Current and emerging issues in M&A

Kurt Burrows

—

16 November 2017

M&A in a challenging economic and political context

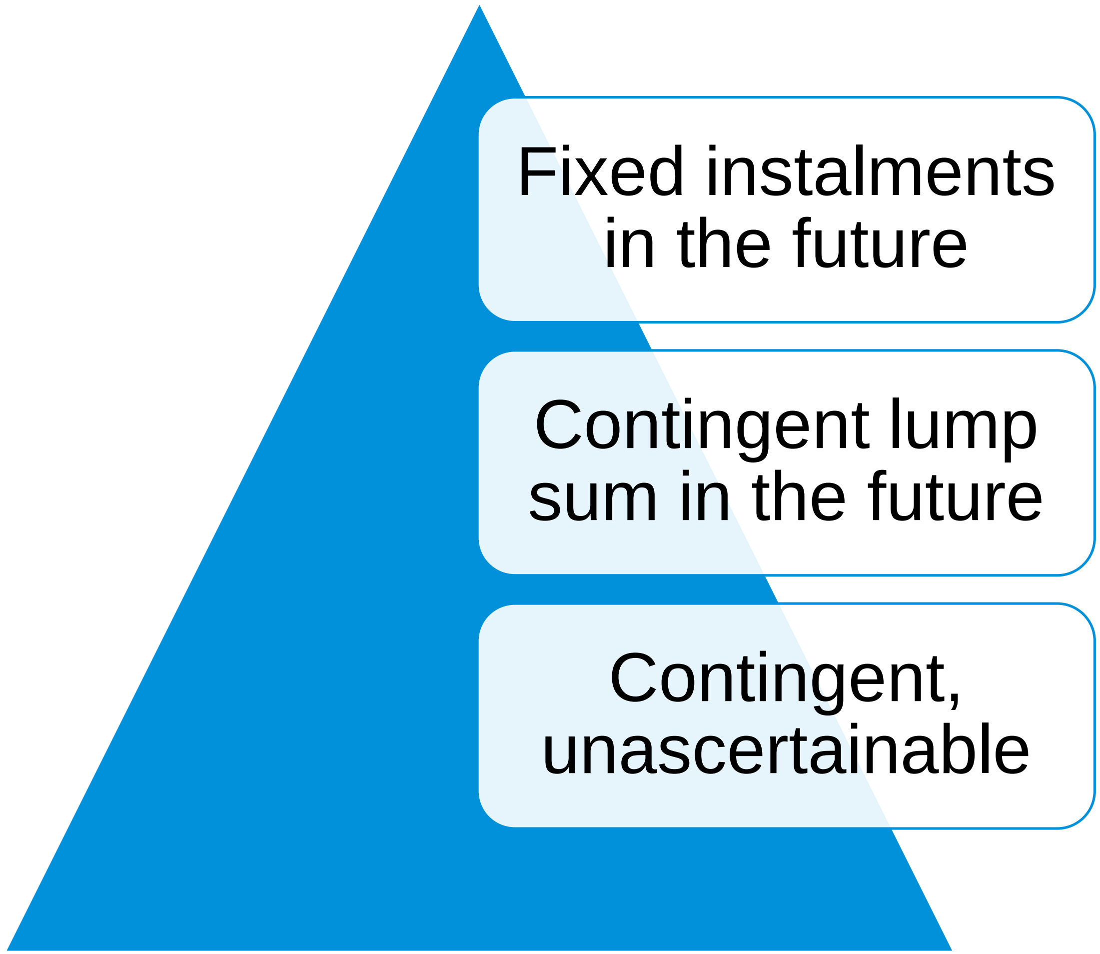
- Commodity prices
- Energy policy
- Regulatory environment
- Social license to operate
- Low levels of exploration

M&A in today's tax environment

- Self assessment?
- Tax governance, justified trust
- Tax policy settings
- Tax administration

