

M&A IN FAST GROWING COUNTRIES: TRAPS AND STRUCTURING OPPORTUNITIES

A study encompassing the BRICS and next 10 emerging or emerged countries



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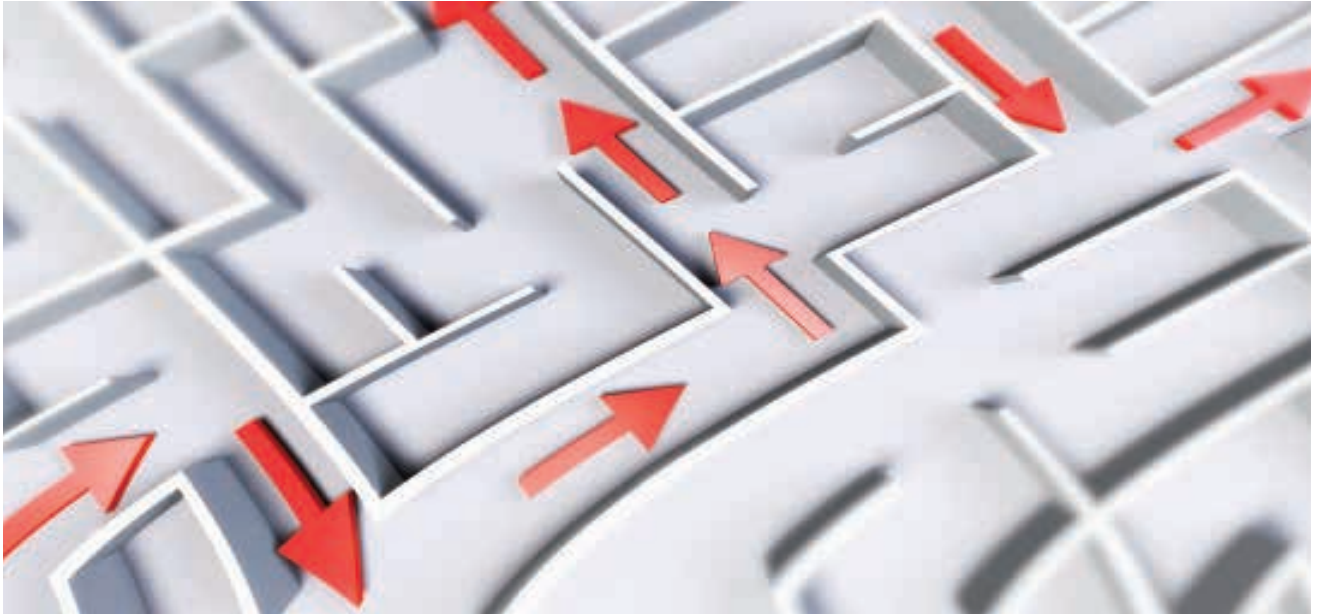
In an era of worldwide competition and integrated markets, external growth is a major strategic response of many companies to a shifting and complex competitive environment.

Higher growth rates, increasing consumer demands, access to natural resources, low cost manufacturing, deregulation of certain industries, innovation skills, tax incentives offered to foreign investors, etc. For all these reasons, emerging markets are viewed by foreign investors as an appealing and attractive proposition, especially when compared to mature economies.

While contemplating transactions in fast growing economies presents attractive opportunities to many investors, the acquisition process as well as the integration process is more complex than when conducting deals in mature economies. Our experts in Transaction Services and Tax optimization often encounter a number of risks threatening the success of the deal-making process in fast-growing markets or the success of the subsequent integration process. In this study, we shed light on transactional risks and opportunities based on our experts' experience from conducting due diligence and tax optimization in growing markets.

We took an extended approach to the notion of fast growing economies by including the five BRICS (Brazil, Russia, India, China and South Africa) and adding another ten promising and growing economies which may present attractive opportunities to investors, as follows: Algeria, Egypt, Indonesia, Malaysia, Mexico, Nigeria, Philippines, South Korea, Turkey and Vietnam.

The main traps identified by our experts during the due diligence processes are related to i) the accuracy of the financial information, ii) ownership and governance practices, or iii) regulatory and legal issues. On the other hand, tax optimization requires identifying and avoiding various tax traps (such as thin capitalization rule) but also benefiting from several tax incentives such as tax treaties and the rules for amortization of assets. Our experts emphasized the importance of engaging with multiple levels of control of the information provided, enlarging the scope of the due diligence to address the critical areas and conducting work on the ground with local experts and advisors.



METHODOLOGY

This study is aimed at guiding investors in connection with both the traps they might encounter and the incentives they may be offered by hosting countries when engaging in acquisitions in the BRICS or in other fast growing economies.

To this purpose, we built a study around the main traps and incentives encountered in due diligence and tax optimization processes when dealing with acquisitions overseas. Our local experts in due diligence and taxation who have been involved in a large number of transactions in growing economies contributed to the study. They, thereby, shed light on how to deal with the traps, their root causes and their consequences, how to overcome the difficulties encountered and how to benefit from the incentives.

The study has been conducted in close collaboration with Mazars' experts operating in the following fifteen targeted fast growing countries: Algeria, Brazil, China, Egypt, India, Indonesia, Malaysia, Mexico, Nigeria, Philippines, Russia, South Africa, South Korea, Turkey and Vietnam.

Colour codes as applied should be interpreted in terms of likelihood of occurrence. For instance, a red colour code implies a high likelihood of encountering the issue, hence a clear red flag. Alternatively, a white colour code does not automatically imply that the issue cannot be encountered in a given jurisdiction, although we do not view the issue to be prevalent in that region of the world.

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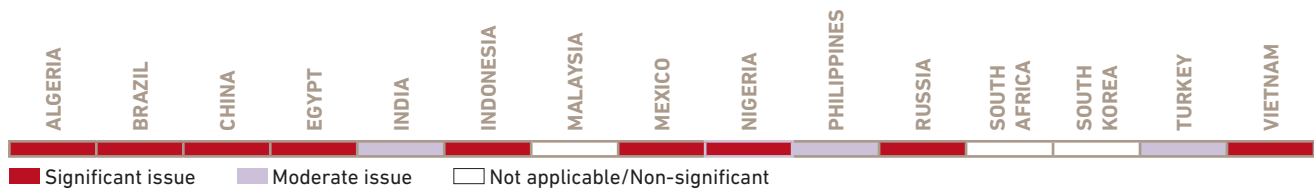
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TOP NINE TRAPS

	ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM
Quality of financial information	■	■	■	■	■	■	□	■	■	■	■	□	□	■	■
Several sets of books	■	■	■	■	□	■	□	■	□	□	■	□	□	■	■
Non-compliance with labor laws and accounting consequences	□	■	■	□	■	■	■	■	■	■	■	□	□	■	■
Hidden liabilities	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Guarantees and other commitments granted to third parties	■	■	■	□	■	■	□	□	■	■	■	■	■	■	■
Lack of satisfactory ownership documentation or multiple ownership titles	□	□	■	□	□	■	□	■	□	□	□	□	□	□	■
Not fulfilling registration requirements with relevant authorities	□	□	■	□	□	□	□	□	□	□	■	□	□	□	■
Profits repatriation and exchange control restrictions	■	■	■	□	■	□	□	□	□	□	■	□	□	□	■
Import/Export restrictions	□	□	■	□	■	■	■	■	□	□	■	□	■	□	■

■ Financial Information	■ Significant issue
■ Governance/Ownership	■ Moderate issue
■ Regulatory/Legal	□ Not applicable/Non-significant

1- QUALITY OF FINANCIAL INFORMATION



ISSUE

Whether intentional or not, inaccuracies in the financial reporting (impacting net revenues, gross margin, EBIT/EBITDA, cash flows, Net Debt, Working Capital, etc.) are to be expected.

ROOTS & CONSEQUENCES

Quality of financial information and level of internal controls can lag well behind the standards routinely applied by the acquirer. Finance and administration are often not a priority. Lack of management transparency with regard to communicating financial information (especially in family owned businesses and holdings).

SOLUTIONS

Be crystal clear prior to signing the (non-binding) Letter of Intent (LOI) that the ensuing due diligence process will trigger purchase price adjustments if discrepancies are found compared to the financial information as disclosed. Get into the due diligence process with an expectation that it is more likely than not that the financial statements will require significant adjustments and reclassifications. Hold firm on negotiating better terms and conditions, including contingent considerations.

ILLUSTRATIONS

BRAZIL

"Revenues and costs may be recognized on a cash basis and not when sales/services occur or when purchases are consumed, whereas accounting principles state that the accrued basis principle is to be applied."

CHINA

"In most cases, the local entrepreneur prefers to show the revenue and margin in their own way. For example, they count revenue on cash basis and estimate gross margin based on key cost components. Note that revenue recognition in China is often a source of argument between the two parties (target and acquirer). Consolidated financial information is often not available."

INDONESIA

"It happens that quality of financial information and audit report may sometimes be questionable. Revenue recognition is often an issue in Indonesia. Furthermore, in some cases, companies use two different auditors for management purpose and for fiscal purpose."

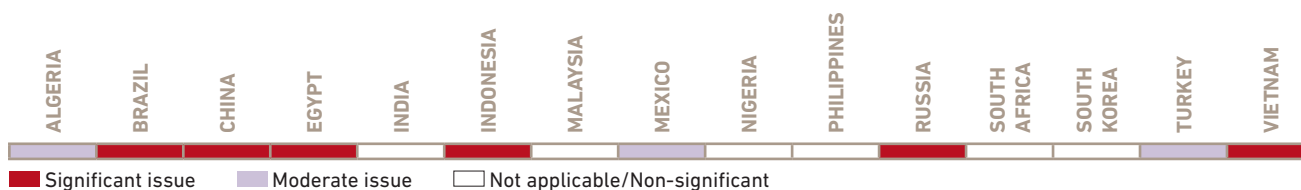
RUSSIA

"Revenues and costs are still often recognized on a document basis and not when sales/services occur or when purchases are consumed. Note that key aggregates such as EBIT or EBITDA cannot be read from statutory financial statements and should be carefully defined. The detailed analytical information is often very rich, but not used by management and not available easily."

TURKEY

"Privately held companies solely apply Turkish Accounting Principles (meaning the combination of Turkish Commercial Code, Turkish Tax Legislation and the Uniform Chart of Accounts published by the Ministry of Finance); therefore, there are material differences between Turkish Accounting Principles and IFRS especially in certain sectors such as construction."

2- SEVERAL SETS OF BOOKS



ISSUE

The target company is maintaining several conflicting sets of accounting records.

ROOTS & CONSEQUENCES

In a best-case scenario, it is legitimate. Discrepancies arise from differences between the way management is monitoring its business (management reporting for instance), accounting for local GAAP versus IFRS purposes, official tax accounting requirements, etc.

In a worst-case scenario, the root cause can be an intent to defraud one or several parties by deliberately understating (tax and labor authorities, business partner) or overstating (a potential acquirer or a new business partner) key financial aggregates.

Sometimes, differences can simply arise from the poor quality of financial processes, systems and staff.

SOLUTIONS

Rule number 1: Obtain all sets of books and proceed with the required 'quality of earnings' restatements.

Rule number 2: Always have an open discussion on the matter at hand, with no hiding place. In some jurisdictions, such facts patterns are to be expected and may not be construed as deal breakers if proper mitigating controls are implemented.

Rule number 3: Reach a clear roadmap with the target as to how and when to eliminate such practices (the sooner the better).

ILLUSTRATIONS

BRAZIL

"Out of book transactions and mirror accounting (official vs. managerial set of books) are still a reality, especially in the retail sector."

