

Deals

How to lock in tax value in a deal?

Practical

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- View this webcast or presentation at a later stage
- Slides will become available afterwards
- Evaluation form afterwards



Agenda

1. Introduction and market trends
2. Pricing mechanism and (Tax) Deal Value Protection
3. Tax in the SPA
4. W&I Insurance and tax specifics



Introduction

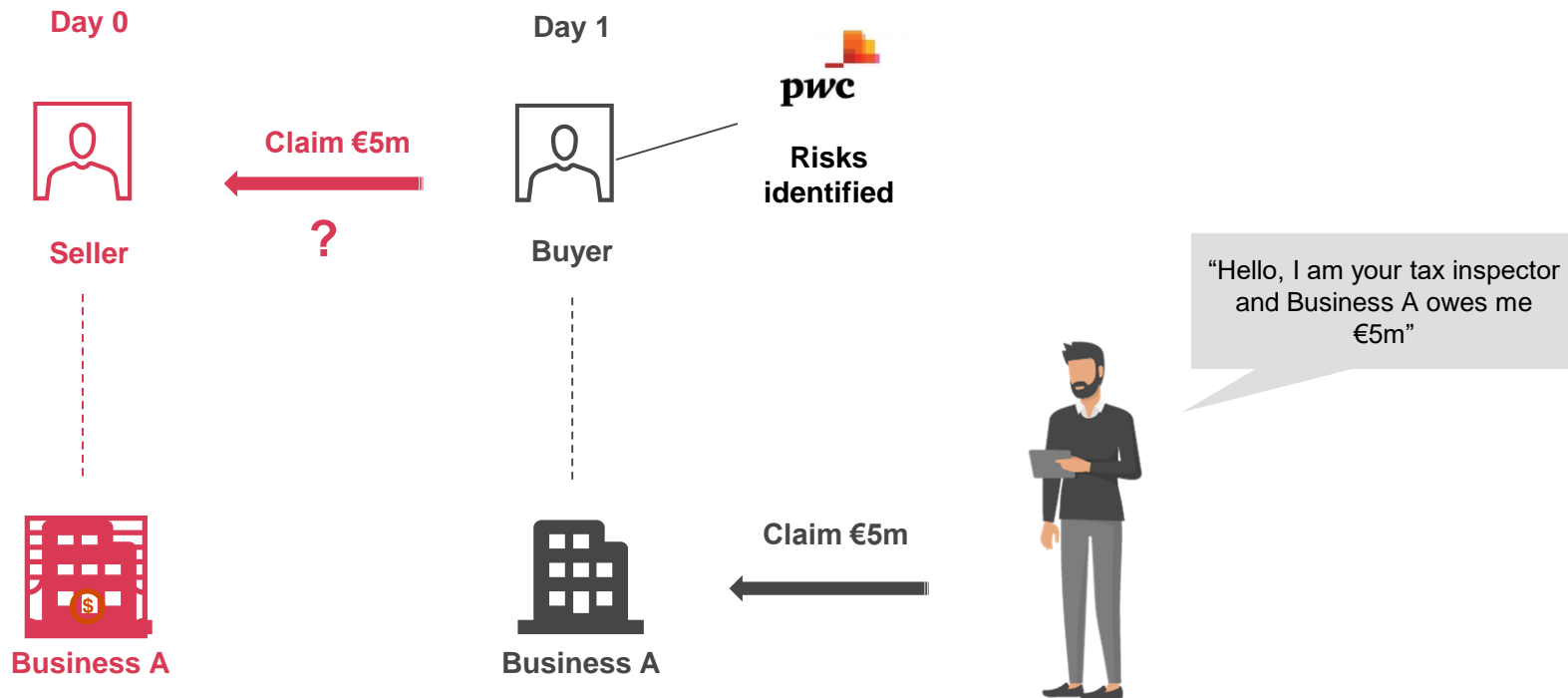
- Competition for investments is fierce and intensifying
- How diligence and contractual transaction matters best interact to (re)assure and secure the tax profile of an asset



Terminology

- **SPA** - (Share) Sale and Purchase Agreement
- **W&I insurance** - Warranty & Indemnity insurance
- **Underwriting** - Due diligence procedures by insurers
- **Escrow** - Deposit of part of the purchase price
- **Locked box price mechanism** - Fixed equity price calculated using a recent historical balance sheet
- **Completion accounts** - Equity price calculated based on the assets and liabilities as at completion (i.e. at a future date)

