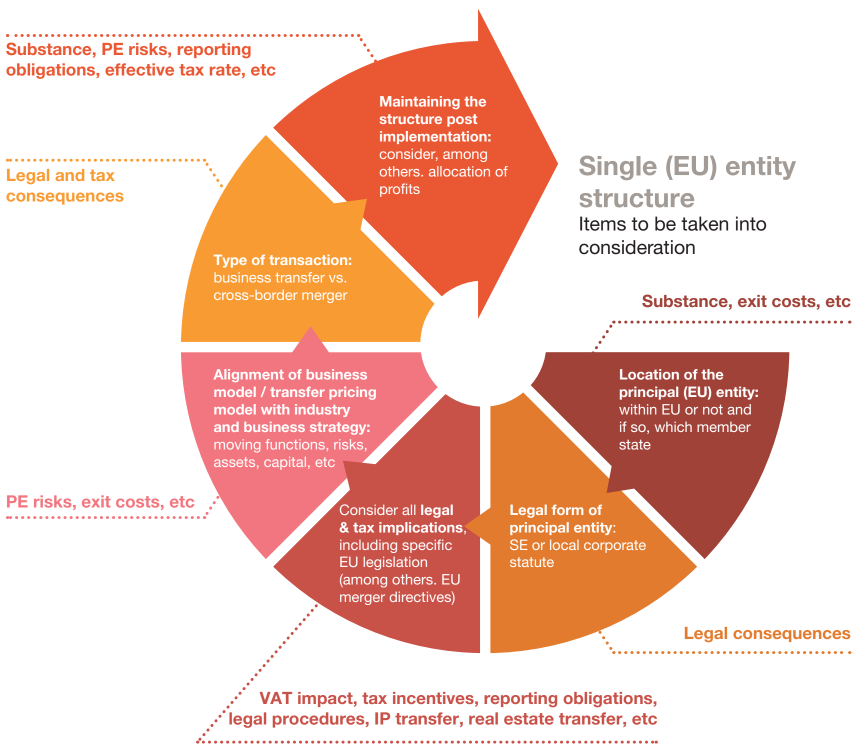
A single European entity addresses the complications of the traditional structures and transforms them into a more flexible international structure.

A single European entity with branches addresses the complications of the traditional structures. It reshapes the existing structures into a more flexible international structure with the following primary benefits:

- the reduction of internal transactions and associated recording and reconciliations costs;
- an improved corporate governance structure;
- the centralised management of risk;
- a simplified and more cost-effective account filing and audit;
- branding as an EU company;
- the removal of local directors duties and non-value added activities;
- VAT and tax management benefits;
- the elimination of PE risks and related double taxation risks.

Because the single entity model is the most far-reaching format of legal entity simplification, it is even more important to carefully consider the management, operational and systems implications before implementation. The below figure provides a non-exhaustive overview of some items to be taken into account when establishing a single EU entity structure.

Figure 84 Items to be taken into consideration upon establishment of a single entity model



E. Case study: Five factors for successful simplification

The key to success is careful planning

We recently advised a client on how to streamline his corporate structure. The objective was to achieve a structure with as few legal entities as possible and with processes that were fully integrated into financial, legal and management reporting systems, are cost effective, risk compliant and flexible enough to meet future business needs.

Based on our experience, there are five critical factors to be taken into account in order to carry out a successful corporate simplification exercise, which are summarised below:

Figure 85 Five factors for successful simplification

1	Manage your stakeholders	• Perform a simple stakeholders' analysis of needs for change and economic drivers and build a "Case for a Change" communication tool at the launch of your project. • Get managers and key stakeholders to sign up to your plan as they will drive the program across the organisation.
2	Robust methodology	• Build a robust methodology and prepare a well-defined plan. • Good coordination of the project teams involved will win you time and effort.
3	Take into account local considerations	• If your plan involves several countries, take into account legal, HR, tax, regulatory and licensing requirements of each geographic location. • Make sure that potential obstacles are identified early so that the transition can be achieved in the required timeframe.
4	Build strong central coordination	• Build a strong coordination team with clear responsibilities to ensure local and central activities are executed in a timely fashion. • Ensure active dependency management and communicate plenty over your goals and objectives.
5	Ensure operational support is in place	• Devote a special focus to the back office functions such as IT and finance, and change the necessary processes and systems (centrally and locally) to ensure they can support the new structure going forward. • It is key to minimise post-deal capacity issues for departments e.g. local consolidation requirements to avoid so-called "regret costs".

The project was a success because it was carefully articulated, planned and delivered, and because we had gained buy-in from all key internal and external stakeholders, including group management, divisional regional and local management, employees, work councils, regulatory bodies, partners and customers.