MEXICO

"Normally, in Mexico family companies (unaudited by third parties) have several kinds of account books, one for tax authorities, one for its internal decisions and another for financial institutions. That is why we recommend carrying out a deeper analysis of the company in case of investment or acquisition."

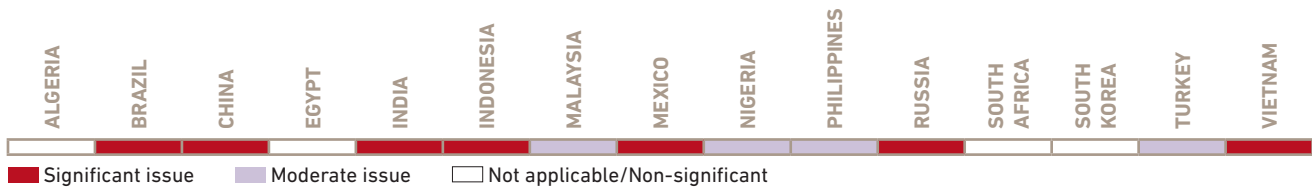
RUSSIA & UKRAINE

"We do encounter such cases of double accounting, especially with small entities with no foreign shareholders. Examples are: a separate set of books dedicated to Russian tax authorities for VAT purposes, or having an official salary recorded in the accounts, plus a certain amount paid aside in cash that is not recorded in tax accounting."

VIETNAM

"It routinely happens with locally owned companies. The experience of locals in the due diligence team is a key factor to success in identifying such issues."

3- NON-COMPLIANCE WITH LABOR LAWS & ACCOUNTING CONSEQUENCES



ISSUE

Often, employee costs and headcount are not properly taken into account through a combination of both (i) understatement of salaries and social expenses and (ii) the payment of the workforce in 'grey' cash and/or through complacent third-party organizations.

ROOTS & CONSEQUENCES

Typical roots causes are: labor laws not sufficiently strict with regard to headcount registration, laxism in labor inspections, young population with high levels of unemployment among 15-25 age strata hence a balance of power in favor of companies.

Such unethical and fraudulent practices may engage acquirers in potential litigation or/and governance issues (even more so for listed acquirers).

Understatement of (charged) labor costs leads to overstated EBIT and Free Cash Flow, thereby triggering overvaluation of the Target as a snowball effect.

SOLUTIONS

Naïve direct questions should always be asked to the target's management and shareholders.

Using a bottom-up approach is typically appropriate, whereby industry experts from our client and from our local due diligence team work hand in hand to come up with the expected headcount level and compare it with declared numbers.

Other effective techniques include cross-checking various internal information sources for inconsistencies and benchmarking with competitors whenever possible.

ILLUSTRATIONS

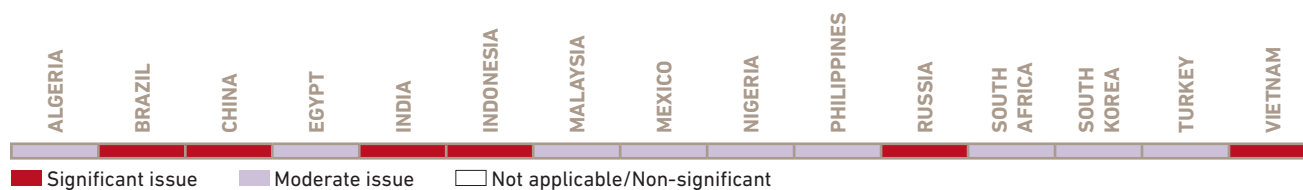
BRAZIL

"Incremental compensation may be paid on the side (either via "incentive house" systems, i.e. commissions paid to the service provider and repaid to employees, or via payment to employees directly in cash by the shareholders through dividends distribution). In such cases, certain staff and social costs are not recorded in the books in whole or in part. Other employees may also be hired as sub-contractors and as a consequence not subject to social charges. Mitigating measures are being taken by Federal Government by calculating social charges based on revenues for sensitive labor intensive sectors."

INDONESIA

"One of the biggest issues in acquiring Indonesian companies is the protection of employees stipulated by the labor law. The labor law stipulates that should there be a change in shareholder structure, the employees should be given an option to go along or leave the company. Leaving the company means that said employee must be compensated with a severance payment amount as stipulated in the labor law; this is quite significant in comparison to other countries. Those issues are manageable if they are taken into consideration in the deal structure and anticipated in the SPA."

4- HIDDEN LIABILITIES



ISSUE

Such unrecorded liabilities include tax and social welfare underpayments, undeclared loans, insufficiently accrued payables, environmental issues, etc.

ROOTS & CONSEQUENCES

This issue can be due mainly to the poor quality of the financial team, cash vs. accrual driven approach, as well as a deliberate intent to present stronger results and a stronger balance sheet.

The quality-of-information-type consequences should be derived in connection with EBIT/EBITDA, Free Cash Flow, Working Capital and Net Debt levels. Since sellers' price expectations are typically high, negotiating reductions in the purchase price often proves extremely difficult.

SOLUTIONS

Although analytical procedures remain key to identify inconsistencies in trends and key ratios, the acquirer should consider requesting that actual audits tests (in addition to the usual due diligence procedures) such as third-party confirmations (time-consuming) be applied to reach a satisfactory level of comfort.

ILLUSTRATIONS

BRAZIL

"In SME context, family businesses are common and some family costs/benefits may not appear clearly in the financial statements. Usual provisions (holidays, year-end bonus, ...) may also not be calculated, especially when taxation (including income tax) is only based on revenues which is an optional tax regime for small companies."

CHINA

"An acquirer should expect hidden liabilities, such as potential underpayments of social welfare/taxes, guarantees, and potential penalties from environmental issues (especially in polluting industry)."

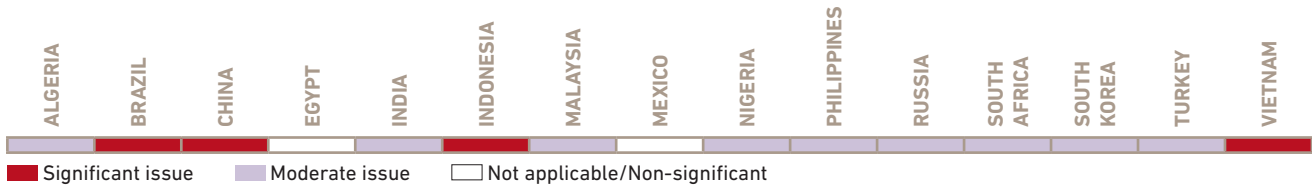
INDONESIA

"Mostly hidden liabilities related to acquisitions in Indonesia are within Tax and Legal environment. In taxation, hidden liabilities arise out of inter usage of assets among affiliated companies, related party transactions, under reporting of revenue and transfer pricing issues. In legal, hidden liabilities are usually in not having proper licenses or having non-transferable licenses that are attached to the target company."

MEXICO

"In acquisition of entities typically, a part of the price is withheld and contributed to an escrow in order to guarantee any possible contingency and is periodically released as time goes on."

5- GUARANTEES AND OTHER COMMITMENTS GRANTED TO THIRD PARTIES



ISSUE

This is a typical situation where management has granted binding guarantees or accepted commitments that are not declared during the negotiation and due diligence processes.

ROOTS & CONSEQUENCES

Although such situations can be encountered anywhere, they are definitely more prevalent and often harder to address in emerging economies. Either due to a poor organization of the finance and legal departments or to a deliberate choice not to disclose the guarantees and other commitments, the consequences might be major with regard to both the conduct of business and the sustainability of profit levels.

SOLUTIONS

It is of the utmost importance that the due diligence team and the law firm work hand in hand to come up with adequate (bulletproof) protections. Ideally, protections include cash held in an escrow account, effective price adjustment formulas and a well-written set of representations and warranties.

ILLUSTRATIONS

BRAZIL

"Guarantees are rarely listed by the companies in their "off-balance sheet" commitments but should be looked for, especially against bank loans, or lease contracts."

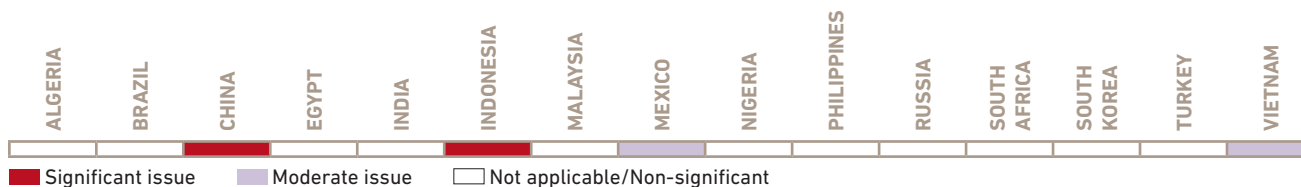
INDONESIA

"Guarantees are rarely stated in the company management accounts and sometimes depending on the quality of the auditor, guarantees may not even be stated in the audited accounts. Therefore, it is important during the due diligence process to have a good team work between several independent advisors (For example, between the FDD, TDD and LDD team). Additionally, the S.P.A. should cover indemnification of items not disclosed by the management of the Target Company."

SOUTH KOREA

"Guarantees are routinely given to related parties."

6- LACK OF SATISFACTORY OWNERSHIP DOCUMENTATION OR MULTIPLE OWNERSHIP TITLES



ISSUE

An unorthodox, yet existing practice is the recognition of declared assets as well as equity shares with no substantial legal proof to back these declarations. Furthermore, land titles can be an issue when various owners of the same plot of land or building are in possession of conflicting sets of original documents.

ROOTS & CONSEQUENCES

This issue may be a result of an archaic registration process (tangible assets/real estate) and/or inaccurate reporting methods (shares ownership).

The consequences of such a trap are post-acquisition dilution of stakes and potential partnership conflicts. Indeed, there could be a risk of legal claims over the ownership of the assets.

SOLUTIONS

The law firm's role is obviously paramount in this matter to thoroughly screen ownership contracts and title deeds. However, it is also the larger due diligence team's responsibility to interact and partner with relevant parties, including lawyers and notaries, so as to ensure that ownership rights are protected.

ILLUSTRATIONS

CHINA

"Ownership of key assets is likely to be an issue (assets without formal acquisition invoices in China)."

"Sometimes, the shareholding structure is not clear as the substantial shareholder will ask someone else to hold the shares in his companies."

INDONESIA

"Nominee shareholders (has been recently made illegal) are common in Indonesia as a company needs to have at least two shareholders. Other issues involve booking assets that are legally owned by the shareholders or management."

MEXICO

"This kind of issue arises when acquisition of land is carried out. We recommend an analysis with a public notary in Mexico in order to prevent ownership issues."

RUSSIA

"One of the main traps a foreign may fall into is having contracts post acquisition on which main conditions have changed with the change in the shareholder structure"

7- NOT FULFILLING REGISTRATION REQUIREMENTS WITH RELEVANT AUTHORITIES

ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM

■ Significant issue
 ■ Moderate issue
 ■ Not applicable/Non-significant

ISSUE

This is typically a situation where the target is not abiding by all the relevant registration requirements to conduct its business, or when the investor is unable to provide proper documentation or warranties to relevant authorities.

ROOTS & CONSEQUENCES

There might be a few reasons behind this, mainly unclear registration requirements, bureaucratic processes, or failure to file in a timely manner or to obtain the right permits.

Caution is advised as the consequences of such hurdles can be devastating in the event that the ability to conduct business is questioned by the authorities.

SOLUTIONS

All registration matters (i.e., authorizations to do business) should be reviewed carefully in a joint team effort between the lawyers and the due diligence team.

