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Border Crossing

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Tax structuring for investment in China and SE Asia

RSM Asia Pacific tax consultants are specialists who can help you add value to a merger & acquisitions transaction in SE Asia. They can participate in the M&A process starting with deal structuring advice, tax due diligence and post-acquisition structuring of operations. Our aim is not only to assist our client to identify and manage the tax risks involved in the acquisition but, more importantly, to help the client to identify and capitalise on the tax opportunities.

The tax regulations and practices in China and SE Asia are complex, even to tax generalists practising in the region, not to mention investors from outside SE Asia. This article outlines some of the major tax issues that investors will need to consider before embarking on an M&A transaction in China and SE Asia.

China

Introduction

China's accession to the World Trade Organisation (WTO) in 2001 has had a significant impact on Chinese foreign trade and investment policies. Tariff reductions, the removal of non-tariff barriers and the relaxation of many of the restrictions over foreign investment have unleashed significant opportunities and challenges to both current players and newcomers.

Mergers and acquisitions are one of the quickest ways for new and existing foreign investors to expand their market share in post-WTO China.

Structuring a share deal

Typically, a foreign investor acquires the equity interest of a Chinese target company from the seller (direct acquisition), or acquires the shares of a foreign company that holds a Chinese target company (indirect acquisition).

A target company in China will remain as a going concern subject to the conditions granted by the relevant Chinese authorities when the target was set up. As there is no change in the legal existence of the acquired entity and no disruption to its tax attributes, a target company cannot re-value its asset base for Chinese tax purposes.

Under a typical share deal model, a buyer would use an offshore investment holding vehicle to acquire a Chinese target company. This is largely due to the fact that foreign companies cannot easily establish special purpose holding companies in China. The countries, which are commonly used to set up offshore-holding vehicles, include Hong Kong, Mauritius and the British Virgin Islands.

Investors with multiple investment projects or Foreign Investment Enterprises (FIEs) in China typically use China Investment Holding companies (CIHCs). The approval conditions for such holding companies are stringent and are listed below.

1. The foreign investor needs to have a good reputation, creditability and financial strength;
2. The minimum registered capital of a CIHC is US$30m;
3. The paid-up capital of the foreign investor's existing investment in China should not be less than US$10m in aggregate;
4. The total assets of the foreign investor in the preceding year should not be less than US$400m; and
5. The foreign investor should have more than three proposed investments approved by the Chinese authorities; or
6. If 3, 4 and 5 above are not satisfied, the foreign investor should have established 10 or more China FIEs that are engaged in manufacturing or infrastructure business and the total paid-up capital of these FIEs should be greater than US$30.

Dividends received by an investor are not subject to any Chinese tax and the cost of funds, such as interest payments on borrowings for financing the acquisition of the equity investment, is not tax deductible. Accordingly, a buyer may need to structure the acquisition in such a way that the cost of funds would be tax deductible in another country.

Since dividend income earned from FIEs is exempted from income tax, claims for the following expenses and losses relating to acquisition of investments in China are also not allowable:

- feasibility study expenses;
- investment management expenses and expenses incurred in the course of deciding on such investment; and
- irrecoverable investment losses upon expiry of the investment period.

In addition, acquisition expenses incurred by the buyer may not be allocated to a target company and therefore may not be claimed as a tax deduction in China.

Structuring an asset deal

A typical asset deal model involves the formation of a new FIE or the use of an existing FIE to acquire the selected assets, liabilities and commercial operations of the target business.

The asset deal model is also commonly used in China when a Chinese partner injects its business into a joint venture. In other situations, rather than effecting a share deal, foreign investors may prefer to form new FIE to take over the business operations so as to minimise their exposures to any inherent tax and business risks, hidden or contingent, that may be associated with the target company. Nevertheless, if customs duty is delinquent on the original importation or upon transfer of assets by the seller, the buyer could still inherit the tax risk associated with the assets transferred.

An asset deal model would facilitate a 'step-up' in the asset value that is eligible for depreciation or amortisation charges for China income tax purpose. In case the fair market value of individual assets cannot be determined, the premium (representing the actual transfer consideration in excess of the aggregated net book value of the assets acquired) may be recorded as acquisition goodwill. Such acquisition goodwill is generally amortised and deductible for income tax purposes over a minimum period of 10 years.