Taxation of deferred consideration

Examples of deferred consideration



Reasons for using deferred consideration

Value gap

- Vendor sees upside value that the purchaser isn't willing to price in
- Purchaser sees downside risk that the vendor isn't willing to price in

Capacity to pay

- Purchaser is not able or willing to fund any additional upfront consideration

Reasons for using deferred consideration

….but tax is not the driver for entering into a deferred consideration arrangement

How deferred consideration should be taxed

To be consistent with what is happening economically:

Vendor should be taxed ___once___ on amounts actually received

Purchaser should have tax cost in assets equivalent to amounts paid

How deferred consideration is actually taxed

1. AusCo sold it's interest in an oil and gas project

2. AusCo received $10M cash upfront

3. AusCo and the purchaser cannot agree on the value of the project beyond the $10M upfront payment

4. As a result, AusCo is also granted a right to future payments over the following 10 years, subject to turnover exceeding an agreed threshold

5. The initial market value of the right to future payments is $2M

6. AusCo actually receives $100k in each of the following 10 years, at which time the deferred consideration arrangement comes to an end

KPMG

Do the qualifying earn out provisions apply?

The object of the look through provisions is to avoid unnecessary compliance costs and disadvantageous tax outcomes when entities involved in the sale of a business:

a) cannot agree on the current value of some or all of the business' assets due to uncertainty about the future economic performance of the business; and

b) resolve this uncertainty by agreeing to potentially provide future additional consideration linked to this performance.

These rules achieve this object by:

a) disregarding any capital gain or capital loss relating to the creation of a look-through earnout right; and

b) for the acquirer of the business — treating any financial benefits provided (or received) under the right as forming part of (or reducing) the cost base or reduced cost base of the business assets; and

c) for the seller of the business — treating any financial benefits received (or provided) under the right as increasing (or reducing) the capital proceeds for the business assets.

Do the qualifying earn out provisions apply?

But, there are a number of limitations that render these provisions largely (or entirely) irrelevant for resource transactions. In particular:

All of the financial benefits that can be provided under the right are to be provided over a period ending no later than 5 years after the end of the income year in which the CGT event happens

If the qualifying earn out provisions don't apply

1. **Vendor might be taxed twice**
   - Firstly on the initial $2M market value of the right to deferred consideration (CGT capital proceeds)
   - And then on the actual payments received, on revenue account over time

2. **For the purchaser the position isn't entirely clear, but potentially benefit twice**

This does not make sense

So, what can we do?

Valuation

Can you support a low or nil market value?

TOFA

Potentially brings all gains and losses onto revenue account

TOFA and deferred consideration

A (highly) simplified view of how things might look under a TOFA scenario

Capital proceeds incl. MV of deferred consideration

For simplicity, assumes pro-rata allocation of TOFA cost (technical query on this point

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10	Total
12.1M	100k	100k	100k	100k	100k	100k	100k	100k	100k	$13M
(200k)	(200k)	(200k)	(200k)	(200k)	(200k)	(200k)	(200k)	(200k)	(200k)	($2M)
11.9M	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**(100k)**	**$11M**

TOFA brings gain/loss onto revenue account

Eventually tax paid on amounts actually received

Is TOFA the answer?