ILLUSTRATIONS

BRAZIL

"The Foreign Investor must comply with Brazilian Law, such as, be represented by Brazilian citizen or foreign individual with permanent visa, CPF – Individual Taxpayer Number, among others. Foreign Investors should also be registered with the Central Bank if international financing of the transaction is contemplated."

INDONESIA

"Aside from operating without proper licenses, sometimes licenses are non-transferable or are attached to the target company leaving the buyers stuck in a share deal if they want to go through."

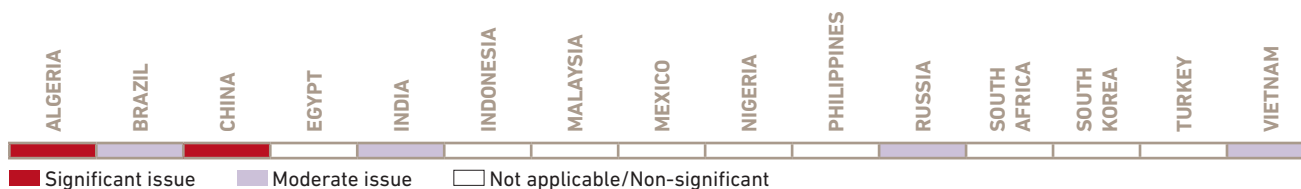
MALAYSIA

"Acquisition of a licensed manufacturing company would require the approval from the Malaysian Industrial Development Corporation. Acquisition of real property exceeding RM20 millions requires approval."

VIETNAM

"All should submit a complete file to the authorities to get an investment license and local authorities will check the feasibility of the project at that time."

8- PROFITS REPATRIATION AND EXCHANGE CONTROL RESTRICTIONS



ISSUE

A few emerging countries have enacted regulation with regard to profit repatriation as well as restrictions over foreign exchange inflows and outflows.

ROOTS & CONSEQUENCES

These protectionist practices are evidently aimed at dealing with growing concerns over currency volatility. As a consequence, primary investments may be locked in the hosting country, thus forcing investors to sell acquired companies at undervalued prices in order to repatriate the underlying cash.

SOLUTIONS

One should anticipate the issue before deciding to invest in countries imposing such regulations. Ad hoc legal and tax planning are highly recommended.

ILLUSTRATIONS

ALGERIA

"Operators must possess a clean audit report and a certificate from the tax authority in order to repatriate funds. In December 2010, the Bank of Algeria put in place new restrictions on foreign shareholders' loans to Algerian subsidiaries. These new provisions mandate that firms receiving such loans after July 26, 2009 must book them as additions to capital.

Foreign investors can repatriate dividends, profits, and real net income out of their assets through transfers or liquidation. In certain cases, due to the inefficiency of the banking system and the heavy bureaucracy, it may take longer to obtain official permission from the central bank to make transfers/payments, or for the local bank to proceed with the transfer."

BRAZIL

"Dividends – including paid to a foreign shareholder - are among the few tax free operations. Other usual schemes such as management fees, royalties ... can lead to significant taxation."

RUSSIA

"Currency-control regulation has been reduced over the last 5 years, but there are still some obligations, such as to document transactions between residents and non-residents by opening a passport of the transaction with a Russian bank."

VIETNAM

"When Government coffers are low, foreign exchange can become more difficult to obtain"

9- IMPORT/EXPORT RESTRICTIONS

ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM

■ Significant issue
 ■ Moderate issue
 Not applicable/Non-significant

ISSUE

The issue here is protectionist practices, including quota settings and prohibitions on merchandise inflows and outflows.

ROOTS & CONSEQUENCES

The main consequence of such a hurdle revolves around production constraints (i.e., spare parts imports, exports to specific countries, etc.).

SOLUTIONS

We advise the acquirer to consider undertaking a thorough due diligence of the supply chain and partner with legal consultants to keep track of the restriction list.

ILLUSTRATIONS

INDIA

"There are a number of goods, which can only be imported under an import license. These include some consumer goods; precious and semi-precious stones; products related to safety and security; seeds, plants and animals; some insecticides, pharmaceuticals and chemicals; some electronic items; several items reserved for production by the small-scale sector. Other items are canalized, that is, imported only through specified channels or government agencies."

INDONESIA

"There are restrictions in importing to and exporting from Indonesia. All importing and exporting activity needs licensing except for what is hand carried (some restriction is still applicable in hand carry goods)."

MALAYSIA

"Some goods such as rice, rubber and timber are restricted under Malaysian law for export and subject to import approval. On the other hand, goods can be exported to any country except Israel."

MEXICO

"It is important to analyze the product origin in order to determine the correct import duties, otherwise for tax purposes such importations will qualify as non-deductible items."

VIETNAM

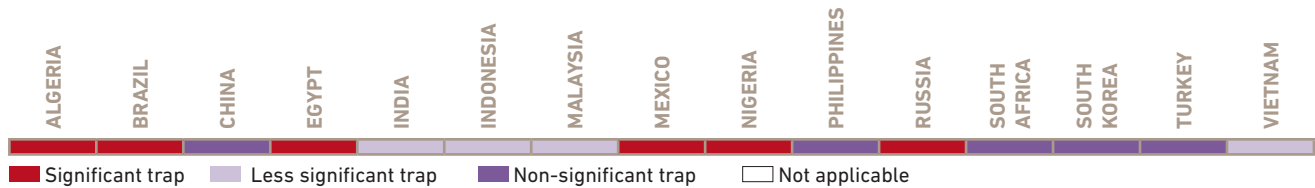
"Sensitive and luxury goods are subject to quota and import control by the Government. IT companies are encouraged through incentives. Import/export types are governed by the need to obtain a specific license."

TOP TAX TRAPS

	ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM
Thin capitalization rules	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Transfer pricing documentation	■	■	■	■	■	■	■	■	■	□	■	■	■	■	■
CFC rules	□	■	■	■	□	■	□	■	□	■	□	■	■	■	□
Dissuasive tax rates (CIT/ capital gains)	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
French tax treaty	■	□	■	■	■	■	■	■	■	■	■	■	■	■	■
Stamps duties on structuring operations	■	□	■	□	■	■	■	□	■	■	□	■	■	■	■
Use of tax losses in case of change of control of the taxpayer	■	■	□	■	■	■	■	■	■	■	■	■	■	■	■

■ Significant trap
■ Less significant trap
■ Non-significant trap
 Not applicable

1- THIN CAPITALIZATION RULES



NATURE

The equity available to a corporate taxpayer corresponds to the only “free” resource enabling the coverage of any company’s liability towards its creditors, who bear the solvency risk of the company. Therefore, local tax provisions most often regulate the proportion of financing of the corporate taxpayer through equity and debt. The corresponding set of rules is generally referred to as “thin capitalization rules” and triggers the add-back of all or part of the financial expenses borne by a corporate taxpayer when its indebtedness is disproportionate to its equity (i.e. its leverage is too high).

Such provisions aim at solving solvency issues borne by the company’s creditors as well as at limiting the possibility of abuses through excessive interest deductions.

IMPACT

Thin capitalization rules determine the proportion of financial expenses actually incurred by the corporate taxpayer that can be considered as deductible for corporate income tax (hereafter “CIT”) purposes.

The amount of interest paid in excess of the limits set forth by thin capitalization rules is not tax deductible, up to the threshold determined by the domestic law of each country.

SOLUTIONS

Companies must comply with the thin capitalization ratios and therefore monitor the level of their equity in order to achieve a full deduction of their financial expenses.

ILLUSTRATIONS

BRAZIL

“As a general principle, related party debts must not exceed twice the amount of the lender’s share in the borrowing Brazilian company’s net equity. Note that a second test, based on the comparison between the Brazilian company’s net equity and this entity’s debt towards non-Brazilian related lenders may also apply, as well as additional requirements in case the related lender is located in a tax haven.”

RUSSIA

“For financial companies, the debt-equity ratio shall not exceed 12:1. For other companies, the maximum ratio is 3:1.”

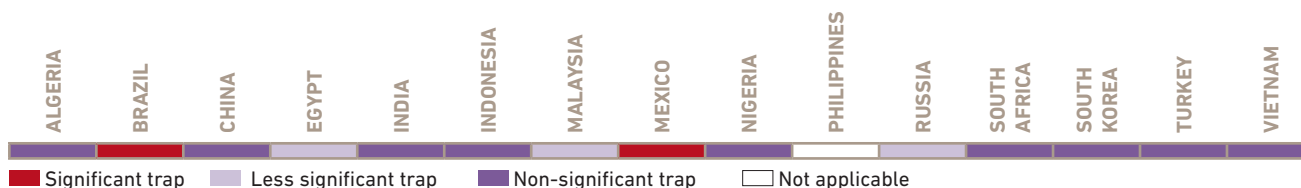
SOUTH KOREA

“If loans from overseas controlling shareholders (OCS) guaranteed by OCS exceed 3 times (6 times for financial institutions) the equity held by OCS, the interest on the exceeding amount of the loans is not deductible.”

TURKEY

“Thin capitalization rules require a gearing of 3: 1 between debts and equity. The interest borne in respect of the portion of debt exceeding this limitation (including exchange rate differences and other expenses paid over this amount) is disallowed for tax purposes. Thin capitalization ratio is considered reached if the loans are received from related banks and/or similar financial institutions.”

2- TRANSFER PRICING DOCUMENTATION



NATURE

Intercompany prices are sometimes used to relocate the companies' tax basis in a favourable tax jurisdiction in order to optimize the amount of corporate income tax. Therefore, in most countries, the local tax authorities have adopted the "arm's length principle" implemented at OECD level, which stipulates that transactions between related parties should be carried out under the same conditions, notably in terms of pricing, as those that would have been agreed to between third parties. The companies must be capable of proving that the intra-group transaction they are involved in meets the arm's length criteria and must be able to justify, based on a sound documentation, that the price or the corresponding allocation of income, assets and/or equity (when recorded in respect of a branch) at stake duly reflects the situation of a non-related party under similar circumstances ("transfer pricing documentation"). In such contexts, the terms "transfer pricing" refer to the setting, analysis, documentation, and adjustment of prices between related parties (for goods, services, or use of property, including intangible property).

IMPACT

Transfer pricing rules may vary from one country to another and may impose, in certain cases, having an updated transfer pricing documentation available at the level of the corporate taxpayer to support all inter-company transactions. In practice, the fraction of inter-company expense exceeding the level of similar expenses incurred at arm's length is added-back to the corporate taxpayer's income for corporate income tax purposes. Similarly, indirect subsidies resulting from prices set below arm's length terms may be disallowed for corporate income tax purposes at the level of the corporate taxpayer. Lastly, in certain cases (e.g., lack of transfer pricing documentation), additional penalties may apply. Note, however, that tax treaties may provide for the possibility of benefiting from symmetrical corrections of local transfer pricing reassessments in the framework of a mutual agreement procedure (art. 25 of OECD model).

SOLUTIONS

Companies must meet the arm's length principle to avoid the tax risks of transfer pricing. Proper documentation should be available to justify the transfer pricing policy applied.

ILLUSTRATIONS

MOST COUNTRIES

"Most countries have a transfer pricing legislation and require a specific transfer pricing documentation. Please note that the Republic of the Philippines is in the process of developing transfer pricing regulations. At this stage, the Tax authorities of this country do not require a specific transfer pricing documentation."