Hong Kong

Introduction

Hong Kong has a territorial tax system that imposes profits tax on a person carrying on a trade or business in Hong Kong in respect of his assessable profits that are sourced in Hong Kong from that trade or business. Income that is derived from non-Hong Kong sources, and Hong Kong sourced capital gains, are not subject to profits tax.

In addition, dividends and bank interest, which have a Hong Kong source, are also generally not subject to profits tax.

The rules apply equally to Hong Kong incorporated entities (generally limited liability companies) and foreign entities carrying on business in Hong Kong through a branch.

Structuring a share deal

Factors which could offset the usual asset purchase considerations and concerns over the unknown liabilities include:

- losses, which would be preferable to preserve and utilise in the target company;
- real estate in the target company, which would result in a significantly higher stamp duty cost if an asset purchase took place;
- potentially higher tax bases for depreciable assets; and
- simplified transaction formalities (eg, contracts may remain undisturbed).

Interest is only deductible in Hong Kong if it is incurred for the purposes of producing assessable profits, and meets one of a number of specified conditions. Thus, interest paid on debt incurred for the purposes of acquiring shares (from which non-assessable dividends will be derived) is not tax deductible in Hong Kong, whereas interest on debt incurred under an asset deal should be deductible.

Share dealers and venture capitalists that carry on business in Hong Kong should, however, be treated differently. They will normally not be able to claim profits from a share disposal as being capital and non-taxable, but on the other hand, they should be allowed a tax deduction on interest on debt used for acquiring such shares.

Share dealers and venture capitalists who do not carry on business in Hong Kong would not be subject to tax on profits from the disposal of shares, and, accordingly, would not be able to obtain a tax deduction for any interest costs.

Structuring an asset deal

The following points should be noted in relation to asset deals in Hong Kong:

- Real estate should be transferred at market value, otherwise the value for stamp duty purposes may be challenged;
- The tax authorities have the power to deem transfer of assets between connected persons for tax purposes at market value;
- Inventory may be assigned at any chosen value (irrespective of whether the parties are connected persons or not), provided the transfer results from a cessation of business and the buyer can claim a Hong Kong tax deduction for the inventory cost. Otherwise, market value should apply;
- An asset purchase that involves a substantial payment for goodwill, which is not tax deductible, may dilute future earnings.

In the case of an asset deal, a tax deduction in Hong Kong may be obtained for financing costs, provided certain conditions are met. In principle, interest on finance obtained from a Hong Kong or overseas financial institution is deductible, but interest paid to non-financial institution is generally only deductible if the interest is subject to Hong Kong profits tax in the hands of the recipient (unlikely in the case of an overseas company). There are further conditions, which permit a deduction in certain circumstances for interest paid on loans to solely finance the acquisition of stock and fixed assets, and on debentures and marketable instruments.

Interest deduction restrictions on intra-group financing for asset and share purchases exist, and complex structures are sometimes developed which may achieve the effect of an interest deduction for offshore finance, although at the risk of challenge from the tax authorities.

Indonesia

Introduction

With a population of over 200 million people and significant natural resources, Indonesia represents both a significant market and potential supplier to the world economy.

The Indonesian government officially welcomes foreign private investment and, over the past several years, the Government has progressively sought to liberalise the local rules governing foreign investment. Since 2001, Indonesia has been in the midst of a serious effort to promote foreign investment, capital accumulation and the export of goods other than oil and gas to expedite economic development and to become internationally competitive.

Structuring a share deal

Foreign investment regulatory rules mean that most share acquisitions are structured as direct investments from outside Indonesia. The acquirer generally seeks to hold Indonesia target companies through a company located in a country, which has entered into a double tax treaty agreement with Indonesia. The choice of a suitable jurisdiction will depend on the acquirer's own tax considerations.

Interest paid on borrowings to finance a share acquisition must satisfy normal tests for deductibility in Indonesia. Where a local corporate entity uses borrowing to finance a share acquisition, interest is not generally deductible because dividends received are not taxable. Dividends are not taxable when:

- Dividends are paid out of retained earnings;
- The relevant shareholders hold at least 25% of the paid in capital; and
- The relevant shareholders have an 'active business' other than shareholding (ie, a holding company).

Interest on borrowings used to finance equity investments in newly established companies or to participate in rights issues is, however, deductible.