Claim example

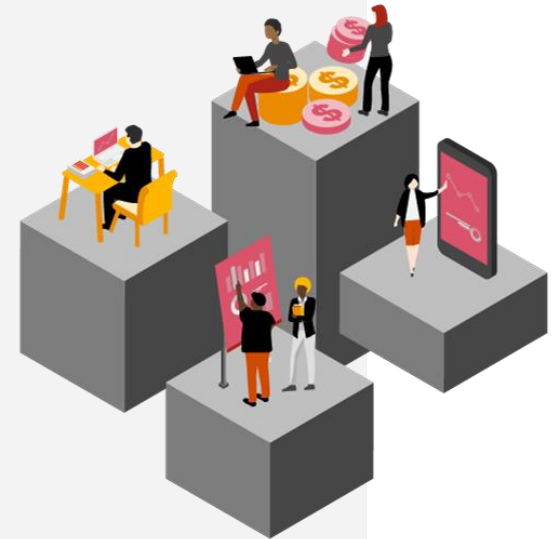


Market Trends

- Accelerated M&A activity fuelled by COVID-19 and available capital
- Shift from Locked Box Accounts to Completion Accounts
- Focus on value creation and preservation
- Continued use of W&I Insurance



Lock in Tax Value



Poll - W&I insurance

I would not take out W&I Insurance unless required by the Seller

- A) Indeed, I do not see the added value as a buyer
- B) No, I (would) consider taking out W&I insurance for all my transactions
- C) This depends on the W&I policy

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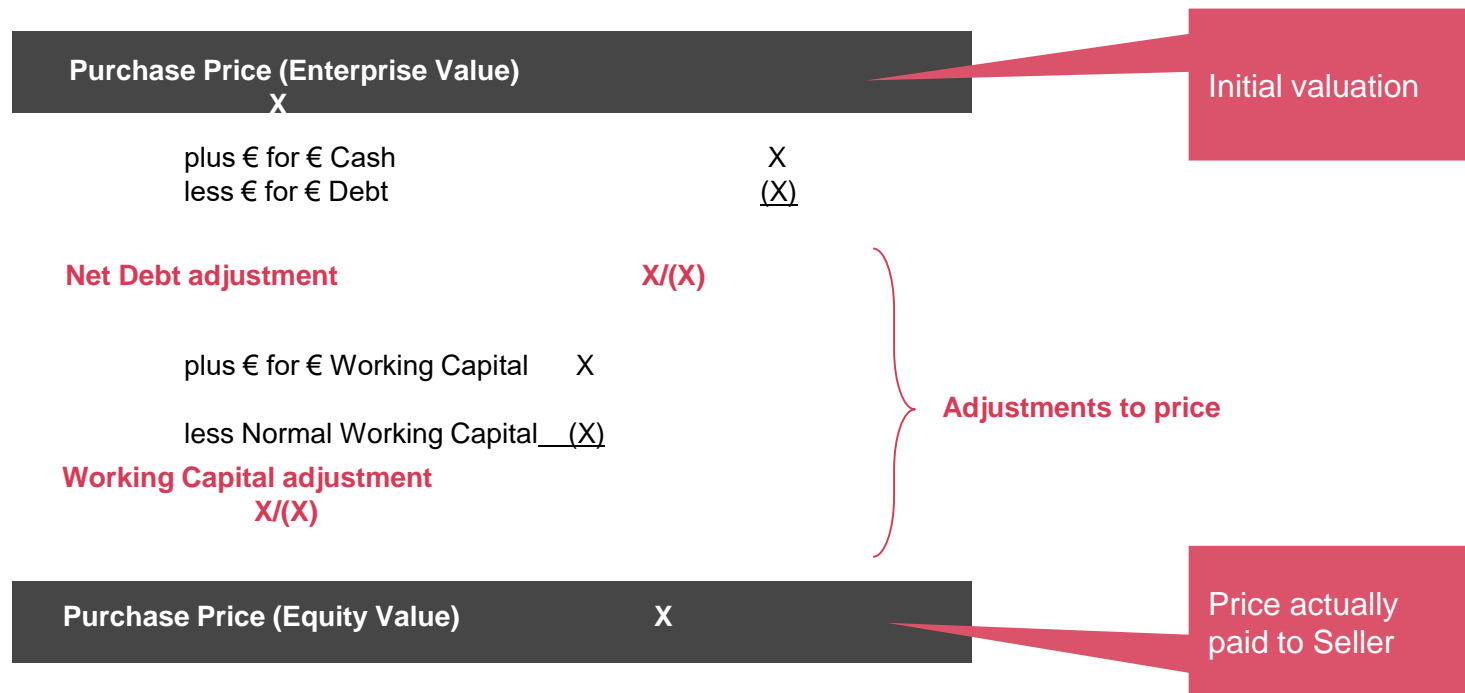


Cash-and-debt free transactions

Typically offers are made on a “Cash-free/ Debt-free basis” assuming a “normal” level of Working Capital (i.e. the Enterprise Value):

- Based on discounted cash flows or a multiple of (normalised) EBITDA
- Before any assumed financing structure – cash-and-debt-free
- Assuming the business is operational

A typical purchase price bridge



Net debt adjustment in SPA

Why do we correct for net debt?