IX. Appendix 1: Structuring of pan-European buy-outs

A. Purpose

This case study illustrates how typical private equity transactions have been structured in European deals over the last decade.

It shows the background of structuring principles and requirements that have to be met to make sure that the acquisition structure can be safely implemented at upper and lower-tier levels.

It will be the basis for further analysis of the changes that are likely to occur due to recent tax changes affecting upper and lower-tier structures and management participation, which will be discussed in future publications.

B. Deal structuring

Objectives

Setting up private equity transactions requires close cooperation between providers of equity and debt. Basically, a private equity fund that can put up the financing at the lowest cost and that succeeds in getting management to buy into the deal has the best chance of winning the race.

Most leveraged buyout (LBO) deals are structured using several acquisition vehicles and debt can be channelled at the level of operating entities by way of a debt push-down.

Capital alignment of debt financing plays a key role in determining returns in a cash flow-driven M&A market. It's not unusual that the financial allocation of proceeds among entities involves yields 30% to 40% of investors' returns. This means the acquisition should be planned very early in the deal, as it has a direct impact on pricing. This is a key success factor in a highly-competitive environment.

Structuring the deal will mainly focus on:

1. identifying a suitable local acquisition vehicle,
2. identifying transaction costs and related planning opportunities (capital duty, transfer tax),
3. tax optimisation of debt-servicing and other financing-related issues (i.e. debt push-down opportunities, group taxation, double-dip financing structures, withholding tax-related issues, the consequences of equity-linked instruments, etc.) and
4. planning exit routes for investors.

However, financing contracted by intermediate holding entities (indirectly for the benefit of the top holding company and its shareholders) must be drawn down in accordance with their corporate interests and comply with the financial assistance restriction. Attention should also be paid to substance and treaty benefit tests across the upper-tier structure.

Illustration

Assuming a deal at an enterprise value and transaction costs of €600m (cash free, debt free) financed by senior loans (€200m), mezzanine (€150m) and junior debt (€150m), investor's funds would amount to €100m. This can be invested in ordinary shares, preference shares or shareholder loans (see section on capital structure below). The source and use of funds are as shown in Figure [86].

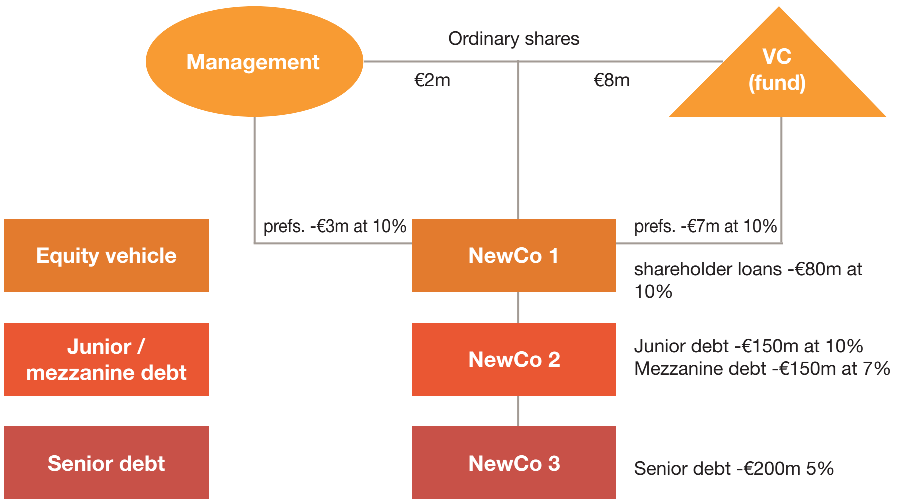
For third-party debt providers, access to the cashflow and securities of target entities is essential.

Seniority of loans can be organised either contractually or by segregating financing amongst several entities. Inspired by Anglo-American practice, structural subordination is becoming much more frequent and requires the use of several acquisition vehicles.

Figure 86 **Case study: Source and use of funds**

Uses	in €m	Sources	in €m
		Debt financing	500,000
Equity	525,000	*Senior*	*200,000*
Options	20,000	*Mezzanine*	*150,000*
		Junior	*150,000*
Debt refinancing	45,000	Equity (shareholders' funds)	100,000
		Shareholder loan	*80,000*
		Preference shares	*10,000*
Transaction costs	10,000	*Ordinary shares*	*10,000*
Total uses	600,000	Total sources	600,000

Figure 87 **Case study: Organisation of multi-tier structural subordination**



1. The target group is purchased for €600m.
2. Managements hold 20% of the group (20% of ordinary shares).
3. Junior/mezzanine debt leverage is provided by senior debt and junior debt, organised is separate holding companies (structural subordination).
4. The ordinary shares are leveraged further by the introduction of preference shares and loan stock into the capital structure

Funds would be allocated among debt and equity and would be organised as shown in Figure 87.

