UNITED STATES

UNITED STATES

INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

- **Contribution of appreciated property to a partnership:** The Internal Revenue Service (IRS) issued Notice 2015-54 in August 2015 to address perceived abuses relating to the transfer of appreciated property (including IP) to a partnership. Temporary and proposed regulations were issued in January, 2017 to implement the Notice. The regulations provide that gain is recognised when a U.S. person transfers appreciated property to a domestic or foreign partnership that has a foreign partner related to the transferor, and 80 percent or more of the partnership is owned by the US transferor and related persons, unless the partnership agreement includes specified terms ensuring that all built-in gain in the contributed property will be subject to US tax. The regulations generally apply to transfers on or after August 6, 2015.
- **Inversions:** In recent years, Treasury has issued regulations under Sections 7874 and 367(a), as well as Notice 2014-52 and Notice 2015-79, to curtail inversions of U.S. companies. When a U.S. corporation becomes a subsidiary of a foreign corporation or transfers its assets to a foreign corporation, and the foreign corporation is owned 80% or more (by vote or value) afterwards by former owners of the U.S. corporation, the foreign corporation will be taxed as a U.S. corporation. Where less than 80% but at least 60% (by vote or value) of the foreign corporation is owned by former owners of the U.S. entity, the U.S. corporation may not be able to offset any gain from establishing the inverted structure with any tax attributes (e.g. net operating losses or foreign tax credits) for 10 years after the inversion. The ownership calculation is subject to a variety of modifications that can have the effect of increasing the ownership percentage of the U.S. shareholders for purposes of these rules. New temporary regulations issued in 2016 affected the application of the ownership percentage test and in effect altered the stock included or excluded in computing the ownership percentage. The inversion rules can also be applied to U.S. partnerships. Care should be taken if there will be any rollover equity, as a rollover over 5% implicate an otherwise all cash transaction and make it subject to the US inversion rules.
- **Related Party Debt Classification:** Treasury issued new regulations in October 2016 to address the reclassification of related party debt to equity. The new regulations automatically recast related party debt as stock when the debt is issued by a U.S. corporation to a foreign or domestic corporation that is part of the same "expanded group" in a distribution, in exchange for stock, or in exchange for assets in a "reorganisation." The regulations also institute new documentation requirements that will go into effect in 2018.
- **Tax Reform:** As of the date of this publication, business tax reform is still one a significant priority of the Administration and controlling political party in Congress. Under the two leading proposals, the corporate tax rate would be reduced from 35% to 15% or 20% and interest deductions would be reduced or eliminated. Other areas that could be impacted include inversions, IP planning, treatment of controlled foreign corporations, and documentation of related party debt.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

To the extent the BEPS recommendations overlap with the US FATCA regime, the US appears content to leave FATCA in place rather than to change its rules to conform more closely with BEPS recommendations.

The IRS has issued regulations to implement Action 13 (Country-by-Country Reporting) for US entities that are the ultimate parent entity of a multinational enterprise with annual revenue of USD 850 million or more, which would be effective for tax years beginning on or after June 30, 2016.

With respect to Action 6 the United States issued a revised U.S. Model Income Tax Treaty in February 2016 with a more restrictive limitation on benefits article. The United States appears to have limited interest in a multi-lateral instrument to amend its income tax treaties as nearly all U.S. income tax treaties now contain a limitation on benefits article.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

In a stock acquisition, the target corporation remains intact, and any pre-closing historical or contingent liabilities remain with the acquired company. Moreover, where a corporation is acquired from a consolidated group, it remains liable for the entire group's federal income tax during the period in which it was a member. Stock acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. Either way, the basis in the underlying assets of the target company carries over and is not stepped up — although where the target is a subsidiary within a consolidated group, complex rules may result in a step-down of the subsidiary's assets to avoid loss duplication. A section 338 election may be made to recognise built-in gains and losses in the assets of the corporation and adjust their basis to fair market value. However, in practice this is rarely used, unless the target corporation is a subsidiary in a consolidated group or a corporation that has elected to be a pass-through entity under subchapter S, where an election can be made without incurring double taxation of gains.

Tax advantages:

In the case of a stock acquisition without a section 338 election, any tax attributes, such as net operating losses or tax credits, continue with the acquired corporation (subject to the aforementioned loss duplication rules), but change in control limitations may be imposed on their use.