- Buyer has to pay for cash left in the business
- Seller has to pay for debt left in the business

Cash → increases purchase price

Debt → reduces purchase price

Net debt:
Cash - debt

- The net debt adjustment is a € for € adjustment

Poll – deferred tax

As a buyer, I would be willing to pay for Deferred Tax Assets that transfer as part of the transaction

- A) No, this is too risky for me
- B) Yes, it has value so therefore I would also pay for it
- C) It depends on the nature of the assets

Discussion area – Taxes



Buyer:

- **Corporation tax** relates to Seller's period of ownership, i.e. Debt
- Resist giving value to **deferred tax assets** as it's uncertain
- Deduction of **deferred tax liabilities**; will crystallise and Buyer bears exposure to future cash outflow

Seller:

- Wants to retain **corporation tax** within working capital?
- Seeks value on **deferred tax assets** that will convert into cash
- No deduction of **deferred tax liabilities** if not crystallising in the short term

Completion accounts vs. Locked box

Completion accounts

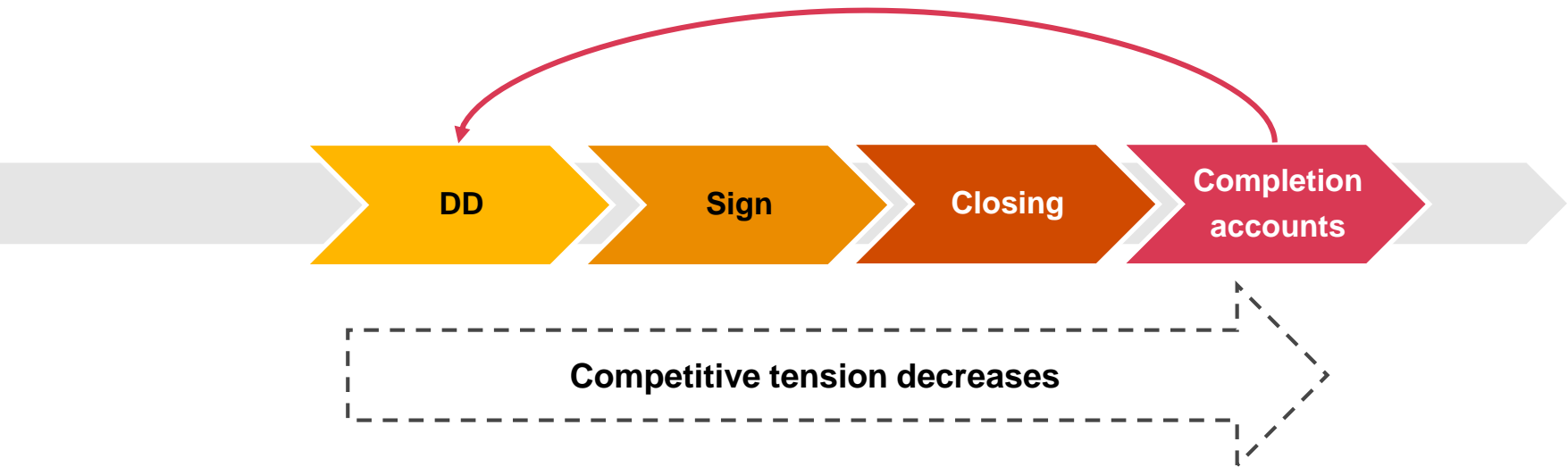
- **Enterprise value** agreed but equity price subject to completion adjustment
- **Definitions** of cash, debt and working capital are agreed prior to signing.
- Adjustments for cash, debt and working capital are based on a completion balance sheet prepared **after closing**
- **Process** for preparing, reviewing and agreeing completion accounts **is set out in SPA**