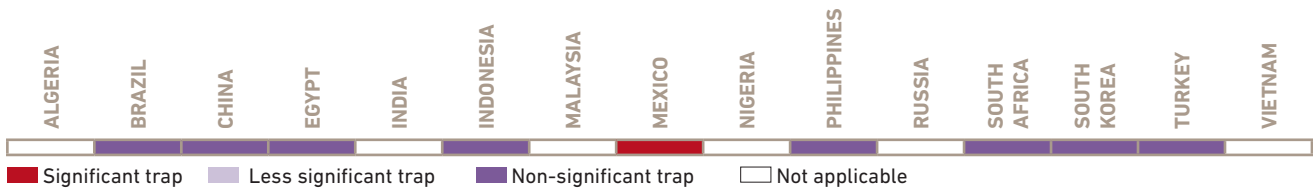
INDIA

"India has a very stiff transfer pricing regime and it is in the interest of persons doing business to ensure proper documentation is maintained."

MALAYSIA

"Further to the introduction of specific transfer pricing legislation with a retrospective effect from 1 January 2009 onwards, all companies entering into related party transactions must prepare a transfer pricing documentation, compliant with local transfer pricing guidelines."

3- CONTROLLED FOREIGN COMPANIES RULES



NATURE

Subsidiaries located in a jurisdiction where they benefit from a privileged tax regime (i.e., low taxation) are sometimes used to relocate their parent companies' tax basis in this favourable tax jurisdiction in order to optimize the amount of corporate income tax.

Controlled Foreign Companies (CFC) rules aim at avoiding the use of low-taxed jurisdictions to shelter profits that would otherwise be taxed at a substantially higher rate.

IMPACT

CFC rules may vary from one country to another. A number of countries do not have such provisions/rules. In most cases, the tax consequences of abusive use of those CFC consist in having the CFC income taxed at the level of the parent company.

SOLUTIONS

Companies should monitor the level of taxation locally and be able to prove the absence of abuse.

ILLUSTRATIONS

Algeria, Egypt, Nigeria, India, Russia and Vietnam do not have CFC legislation.

BRAZIL

"CFC rules apply. The profits generated by a foreign company must be included in the December 31 financial statement. In certain circumstances, these profits are subject to taxation in Brazil and the financial statements must be prepared consistently with local legislation and converted into Brazilian currency. "

CHINA

"CFC rules apply when the foreign companies are in a country where the tax burden is less than 12.5%. However, companies can avoid CFC rules when certain conditions are met."

MEXICO

"CFC rules apply in Mexico under the form of a 40% withholding tax on payments made to residents in jurisdiction that qualify as tax havens. Double tax treaties may mitigate/eliminate this withholding tax,..."

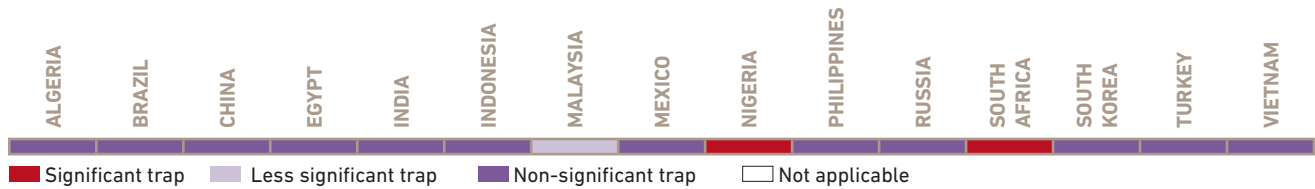
SOUTH AFRICA

"CFC rules apply to foreign companies controlled (up to more than 50% of the equity shares or voting rights) by South African residents."

SOUTH KOREA

"CFC rules apply when the foreign corporation is in a country where the tax burden is less than 15%."

4- DISSUASIVE TAX RATES (CORPORATE INCOME TAX/CAPITAL GAINS)



NATURE

Capital gains tax rates may differ from local corporate tax income rates in order to limit the disposal of assets locally. This may be related to the nature of the assets at stake or to the way the assets are held (i.e., the vehicle through which the assets are owned).

IMPACT

Some applicable rates may discourage investors from selling their assets. Tax treaties should also be taken into account as they may provide reduced tax rates or exemptions.

SOLUTIONS

Appropriate structuring may help minimize the tax impact, for instance through the disposal of the enterprise at a higher tier of the legal structure, enabling the taxable gain to be located in a country where it is subject to a lower tax rate.

ILLUSTRATIONS

INDONESIA

"Capital gain tax is the same as the corporate income tax (rate of 25%)"

MEXICO

"Alienation of shares is taxable at 25% income tax rate on the gross payment (option to tax gains on alienation of shares at tax rate of 30%)."

NIGERIA

"Business profits issued from petroleum activities are taxed at a 85% rate."

RUSSIA

"Capital gains are taxed at general rate of 20%, usage of tax optimization tools with treaty shopping and offshore countries participation is widely practiced."

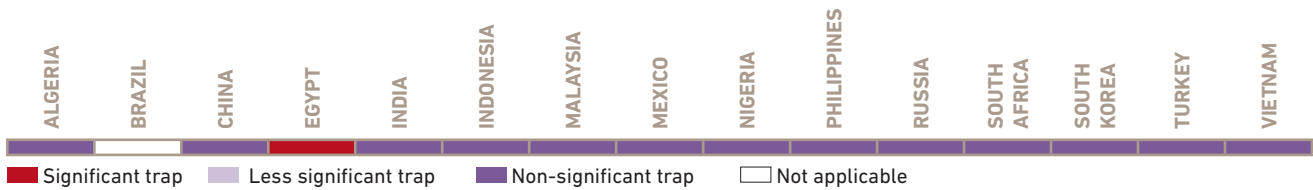
SOUTH AFRICA

"Capital gains are subject to an effective tax rate of (66% of the normal company tax rate of 28%)."

TURKEY

"Under certain specific conditions, tax rate can reach 75% of the capital gains from disposal of subscription shares that is held for over two years."

5- TAX TREATIES



NATURE

Since taxes aim to finance state budgets, they are generally set by governmental bodies and legislators that have jurisdiction over one country.

Therefore, conflicting provisions from distinct countries may result in double taxation issues. To avoid such issues, States often enter into tax treaties that aim at avoiding double taxation. Tax treaties are drafted based on models issued either by the OECD and/or, more rarely, the UNO.

For example, France has signed a significant number of tax treaties with emerging countries. These treaties aim at limiting double taxation and facilitating economic exchange between different countries.

IMPACT

In practice, the provisions of the tax treaties considered allow two objectives to be achieved:

- Avoidance of double taxation: double taxation is avoided either through exclusive taxation of the income measured in the State who is a member of the tax treaty or through granting tax credits that aim at neutralizing the impact, at the level of the beneficiary of the income, of the taxes possibly withheld at source at the level of the taxpayer who generated the income.
- Reduction of withholding tax rates: tax treaties often introduce specific reduced withholding tax rates applicable to certain types of income (e.g., dividends, interests and royalties).

SOLUTIONS

Proper tax structuring could improve tax leakage on repatriation of profits, notably through the re-routing of profits which may enable withholding tax savings.

ILLUSTRATIONS (CASE OF FRENCH TAX TREATIES)

BRAZIL

"The minimum rate of withholding tax is 15% for interests paid to non-residents and royalties. Capital gains at 15% for non-residents and at the normal income tax rate for residents."

INDONESIA

"Tax treaty with France provides for 10% WHT rate on dividends for shareholding at least 25% and 15% for any other case, 10% WHT rate on royalties and a 15% WHT on interest income."

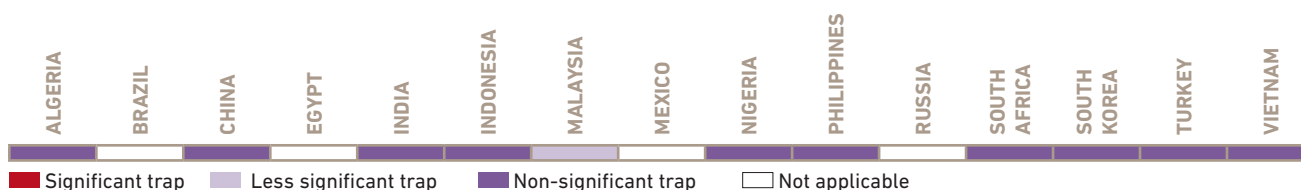
MEXICO

"Dividend payments are tax free (local law); withholding tax for royalties is 15% and for interests is 15%. Such rates can be reduced under the most favorable treaties."

RUSSIA

"Thanks to the tax treaties entered into by Russia, withholding tax rate on dividends may be reduced from 15% (local rate) down to 5%. On interest, royalties or capital gains, withholding tax rate may be reduced from 20% (local rate) to 0%."

6- STAMP DUTIES ON STRUCTURING OPERATIONS



NATURE

Where enforced, this tax is applied on the transfer of homes, buildings, copyrights, land, patents and securities. When this tax exists, the transfer of documents in locations is legally enforceable only when they are stamped, which proves the amount of tax paid.

As they correspond in most cases to fixed amounts or relatively low costs, stamp duties are often seen as ancillary taxes. However, structuring transactions (asset deals, share deals, capital decreases, mergers...) usually involve stamp duties depending on the laws of the countries. In certain cases, those costs may be substantial and could impact the carrying out of a transaction.

IMPACT

Stamp duties are an actual cost in transactions which has a direct cash effect at the level of the paying party. In certain countries, there exists a joint liability of both parties to a transaction for the payment of the stamp duties related to the transaction.

SOLUTIONS

In practice, companies should adopt the best routes that involve the most minimal stamp duty costs, either through the re-location of the transaction or the modification of the assets transferred.

ILLUSTRATIONS

There are no stamp duties in Egypt, Mexico, Brazil and Russia.

INDONESIA

"Stamp duty is common in Indonesia but is generally not material (less than 1 Euro per transaction)."

PHILIPPINES

"In this country, the transfer tax rates are as follow: (i) Shares: $\frac{1}{2} \times 0.75\%$ of par value; (ii) Complete branch of activities (nor capital increase/ decrease): $\frac{1}{2} \times 1\%$ of par value. Stamp duties are only due on original issue for mergers or assimilated transactions."

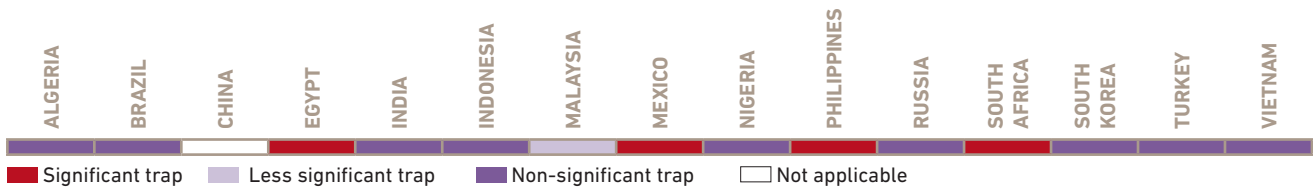
SOUTH AFRICA

"Transfers of shares are taxed at 0.25%. This country has no taxation of transfer of a complete branch of activities. A stamp duty is payable if the increase/decrease in capital takes place in the form of shares. The transfers on mergers or assimilated transactions are liable to stamp duty unless exempted by specific provisions."

TURKEY

"Documents related to contracts, commitments, assignments, receipts, official reports, and other specified papers related to commercial transactions may be subject to Stamp duties locally."

7- USE OF TAX LOSSES IN CASE OF CHANGE OF CONTROL OF THE TAX PAYER



NATURE

For corporate income tax purposes, most States enable the offsetting of past tax losses carried forward against the taxable income of the year to enable the determination of the corporate taxpayer's corporate income tax basis. Therefore, existing tax losses may give rise to the recognition of deferred tax assets in the consolidated accounts, when it is likely that the losses will be used for offsetting tax purposes.