A stock acquisition often makes sense where an asset acquisition is not practical because it would subject the seller to two levels of income tax or because it would be too difficult to transfer the assets, contracts and licenses into the name of the acquirer.

The sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

It should also be noted that the gain on the sale of stock is generally capital and therefore subject to preferential rates if the seller is an individual. Foreign persons are not generally taxed in the U.S. on gains from the sale of a corporation's stock, except where the corporation is a U.S. real property holding corporation.

Tax disadvantages:

Certain disclosure and withholding rules may apply to stock transfers to non-U.S. resident buyers (entities or individuals). Assuming there is no Section 338 election, there would be no step-up in the tax basis of the underlying assets.

B. Asset deal

A significant reason for structuring a transaction as an asset acquisition is that historical income tax liabilities of the target business ordinarily do not carry over to the acquirer. These liabilities remain with the seller unless there is a contractual agreement specifically providing otherwise. However, certain non-income tax liabilities (sales and use, payroll, and property) may be inherited by a buyer of the business assets.

Asset acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. In addition, it may be possible to treat the acquisition of certain entities as if an asset purchase occurred for income tax purposes even though it is the ownership interests that are legally acquired (i.e., through a Section 338 election, acquisition of a disregarded entity, or acquisition of 100% of a partnership).

Tax advantages:

A major advantage of a taxable asset purchase is that, in the instance where the seller recognises gain, the buyer receives a corresponding step-up to fair market value in the basis of the acquired assets, generally resulting in increased future depreciation or amortisation deductions for the buyer. Existing tax attributes, such as net operating losses, do not carry over to the purchaser.

If the assets are acquired in a tax-free exchange, the acquirer generally takes over the target's historical basis in the assets. Other tax attributes are generally lost unless the acquisition is structured as a business combination that is classified as a "reorganisation." Here, the survivor succeeds to the target's historical attributes and liabilities, though the attributes may become restricted under various rules.

Asset purchases are usually most viable when the target assets are held in a pass-through entity such as a partnership or an S corporation (which is not subject to an entity-level income tax), or where the assets are held by a subsidiary of a consolidated group of corporations. In contrast, where the target assets are appreciated and held in a C corporation, an asset sale may not be practical because there are two levels of income tax: (1) corporate-level tax on the gain and (2) shareholder-level tax on any subsequent distribution to the shareholders. If, on the other hand, assets are depreciated, a C corporation with operating income may be motivated to sell assets in order to recognise loss and offset such operating income.

Tax disadvantages:

Asset sales may result in significant taxes. Many states and local jurisdictions impose sales and use tax on asset transfers, though occasional or isolated sale exemptions often apply. Real property is generally subject to realty transfer or documentary stamp tax.

Asset purchases may also create issues for many non-tax reasons. For instance, an asset purchase may not be feasible where the target business has significant assets, licenses or contracts that would be administratively burdensome or expensive to transfer or renegotiate.

It should also be noted that asset sales may give rise to both ordinary and capital gain (taxed at a reduced rate for individuals). In the case of a disposition by a foreign person, gain is ordinarily treated as effectively connected income subject to U.S. tax.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

Where a corporate buyer purchases at least 80% of the stock (vote and value) of another corporation in one or a series of transactions within a 12-month period from an unrelated seller, it may be possible to make an election under Section 338 to treat the stock acquisition as an acquisition of assets for income tax purposes. Depending on the nature of the transaction, the election may be made unilaterally by the buyer or jointly by the buyer and seller. Situations where the target is an S corporation or a member of a consolidated group often provide the best opportunity for this type of planning.

A step-up may also be obtained under Section 336(e) where there is a "qualified stock disposition." A qualified stock disposition is a taxable disposition by a domestic corporation or the shareholders of an S corporation of at least 80% (by vote and value) of the stock of a domestic corporation during a 12-month period. A seller can make a Section 336(e) election, regardless of the legal form of the buyer(s). The Section 336(e) election may be

most appealing in circumstances in which the acquiring entity is an LLC or partnership. Care should be taken in assessing the requirements for a valid 336(e) election where there may be continued ownership by the sellers in the acquiring entity.

In the context of a foreign target, a Section 338(g) election should be considered, which also causes the transaction to be treated as an asset purchase for U.S. tax purposes. This election enables the target to step-up its basis in its assets and purge its pre-closing earnings and profits, thereby making it easier to push down debt and repatriate profits efficiently.

