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Tax considerations in M&A Transactions Luxembourg

Tax is often a contentious issue, albeit an essential one. An inevitable fetaure of life, tax is something that affects us all, and it is one of the most important things to pay attention to in business. Here we take a look at the tax considerations to be aware of when involved in a merger or acquisition, by speaking to Olivier Remacle, one of the founding partners of Atoz. ATOZ is a high-end advisory firm offering tax, corporate implementation and corporate finance solutions in Luxembourg.

Please introduce yourself, your role and your firm.

Atoz was formed in 2004 with the view to provide high-end tax advisory services to a wide range of institutional and sophisticated investors. Nowadays, with approximately 100 professionals Atoz is the largest high-end independent tax advisory firm in Luxembourg.

Numerous governments globally have been reforming tax systems over the past year in order to boost revenue. What reforms has your country seen recently?

Although the crisis has hit the Luxembourg economy, the Luxembourg government has tried to preserve the flexibility of its tax system. Some measures have been taken but very few of them are in relation with the corporate income tax or the tax provisions in relation with M&A transactions. The most notable measure for corporations consists in the introduction of a minimum corporate income tax of EUR 3.210 (2013 onwards) for most holding and financing entities. Operating entities will be subject to a mininum corporate income tax capped at EUR 21.400

The measures taken for private individuals include an increase of the income tax rate for individuals earning more than EUR 100.000, suppression of some deductible items, increase in the solidarity surcharge.

Recently the Prime minister has announced additional measures to be taken over the next two years, including an increase in the standard VAT rate for 2015-6 to compensate the changes of VAT rules in respect of e-commerce.

What will be the effects of these?

Those changes have minor or no impacts of the M&A transactions and the tructuring of those.

What are the key taxation considerations for investors when embarking upon mergers and acquisitions in your jurisdiction?

Even if the last 2-3 years have shown an significant number of operations, the Luxembourg M&A market is particular, in the sense that due to the size of country only few operations occur typically every year. However Luxembourg is largely used as a JV jurisdiction for pan-european M&A transactions.

In any case Luxembourg offers:

- the stability and the flexibility of its tax legislation
- a comprehensive participation exemption regime for dividends and capital gains
- the absence of withholding tax on cash repatriation
- an extensive network of double tax treaties
- the choice between various corporate legal entities or partnership structures
- a rather flexible corporate company law
- an smooth access to the Luxembourg tax authorities for clarifying the tax treatment of operations not cleary defined/covered by the tax law.

The combination of all those aspects makes Luxembourg attractive to structure international investments or undertake local M&A activities.

In your experience, what are the most common challenges that arise? How do you assist your clients in overcoming these challenges?

In structuring operations clients want to make sure that intermediate jurisdictions used will be tax neutral and would allow an efficient tax cash repatriation mechanism. The former is easily achieved thanks to the flexible participation exemption regime anchored in the Luxembourg tax legislation. But this is not enough as a foreign tax authorities may always try to challenge the fact the intermediate entity is a sham. Therefore it is important that clients understand that they have to invest in substance and infrastructure. This means that having a company managed by trust company is not going comply with foreign tax authorities expectations. Appropriate personnel shall be on the ground and carry out real and effective activities. Own premises – rented or owned – with appropriate level of communication (telephone, internet access, emails) is more than „nice to have". We are spending a large amount of time in raising awareness of our clients on the substance issues, convincing them that this is small expense to incurr compared to the benefits of the structure.

On the cash repatriation mechanism this is more a question of technique used to mitigate the withholding tax cost. The process resides in a deep analysis of the tax constraints pertaining to the investors, together with the need to not jeopardize the substance built.

Can you tell us about any recent, particularly interesting (tax-wise), M&As you have been invovled in?

Recently we have been involved in structuring the acquisition of a listed company for one of our clients which made that strategic acquisition to gain access to new markets. Besides the classic aspects of the M&A transactions, we had to ensure the migration of the entire group from an offshore jurisdiction to Luxembourg and deal with all the tax consequences linked to that.

What are the main post-merger tax considerations in relation to M&As in your country?

The typical tax issue „post-merger" is the ability to deduct the financing expenses on the shareholder loan/bank loan which was used to acquire the operating group. Unlike several countries, Luxembourg has not implemented any interest barrier regulations. In addition, the Luxembourg debt/equity ratio is rather favourable (approx 6-to-1), resulting from an administrative practice, and only applies on shareholder debt, i.e. bank debt – if not secured by the shareholder – is not taken into consideration. Therefore a typical structuring consists in indebting the acquisition vehicle and than merging it with the operating group. As a result, the operating profits would be offset with the interest expenses. This structuring, although appearing attractive and simple from a tax point of view, triggers a number of commercial questions and issues, as as a result of the merger all contractual agreements, employment contracts, etc have to be taken over by the surviving entity. An alterntive to this would consist in applying for a tax consolidation between the acquisition entity and the operating group. **LM**

Contact Details:

Olivier Remacle
Partner
Email: olivier.remacle@atoz.lu

ATOZ LUXEMBOURG

OLIVIER REMACLE is a founding Partner of ATOZ and a Partner of its International and Corporate Tax practice. ATOZ is a high end advisory service firm offering comprehensive solutions, encompassing the entire life cycle of an investment entity: from tax planning, design and implementation to compliance and exit planning, with industry focus on Private Equity, Real Estate, Multinational Corporations, Financial Institutions and Family Offices.

ATOZ is a high-end advisory firm offering tax, corporate implementation and corporate finance solutions. ATOZ guides leading international organizations from the Private Equity, Real Estate, Corporate, Financial Services and Family Office sectors through complex multi-jurisdictional tax issues. Drawing on decades of experience, industry knowledge and a vast network of relationships, ATOZ professionals work to create, optimize and preserve investment value throughout the entire life cycle of an investment entity in a proven and practical way.