In order to limit the abusive use of tax loss carry-forwards by corporate taxpayers who did not generate the corresponding losses and to whom the tax attributes have been transferred, the change of control may trigger the forfeiture of tax losses or may limit their use.

IMPACT

The total or partial forfeiture of tax losses carried forward in case of a change of control could have a potential impact on cash flows (as the corporate income tax cash out increases) and on deferred taxes. Please note that several countries have no restrictive legislation on this matter.

SOLUTIONS

It is very difficult in practice to avoid the forfeiture of tax losses in case of a control change, when the local tax provisions impose such forfeiture.

In this case, the risk could be reduced by acquisition price adjustments considering the amount of tax attributes lost.

ILLUSTRATIONS

Algeria, China, Indonesia, Malaysia, Nigeria, South Korea, Russia and Vietnam have no restrictive legislation on this matter.

BRAZIL

"A change of shareholder does in principle not impact the tax loss carry-forwards unless a change of activity follows the change of control. Tax losses can be used for an indefinite period, at a limit of 30% of the taxable income of the year."

INDONESIA

"Tax losses carried forward are not impacted by a change of control to the extent there is no change in the underlying business line that generated the tax loss (losses may be carried forward for five years maximum; the carry-back of losses is not permitted)."

SOUTH AFRICA

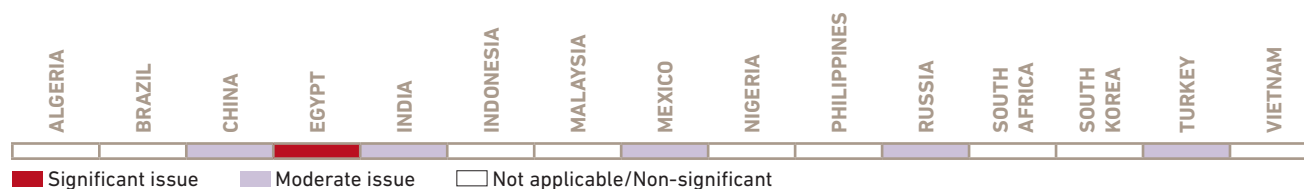
"Capital gains or income resulting from a change of shareholder may not be offset against capital losses or losses carried forward for tax purposes in the event the operation is proved to be mainly tax driven. A company will lose its tax losses if it ceases to trade for a year of assessment."

NEXT NINE ISSUES

	ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM
Significant differences between local and international accounting standards	□	□	■	■	■	□	□	■	□	□	■	□	□	■	□
Significant post-acquisition salary increases	□	□	■	■	■	■	□	□	■	■	■	□	□	□	■
Choosing an inappropriate legal form	■	□	■	□	■	■	■	□	■	■	■	■	■	■	■
Unclear power sharing agreement	□	□	■	□	■	□	□	□	□	□	□	□	□	□	■
Prohibited sectors	□	■	■	□	■	■	□	■	■	■	■	□	□	□	■
Earnouts not allowed	□	□	■	□	■	□	□	□	□	□	□	□	□	□	■
Minimum amount for FDI	□	□	■	□	□	■	■	□	□	■	■	□	■	□	□
Control ceilings	■	□	■	□	■	■	□	□	□	□	■	□	□	□	□
Personal liability of Legal representative	■	■	■	□	□	□	□	□	■	□	■	□	□	■	□

■ Financial Information	■ Significant issue
■ Governance/Ownership	■ Moderate issue
■ Regulatory/Legal	□ Not applicable/Non-significant

1- SIGNIFICANT DIFFERENCES BETWEEN LOCAL AND INTERNATIONAL ACCOUNTING STANDARDS



ISSUE

The issue arises when local accounting standards diverge from international standards, which makes it harder for an international investor to analyze financial statements.

ROOTS & CONSEQUENCES

It is a known fact that a number of emerging countries have not yet embraced international accounting standards in whole or in part.

Countries where local and international standards coexist still have a large number of companies and especially SMEs who prefer to use local GAAP.

This issue arises in many fast-growing countries and in most of the BRICS (except for South Africa).

SOLUTIONS

The due diligence team should bridge the gap between local and international accounting standards on key financial aggregates (revenues, gross margin, EBIT, net income, equity reconciliation) during the due diligence process.

ILLUSTRATIONS

INDIA

"Although some changes have been made in the last decade to existing Indian GAAP, there are still a number of differences between Indian GAAP and IFRS. The implementation of new Indian Accounting Standards converging with IFRS has recently been postponed without clarity on the scope and revised timeline at this stage."

INDONESIA

"Indonesia still uses Indonesian GAAP, which are fully convergent to IFRS standards. However, a transposition time still exists on adoption of new changes."

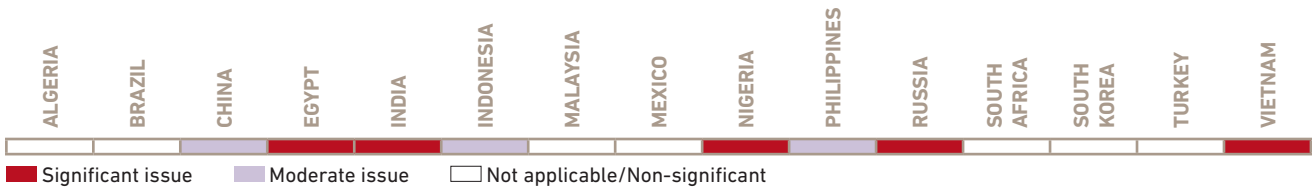
MEXICO

"Public companies in Mexico are obliged to apply IFRS since 2012, non-public entities are not obliged, but some of them use IFRS and local GAAP (known as NIF). The differences between NIF and IFRS are not significant, but such accounting standards will never converge, that is derived from certain local provisions. We recommend analyzing the recognition of assets and the determination of the inflationary effect on non-monetary assets."

TURKEY

"Current Turkish accounting standards are very 'tax-oriented' and thus cannot be considered as «developed». Listed companies are obliged to prepare financial statements in accordance with IFRS and certain big holding/group companies will apply IFRS as well in accordance with the recently published independent audit law."

2- SIGNIFICANT POST- ACQUISITION SALARY INCREASES



ISSUE

In some jurisdictions, under certain circumstances, significant salary increases are a common practice.

ROOTS & CONSEQUENCES

On top of inflation-driven salary increases which are standard in many fast-growth economies, it can be customary to have significant compensation increases in case of a change of ownership, particularly when the acquirer is a foreign corporation. Quite often, we find out that management has promised his employees that the new investor would grant sky-high salary increases and bonuses.

Some countries even require by law that foreign-owned companies pay a certain minimum wage level.

SOLUTIONS

The acquirer should discuss this matter openly with management, and take advice from local finance and legal advisors as to customary or mandatory practices.

Besides, he should include the projected salary increase in the Business Plan for valuation purposes. Those typically exceed 10 to 15% on average.

ILLUSTRATIONS

INDONESIA

"Post-acquisition salary increases are not too common in Indonesia. The main issue is the severance payment triggered by a change of shareholder composition. However, the salary increase issue may arise when labor union is in the picture: where the union negotiates for salary increase or will not go along with the new owner triggering severance payment liability."

RUSSIA

"The typical salary raise following an acquisition by a foreign investor is around 25 to 30%: Russian salaries in local companies are lower than in international companies. It is also quite usual to have official and unofficial salary, 50% paid officially and 50% paid unofficially for instance. International companies after acquisition try to officialise the business, so there is a 50% mechanical raise in the recorded salaries."

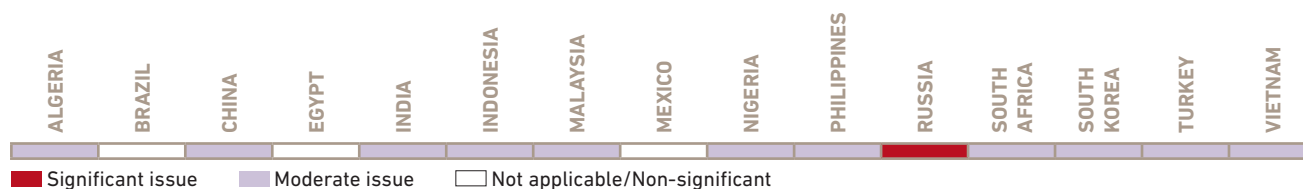
TURKEY

"Generally, in SME's and family-owned companies, the major shareholder occupies the general manager/ CEO position of the company and is not fairly paid by the company due to tax issues. In the post-acquisition period, a fairly determined salary for the position leads to a decrease in the EBITDA level of the company. This should be considered in the projections during the company valuation process."

VIETNAM

"The minimum salary for employees is different for a local investor and a foreign investor (depending also on the region). The typical rate increase these days is around 10%, but can include an incremental increase to abide by the minimum salary rule with regard to foreign shareholding."

3- CHOOSING AN INAPPROPRIATE LEGAL FORM



ISSUE

This issue is about choosing a legal form that is not optimal to run operations or with respect to tax optimization and limitation of liability exposure.

ROOTS & CONSEQUENCES

The root of this issue could be the pre-existing legal form that might not be optimal for a FDI (Foreign Direct Investment) for various reasons (limitation of liability, repatriation of cash, foreign management, etc.). The pre-existing legal form might not prove business-friendly in terms of alignment with ambitious business growth plans.

SOLUTIONS

The best way to get around the problem is to plan ahead the legal and tax structuring while keeping in mind the day-to-day operational requirements of the business.

The acquirer should draw conclusions from the findings of the due diligence process to adjust the planned legal and tax structuring on an as-needed basis.

ILLUSTRATIONS

INDIA

“When the type of activity planned by a foreign investor is of liaison or of representative nature, a Liaison Office is the appropriate legal form. A Liaison Office adheres to less regulatory compliances than the other legal forms and when properly run will not be liable to income tax.

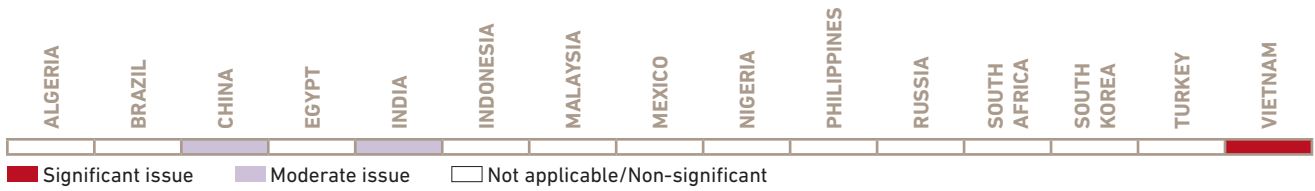
In India, a Liaison Office can undertake the following activities: (i) representing the parent company or a group companies; (ii) promoting export or import from/to India; (iii) promoting technical/financial collaborations between the parent company or group of companies and Indian companies; or (iv) acting as a communication channel between the parent companies and Indian companies.

For a Liaison Office, it is not permitted to undertake export or import transactions. However, given its representative nature, it is possible to look for opportunities for trade, develop these opportunities or facilitate the trade.”

SOUTH KOREA

“Hapmyoung Hoesa (similar to General partnership) and Hapja Hoesa (similar to Limited partnership) are not preferred considering the unlimited liability.”

4- UNCLEAR POWER SHARING AGREEMENT



ISSUE

This issue corresponds to the situation where the operating agreement is not clear enough with respect to the allocation of responsibilities and decision powers.

ROOTS & CONSEQUENCES

It is a known fact that size and corporate culture (of historically family-owned businesses, for example) can prove to be major obstacles to running operations on a day-to-day basis.

Also, blurry frontiers of shared responsibilities among executives along with integration issues of the new management with the old team can turn into a major hurdle with respect to decision-making and managing the business.