A change in ownership of the shares of a company does not alter the depreciation allowances claimed by the company or its carry-forward tax losses.

There is no facility for stepping up or increasing the cost base of assets to reflect the purchase price.

The acquisition of shares in a tax loss company provides flexibility in loss utilisation because of Indonesia's lack of provisions with regard to continuity of ownership or business.

Structuring an asset deal

An asset acquisition is subject to the approvals of various government departments including that of the foreign investment regulatory body (BPM).

The acquisition of assets may be effected either by an existing subsidiary company or through a newly established Indonesian entity.

Generally, an asset acquisition is preferred in Indonesia because of the difficulties in determining the undisclosed liabilities (such as tax) of operating Indonesian entities. The ITO has 10 years in which to initiate a tax audit and therefore potential tax exposures can arise long after an acquisition has been completed. In addition, the legal uncertainties in trying to enforce warranties and indemnities against vendors generally mean that assets acquisitions are preferred.

The buyer in an asset acquisition would be entitled to deductions for interest expenses on loans used to acquire such assets, provided that the assets are used in generating income and the transaction has been effected at arm's length.

On an acquisition of assets, the assets should be recorded at transfer value. An asset appraisal is generally required for a related party transaction to determine the market value.

Asset depreciation is calculated on an asset-by-asset basis. Buildings are divided into two classes: permanent (useful life of 20 years) and non-permanent (useful life of 10 years).

Purchased goodwill and cost of intangible property can be amortised, and the amount of amortisation will generally be tax deductible.

In addition, costs incurred to extend rights over land such as rights to build, rights to commercial use, and rights to use, can be amortised over the useful life of the rights. Land acquisition costs remain non-deductible.

VAT paid by the buyer should be available as input VAT, which may be recovered against output VAT, or by claiming a refund. It should be noted that a request for a VAT refund would automatically trigger a tax audit. Concessions may be available, for example, where a transferor company is a company not required to be registered for VAT purposes.

5% transfer tax, which is determined on the transfer value or the value forming the basis of the land and building tax, whichever is higher, is considered as a cost of acquisition. That is, it is not deductible against income tax.

Malaysia

Introduction

Malaysia operates a unitary tax system on a territorial basis. Tax residents of Malaysia, whether corporate or individuals, are taxed on income accruing in or derived from Malaysia. Resident companies are exempted from income tax on foreign-source income remitted to Malaysia, except for those carrying on banking, insurance, air or sea transport, as those companies are taxed on a worldwide basis. Non-residents are only taxed on income accruing in or derived from Malaysia.

Structuring a share deal

It is common for shares in a Malaysian target company to be acquired through an investment holding company. Such an investment holding company provides the flexibility for additional future acquisitions. Moreover, as the investments held by an investment holding company are typically for long-term purposes, subsequent disposals of investments are normally not taxable unless the buyer is regarded as a share trader.

However, an investment holding company is not regarded as carrying on a business, and therefore the deduction of expenses is limited. Thus, if an investment holding company were desired for other purposes, it would be prudent to push most, if not all, the operating expenses to the subsidiaries.

Alternatively, it is possible to use the investment holding company to provide management services to its subsidiaries and charge the subsidiaries, fees for services provided. However, care needs to be taken, as there may be service tax implications on the management services provided.

For Malaysian tax purposes, there are no thin capitalisation rules. Thus it would make sense to maximise the amount of debt used to acquire the shares of a target company. However, the Malaysian Central Bank may impose restrictions on the amount of local borrowings.

In a share deal, interest expense on the acquisition of shares is deductible to the extent that dividend income is received in the same year, and pursuant to Malaysian tax law, this should also result in a tax refund to a shareholder company.

Withholding tax is applicable if the interest is paid to an overseas lender, and such withholding tax may be avoided by interposing a Malaysian or Labuan bank as the lender.

It is important to time the payment of interest with the flow of dividends to maximise the interest deduction and therefore maximise the tax refund. It should be noted that excess interest costs are not eligible for carry forward to offset against future dividend income in Malaysia.

Expenses incurred in relation to the acquisition (eg, restructuring expenses, professional fees and transaction costs) are generally not tax deductible.

Unabsorbed tax losses, unutilised tax deprecation, tax incentives and dividend franking credits remain with a target company irrespective of the change of ownership in a target company.