Financial alignment

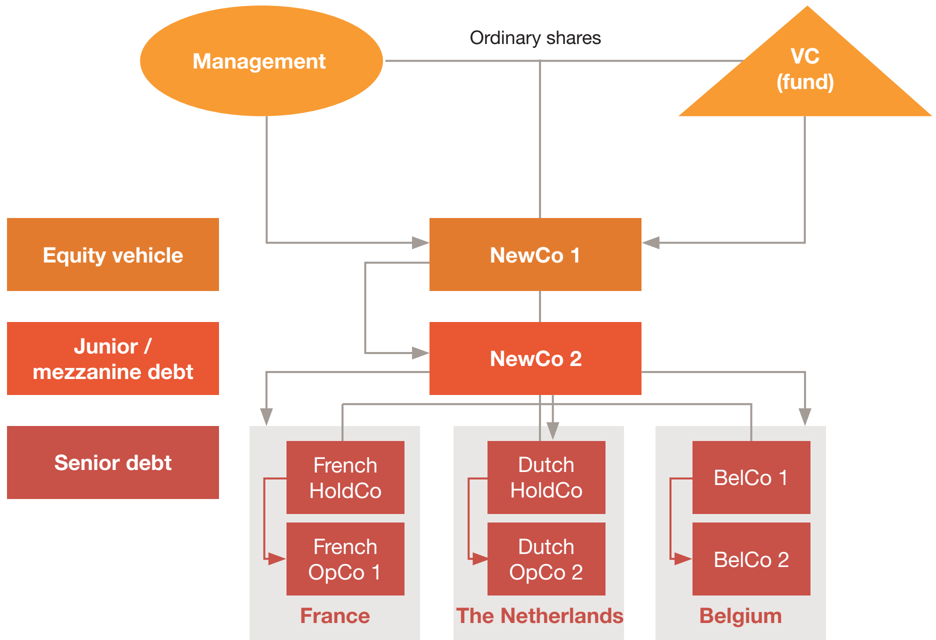
There's no standard financial alignment planning scheme and each acquisition requires ad hoc analysis.

The most common way to allocate debt finance to the target group is to undertake a capital alignment operation by means of dividend distribution, a share buy-back or a reduction in the share capital of the target company.

In the case of an international acquisition, the layering of debt is usually organised by means of regional alignment, which consist of local sub-holding companies acquiring local target entities and a local tax group being created in each jurisdiction, providing for group relief. This is illustrated in the figure below.

The local holding company can be capitalised by first acquiring the target entities and consequently selling part of them and contributing their shares to the local holding companies. This can be done to meet local thin-capitalisation ratio requirements where local grouping rules don't rule out intra-group sales.

Figure 88 **Case study: Regional alignment**



1. Incorporation of NewCo 1 (Equity Co) by management and the fund
2. Incorporation of local holding companies in France and the Netherlands (minimum equity), and use of an existing Belgian company as local acquisition vehicle.
3. Draw-down of financing in NewCo 1 (shareholder loans from the funds) NewCo 2 (junior and mezzanine debt), French HoldCo (senior debt), Dutch HoldCo (senior debt) and BelCo 1.

Optimisation

The parameters guiding optimisation of financing and its allocation by country are influenced by local thin-capitalisation rules, capital duty (possibility of share-for-share exemptions), tax leakage on upstreaming interest or dividends and local group-taxation rules.

We've seen constant shifts in the thin-capitalisation rules in Europe in recent years. They now contain a wide variety of limitation and anti-abuse measures. The trend is clearly towards the use of a difficult arm's length financing structure test rather than a static safe harbour ratio.

This is discussed further in our chapter on lower-tier structures which specifically addresses debt allocation.

Tax issues affecting the location of the top holding company are similar to those that relate to local holding companies, with a particular emphasis on taxation at exit, either as a straight sale or as a (full or partial) liquidation and share buy-back. Historically, the most popular structures involved a Dutch cooperative, a double LuxCo with PECs and CPECs (a debt instrument in Luxembourg which can be treated as equity for US investors), a Spanish ETVE (which may allow tax depreciation of the goodwill) or a Belgian company due to the favourable participation exemption and notional interest relief on equity for financing companies.

All these structures now need to be revisited in the light of BEPS. Please see our release on uppertier structures.