If a partnership interest is acquired, it may be possible for a buyer to step up its proportionate share of the partnership's underlying assets by causing the partnership to make an election under Section 754. Otherwise, the partnership's assets are not ordinarily stepped up, unless all the interests in the partnership are acquired by a single purchaser.

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Intangible assets (including goodwill) acquired as part of a trade or business are amortised using the straight-line method over a 15-year period. Intangible assets not acquired as part of a trade or business are generally amortised using a straight-line basis over their estimated useful lives. Software not acquired as part of a trade or business may be amortised using the straight-line method over three years.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

In general, a deduction is allowed for interest paid or accrued within a tax year on valid indebtedness of the taxpayer. However, numerous exceptions and provisions may limit or bar the deduction. Some of the major limitations are highlighted here:

Debt or equity considerations: Purported indebtedness may be reclassified as equity if the instrument characteristics create a sufficient resemblance to such. Interest on debt that is reclassified may be recast as a nondeductible dividend. Whether an instrument is reclassified is highly subjective and fact intensive. Courts rely on several factors, and no one factor is determinative. Here are just a few of the many factors:

- The intent of the parties and the adherence to formalities,
- The identity of the creditors and shareholders,
- The ability of the corporation to obtain funds from outside sources, and
- The thinness of the capital structure and the risk involved.

Additionally, as discussed in the Recent Development section, new regulations have been issued under Section 385 that can automatically recast related party debt as stock when the debt is issued by a U.S. corporation to a foreign or domestic corporation that is part of the same "expanded group" in a distribution, in exchange for stock, or in exchange for assets in a "reorganisation."

Transfer pricing: The Internal Revenue Service has the ability under Section 482 to adjust the interest rate on loans between related parties to reflect an "arm's-length" standard.

Interest owed to related foreign persons: In general, interest owed to a related foreign person that is otherwise deductible may not be deducted until it is paid.

Earnings stripping: Section 163(j) limits the deductibility of interest paid by a U.S. corporation if the debt is borrowed from or guaranteed by a related foreign person and the interest is exempt from U.S. tax or subject to a reduced rate of withholding tax. Section 163(j) applies if the U.S. corporation's debt-to-equity ratio exceeds 1.5 to 1. In general, the rule prohibits a corporation from deducting the interest paid to a related foreign person (or paid

on debt guaranteed by a related foreign person) to the extent its "net interest expense" exceeds 50% of the corporation's "adjusted taxable income" (essentially EBITDA) as those terms are defined. Interest in excess of this 50% limit can be carried forward indefinitely, but must be subjected to the same limitation in future years.

AHYDO: If an instrument is classified as an applicable high-yield discount obligation (AHYDO), a portion of the interest deduction is deferred until paid and a portion may be permanently disallowed and treated as a nondeductible dividend. In general, debt issued by a corporation may constitute AHYDO if it:

- Has a maturity date of more than five years,
- Has a yield to maturity of five percentage points over the "applicable federal rate" (as published by the IRS), and
- Has "significant original issue discount" (an excess of original issue discount accruals over actual interest payments).

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

The primary strategy to push down debt is to form a domestic holding company which, in turn, forms a transitory merger subsidiary used to affect the acquisition. Upon the consummation of the transaction, the merger subsidiary is merged into the target and the proceeds are disbursed to the selling shareholders in exchange for their stock. Financing is arranged for the merger subsidiary, which is subsequently assumed by the target as the successor to the merger. Financing may come directly from third parties or internally through back-to-back loans (subject to conduit financing rules). A US Bidco can also be formed and capitalised with third party or related party debt to acquire the target and then file a consolidated U.S. federal income tax return with the target. As not all states allow consolidated income tax filings, state tax implications must be considered.

Other typical strategies to push-down debt, including related party sales or post-acquisition financing, are no longer viable due to the new regulations issued under Section 385.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no tax incentives for equity financing in the United States. Instead, there are tax advantages to debt financing, including the deductibility of interest and ability to distribute cash tax free as a repayment of principal.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Generally, a net operating loss may be carried back to the two years preceding the loss and then forward to the subsequent 20 years to offset the taxable income in those years. Where the stock of a corporation is acquired, any net operating losses remain intact and may be used by the acquiring corporation, subject to certain change in control limitations. The most common limitation is imposed by Section 382. Here, where a corporation undergoes an "ownership change," generally defined as a more than 50 percentage point change in its ownership over a three-year period, U.S. tax rules impose an annual limitation, called a "Section 382 limitation," on the amount of taxable income that can be offset by any pre-change net operating loss carryovers and built-in losses.