Locked Box

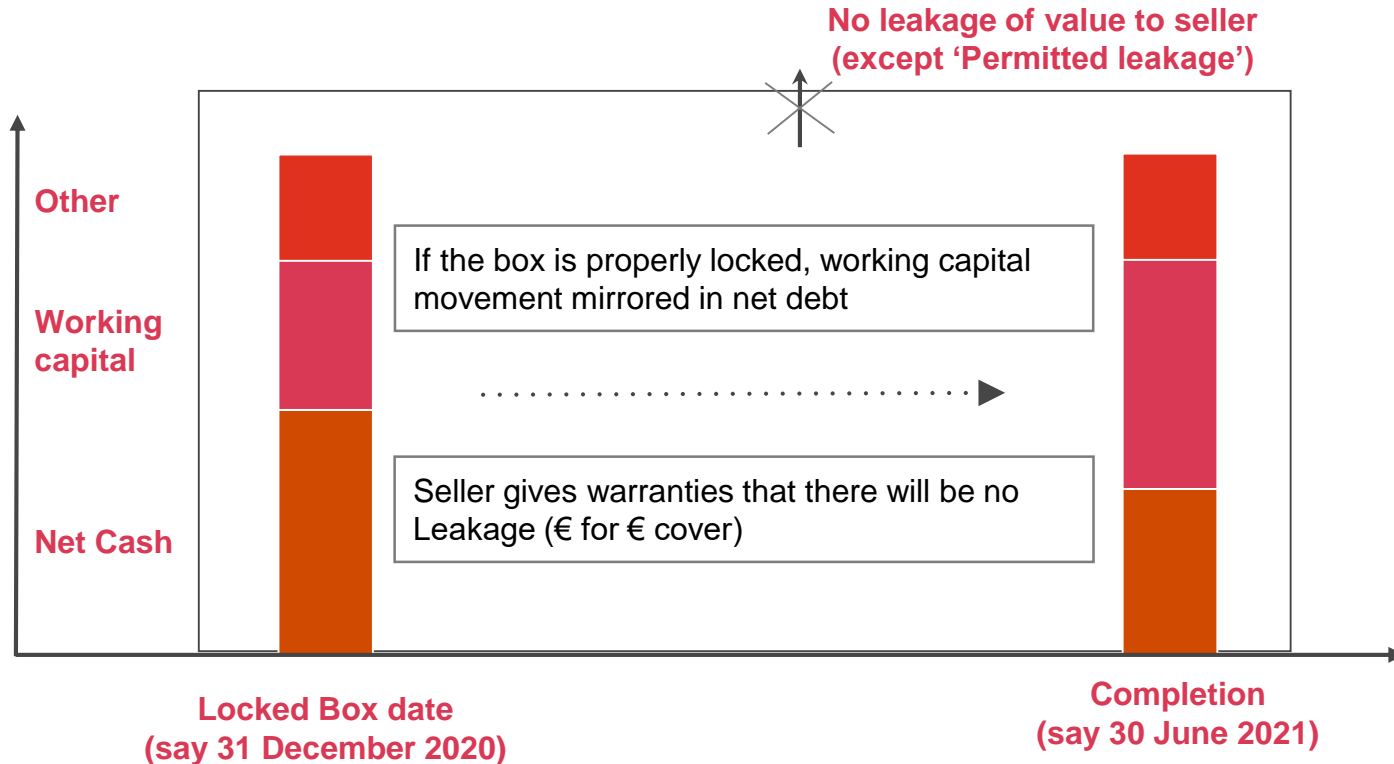
- Fixed **equity price**
- **Price adjustments** for cash, debt and working capital are **agreed prior to signing**
- Based on **historical balance sheet**
- Seller provides indemnity that there will be no leakage of value from the locked box date
- No completion accounts and associated review process
- **No adjustment to purchase price** after closing

Completion accounts

Under Completion Accounts the value levers are quantified after signing



Locked Box



Key market trends



Pre-Covid19 Locked box dominant

- As we were in a seller-driven market, locked box had gained significant ground
- In year before Covid we worked on c.60% LB and 40% completion accounts



Covid19 - increased use of Completion Accounts

- Economic downturn and current market volatility results in uncertainty of valuation and cash profits during LB period
- Earn-outs or deferred considerations offer an alternative approach to bridge valuation gaps

Key Takeaways

- Understand cash profile of tax items
- Understand whether tax balances will be settled at completion or on a historical date
- The Net Debt definition is a negotiated item



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Tax Relevant SPA Clauses



1

Transaction perimeter and deal structure

2

Definition of Tax

3

Tax Warranties, Indemnities and Limitations

4

Cost and Transaction Tax Allocation

5

Conduct of Tax Matters

Definition of Tax

What should the definition of 'Tax' cover?

- All relevant taxes levied by governmental bodies in the broadest sense, including foreign equivalents
- Green taxes and levies
- Primary and secondary tax liabilities
- Penalties, fines, interest
- State aid?