C. Management participation

In most deals, financial buyers expect managers to invest alongside them in the target company. The tax implications of management participation (by the directors or previous owners of the target) are a key question to be addressed in order to ensure that the after-tax incentive is maximised and management is motivated.

Genuine performance-related cash remuneration alone is, in most cases, expensive and an insufficient incentive. The same goes for any cash-settled stock appreciation scheme where directors' bonuses are linked to changes in the value of the underlying shares. In most cases this would also be treated as pure salary for tax and social security purposes. Equity-based compensation is therefore frequently used to align the interests of the private equity investor and managers in increasing the value of the target.

In practice, management's investment will be made as part of the private equity investment in ordinary shares, preference shares, loan notes or stock options. In most cases, the instruments will include a conversion mechanism (called a "ratchet") which ensures dynamic control over management and protects the private equity investor's return.

As a general rule, if shares are acquired at market value, there's no benefit to the purchaser, and thus no income tax charge. The share forms part of the individual's private assets and the capital gains at exit are taxed as gains and not earned income.

However, if shares can be acquired at a discount or are acquired with restrictions that are lifted during the course of the venture, an income tax charge may be levied.

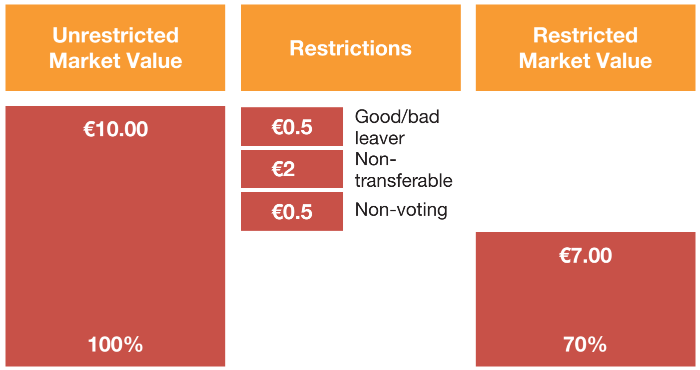
Where management's shares are acquired at a value lower than their real value – i.e. at a discount compared to the market value– the discount should in principle be treated as pay for tax and social security purposes.

In certain circumstances it should be assessed whether some discount may be applied on the basis that the shares subscribed to by managers include some restrictions in most cases.

One can defend restricting shares being traded at a discount varying between 20% and 45%. A discount on non-voting shares is also customary and could represent 5% to 8%.

In practice, each restriction on a share (e.g. no right to transfer the share for a certain period of time, no voting rights, etc.) should be assessed to estimate its restricted value. Only where management acquires restricted shares at a price below its restricted value would a potential taxable benefit crystallise.

Figure 89 **Case study: Unrestricted v. Restricted Market Value**



In this example, the unrestricted market value of the share is €10. The restricted market value (value with bad-leaver provisions, non-transferability restrictions and non-voting rights attached) is €7.

If shares are acquired at the unrestricted market value (€10), no discount arises and nor does any tax charge.

If shares are acquired at a discount (of €3) that reflects the restrictions attached to the shares, again, no taxable discount should arise because the shares are acquired at a restricted market value.

D. Structuring the investment

Objectives

One of the key issues in planning a buy-out is structuring the equity brought in by the private equity investor and managers.

Equity financing by the private equity manager is commonly referred to as "shareholders' funds" and is mainly composed of the following elements:

- loan stock, which can take the form of subordinated bonds/loans (shareholder loans) or, occasionally, preference shares (referred to as "senior preferred shares") with a fixed return;
- ordinary shares, the return on which is dependent on the outcome of the venture;
- preference shares (referred to as "junior preferred shares") giving a right to an extra return (called a "ratchet") above a certain hurdle (being expressed as a yield or money multiple) which can be subscribed to by managers.

The private equity investor's return is allocated among these instruments and is composed of the yield on shareholder loans (loan stock/preference shares) and the gain or loss at exit on ordinary shares.

Figure 90 shows how shareholders' funds of €100 million are allocated among these financial instruments. We'll also look at the parameters that guide the allocation of shareholders' funds.

Figure 90 **Case study: Allocation of shareholders' funds**

	Total	VC 95%	Management 5%	IRR
Ordinary shares	10,000	8,000	2,000	55%
Loan stock:				
Shareholder loan	80,000	80,000	-	10%
Preference shares	10,000	7,000	3,000	10%
Total sources	**100,000**	**95,000**	**5,000**	**35%**

IRR on total shareholders' funds: 35%
IRR on shareholder loan & preference share: 10%
IRR on ordinary shares: 55%

The blended target rate of return required on total shareholders' funds varies between 15% and 40% IRR ("implied rate of return"; 35% in our example). The main element of this has to be taken as a capital gain and is allocated to ordinary equity, which can generate very high returns (55% in our example).