SOLUTIONS

As the purchase and operating agreements get drafted by the law firms, one must ensure that any operations-related knowledge gained through the due diligence process gets factored into consideration. The assistance of governance experts might prove handy.

In unfamiliar fast-growing markets, uncertainties as to where the decision-making responsibilities lay can prove to be a recipe for failure.

ILLUSTRATIONS

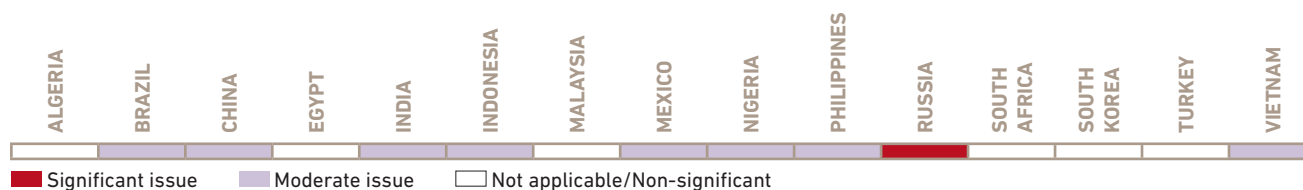
CHINA

“Sometimes the local entrepreneur runs a single business through several legal entities. For secrecy reasons, he will not disclose all information to his finance team. They, in turn, are not able to prepare consolidated financial statements. When starting a disposal project with a potential acquirer, the seller may not have a whole picture of the business.”

VIETNAM

“In the event that the seller remains a minority investor in the target, it is of the utmost importance for the investor to secure certain top management positions, i.e. CEO, COO or CFO, so as to ensure control and transparency in reporting to the parent company.”

5- PROHIBITED SECTORS



ISSUE

This is the issue of an investor engaging in the acquisition of a company in an industry prohibited to foreigners.

ROOTS & CONSEQUENCES

Many countries have established lists of industries and sectors that are prohibited to foreign investors. A foreigner trying to invest in such sectors will, therefore, simply not be granted a business license by relevant authorities.

Bear in mind that significant time, money and energy can be wasted as a result of this hurdle, a recurring issue in many emerging countries.

SOLUTIONS

Companies in prohibited sectors can sometimes be acquired indirectly through a local investment vehicle (e.g. Special Purpose Vehicle, subsidiary already in existence, Variable Interest Entity).

The acquirer must keep track of any changes made to the list of prohibited sectors as it is subject to frequent modifications.

ILLUSTRATIONS

BRAZIL

"Certain investments can be made indirectly in prohibited sectors by using a local investment vehicle."

INDIA

"There are checks and rules in place to stop any indirect ownership. When the government of India says no, it means it and will change regulations if necessary to stop and roll back any innovative structuring, once it realizes what has happened. Hence we strongly discourage any back door entry attempts."

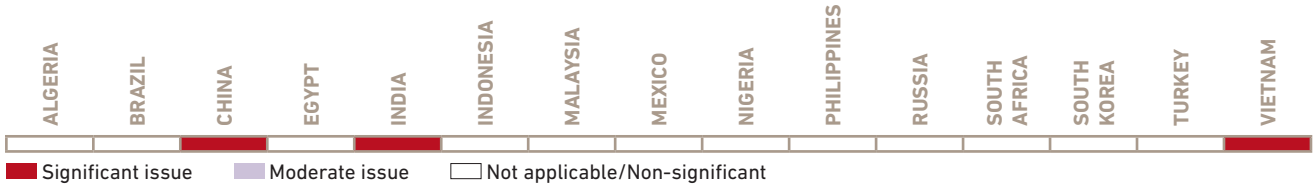
INDONESIA

"In Indonesia, foreign capital investment is under the authority of Capital Market Coordinating Agency ("BKPM"). BKPM provides a list of negative investment and maximum foreign shareholding for a specific industry. Even though the list is available in BKPM website, some industries may fall in a grey area where special ruling needs to be made by the agency."

MEXICO

"There are certain activities or sectors prohibited to Mexican and foreign investors, for example: petroleum, electricity (direct sale to individuals or entities), hydrocarbons, basic petrochemicals, nuclear energy, radioactive minerals, telegraphy, postal services and printing money."

6- EARNOUTS NOT ALLOWED



ISSUE

Earnouts are forbidden in some countries, and therefore cannot be used as incentives over future periods when the historical shareholder agrees to stay on to run or assist in running the company.

ROOTS & CONSEQUENCES

Some jurisdictions require that the purchase price be paid at once.

This, in turn, implies that any future payments are viewed as compensation, subject to social charges and standard income tax for the Seller (instead of capital gain treatment).

Countries that do not allow earnouts include China, India and Vietnam.

SOLUTIONS

We suggest that legal and due diligence teams work jointly to find effective alternatives to a pure earnout approach.

Bear in mind that the dual objective is the 'incentivization' of historical management into staying on, along with acceptable accounting treatment for the consolidated financial statements of the parent company (as an equity investment).

ILLUSTRATIONS

INDIA

"Earnouts would normally be relevant in the case of privately held companies and in such cases, these would not be directly allowed due to foreign exchange law considerations requiring the full payment for shares acquired. However, some modifications of the acquisition schedule payment would suffice in most cases as an adequate substitute."

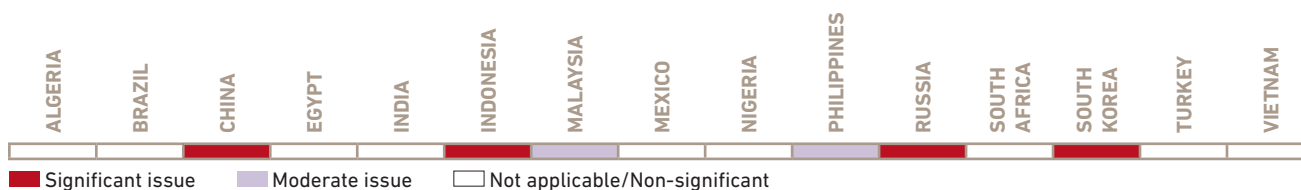
RUSSIA

"Negative covenants, preventing one party manipulating the trading business to produce short-term results affecting earn-out payment, are not permitted in Russian SPAs."

TURKEY

"Earn outs are allowed, however they are taxable."

7- MINIMUM AMOUNT FOR FDI



ISSUE

The issue here is that some countries require a minimum amount to be invested by foreigners wishing to enter the local market.

ROOTS & CONSEQUENCES

This could be a case of protectionism in the form of limitations for small investors. This is the case for many fast-growing countries imposing a minimum invested amount for a foreigner to establish a presence in the local territory.

SOLUTIONS

When faced with this issue, we suggest that the acquirer join a pool of investors.

ILLUSTRATIONS

BRAZIL

"In general terms there is no minimum capital requirement. However, there are some exceptions, such as when a foreign individual is appointed as a company's manager, administrator or executive director. In that case, a minimum capital investment will be required (Resolução Normativa RN 95 – 10/08/2011): investment in foreign currency of an amount equal or higher than R\$ 600.000 per foreigner, or R\$ 150.000 per foreigner combined to commitment of creating 10 new jobs (per foreigner as well) at least during the following 2 years."

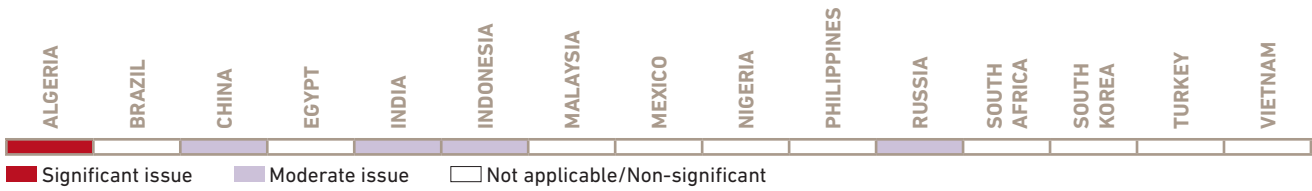
INDONESIA

"In Indonesia, the authorized capital shall be at least Rp 50,000,000 and at least 25% (twenty five percent) of the authorized capital shall be subscribed and paid up in full. However, there are certain business activities that demand higher authorized capital. Those business activities are among others banking, insurance or freight forwarding business. Also, foreign investment companies, which are companies having one or more foreign shareholders, are normally given a minimum paid up capital requirement of USD 100,000 or more by the Foreign Investment Coordinating Board ("BKPM") depending on the business field."

SOUTH KOREA

"There is a minimum FDI amount: no less than 100 million KRW and no less than 10% of either the total number of voting stocks issued by a Korean corporation or by a company run by a national of the Republic of Korea, or its total equity investment."

8- CONTROL CEILINGS



ISSUE

This refers to a situation where a country sets a maximum authorized percentage of controlling shares to be owned by a foreign investor.

ROOTS & CONSEQUENCES

The issue may be due to a clear, State-driven protectionism.

SOLUTIONS

One straightforward solution is to avoid limited foreign ownership solutions, particularly in those countries where running a business through minority stakeholdings proves unrealistic.

The acquirer may also under certain authorized circumstances optimize stake holding through indirect investment vehicles.

ILLUSTRATIONS

ALGERIA

"Since 2009, foreign shareholders have not been allowed to own more than a 49% stake in companies dealing in manufacturing, construction and services. 51% should be owned by Algerian nationals residing in Algeria. Companies dealing in trading shall be owned at a minimum of 30% by Algerian nationals residing in Algeria."

INDONESIA

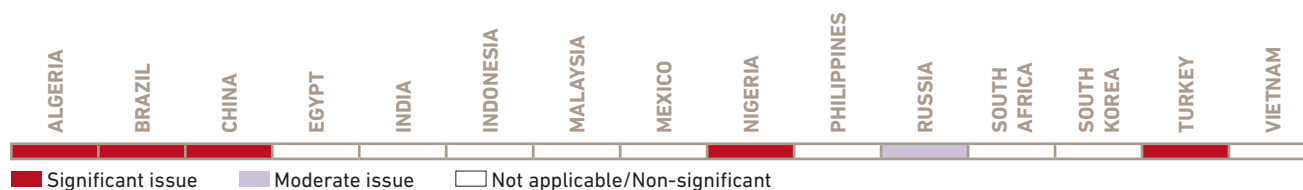
"Provided the line of business is not in a negative list and also not subject to maximum ownership regulation, foreign shareholding can be up to 100% (need to divest part of it after 15 years since its commercial operation). However, minimum number of shareholders is 2.

With regards to maximum shareholding, sometimes business may fall in the grey area. In such case, one needs to obtain a special ruling from BKPM."

RUSSIA

"There are some restrictions imposed for foreign investors in relation to their investment in the authorized capital of business entities which have strategic importance for national defense and state security, and (or) if they have committed transactions that entail control over such business entities. Foreign shares in such business entities should not typically exceed 50% of voting shares."

9- PERSONAL LIABILITY OF LEGAL REPRESENTATIVE



ISSUE

Some countries hold a company's representative (the CEO, Manager, etc.) personally liable with regard to legal matters affecting the company he or she works for.

ROOTS & CONSEQUENCES

It goes without saying that qualified people (especially foreigners) can be reluctant to occupy such positions and to bear such responsibilities. Such legal exposure exists in Algeria, Brazil, China, Nigeria and Vietnam.

SOLUTIONS

We suggest that the acquirer assign a priority to taking this issue into consideration when choosing the company's legal form.