Allocation of taxes and cost

Allocation of taxes and cost

- Different market practices across geographies and industries
- Transaction related taxes
 - (Real) estate transfer taxes
 - (In)direct capital gains taxes
 - Withholding taxes
- Again - be aware of potential interaction with other transaction documentation



Tax Warranties & Disclosure

Tax Warranties

- General versus specific warranties
- Confirm and validate diligence findings
- Trigger additional disclosures
- Ensure referencing to the right legal entities

Disclosures

- Fair disclosure limitations
- Disclosures qualify warranties - no W&I protection!
- How to deal with 'new' exposures arising from disclosure?



Tax filings and payments

Tax audits and investigations

Tax rulings and agreements

Administration & retainment

Tax consolidation

Tax planning schemes / DAC6

Transfer pricing

Subcontracting

Real estate tax/VAT/customs

Management incentive plans

Employer / employment taxes

Tax Indemnity

- General versus specific tax indemnities
 - Pre-closing restructuring tax liabilities
 - Specific tax exposures
 - Exposures excluded from W&I
- EUR-for-EUR compensation
- Locked Box versus Completion Accounts
- No/limited protection
 - Private Equity - Clean Exit
 - Public deals



Poll - Contractual Tax Protection

Does W&I Insurance / Tax insurance offer the same level of protection as a Tax Indemnity?

- A) Yes
- B) No
- C) Depends

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W&I Insurance – What is it?

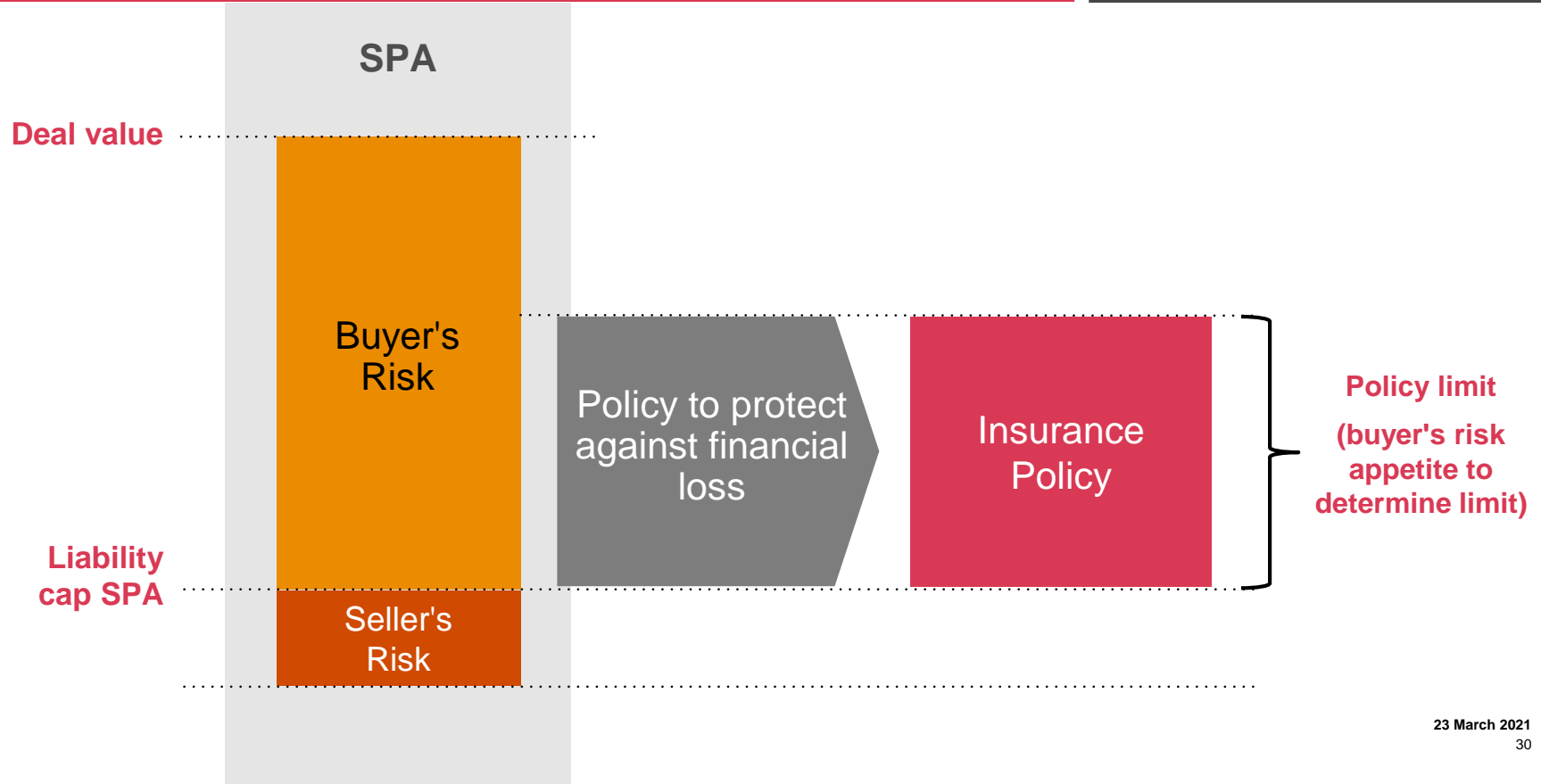
W&I Insurance responds to **financial loss** arising from **UNKNOWN** breaches of Sellers' warranties and tax indemnities under the SPA