The common methods of repatriation of profits through payments of dividends, interest, royalties and management fees are used in Malaysia.

However, it should be noted that for certain industries (eg, the manufacturing industry), prior approval from the relevant licensing authority is required on the rate of royalty and management fees payable to non-residents.

Structuring an asset deal

An acquisition company may be an existing company of the buyer or a new company, depending on the tax position of the existing company. If the existing company is in a tax loss situation, it may be appropriate for the existing company to acquire the new business and for the profit earned by the new business to be set off against the tax loss of the existing company.

Where a new business is not expected to return profits, or it has a longer gestation period, it might be useful to consider injecting the new business into an existing profitable subsidiary.

Arrangements such as the above, however, must reflect commercial considerations to avoid any potential challenge from the tax authorities.

The acquisition of assets or interest in Malaysian incorporated companies of more than RM5.0m in value or where there is acquisition of 15% or more of the voting rights in a Malaysian company by foreign interest would require the approval of the Foreign Investment Committee (FIC). The FIC may impose foreign ownership restriction if it considers it appropriate.

Interest incurred on funds used to acquire a business under an asset deal should be fully tax-deductible.

It is possible to step up the cost base of depreciable assets for the buyer. However, in allocating the purchase price to the assets, an independent professional valuation should be obtained to support the reasonableness of the allocation of the purchase price to the various asset categories.

A step-up in the cost base may not be possible if the transaction is between two related parties as the tax provisions would deem the transfer of fixed assets to be at their tax written down values.

No tax deduction is available for the amortisation of goodwill. Therefore, the purchase price on an asset deal should, ideally, be allocated as much as possible to inventory, depreciable assets and other items, which are entitled to a tax deduction or tax depreciation. However, any gains derived by the seller on the sale of inventories and depreciable assets (to the extent of tax depreciation recouped) would be taxable in the hands of the seller.

Unabsorbed tax losses, unutilised tax deprecation, tax incentives and dividend franking credits may not be transferred to the acquiring company.

The Philippines

Introduction

The Philippines imposes income tax on income derived in the Philippines, and on income, which is derived outside the Philippines and received in the Philippines.

Capital gains are subject to taxation depending on the nature of the underlying transactions.

Various incentives are available for industries and activities encouraged by the Philippine government. These include:

- Board of Investment registered enterprises;
- Philippine Economic Zone Authority registered enterprises;
- Subic Bay Freeport registered enterprises;
- Regional headquarters; and
- Regional operating headquarters.

Entities carrying on approved activities may take advantage of reduced/preferential tax rates or full exemption from income tax and certain taxes for a specified period (generally between four and eight years) depending on the nature of tax incentives.

Structuring a share deal

Setting up a holding company in the Philippines may not be tax efficient due to the imposition of the Philippines' 10% accumulated earnings tax on unreasonable amounts of retained profits.

To avoid this tax, retention due to reasonable business needs must be proven. But retention of profits in a holding company is prima facie evidence of unreasonable profit retention.

Hence, a holding company in the Philippines may not be a tax efficient structure to park dividends.

To minimise Philippines tax on gains derived from any subsequent disposal of an investment in the Philippines, depending on the tax regime of the investor's home jurisdiction, if the holding company of the Philippines target is located in countries such as the Netherlands and Singapore, any gains derived from the sale of the shares of the Philippines target should not be subject to Philippines tax. However, in respect of gains derived by a Singapore investor, the exemption would apply provided that the target's major assets do not consist of immovable properties.

There is no specific debt to equity ratio prescribed for tax purposes. Deductibility of interest is largely dependent on whether the transactions between the related parties are considered arm's length.

In practice, a debt to equity ratio of 3:1 is often used as a safe haven as this is also the ratio required for entities registered with the Board of Investment as a condition for the incentives.

Acquisition costs, which include, among others, professional fees and taxes passed on to the buyer, are not deductible for income tax purposes. The same should be capitalised or should form part of the cost of the investment, and will be allowed as deduction for purposes of calculating the capital gains tax, which is applicable in case of subsequent disposal of the shares.

For acquisition costs to be deductible against income, it may be necessary to book such expenses in a country where an appropriate tax deduction may be allowed.

Where a target company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business through a share deal, as there are no provisions to transfer losses from one entity to another.