This limitation equals the product of the value of the loss corporation's equity immediately before the ownership change and the applicable federal long-term tax-exempt rate. The limit may be adjusted in certain circumstances which commonly include stuffing transactions and corporate contractions. If the Section 382 limitation for a post-change year exceeds the taxable income that is offset by pre-change loss, the Section 382 limitation for the next post-change year is increased by the amount of such excess. Special rules also apply for corporations with built-in gain (or loss) and those in bankruptcy.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

Anti-churning: The anti-churning rules are designed to prevent taxpayers from converting intangibles that existed on or before August 10, 1993, and for which amortisation was not allowed, to amortisable intangibles. The rules apply if the historic shareholders of a business retain an interest of twenty percent or more in a company post-transaction, and the Company commenced operations (and non-amortisable intangibles/ goodwill existed) prior to August 10, 1993. Any goodwill and the related amortisation deductions generated by a transaction would be disallowed if the goodwill was not amortisable under the law in effect prior to August 10, 1993.

Deferred Revenue: Generally, advance payments are taxed upon receipt, though there are certain exceptions permitting limited deferral. Under the "Deferral Method," income from an advance payment is recognised in the tax year of receipt to the extent that the taxpayer recognises the payment as revenue in the taxpayer's financial statements for that tax year, with the "deferred" portion of the payment being recognised in the following tax year, regardless of when it is recognised for book purposes.

State Tax Diligence: Companies are subject to income and non-income taxes in a state if they have sufficient nexus in that state. There are different types of contact that can generate nexus including economic, click-through, affiliate, and physical presence. Where a company has nexus across multiple states, it is important to understand the company's methodology for apportioning activity between states as that determines the amount of income that should be taxed in each state.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

The sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states may impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

Generally, whether acquisition costs are deductible or must be capitalised hinges principally on the point in time at which the costs are incurred. The tax treatment of expenditures incurred in business acquisitions and dispositions is based on a fact-intensive determination of the nature and reason for such expenses.

The general rule requires the taxpayer to capitalise all costs that facilitate a transaction. In general, amounts paid in the process of investigating or otherwise pursuing a transaction are deductible only if the amount relates to activities performed before the "bright line date," generally the date the parties sign a letter of intent or otherwise commit to the transaction.

Costs that are inherently facilitative of the transaction are required to be capitalised regardless of whether they are incurred before or after the bright line date. Costs that are typically classified as inherently facilitative may include costs associated with appraisals, fairness opinions, structuring the transaction, preparation and review of transaction documents, obtaining shareholder approval and property conveyance costs (i.e., transfer taxes and title registration costs).

In addition, taxpayers can elect to treat any success based fees (e.g., banker fees) in accordance with Rev. Proc. 2011-29, which provides a taxpayer with a safe harbor that generally allows for the deduction of 70% of the success based fee (though certain other limitations may apply) and capitalisation of the other 30%.

A certain portion of the costs incurred in a transaction may relate to debt issuance. In general, the costs associated with a borrowing are required to be capitalised and amortised over the term of the debt. When a debt obligation is satisfied, retired, or exchanged the taxpayer may deduct the unamortised debt issuance costs.

Determining the deductibility of transaction costs is a very fact-intensive analysis, especially when dealing with multinational target companies where the transaction costs must be allocated across the different entities and

jurisdictions involved. When transaction costs are expected to be significant, we recommend undertaking a formal transaction cost analysis, as this area is consistently challenged by the IRS.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

There is no VAT, or related tax, imposed on transaction costs incurred in the U.S.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

Choice of entity: Foreign investors may choose from several types of entities to invest in the U.S. Partnerships and Limited Liability Companies (LLCs), are generally not subject to income tax but instead are treated as "flow-through" entities whose income is taxed to their owners. Corporations are subject to tax on their income and their shareholders are subject to tax when the income is distributed to them. Flow-through entities provide the advantage of a single layer of tax (as opposed to the double layer of tax in the corporate regime) and provide a seller a more tax efficient means to convey a step-up in the basis of the underlying assets to a buyer. Importantly, flow-through entities subject their owners to U.S. income tax and filing requirements and, for this reason, many foreign investors prefer to invest in the U.S. through a blocker corporation.