ILLUSTRATIONS

BRAZIL

"The legal representative is personally liable. In case of dispute/debts of the company, the company will pay the amount that must be paid with its fixed assets, bank account, etc. However, if the company does not have the money to pay, the personal assets from the legal representative will be demanded to pay the debt on behalf of the company. Also, as the legal representative is the identity of the company, he/she is personally responsible for all acts before the Brazilian Public Authorities. So, in case of fraudulent administration, for example, the legal representative will be processed according to Civil, Criminal, Tax laws, among others."

CHINA

"For instance and according to prevailing laws, the legal representative will be sentenced to prison if the Company is found guilty of tax evasion."

MEXICO

"The legal representative is personally liable if she or he exceeds the faculties granted to her or him. If we are talking about a Limited Liability Stock Corporation or Company (Sociedad Anónima or Sociedad de Responsabilidad Limitada), the legal form will grant a protection, initially, to the extent that she or he does not breach such faculties and does not exceed the corporate purposes. Without prejudice to the generality of the foregoing, the legal representative may have a criminal responsibility if unlawful activities are found that lead to a tax evasion."

SOUTH KOREA

"The liability of the legal representative depends on the legal form. He is liable in the case of a Hapmyoung Hoesa (similar to General partnership) and Hapja Hoesa (similar to Limited partnership) and non-labile in case of Yuhan Hoesa (similar to Private company) and Jusic Hoesa (similar to Corporation)."

TURKEY

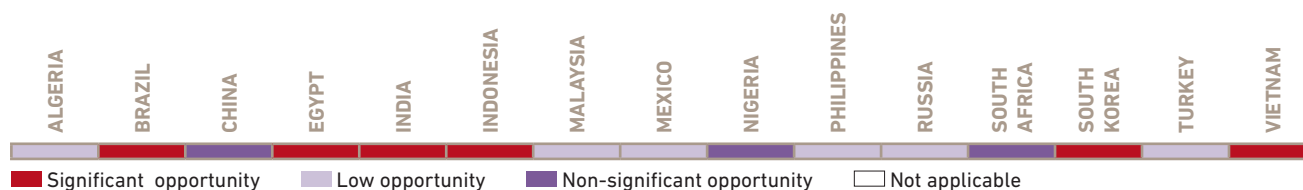
"Board members are personally liable with regards to bad practices, which negatively affect the financial position of the company (bankruptcy, liquidation, etc.)."

TOP TAX INCENTIVES

	ALGERIA	BRAZIL	CHINA	EGYPT	INDIA	INDONESIA	MALAYSIA	MEXICO	NIGERIA	PHILIPPINES	RUSSIA	SOUTH AFRICA	SOUTH KOREA	TURKEY	VIETNAM
Amortization of assets/goodwill	Low opportunity	Significant opportunity	Non-significant opportunity	Significant opportunity	Significant opportunity	Significant opportunity	Low opportunity	Low opportunity	Non-significant opportunity	Low opportunity	Low opportunity	Non-significant opportunity	Significant opportunity	Low opportunity	Significant opportunity
CIT rate/capital gains	Non-significant opportunity	Low opportunity	Non-significant opportunity	Non-significant opportunity	Low opportunity	Non-significant opportunity	Significant opportunity	Low opportunity	Low opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity
Carry back /carry forward	Low opportunity	Low opportunity	Low opportunity	Significant opportunity	Low opportunity	Low opportunity	Significant opportunity	Low opportunity	Non-significant opportunity	Low opportunity	Significant opportunity	Significant opportunity	Significant opportunity	Low opportunity	Low opportunity
French tax treaty/Tax sparing credits	Non-significant opportunity	Significant opportunity	Significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity
Deduction of financial costs	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Low opportunity	Significant opportunity	Low opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity	Low opportunity
Group tax regime	Significant opportunity	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Low opportunity	Not applicable	Not applicable	Not applicable	Low opportunity	Not applicable	Not applicable	Not applicable
Tax exemption applied to mergers/demergers	Not applicable	Not applicable	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity
Local incentives supporting investments	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Significant opportunity	Non-significant opportunity	Non-significant opportunity	Significant opportunity	Low opportunity	Non-significant opportunity	Significant opportunity	Low opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity	Non-significant opportunity

■ Significant opportunity
■ Low opportunity
■ Non-significant opportunity
 Not applicable

1- AMORTIZATION OF ASSETS/GOODWILL



NATURE

As a general principle, goodwill is an intangible asset which provides a competitive advantage, such as a strong brand, reputation, or high employee morale.

In an acquisition or restructuring, goodwill appears on the balance sheet of the acquirer in the amount by which the purchase price (or transfer value) exceeds the net tangible assets of the acquired business/company. In such a context, this amount is considered as representing the synergies between the existing business and the acquired/transferred business, either in the form of Cost reductions and/or revenue enhancement. The recognition of such goodwill is sometimes supplemented by the possibility to amortize such goodwill from an accounting standpoint and, in some countries, from a tax standpoint, in order to reflect that a part of the price paid at the moment of acquisition, corresponds to future profits of the business transferred or acquired.

Note that the amortization of goodwill and intangible assets for tax purposes is not systematically allowed.

BENEFITS

Where possible, the goodwill (market share, opportunities...) and intangible assets (patents, software...) may gradually be amortized using a straight-line method.

Amortizing those assets may lead to significant tax cost reductions.

OPTIMIZATION PROCESS

Accordingly, companies should carry out further studies about the feasibility and the domestic tax treatment with respect to amortization.

ILLUSTRATIONS

EGYPT

"Goodwill and intangible assets could be amortized for tax purposes at a 10% annual rate."

INDONESIA

"Goodwill and intangible assets could be amortized."

RUSSIA

"Amortization of goodwill is non-tax deductible in Russia. Intangible assets such as KH, trade-marks and exclusive rights are subject to depreciation for tax purposes."

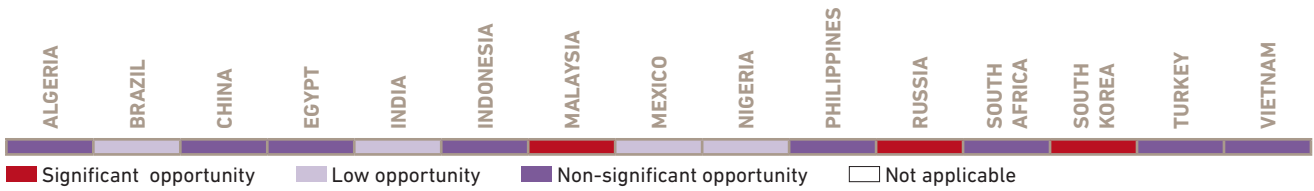
SOUTH KOREA

"Goodwill and intangible assets can be amortized up to the smaller amount between acquisition cost and fair value."

VIETNAM

"Goodwill incurred on the acquisition of assets could be amortized for tax purposes within three years."

2- CORPORATE INCOME TAX/CAPITAL GAINS RATES



NATURE

The profits derived from a corporate taxpayer’s day-to-day activities as well as the gains resulting from the disposal of its assets are generally subject either to CIT under standard rules or to capital gains tax, the rate of which often varies depending on the nature of the assets disposed.

In a number of cases, reduced tax rates may be set up by local tax authorities and used as incentives to corporate taxpayers.

Please also note that most tax treaties aiming to avoid double taxation also set forth reduced tax rates (mainly for withholding tax purposes) which may enable tax savings upon proof of the tax residency of the taxpayers on each end of the financial flow.

BENEFITS

Some applicable rates may encourage investments.

OPTIMIZATION PROCESS

An appropriate structuring could improve the utilization of these incentives, notably through proper routing of the financial flows of income.

ILLUSTRATIONS

INDIA

“Long-term capital gains (holding period exceeding 1 year) are free of tax.”

MALAYSIA

“No capital gains tax except for real property. The capital gain is then subject to a 10% rate after 2 years of ownership, a 5% rate within 3 and 5 years of ownership and is totally exempt after a 5 years disposal.”

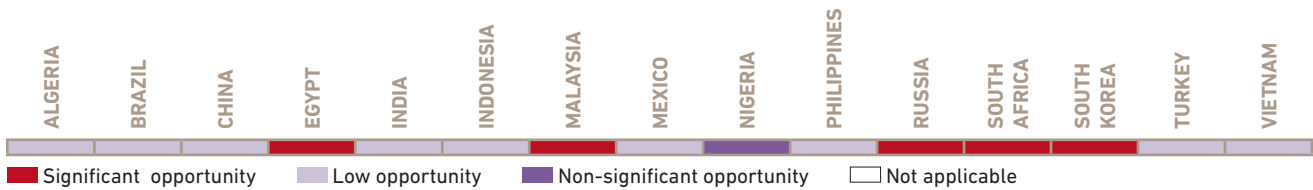
MEXICO

“There are some invest incentives for real estate developers entities, i.e. no monthly advance payments, renewal of real estate assets value.”

RUSSIA

“General rate on income is 20%. In case of appropriate structuring with inclusion of correct holding structures, it is possible to optimize taxes on dividends.”

3- CARRY BACK/CARRY FORWARD OF TAX LOSSES



NATURE

For corporate income tax purposes, most States enable the carry-forward or the carry-back of past tax losses in order to offset them against the taxable income of either past years (carry-back) or subsequent years (carry-forward). Thus, the carry-forward and the carry-back impact the determination of the corporate taxpayer's corporate income tax basis. Therefore, existing tax losses may give rise to the recognition of deferred tax assets in the consolidated accounts if it can be evidenced that it is likely, at year-end, the taxpayer will generate enough tax basis in the future to offset those tax assets. Carry forward is mainly adopted by emerging countries but not all countries allow carrying tax losses back.

BENEFITS

Both carry-back and carry-forward mechanisms allow some flexibility in the management of losses by corporate taxpayers. Also, having losses carried forward or carried back will impact the deferred tax in consolidated accounts.

OPTIMIZATION PROCESS

Companies should monitor the expiry of the tax losses in accordance with the provisions of their domestic tax law.

ILLUSTRATIONS

BRAZIL

"The offsetting of tax losses carried forward against taxable profits is generally allowed. Losses can be carried forward indefinitely but the fraction offset cannot exceed 30% of the taxable income of the year. Carrybacks are not permitted under Brazilian tax law."

CHINA

"Losses can be carried forward 5 years and set off against taxable income. No carry-back is allowed. In the case of a merger or division, losses that were suffered by companies or an establishment prior to the merger that have not been utilized may be set off against the taxable income of the consolidated company after the merger and carried forward over a maximum period of 5 years, under special tax arrangement."

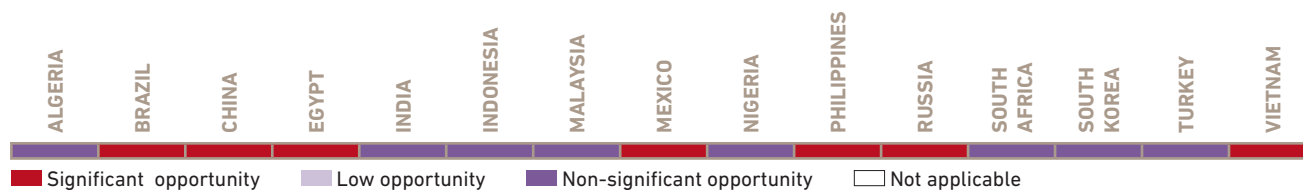
MALAYSIA

"Business losses incurred in a year can be utilized to set off all other sources of income (other than dividend income) derived in the same year. Unabsorbed losses arising from a business source are allowed to be carried forward to set off future business income only. As a general principle, there is no time limit to carry forward the losses."