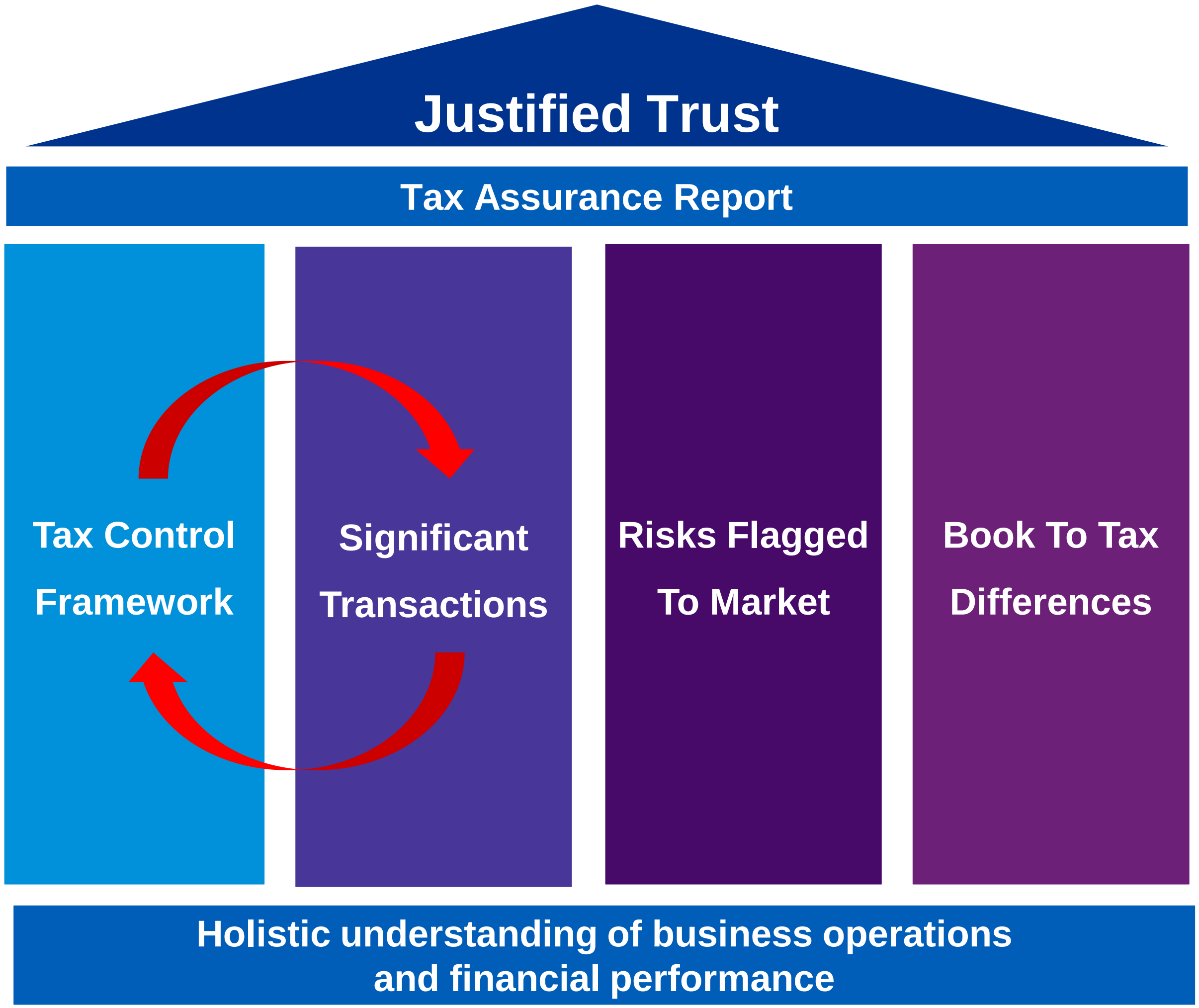
It certainly helps, but its not perfect

- **What if one of the buyer or seller is not subject to TOFA?**
- **How to allocate the ‘cost’ of the TOFA arrangement to each receipt?**

  See section 230-70 which requires a ‘reasonable attribution’ of cost ‘applying appropriate and commercially accepted valuation principles’
- **There is still upfront taxation, with the corresponding ‘recovery’ being deferred, potentially for many years**

Whistle stop tour of other hot topics

ATO is focused on governance frameworks



Other points to note

- Foreign resident CGT withholding
- Natural resource payments
- Funding
- TSA hygiene
- PRRT
- Vendor payments to sell assets

Thank you

kpmg.com.au

kpmg.com.au/app

kpmg.com.au

kpmg.com.au/app