Capitalisation: Investors may capitalise their investment with debt, equity, or a combination of both. Debt may be from an external source or related party. The choice between debt and equity may influence a company's taxable income and its ability to repatriate earnings efficiently. A key differentiating feature is that interest is deductible (subject to certain limitations) whereas dividends are not. Furthermore, repayment of debt is not subject to withholding whereas redemption of equity may be treated as a dividend subject to withholding.

Treaty protection: The U.S. has an extensive network of treaty partners. The ability to choose a favorable jurisdiction from which to invest should be a significant consideration. However, nearly all U.S. treaties contain limitation on benefits provisions that restrict treaty shopping.

Inversions: The Inversion rules need to be considered when a U.S. corporation is acquired by a foreign company. These rules can impact the U.S. tax treatment of the foreign acquirer, as well as the recognition of gain or loss related to the transaction.

Exit considerations: Capital gains recognised by foreign persons are not generally taxed in the U.S. However, capital gains realised on the sale of an interest in a partnership engaged in a U.S. trade or business are generally subject to tax, as are gains on United States Real Property Holding Corporations..

Other considerations: Where a foreign buyer with a U.S. subsidiary is acquiring a foreign target, consideration should be given to causing the target to be acquired by the foreign parent so as not to create an inefficient "sandwich" structure.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

A group may be able to reorganise and simplify tax neutrally after an acquisition through internal tax-free reorganisations, liquidations, mergers, etc. State tax consequences of such transactions should always be considered, as state tax consequences can vary from federal treatment, especially with regard to transactions between members of a U.S. consolidated return group for federal tax purposes.

Additionally, care should be taken with regard to the impacts of the "step-transaction" doctrine, which courts often apply to integrate a series of otherwise separate steps, resulting in unanticipated and potentially unfavorable tax consequences. Additionally, recent U.S. law also codified the "economic substance" doctrine. In general, the doctrine denies tax benefits arising from transactions that do not result in a meaningful change to

the taxpayer's economic position other than a purported reduction in Federal income tax. If a transaction is found to lack economic substance, a strict liability penalty between 20% - 40% of the underpayment of tax attributable to the disallowance of the claimed tax benefit applies.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The Foreign Investment in Real Property Tax Act (FIRPTA) taxes non-resident aliens and foreign corporations on dispositions of a U.S. Real Property Interest (USRPI), including dispositions of a U.S. Real Property Holding Corporation (USRPHC). A withholding tax of 15% of the amount realised by the foreign transferor must generally be withheld by the seller of a USRPI to ensure that an appropriate amount of tax is paid upon the disposition (higher withholding rates can apply in certain circumstances). The buyer can choose to file a U.S. tax return and report and pay tax on the actual gain realised at standard U.S. tax rates. A withholding tax also applies to non-resident aliens and foreign corporations that are partners, trust beneficiaries, or estate beneficiaries on the distribution of profits attributable to the sale of a USRPI.

In general, a domestic corporation is a USRPHC if the market value of its USRPI constitutes 50% or more of its value. Recent amendments provide exemptions for sales of shares in certain investment entities, and sales by qualified foreign pension funds.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

U.S. corporations may elect to consolidate their earnings and losses for federal income tax purposes and file consolidated returns where there is an "affiliated group" of entities which are at least 80% related (by vote and value). Losses of one member of a consolidated group can generally be used to offset losses of another member of the consolidated group. A consolidated group can also simplify tax preparation as the number of income tax returns to be filed is reduced.

Consolidated (or combined) filings are required in certain states if related entities satisfy certain ownership requirements (ownership requirements vary by state) and are sufficiently interdependent. Other states may permit consolidated (or combined) filings where the entities in the group each have sufficient nexus or connections with that state and make an election. A minority of states do not allow for any form of consolidated (or combined) income tax reporting.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

Capital gains recognised by individuals are taxed at a preferential rate (currently a 15 - 20% federal rate for the sale of assets held for longer than a year vs. a maximum 39.6% federal rate for "ordinary" type income), while those recognised by corporations are taxed at the corporate rate (currently a maximum 35.0% federal rate). Capital gains are also subject to state income taxes with rates ranging from 0% to approximately 10%. Capital gains recognised by foreign persons are not generally taxed in the U.S. However, capital gains recognised on the sale of an interest in a partnership that is engaged in a U.S. trade or business are generally subject to U.S. tax. U.S. individuals, estates, and trusts may also be subject to the 3.8% net investment income tax. The U.S. does not have a participation exemption regime. In addition, foreign persons are subject to tax on gains from the disposition of a U.S. Real Property Interest under the FIRPTA regime.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

Depending on the nature of the target business and the business objectives of the parties, it is possible for sellers to defer gain by reinvesting in the continuing enterprise. Caution should be exercised, however, to ensure these complex rules are satisfied.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

The U.S. imposes federal income tax on a residence basis, so any holding or finance company established in the U.S. will be subject to corporate level tax in the U.S., regardless of its substance. Companies not incorporated in the U.S. are generally not subject to U.S. income tax unless they have a sufficient presence (amounting to permanent establishment or "U.S. trade or business") or receive certain passive type income subject to withholding.