The W&I Insurer "steps into the shoes" of the Seller

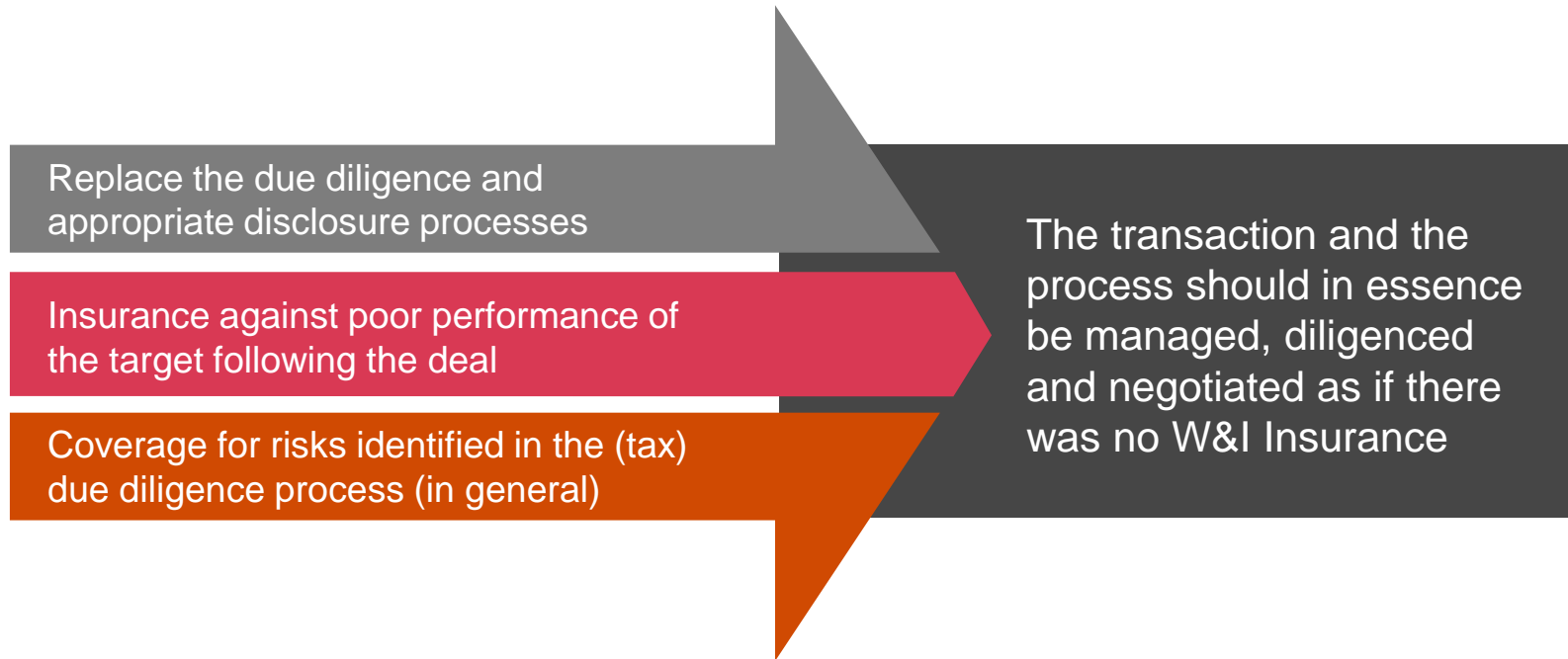
Risk transfer
Reduction of Sellers' liability

Strategic use
Optimizing M&A strategy, particularly in auctions

Buy-side policy



W&I Insurance – What is it not?