However, losses will not be allowed to be carried over if there has been a substantial change (ie, more than 25%) in the ownership of the business.

If a target company has been granted tax incentives, the buyer will have to acquire the shares of the company if it wishes to preserve the incentives. However, approval from the relevant government body must be obtained.

Structuring an asset deal

For assets deals in the Philippines, care should be taken to ensure that income tax, value-added tax and local business tax (based on gross selling price), documentary stamp tax and transfer tax (particularly with respect to the transfer of property) are minimised.

Interest incurred on funds used to acquire a business under an asset deal is tax deductible.

An asset deal also allows the buyer to step up the cost base of acquired assets for tax purposes. This enables tax deductions to be maximised through depreciation or amortisation and/or additional interest costs if the acquisition is funded by debt.

Where real estate is involved, documentary stamp tax, transfer tax, and local business tax on the transfer may be significant costs.

Amortisation of goodwill is not tax deductible, but certain business rights may be amortised for tax purposes.

Singapore

Introduction

Singapore imposes income tax on income derived in Singapore and on income, which is derived outside, and received in, Singapore.

'Received in Singapore' means income that is:

- remitted to, transmitted or brought into Singapore;
- applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
- applied to purchase any movable property, which is brought into Singapore.

Capital gains are generally not subject to tax. However, gains from disposals made by property traders and property developers continue to be subject to income tax as ordinary business profits.

A number of incentives are available for industries and activities encouraged by the Singapore government. These include:

- Pioneer enterprise;
- Export enterprise;
- Operational headquarters;
- Business headquarters;
- Finance and treasury center;
- Approved fund managers;
- Approved international shipping enterprise;
- Global trader programme; and
- Venture capital companies.

Entities carrying on approved activities may take advantage of a reduced tax rate (generally 10%) or full exemption from income tax for a specified period (generally between five to 10 years depending on the nature of tax incentives).

Structuring a share deal

Whether a deal is structured as a share deal or asset deal may largely depend on commercial considerations. A share deal may, however, be subsequently restructured as an asset deal to allow it to be completed on a more tax-efficient basis.

Generally, it is less expensive for a purchaser to acquire the business under a share deal as the stamp duty on the transfer of shares is a lot lower than the stamp duty on asset deals involving real property.

Where a target company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business via a share deal, as there are no provisions to transfer losses from one entity to another. Rules exist that require continuity of shareholdings in order to utilise the losses. However, if the available losses do not affect the price, a waiver should generally be granted.

If a target company has been granted a tax concession, a buyer will also have to acquire the shares of the company if it wishes to preserve the concession and seek prior approval from the relevant government body to continue to benefit from the concession.

Interest expense on the acquisition of shares is deductible to the extent of the dividend income received in the same Year of Assessment and should result in a tax refund to a shareholder company.

However, if the interest is paid to an overseas lender, interest withholding tax may apply.

The timing of the payments of the dividend should coincide with the payment of interest. Loans should be structured in such a way as to take into account the timing of the flow of dividends to maximise the interest deduction and therefore the tax refund. It should be noted that excess interest costs are not eligible for carry-forward to offset against future dividend income.

Singapore has a wide network of double tax agreements and a favourable regime relating to foreign dividends (ie, generally tax-free). The use of a Singapore company as the acquiring company for targets both inside and outside Singapore should maximise a group's after-tax profits.

Structuring an asset deal

Interest incurred on funds used to acquire a business under an asset deal should be tax deductible. Since Singapore does not have a debt to equity ratio requirement for tax purposes, it is possible to maximise the amount of debt used to acquire a business.

Where, however, assets of Singapore businesses that are acquired, which may not produce regular returns (eg, investment in a subsidiary), interest is not tax deductible to the extent that no income is derived from such assets in a particular year. Thus, in an asset deal, such assets may be acquired by separate entities and the debt/equity may be appropriately structured to maximise the interest deduction.

No tax deduction is available for the amortisation of goodwill. Therefore, the purchase price on an asset deal should be allocated as much as possible to inventory, depreciable capital assets, and other items, which will generate a tax deduction.

In allocating the purchase price to assets, a formal valuation report should be obtained to support the reasonableness of the allocation.