Generally, choosing a holding company jurisdiction for the purpose of avoiding or reducing withholding tax can be challenging in the U.S. because of anti-conduit provisions under U.S. law and the limitations on benefits clauses in nearly all U.S. treaties. Generally, substance in the holding company jurisdiction is required. That said, various treaties provide reduced treaty rates.

Careful consideration should be given to the impact of the choice of jurisdiction of the holding company on other applications of withholding tax, including on interest and royalties paid by the U.S. company to related parties.

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Mergers and spin-offs can be taxable or non-taxable depending on how they are structured and the nature of the consideration paid. For a merger or spin-off to be tax-free, a substantial part of the proprietary interest in the target must be preserved through the proprietary interest in the acquirer, the historical business of the target or a significant part of its historical assets must be used in a continuing business, and the merger cannot have as its principal purpose the evasion or avoidance of federal income tax. Reverse subsidiary mergers and forward subsidiary mergers may also be non-taxable provided these and other requirements are satisfied.

Tax-free spin-offs also require a transfer by a corporation of all or part of its assets, immediately after the transfer the transferor is in control of the transferee and all the stock of the transferee is distributed. A post-spin merger of the transferor corporation will result in a taxable transaction. The rules for spin-offs are complex, and in practice require a great deal of planning to execute. If a spin-off fails to meet the requirements of a non-taxable transaction, then it will be treated as a taxable dividend.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

There are multiple ways to structure incentive plans for management. The two most common are stock options and profits interests. Companies can also implement cash-based annual incentive plans (AIP), tied to service and execution of the annual budget; issue stock appreciation rights; issue time-based restricted stock/units or performance shares (units)); or payout additional cash compensation based on performance over a multi-year period.

When stock options (as well as restricted stock/units or performance shares (units)) are issued generally there is no taxable event for the issuer or the recipient. When the options are exercised, the difference between the fair value of the shares at the time of exercise and issuance of the stock option is deductible to the issuer as compensation. The holder of the stock option is subject to ordinary income tax on the same amount. Stock

options are often exercised and sold (or simply cashed out) at the closing of a transaction, triggering ordinary income tax to the option holders, and a corresponding deduction to the issuer.

Holders of profits interests in partnerships may receive annual allocations of profit or loss from the issuing partnership or a portion of exit proceeds on the sale of the partnership or its assets, once predetermined performance hurdles have been satisfied. This structure can allow profits interests holders to recognise capital gains on exit proceeds in a transaction, rather than ordinary income, which is generally the result in a stock option structure, which would be taxed at higher rates. The partnership, however, does not get a deduction, as they would with a stock option structure. Profits interests are commonly used in operating partnerships, as well as where the only asset of the issuing partnership is the stock of a corporate operating subsidiary.

Stock appreciation rights and performance bonuses are taxed as compensation to management as ordinary income and deductible to the company.

Additional points to consider when structuring management incentive plans are as follows:

Executives may receive accelerated rights to cash incentives, or the vesting of equity compensation because of a transaction. These may be "parachute payments," subjecting the executives to an excise tax, and the payments are not deductible by the seller/target under Section 280G.

For publicly traded companies, compensation greater than USD 1 million paid to executives named in the company's proxy statement is not deductible unless based on pre-established performance goals under Section 162(m). A discretionary payment of incentive compensation in response to an acquisition will likely not be consistent with the original performance goals, and thus some planning or adjustment may be required to preserve the deduction.

Compensation payment deferral, including deferred incentive compensation, is regulated under Section 409A. Among the regulatory details of that section are specific definitions of a change in control and separation from service that may determine the right and timing to payment, and a rule that requires specified employees to defer payment of compensation for six month following a separation from service. Target equity awards may be converted into buyer's equity, the method by which this is accomplished may be regulated under Section 409A. Failure to comply with Section 409A can result in early income inclusion, penalties and interest.

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