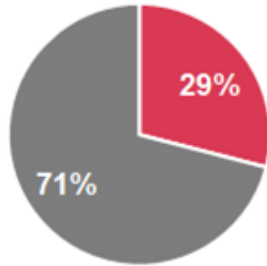


W&I Incidence

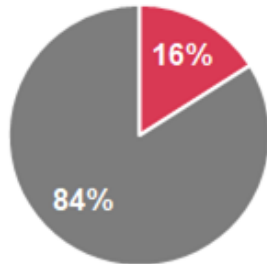
2014

Benelux

Private equity

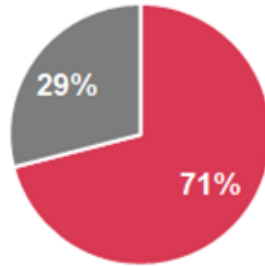


All transactions

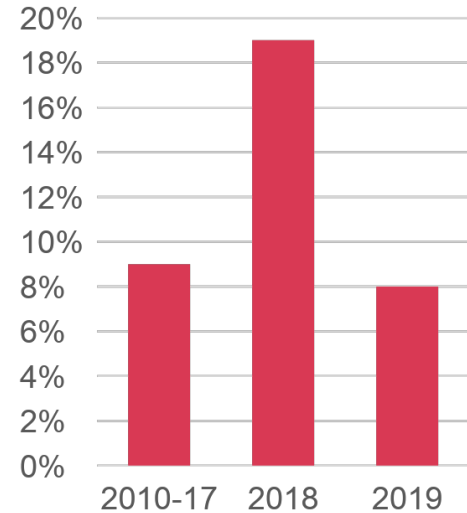
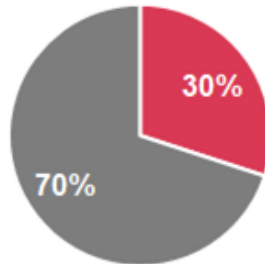


2019

Private equity



All transactions



Key

- W&I Insurance taken out
- W&I Insurance **not** taken out

Advantages for Sellers

- Facilitate clean exit for sellers
- Eliminate need for an escrow
- Free-up sale proceeds for reinvestment / return to investors and shareholders