An assets deal allows the buyer to step up the cost base of acquired assets for tax purposes. This enables tax deductions to be maximised through depreciation or amortisation and/or additional interest costs if the acquisition is funded by debt. Where real estate is involved, the stamp duty on the transfer may be significant and thus, in structuring the deal, such duty should be considered.

Acquisition costs are generally not tax deductible to a buyer in Singapore. Thus, buyers should look to booking such expenses in a country where an appropriate tax deduction may be available.

For financial buyers who require a good exit multiple through an IPO, goodwill should possibly be housed in an appropriate vehicle to avoid diluting the group profits on which the IPO price may be based. There are no restrictions as to the transfer of 'goodwill' to an entity outside Singapore.

Such 'goodwill' may be packaged such that a foreign acquirer may obtain a tax deduction for the purchased goodwill and on-charge a Singapore company a fee for benefiting from the use of the goodwill.

Purchasers of Singapore assets are eligible to claim a deduction on a straight-line basis over a period of five years in respect of the capital cost incurred in acquiring approved know-how or patent rights and intellectual property rights (ie, copyrights, trade-marks, registered designs etc).

The Economic Development Board (EDB) grants approval for know-how and patent rights in respect of the manufacturing and trading sectors and by the Infocom Development Authority (IDA) for the technology sector. The qualifying criteria are:

- The company should be the sole legal and economic owner of the rights;
- The rights should be used for activities based in Singapore;
- The company should use the rights in its business by the third year of acquisition;
- The company should commit an incremental Total Business Spending (TBS) equivalent to 30% of the cost of the rights over the five years writing-down period. The incremental TBS should be incurred on activities that involve the use of the rights acquired; and
- All transactions should be concluded at arm's length and applicants should submit an independent valuation report (eg, from a public accounting firm) if the purchase price of the rights exceeds S$1m for related party transactions or S$5m for non-related party transactions. The EDB or IDA may require certification of the legal ownership of the rights by a law firm upon request.

Thailand

Introduction

Domestic corporations are subject to corporate income tax on their worldwide income. Foreign corporations are only taxed on their income earned in Thailand. Capital gains are taxable as ordinary income.

M&A transactions may give rise to liabilities to a number of taxes in Thailand, including corporate income tax, value added tax, specific business tax and stamp duties. However, exemptions from taxes are available in certain circumstances. Recent tax incentives being granted include:

- Reduction/exemption from corporate income tax and/or personal income tax to a Regional Operating Headquarters (ROH) established in Thailand;
- Reduction in corporate income tax for existing companies and new companies listed on the Stock Exchange of Thailand (SET) and new companies listed on the Market for Alternative Investment (MAI). MAI is a newly established trading board; and
- Reduction in corporate income tax to small and medium enterprises (companies with 5m Baht of paid up capital or less) which are available to foreign investors).

Structuring a share deal

The Foreign Business Act imposes restrictions on ownership by foreigners, and therefore share deals generally require either Board of Investment promotion, wholly owned US shareholder corporations, or the necessity to establish an intermediate holding vehicle in Thailand or a preference share operating company in company.

Most share acquisitions are structured and direct investments from outside Thailand. If it is intended that the whole, or part of, the investment in the Thai target will be sold, it would be advantageous to hold the investment through a holding company located in a country which has entered into a double tax agreement with Thailand that exempts gains on a subsequent sale of a Thai target from Thai tax.

Foreign investors also have the opportunity to invest through property or equity funds. Investment through such funds has been used both in order to take advantage of preferential tax treatment granted to such funds and as a mechanism for avoiding the foreign ownership restrictions under the Foreign Business Act.

Interest on loans used to fund investments is deductible from profits subject to corporate income tax. However, as Thailand has no group tax relief or consolidated filing, the use of a leveraged Thai holding acquisition vehicle is not tax effective. In addition, as dividends received by the holding vehicle should be fully exempt from tax, the holding vehicle would have no taxable income against which to offset interest costs.

A change in ownership of a company does not affect the carry-forward of tax losses. A change in ownership will also not affect the availability of tax incentives, provided there is no breach of any condition imposed by the Board of Investment.