SOUTH KOREA

"Business losses incurred in a fiscal year can be carried forward for up to 10 years, as far as the amount of loss is confirmed either in a tax return filed or by a determination of the tax office. Carry-back of losses is not permitted in general, but small and medium-sized companies are allowed to carry losses back for 1 year."

4- TAX TREATIES (TAX SPARING CREDITS)



NATURE

In some cases, the amount of tax credit necessary to avoid double taxation may be higher than the amount of the income tax that should be paid in the country where the income is originated.

This results in a potential tax optimization when the tax credit can be offset by the tax due at the level of the beneficiary of the income.

BENEFITS

Such mechanism increases the tax credit to be offset by the tax charge of the beneficiary of the income sourced abroad.

OPTIMIZATION PROCESS

Considering that the gain could be significant for a company that operates an entity in an emerging country - benefiting therefore from tax-sparing credits - companies should find a way to manage the tax credit offsetting at the level of the beneficiary.

ILLUSTRATIONS (CASE OF FRENCH TAX TREATIES)

BRAZIL

"The tax treaty between France and Brazil provides a favorable tax credit. The taxpayer will receive in France a tax credit superior to the withholding tax on interests paid in Brazil since the convention provides that the Brazilian tax shall be considered as being levied at a minimum rate of 20%."

CHINA

"The tax treaty between France and the People's Republic of China provides for tax sparing credits on royalties and income (tax credit rate exceeds withholding tax rate by more than 5 points)."

MEXICO

"The withholding income tax applicable to royalties' interest is 15%, the most favorable tax treaties may reduce those rates to 5% and 10%."

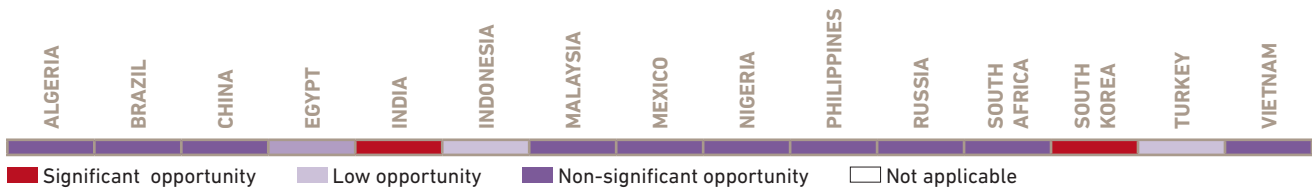
PHILIPPINES

"For interests, dividends and royalties, the amount of the tax credit granted to French residents shall be the higher of the following amounts: (i) the amount of the Philippine tax actually levied; or (ii) with respect to income referred such as interests, capital gains, 20% of the gross amount of such income; with respect to royalties, 15% of the gross amount of such income, but shall not exceed the amount of French tax levied on such income."

RUSSIA

"Thanks to the tax treaties entered into by Russia, withholding tax rate on dividends may be reduced from 15% (local rate) down to 5%. On interest, royalties or capital gains, withholding tax rate may be reduced from 20% (local rate) to 0%."

5- DEDUCTION OF FINANCIAL COSTS



NATURE

As a general rule, it is important to determine whether domestic tax law provisions put limitations to the tax deduction of financial expenses.

Indeed, such restrictions may result either from thin capitalization rules, aiming at preserving the solvency of the corporate taxpayer at stake or from specific provisions aiming at discouraging a number of tax optimizing structures considered abusive by the local tax authorities.

BENEFITS

The deduction of financial costs enables tax leveraging of investments abroad and more flexibility in the repatriation of profits.

OPTIMIZATION PROCESS

Companies should seek an improvement of the gearing between equity financing and debt financing and optimize the use of specific capital structures.

ILLUSTRATIONS

BRAZIL

"There are no specific limitations to tax deduction of financial costs on acquisitions. However, Brazilian entities are subject to thin capitalization rules that may impact the limit of deduction of interests paid to non-residents."

INDIA

"The deduction of financial costs related to acquisition of shares and assets is allowed to the extent those costs cannot be regarded as interest paid on moneys borrowed to earn tax-free income is generally not tax deductible."

MEXICO

"As a general principle, interests paid abroad are deductible for income tax purposes (standard provisions such as related to withholding tax, thin capitalization, back to back rules and arm's length principle may apply)."

RUSSIA

"Debt push down is allowed to the extent non tax driven and compliant with local thin capitalization rules."

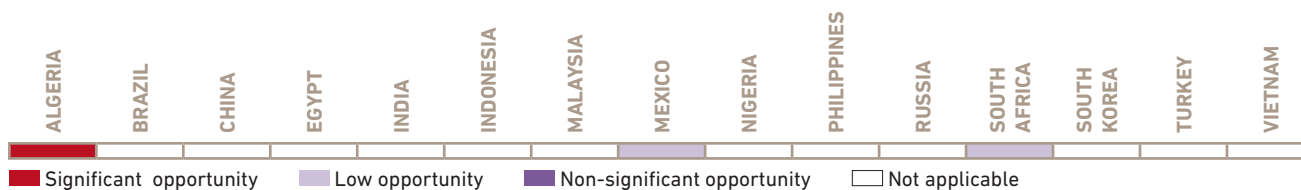
SOUTH AFRICA

"Interest incurred further to the acquisition of a controlling interest in an operating company will be tax deductible at the level of the acquiring entity."

SOUTH KOREA

"The deduction of financial costs related to acquisition of shares and assets is allowed."

6- GROUP TAX REGIME



NATURE

Specific incentives may apply to groups of companies (participation exemption, assessment of corporate income tax charges based on the aggregated income of the group members, etc.)

BENEFITS

The group tax regime enables a reduction of the tax basis through the offsetting of the losses incurred by tax group members by the profits earned by other tax group members.

OPTIMIZATION PROCESS

Proper structuring is sometimes needed to be eligible to participation exemption or tax group regimes.

ILLUSTRATIONS

ALGERIA

"Algeria introduced the concept of "group companies" formed by two or more legally independent joint-stock companies, where the parent company holds at least 90% of the capital of the subsidiary."

BRAZIL

"There are no rules about tax consolidation. Federal, State and Municipal authorities apply separate taxations to each company and branch/establishment of the same company."

MEXICO

"The Mexican group tax regime enables income tax deferrals and enables tax optimization on operating losses and dividend distributions. This tax regime only applies for income tax purposes as opposed to single-rate corporate tax (IETU)."

RUSSIA

"Group tax regime (consolidated taxpayers regime) is available only for the biggest taxpayers with the group turnover exceeding 2 bln euro and with assets exceeding 7.5 bln euro."

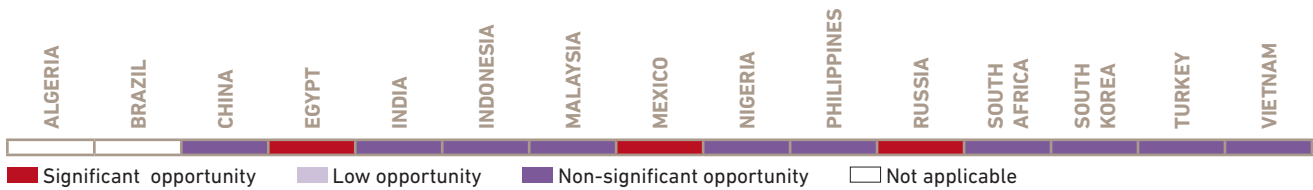
SOUTH AFRICA

"General profit or loss transfers between group companies are not possible for tax purposes. Tax relief, mostly in respect of capital gains tax, income tax on recoupments and transfer taxes, is available in respect of specifically defined transactions between group companies."

SOUTH KOREA

"Consolidated tax return is allowed if a company owns 100% of the shares of another company."

7- TAX EXEMPTION APPLIED TO MERGERS/DEMERGERS



NATURE

In a number of countries, the tax impact of mergers, de-mergers and transfers of branches of activities may be neutralized (tax roll over) to the extent that a number of requirements are met.

BENEFITS

Companies are tax-exempt on the gain that may result from a merger, de-merger or assimilated transaction at the level of the absorbing company.

OPTIMIZATION PROCESS

Eligibility to such regimes should be carefully verified.

ILLUSTRATIONS

BRAZIL

"There is no tax exemption applicable in a merger/de-merger. However, if a specific branch of an acquired company benefited from a tax exemption and was incorporated in the acquiring company, the tax exemption is usually maintained."

INDONESIA

"The tax exemption regime has to be approved by the tax authorities."

MEXICO

"No tax effects for income tax, value added tax and IETU, if some requirements are met."

PHILIPPINES

"No gain or loss shall be taxed in a merger, but if real property is transferred, the operation is subject to 12% VAT."

RUSSIA

"Gains or losses in a merger/de-merger are tax neutral, only pure asset deals are subject to tax."

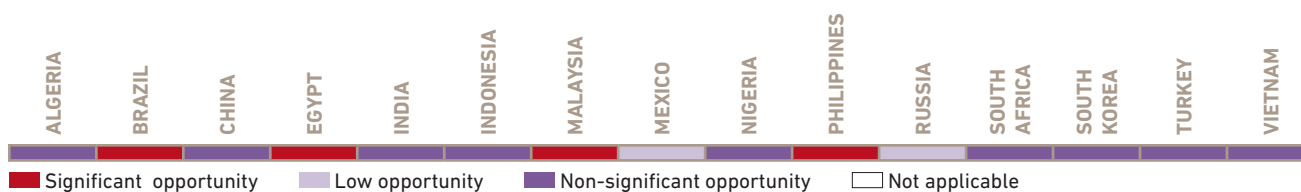
SOUTH AFRICA

"Certain roll-over relief is provided in respect of income tax, capital gains tax, dividends tax and securities transfer tax in respect of transactions carried out under the special rules relating to asset-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distributions."

TURKEY

"Capital gains derived from mergers, acquisitions (change of control) and spin-offs based on book values are not taxed in Turkey. Debt-push-down is generally not allowed."

8- LOCAL INCENTIVES SUPPORTING INVESTMENTS



NATURE

Local tax law may encourage the development of a sector of activity or of an undeveloped geographic area by granting various tax incentives (e.g., corporate income tax exemption or a lower tax rate).

BENEFITS

A company entitled to benefit from such incentives will reduce its tax burden. As a result, it will be able to expand its activity.

OPTIMIZATION PROCESS

Identification and eligibility to a specific tax incentive may sometimes be a driver for the location of the foreign establishment.

ILLUSTRATIONS

BRAZIL

"The Brazilian tax system provides for a number of incentives, including notably the accelerated depreciation of R&D equipment or the special customs regimes available in specific areas (e.g. Manaus in Amazonia), in order to increase the importation of goods not available in the Brazilian market."

CHINA

"New high technologies, approved agricultural, fishery, forestry projects, environmental protection projects, technology transfer, approved infrastructure projects. For Western regions, a 15% corporate income tax rate (general income tax rate is 25%) may be granted in case of investments in these areas."

MEXICO

"There are some tax incentives for Mexican entities that acquire new fixed assets, i.e. renewable energy assets are deductible at 100% in the year. Some assets could be amortized according to their present value (immediate deduction) in the acquisition year."

RUSSIA

"The general rate of income tax is 20% that may be decreased by 4.5% via conclusion of special investment agreements with local state authorities. Usually such investment agreements are concluded with significant investors that open factories, etc. Reduced tax rates may be given to taxpayers from agriculture sector and specific IT sectors."

SOUTH AFRICA

"Mining, oil and gas, strategic industrial projects, energy-efficient equipment, headquarter company regime, research and development (150% deduction for qualifying R&D expenditure)."

TURKEY

Specific investment incentives such as reduced corporate/ income tax rate, social security premiums etc. may apply in Turkey (under requirements).

Mazars is present on 5 continents.

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