It's the investment in ordinary shares that generates the large capital gain required, whereas the subordinated loan stock acts as the repayable element and generates the yield.

The allocation of shareholders' funds is also highly relevant to managers who're invited to invest alongside the private equity fund. The investment opportunity allows them to buy shares in the target company, which can generate significant returns. Their investment is often realised dynamically, involving the use of convertible shares – e.g. preference shares that can be converted into ordinary shares at exit depending on the development of the venture.

Sweet equity

The relative proportion of the investment made by the private equity manager in ordinary shares rather than loan stock is driven by the amount invested by other investors and their equity percentages.

The allocation of return between the private equity investor and management is measured by the "envy ratio". This is the ratio of the cost of the private equity investment to the cost of management's investment. In our example, it's calculated as follows:

Figure 91 **Ratio of sweet equity (Envy ratio)**

$$\frac{\text{(VC's total investment) / VC ordinary shares)}}{\text{(Mgt's total investment) / (Mgt ordinary shares)}} = \frac{\frac{95{,}000}{8{,}000}}{\frac{5{,}000}{2{,}000}} = 4.75$$

It compares how much the private equity investor pays for each percentage point of its equity with how much management pays for each percentage point of their equity (4.75 in our case). It covers two key variables:

1. the level of management return;
2. the level of management's investment relative to the venture capitalist's investment.

Ratchets

It's become very common in buy-out deals to use convertible features in debt or equity instruments.

The use of convertible shares is now much more frequent than that of convertible loans, with convertible shares carrying a right to conversion or multiplication upon the occurrence of certain events (e.g. realisation of a target return, exit, etc.).

These conversion agreements are also referred to as "ratchets", which, in a buy-out, can provide for the automatic multiplication of certain shares or the conversion of one class of shares into another. The same mechanism can be used to convert bonds into shares.

While ratchets may allow management shareholders to increase their stake if the company performs particularly well, they can also provide for the opposite in the event the company performs poorly (a reverse ratchet).

In Anglo-American practice, ratchets can also include automatic conversion into worthless shares or an automatic buy-back (retractable or redeemable shares).

These instruments have no equivalent in many countries owing to company law considerations, due to the strict limitations and procedures applicable to the buy-back of own shares.

Loan stock or preferred shares

Loan stock within a buy-out structure enables a private equity investor to receive a fixed yield while allowing for the majority of its money to be repaid.

The level of return on the last subordinated debt is usually benchmarked against the cost of borrowing, typically 3% to 4% over five-year EURIBOR rates.

The definition of the rate of return attached to loan stock should be analysed carefully as it can generate a value shift from the loan stock to ordinary shares, which can result in reclassification of the debt instrument as equity.

The issue of value shift, caused by the return attached to the loan stock, has been addressed by the UK tax authorities.

Basically, the Inland Revenue considers that the gain on ordinary shares only qualifies as capital rather than income to the extent that the leverage provided by the private equity manager in the form of loan stock or preference shares is on commercial terms (i.e. in our example, the yield on the loan notes of 10% may not be less than the rate charged on the most expensive external debt).

Because the loan stock is subordinated to all other external financing, there may not be sufficient cash available to repay the full amount in the early years of a highly-leveraged transaction, and the interest may be rolled up.

In some cases, the loan stock can be structured as preference shares or profit-sharing certificates providing for a fixed dividend right (right to a first dividend – fixed and cumulative).

Preference shares may provide for an accrued dividend, which will defer the withholding tax on the dividend. The conversion of such shares-cum-dividend into ordinary shares may allow an exit to be made in the form of a capital gain instead of a dividend.

X. Appendix 2: BEPS Action Points

BEPS Action Plan

Action 1: Address the tax challenges of the digital economy[1]	**Action 2:** Neutralise the effect of hybrid mismatch arrangements[1]	**Action 3:** Strengthen CFC rules[2]	**Action 4:** Limit base erosion via interest deductions and other financial payments[2]	**Action 5:** Counter harmful tax practices more effectively[1/2]
Action 6: Prevent treaty abuse[1]	**Action 7:** Prevent the artificial avoidance of PE status[2]	**Action 8:** Align transfer pricing outcomes with value creation: Intangibles[1/2]	**Action 9:** Align transfer pricing outcomes with value creation: Risks and capital[2]	**Action 10:** Align transfer pricing outcomes with value creation: Other high-risk transactions[2]
Action 11: Measuring and Monitoring BEPS[2]	**Action 12:** Mandatory disclosure rules	**Action 13:** Re-examine transfer pricing documentation[1]	**Action 14:** Make dispute resolution mechanisms more effective[2]	**Action 15:** Develop a multilateral instrument[1/3]