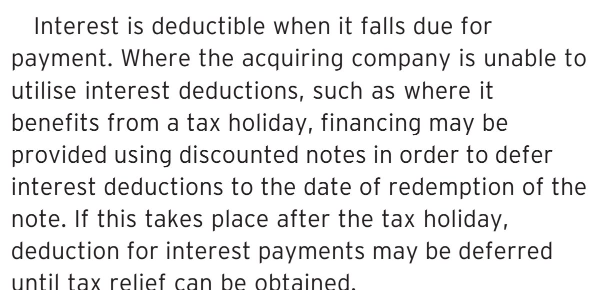
Structuring an asset deal

In most asset acquisitions, foreign ownership restrictions apply and the buyer will form a new limited company in Thailand through which the assets would be acquired. A foreign investor does not directly acquire assets in Thailand.

In the case of acquisitions of real property assets, the foreign ownership restrictions require Board of Investment promotion or the majority participation by Thai national investors. In such cases, the Thai national investors may hold preference shares, carrying diluted rights.

Preference share financing may also be used where the company acquiring the assets would be unable to utilise interest deductions, for example, where it has been granted a corporate income tax holiday under investment promotion privileges. In such circumstances, the preference shares will be used as quasi-debt, with mechanisms being put in place to effectively redeem the preference shares on termination of the tax holiday.

Interest on loans used to acquire assets is generally fully deductible in calculating profits subject to corporate income tax. One exception is where the acquired asset is not immediately brought into use in the business. In such circumstances, interest should be capitalised as part of the cost of acquiring the asset, until such time as it is brought into use. Capitalised interest may be depreciated as part of the cost of the asset.



Interest is deductible when it falls due for payment. Where the acquiring company is unable to utilise interest deductions, such as where it benefits from a tax holiday, financing may be provided using discounted notes in order to defer interest deductions to the date of redemption of the note. If this takes place after the tax holiday, deduction for interest payments may be deferred until tax relief can be obtained.

Unless a transfer of assets has taken place on a tax-free basis (ie, a transfer of a whole business with the transferor being liquidated in the same accounting period), the buyer can depreciate assets acquired based on the acquisition price. The buyer may therefore obtain a step-up in the cost base of the asset and depreciate the asset as if it was acquired new.

Goodwill purchased as a separately identifiable asset may be capitalised for tax purposes and depreciated over a period of not less than 10 years.

Tax losses are not transferable on a sale of assets, even where the sale represents the transfer of an entire business. Tax incentives may be transferred at the discretion of the Board of Investment.

If a transfer is not otherwise exempt from VAT, then, provided the buyer and the seller are VAT registered at the time of the transaction, the buyer should be entitled to recover any VAT paid on the acquisition of the assets. The recovery may be made either by offsetting the VAT paid against future liability to output VAT, or by claiming a cash refund. But claiming a cash refund will subject the buyer to a detailed tax investigation.

Vietnam

Introduction

With a foreign policy to build up good relationships with all other countries, Vietnam has deliberately and proactively pursued a benign foreign policy with a wide range of countries.

The relationship with China became normalised in 1991. Diplomatic relations between Vietnam and the United States were re-established in 1995 and both countries signed a bilateral trade agreement in 2000. Vietnam also became an official Association of Southeast Asian Nations (ASEAN) member in 1995, and the country concluded a cooperation agreement with the European Union.

Relationship with multi-national financial institutions such as the World Bank, the International Monetary Fund and the Asian Development Bank has been re-established. Vietnam's economic access to the region and the world has been accelerated. Since 1996, Vietnam has been participating in the ASEAN Free Trade Area (AFTA) and joined the Asia Pacific Economic Cooperation (APEC) in 1998.

Structuring a share deal

Under a typical share deal model, a buyer would use an offshore investment holding vehicle to acquire a Vietnamese target company. This is largely due to the fact that foreign companies may not establish special purpose holding companies in Vietnam.

Where a target company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business via a share deal, as there are no provisions to transfer losses from one entity to another.

If a target company has been granted a tax concession, the buyer will have to acquire the capital of the company if it wishes to preserve the concession.

The cost of funds used to acquire the equity interest is not tax-deductible. Accordingly, a buyer may need to structure the acquisition in such a way that the cost of funds may be tax-deductible in another country.

Acquisition expenses incurred by the buyer may not be allocated to a target company and therefore may not be claimed as a tax deduction in Vietnam.

Structuring an asset deal

A typical asset deal model involves the formation of a new Foreign Investment Enterprise or the use of an existing FIE to acquire the selected assets, liabilities and commercial operations of the target business.

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