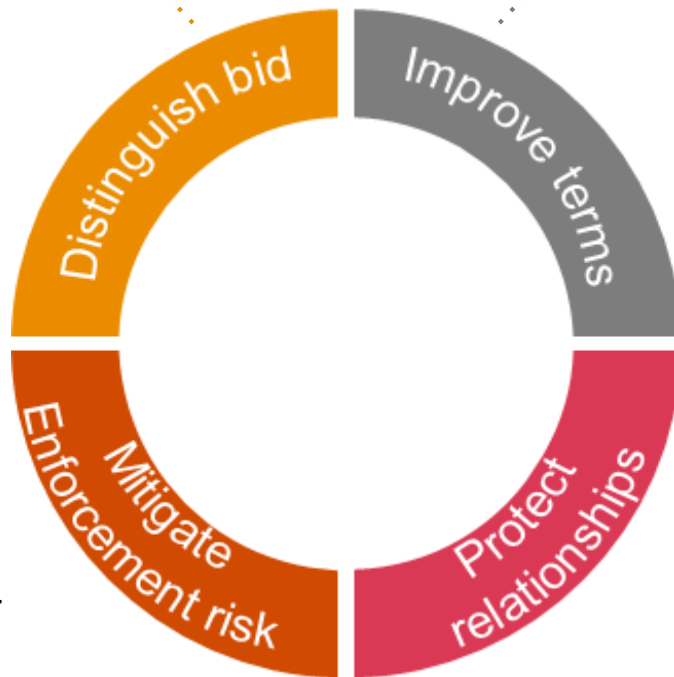
Advantages for Buyers

Distinguish bid

- Reducing seller's liability cap, improving bid

Mitigate enforcement risk

- Claims are backed by high-rated insurance capital



Improve terms

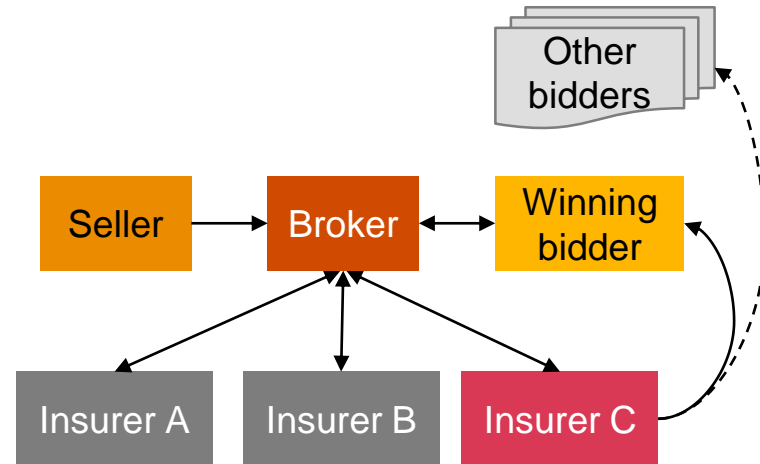
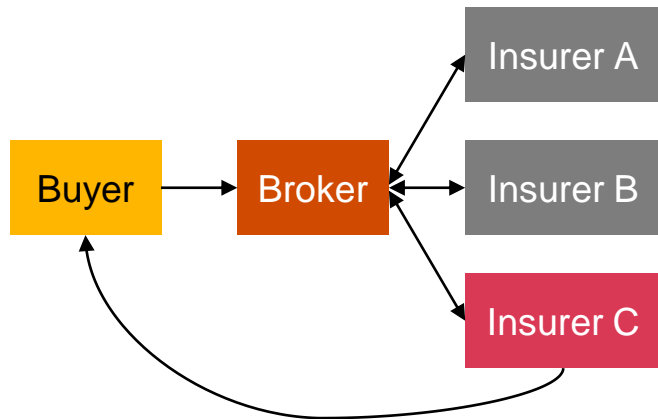
- Extend time limitations
- Extend liability cap
- Synthetic enhancements

Protect relationships

- Claims are brought against an insurer rather than roll-over Sellers/management

Process

Bilateral sale Auction process



W&I policy - Coverage

Tax coverage

- Tax coverage will broadly mirror the scope of the tax due diligence
- Specific coverage position for each warranty (Cover / Partial Cover / Exclude)

Standard tax exclusions

- Transfer pricing
- Secondary tax liabilities
- Loss of tax assets

Specific tax exclusions

- Result of underwriting (e.g. disclosure gaps)

Cover for Identified Tax Risks

W&I Context (affirmative tax cover)

- Identified risks are excluded from coverage
- Affirmative cover of low risks available

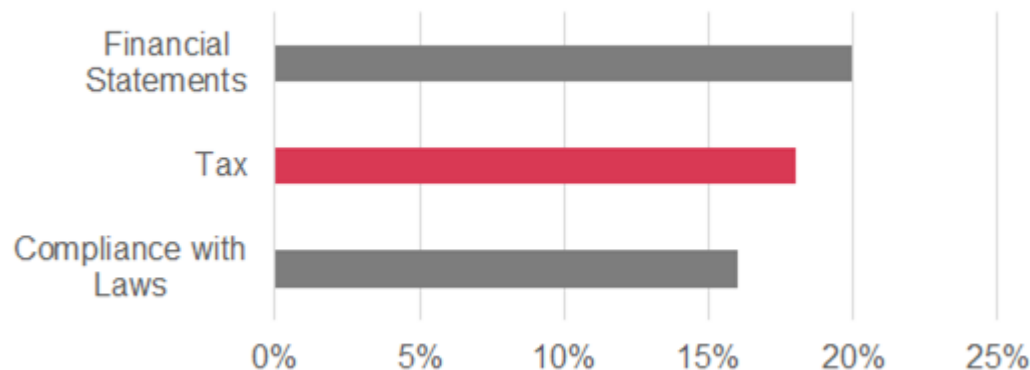
Significantly improve bid: low risk, high exposure items not factored in bid, but the risk shifted to insurer for a fixed premium.

Stand-alone Tax Insurance

- Allows parties to allocate risk and ring-fence tax issues away from deal negotiations
- Ruling practice changed over the years

Claims

Top-3 claims



- Majority of claims is protective
- Generally filed within 24 months after completion
- 50% of tax claims take more than 12 months to settle after notification

Poll - W&I insurance

I would not take out W&I Insurance unless required by the Seller

- A) Indeed, I do not see the added value as a buyer
- B) No, I (would) consider taking out W&I insurance for all my transactions
- C) This depends on the W&I policy

Key Takeaways

- Get clarity on the transaction process and timelines to avoid surprises
- Start negotiations with W&I Insurer/broker early in the process
- Tailored tax due diligence procedures
- Careful drafting of tax clauses in transaction documentation



Questions & Answers



Closing

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- Please fill in the evaluation form

Evaluation

- How would you rate this webinar on a scale from 1 to 10?
- The content was relevant. (Totally agree/Agree/Neutral/Disagree/Totally disagree)
- Do you have any suggestions and/or comments?
- Do you have specific questions and would you like us to contact you?



Thank you

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