[1] 2014 Deliverables
[2] 2015 Deliverables
[3] open for signature by 31 December 2016

Final BEPS reports published

The tax challenges of the digital economy (Action 1)	• No ring-fencing of the digital economy for tax purposes.
	• BEPS issues are addressed by other parts of the BEPS Action Plan such as:
	  • Effective CFC rules for revenue typically earned in digital economy structurings (Action 3);
	  • Definition of PE and the concept of preparatory and auxiliary arrangements (Action 7);
	  • Legal ownership issues in the revised transfer pricing guidance on intangibles (Action 8).

Neutralise the effect of hybrid mismatch arrangements (Action 2)	• Changes to the OECD Model Tax Convention:
	  • Dual residence is addressed in Action 6 (prevent treaty abuse);
	  • Subsequent work on changing provisions and commentary of the OECD Model Tax Convention.
	• Recommendations on including a primary and secondary rule in domestic rules:
	  • Primary rule: Denial of the deduction for payments not included in the taxable income of the receiving entity;
	  • Secondary rule: Payment included as income of the paying entity or double deduction denied.

Designing effective CFC Rules (Action 3)	• Development of six building blocks for countries wanting to adopt effective CFC rules: • Definition of a CFC: When do shareholders have sufficient influence?; • Exemptions and thresholds: Eg when the tax rates are significantly lower than in the parent country; • Definition of income: Non-limitative list of potential elements to be used when defining income; • Computing income: Use rules of the parent country and set off losses only against profits of the same CFC or other CFCs in the same jurisdiction; • Attributing income: By reference to the proportionate ownership or influence; • Prevention and elimination of double taxation.
Interest deductions (Action 4)	• Recommendation on an approach based upon a fixed ratio rule limiting deductions for interest (or equivalent payments) to a percentage (10 % - 30 %) of its EBITDA. • A ratio based on the worldwide group may supplement the approach considering that not all groups are geared the same way.
Counter harmful tax practices more effectively (Action 5)	• Nexus approach for regimes targeting intellectual property: an entity can take advantage of an IP regime insofar that entity incurred research and development expenses generating IP related income. • Compulsory exchange of tax ruling from 1st April 2016 on preferential regimes, unilateral advance pricing arrangements or other unilateral transfer pricing rulings, downward profit adjustments, rulings covering permanent establishments, conduit rulings, and any other type of ruling that could give rise to BEPS if it were not exchanged.
Prevent treaty abuse (Action 6)	• Recommendations to countries adopting the following strategies to counter treaty shopping: • Avoid non-taxation or reduced taxation opportunities in the treaties; • Introduce a limitation-on-benefits (LOB) rule in the treaties; • Introduce a more general anti-abuse rule base on a 'principal purpose test' for situations not covered by the LOB-rule.
PE status avoidance (Action 7)	• Extension of the definition of PE. • Changes to certain approaches such as commissionaire arrangements. • A PE shall be deemed not to exist for activities that have a pure preparatory and auxiliary character. • Fragmenting transactions shall no longer be possible. • Guidance to be developed on the Authorised OECD Approach (AOA – Attribution of profits to PEs) before the end of 2016.
Align transfer pricing outcomes with value creation: Intangibles (Action 8)	• The legal owner is entitled to the returns from an intangible if: • it performs and controls all of the functions related to its development, enhancement, maintenance, protection and exploitation; • it provides all assets, including funding, necessary for these functions; • it assumes all related risks. • Valuation methods such as DCF approaches can be used. • Hard-to-value intangibles and information asymmetry: possibility to use ex -post results to qualify and re-price ex-ante arrangements.
Align transfer pricing outcomes with value creation: Risks and capital (Action 9)	• Importance of accurately delineating the actual transactions, and including guidance on the relevance and allocation of risk, determining the economically relevant characteristics of the controlled transaction, and non-recognition of transactions. • Discussion on important comparability factors such as location savings, local market features, assembled workforce and group synergies.
Align transfer pricing outcomes with value creation: Other high risk transactions (Action 10)	• Commodity transactions: recognition that a comparable uncontrolled price (CUP) method would generally be an appropriate transfer pricing method for commodity transactions. The pricing dates used in the contract may be disregarded under certain conditions and allow for the adoption of the "most advantageous" quoted price. • Scoping when profit splits can be the most appropriate method and when they can be reliably applied. • Guidance on low value-adding intra-group services which only need a very limited return and introducing a simplified approach.
Measuring and monitoring BEPS (Action 11)	• Potential indicators of BEPS behaviour: • Profit rates of entities located in lower-tax countries are higher than the group's worldwide profit rate; • ETR of a group is 4 to 8½ percentage points lower than ETR of domestic enterprises; • Concentration of foreign direct investments compared to GDP; • Separation of taxable profit from location of value creation; • Concentration of debt in high-tax countries.
Aggressive tax planning disclosure (Action 12)	• Recommendation to countries to develop clear and easy to understand rules. • Compliance costs must be balanced with perceived benefits. • Identification of certain key features in designing disclosure rules. • With regard to international schemes, countries should only focus on schemes that cause concerns and taxpayers should enquire whether the transaction falls under a scheme that should be disclosed mandatorily.
Transfer pricing documentation and country-by-country reporting (Action 13)	• A three-tiered approach to transfer pricing documentation: • Master file containing standardised information for all group members; • Local files providing specific information relating to the transactions of local taxpayers; • A country-by-country reporting (CbCR) template. • Mechanisms by which tax authorities will share the template have been agreed. • The CbCR is aimed at facilitating a consistent and swift implementation of new transfer pricing reporting standards, ensuring that tax administrations obtain a complete understanding of the way multinational companies structure their operations, while also ensuring that the confidentiality of such information is safeguarded. • The CbCR may only be used for high level transfer pricing risk assessment purposes or other BEPS related risks and should not be used to propose adjustments to income.
Dispute resolution mechanisms (Action 14)	• Action 14 should ensure certainty and predictability for business. • Solutions to address obstacles preventing countries solving treaty-related disputes. • Introduction of a minimum standard (timely resolution of the disputes and granting access to MAP when eligible) and a peer-based monitoring system.
Development of a multilateral instrument (Action 15)	• Development of a multilateral instrument adapting the existing bilateral tax treaties in line with the BEPS outcomes. • Work on the multilateral instrument has started in May 2015 with the aim to conclude the work and open the instrument for signature by 31st December 2016.

XI. List of abbreviations

- AIFM: Alternative Investment Fund Manager
- AIFMD: Alternative Investment Fund Managers Directive
- AOA: Attribution of Profits
- ATAD: EU draft Anti-Tax Avoidance Directive
- BE: Belgium
- BEPS: OECD's Base Erosion Profit Shifting project
- BidCo: Bidding Company
- B2B: Business-to-Business
- B2C: Business-to-Consumer
- c.: abbreviation of the Latin word 'circa' meaning 'about'
- CbC: Country-by-Country
- CbCR: Country-by-Country Reporting
- CCA: Cost Contribution Arrangement
- CEO: Chief Executive Officer
- CFC: Controlled Foreign Company
- CFO: Chief Financial Officer
- CIT: Corporate Income Tax
- CIV: Collective Investment Vehicle
- Coop.: Cooperative
- CPEC: (Luxembourg) Convertible Preferred Equity Certificate
- CRS: Common Reporting Standard
- CUP: Comparable Uncontrolled Price
- DD: Due Diligence
- DEMPE (functions): Developing, Enhancing, Maintaining, Protecting and Exploiting intangibles
- DRD: Dividend Received Deduction
- DTT: Double Taxation Treaty
- EBITDA: Earnings before Interest, Taxes, Depreciation and Amortization
- ECJ: European Court of Justice
- E.g.: abbreviation of the Latin phrase 'exampli gratia' meaning 'for example'
- ERP: Enterprise Resource Planning
- ETR: Effective Tax Rate
- ETVE: 'Entidades de Tenencia de Valores Extranjeros' in Spanish
- EU: European Union
- ECJ: European Court of Justice
- EUR: Euro
- EURIBOR: Europe Interbank Offered Rate
- EVCA: Invest Europe, formerly known as EVCA, European Private Equity & Venture Capital
- Excl.: Excluding
- ExCom: Executive Committee
- FATCA: Foreign Account Tax Compliance Act
- FCPR: (French) Fonds Commun de Placement à Risque
- FDI: Foreign Direct Investment
- FinCo: Financing Company
- FMV: Fair Market Value
- FE: Fixed Establishment
- FR: France
- GAAP: General Accepted Accounting Principles
- GAAR: General Anti-Abuse Rule
- GDP: Gross Domestic Product
- G20: Group of Twenty
- GP: General Partner(-ship)
- GST: Goods and Services Tax
- HNWI: High Net Worth Individual(s)
- HoldCo: Holding Company
- HQ: Headquarters
- HR: Human Resources
- HTVI: Hard-to-Value Intangible
- ICIJ: International Consortium of Investigative Journalists
- I/C: Inter-Company
- i.e.: abbreviation of the Latin phrase 'id est' meaning 'that is'
- Inst.: Instrument
- IP: Intellectual Property
- IPCo: Intellectual Property Holding Company
- IPO: Initial Public Offering
- IRR: Internal Rate of Return
- IT: Information Technology
- k: Thousand(s)
- LBO: Leverage Buy-Out
- LLP: (UK) Limited Liability Partnership
- LOB [clause]: Limitation on Benefits
- LP: Limited Partner(-ship)
- LU: Luxembourg
- m: million
- ManCo: Management Company
- MAP: Mutual Agreement Procedure
- M&A : Mergers & Acquisitions
- Mgt: Management
- MIP: Management Investment Plan
- Misc.: Miscellaneous
- MNC: Multinational Corporation
- MNE: Multinational Enterprise
- MoM: Multiple Of Money
- NewCo: New Company
- NFD: Net Financial Debt
- NGO: Non-Profit Organisation
- NL: The Netherlands
- OECD: Organisation for Economic Co-operation and Development
- OpCo: Operating Company
- O.S.: Ordinary Share(s)
- o.w.: of which
- PE: Permanent Establishment
- PE: Private Equity
- PEC: (Luxembourg) Preferred Equity Certificate
- P&L: Profit and Loss
- PHC: Personal Holding Company
- PIT: Personal Income Tax
- PMC: Personal Management Company
- PPL: Profit Participating Loan
- PPT [clause]: Principal Purpose Test
- Pref.: Preference Share(s)
- Pricaf : Société d'Investissement Privée à Capital Fixe
- PSD: Parent-Subsidiary Directive
- PwC: PricewaterhouseCoopers
- R&D: Research & Development
- ROI: Return On Investment
- SCA: Société en Commandite par Actions
- SE : 'Societas Europaea' in Latin, meaning 'European Company'
- SHL: Shareholder Loan
- SIC: Société d'Investissement en Créances
- SICAR: Société d'Investissement à Capital à Risque
- SICAV: Société d'Investissement à Capital Variable
- SIF: Specialised Investment Fund
- SME: Small and Medium-Sized Enterprise
- SPA: Stock Plan Administration
- SPA: Share Purchase Agreement
- SPV: Special Purpose Vehicle
- SST: Social Security Tax
- SWF: Sovereign Wealth Fund
- TC: Treasury Company
- TNMM: Transactional net margin method
- TP: Transfer Pricing
- U&S: Uses and Sources
- UK: United Kingdom
- UN: United Nations
- US: United States
- USD: American Dollar
- VAT: Value Added Tax
- VC: Venture Capitalist
- VCT: Value Chain Transformation
- WHT: Withholding Tax

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About us

Our clients face diverse challenges, strive to put new ideas into practice and seek expert advice. They turn to us for comprehensive support and practical solutions that deliver maximum value. Whether for a global player, a family business, a private equity fund or a public institution, we leverage all of our assets: experience, industry knowledge, high standards of quality, commitment to innovation and the resources of our expert network in 157 countries. Building a trusting and cooperative relationship with our clients is particularly important to us – the better we know and understand our client's needs, the more effectively we can support them.

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About this guide

BEPS has been a hot topic in the international tax scene over the past few years. The project will change the way companies do business and the impact on M&A will be dramatic.

This guide is a must-read for everyone involved in M&As, from those tasked with operational alignment to the experts dealing with people issues, corporate alignment, harmonising financial systems, and so on.

No matter what role you play in the transaction process, you need to be aware of the issues at hand and how they impact your area of expertise.

We have designed this booklet to offer information in an easy-to-grasp format for tax and non-tax experts. It has been structured to take you through a typical transaction process via specific sections, and also covers important topics for particular audiences.

"BEPS due diligence processes should rely on a sound understanding of the value chain as it will be key to assess the sustainability of the operating model (and ETR) post BEPS."

"Taxes should now be high on the agenda of CFOs and CEOs looking to protect their corporate image and comply with the new level of transparency and required disclosures."

"Companies should take the opportunity of an acquisition to integrate transfer pricing policies and dismantle uncompliant tax structures."

"The tax function of the future will rely on new technologies and processes to contribute to the company-wide enhancement of risk strategy, governance, corporate branding and resource management."

"Traditional acquisition structures will need to be revisited and reshaped to rely on substance, transparency and arm's length leverage."

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